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Indira Gandhi National Open University
School of Management Studies

BCOC-135
Company Law

Block

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SHARE CAPITAL AND MEMBERSHIP

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September, 2020

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ISBN- 00000000000000

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Further information about the School of Management and the Indira Gandhi National Open University courses may be obtained from the University's Office at Maidan Garhi, New Delhi-110068 or website of IGNOU www.ignou.ac.in

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi by Registrar, MPDD, IGNOU, New Delhi.

Laser Typeset by : Rajshree Computers, V-166A, Bhagwati Vihar, (Near Sec. 2, Dwarka), Uttam Nagar, New Delhi-110059

Printed by :Educational Stores, S-5 Bulandshahar Road, Indi. Area, Site-I Ghaziabad (UP)-201009

BLOCK 3 SHARE CAPITAL AND MEMBERSHIP

In Block 1 and 2 you learnt about the process of promotion and formation of a company including the nature and significance of principal documents involved. After the company has been incorporated, the promoters have to take the next important step of raising funds for the company by issuing shares and debentures to the public. In this block, you will study about various types of shares and debentures that can be issued by a company and the procedure to be followed for their issue. This block also covers the rules relating to the transfer and transmission of shares, issue and allotment of shares and rules relating to members of a company.

Unit 9 explains the types of shares and debentures that can be issued by a company. It also discusses the meaning of deposit, loans and the difference between debenture and deposits and rules relating to public deposits; and global depository receipts.

Unit 10 describes the rules for issue and allotment of shares. It explains the public issue of shares, Initial public offering, further public offering, private placement of shares, and also issue of a share certificate, calls on shares, the forfeiture and surrender of shares, buy back of shares and book building.

Unit 11 is about transfer and transmission of shares. It explains the procedure of transfer of shares, blank transfer, transfer under depository mode and nomination. It further describes the difference between transfer and transmission, and transmission of shares in case of death and insolvency. It also discusses insider trading and whistle blowing.

Unit 12 deals with membership of a company. It explains the difference between a shareholder and a member and describes the modes of becoming a member, termination of membership and it also explains the rights, liability of members and the rules for maintenance of register of members.

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UNIT 9 SHARE AND LOAN CAPITAL

Structure

9.0 Objectives

9.1 Introduction

9.2 Meaning and Types of Share Capital

9.3 Meaning and Nature of a Share

  9.3.1 Meaning of a Share

  9.3.2 Nature of a Share

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9.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning and types of shares;
- describe the types of capital;
- distinguish between share and stock;
- explain the meaning of debenture and classify them;
- distinguish between share and debenture;
- explain what is a deposit and loan;
- list the rules regarding acceptance of deposits by non-banking, non-finance companies; and
- discuss about the global depository receipts.

9.1 INTRODUCTION

You have learnt that a public company may raise the necessary funds by issuing shares and debentures and by accepting deposits from the public. In this unit, you will learn about the meaning of share and share capital, various types of shares, meaning and types of debentures and meaning of loan, difference between deposit and loan, the rules relating to deposits; and also learn about the global depository receipts.

9.2 MEANING AND TYPES OF SHARE CAPITAL

You know that to carry on any business, some money is needed, usually called 'capital'. In the case of a company where large amount of money is required, it is raised by issue of shares. The amount so raised is called the 'share capital' of the company.

A company having share capital should state its amount of share capital in the Memorandum of Association. The capital clause of the Memorandum of Association states the amount of capital that the company may raise during its lifetime unless it is increased. It's called authorized capital or nominal capital. The authorized capital is divided into specified number of shares of a fixed amount. For example, the authorized share capital of a company may be divided into shares of Rs.10 each. The persons contributing towards the share capital are known as 'shareholders'. **You should note that the money borrowed by the company by issuing debentures, is not part of the share capital of the company.** It is in the form of a long-term loan to the company.

In view of the stages involved in collecting the money on shares, the share capital of a company may be classified as follows:

1) **Nominal or Authorised Capital:** It refers to the amount stated in the Memorandum of Association as the capital of the company with which it is to be registered. This is the maximum amount of capital which a company is authorised to raise by issuing the shares. This is also known as 'registered capital', as this is the amount of capital with which the company is registered. This amount is divided into shares of a fixed amount. It can be increased by adopting the prescribed legal procedure.

2) **Issued Capital:** It is that part of the authorised capital which is issued to the public for subscription. It is not necessary for a company to issue all the nominal capital in the beginning itself. In fact, the term 'issued capital' means that part of the share capital which has been actually issued or offered by the company. The balance of nominal capital remaining to be issued is called 'unissued capital'.

3) **Subscribed Capital:** It is that part of nominal value of issued capital which has been actually subscribed by the public. In other words, it is that part of issued capital for which the applications have been received from the public and shares allotted to them.

   A company cannot accept for subscription an amount greater than the issued amount. Where the shares issued for subscription are wholly subscribed, issued capital will be the same as the subscribed capital.

4) **Called-up Capital:** It is that part of nominal value of issued capital which has been called-up or demanded on the shares by the company. Many times, a company does not collect the full amount on shares it has allotted. It collects it in installments known as application money, allotment money, first call, second call and so on. The amount of installments which have been demanded for the time being are termed as 'called-up capital' and the amount not yet demanded is termed as 'uncalled capital' and the shareholders continue to be liable to pay this amount as and when called.

5) **Paid-up Capital:** It is that part of the called-up capital which has actually been received from the shareholders. For example, a company has called-up Rs.5 lakhs, but it has actually received Rs.4,90,000 then Rs.4,90,000 is the paid-up capital of the company. The amount not paid in respect of allotment and calls made is known as 'calls in arrears'. In the above example, Rs.10,000 is the amount of calls in arrears. In case there are no calls in arrears, the paid-up capital will be the same as the called-up capital.

9.3 MEANING AND NATURE OF A SHARE

9.3.1 Meaning of a Share

The capital of a company is divided into a number of indivisible units of a fixed amount. These units are known as 'shares'. According to Section 2(84) of the Companies Act, 2013, "A share is a share in the share capital of a company and includes stock."

The Supreme Court of India in the **Commissioner of Income-tax v. Standard Vacuum Oil Co. [1966]** observed "By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company".

In another case, Supreme Court defined a share as "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound-up **[Bucha F. Guzdar v. Commissioner of Income-tax, Bombay]**.

In short, a 'share' does not merely represent an interest of a shareholder in a company; it carries with it certain rights and liabilities while the company is a going concern or while the company is being wound-up. It thus represents a 'bundle of rights and obligations.

9.3.2 Nature of a Share

A 'share' is not a sum of money but 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, but also consisting of a series of mutual 'covenants' entered by all the shareholders inter se **[Borland's Trustees v. Steel Bros. & Co. Ltd. [1901].**

A share is a chose-in-action. A chose-in-action implies the existence of some person entitled to the rights, which are rights in action as distinct from rights in possession, and until the share is issued no such person exists.

In India, a share is regarded as 'goods'. Section 2(7) of the Sale of Goods

Act, 1930 defines 'goods' to mean any kind of movable property other than actionable claims and money and includes stock and shares. However, Section 44 of the Companies Act, 2013 while recognizing shares as movable property, suggests that they shall be transferable only in the manner provided by the articles of the company.

In **Vishwanathan v. East India Distilleries [1957]**, it was observed:

"A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. Such commodities are not brought into existence by legislation, but a share in a company belongs to a totally different category of property. It is incorporeal in nature, and it consists merely of a bundle of rights and obligations."

Again, in **Shree Gopal Paper Mills Ltd. v. CIT [1967]** the learned Judge observed that the share when it becomes associated with a member becomes a movable property. It is, however, not a movable property whose transfer is solely regulated by the Sale of Goods Act. Its transfer is also governed by the Companies Act and/or Articles of the Company… Each share again bears a distinguishing number. It is, however, not a tangible property for it is not the share certificate; it only consists of a bundle of rights and obligations. Also, a share is not a negotiable instrument.

9.3.3 Types of Shares

As per the Companies Act, 2013, only two kinds of shares can be issued by a company. Section 43 of the Act provides that the share capital of a company limited by shares shall be of two kinds only, namely :

a) **Equity share**

   i) with voting rights, or

   ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed;

b) **Preference share.**

a) **Equity Shares [Section 43)]**

The equity shares are those shares which are not preference shares. In other words, shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital are known as equity shares. After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable net profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available. The rate of dividend is recommended by the Board of directors of the company and declared by shareholders in the annual general meeting.

Every member of a company limited by shares and holding equity share capital therein, shall have:

a) a right to vote on every resolution placed before the company; and

b) his voting rights, on a poll, shall be in proportion to his share in the paid-up equity share capital of the company. As compared to this, the holders of preference shares can vote only on such resolutions which directly affect

the rights attached to the preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital. However, if the preference dividend is not paid for two years or more, the preference shareholders shall also get voting right on every resolution placed before the company (Section 47).

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

Rules for Issue of Equity shares with differential rights as to dividend, voting or otherwise

With respect to issue of shares with differential voting rights, the Department of Company Affairs has notified the Companies (Share Capital and Debentures) Rules, 2014. As per Rule 4 of these rules, no company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with, inter alia, the following conditions:

a) the articles of association of the company authorizes the issue of shares with differential rights;

b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders:

   Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot ;

c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

d) the company has consistent track record of distributable profits for the last three years;

e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

   A company may, however, issue equity shares with differential voting right upon the expiry of five years from the end of financial year in which such default was made good (MCA notification No GSR 704(E) dated 19.7.2016.

h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies are being regulated by sectoral regulators;

i) the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.

b) **Preference Shares**

Preference Shares or Preference Share Capital means that part of the share capital of the company which fulfils both the following requirements:

1) During the life of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (say, one lac rupees) payable to preference shareholders before anything else is paid to the equity shareholders. Alternatively, the amount payable as preferential dividend may be calculated at a fixed rate, e.g., 10% of the nominal value of each share.

2) On the winding-up of the company it must carry a preferential right to be paid, i.e., amount paid up on preference shares must be paid back before anything is paid to the equity shareholders.

Rules relating to issue and redemption of preference shares

Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014, inter alia, provide:

1. **A** company having a share capital may issue preference shares only if so authorized by its articles.

2. A special resolution in the general meeting of the company must have been passed authorizing the issue.

3. The company, at the time of such issue of preference shares, must not have any subsisting default in the redemption of preference shares issued earlier or in payment of dividend due on any preference shares.

4. The Register of Members maintained under section 88 must contain the particulars in respect of such preference shareholder(s).

5. A company intending to list its preference shares on a recognized stock exchange shall issue such shares in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

6. A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. The preference shares may be redeemed:

   a) at a fixed time or on the happening of a particular event;

   b) any time at the company's option; or

   c) any time at the shareholder's option.

Types of Preference Shares

a. **Participating and non-participating shares** - Participating preference shares are those shares which are entitled to a fixed preferential dividend and, in addition, carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders. For example, after 20% dividend has been paid to equity shareholders, the preference shareholders may share the surplus profits equally with equity shareholders. Again, in the event of winding-up, if after paying back both the preference and equity shareholders, there is still any surplus left, then the participating preference shareholders get additional share in the surplus assets of the company. Non participating share holders have no right in surplus profits or assets. If articles are silent all preference shares are considered as non-participating.

b. **Cumulative and non-cumulative shares** - With regard to the payment of dividends, preference shares may be cumulative or non-cumulative. A cumulative preference share confers a right on its holder to claim fixed dividend of the past and the current year(s) out of future profits. The fixed dividend keeps on accumulating until it is fully paid. The non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividends out of the profits of each year. If no profits are available in any year, the shareholders get nothing, nor can they claim unpaid dividend in any subsequent year.

   Preference shares are cumulative unless expressly stated to be non-cumulative. Dividends on preference shares, like equity shares, can be paid only out of profits.

c. **Redeemable and Irredeemable Preference shares** – As per Section 55 of the Companies Act, 2013:

   1. No company limited by shares can issue any preference shares which are irredeemable.

   2. A company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue.

      However, a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

      Rule 10 of the Companies (Share Capital and Debentures) Rules, 2014, in this regard, provides that a company engaged in the setting up of infrastructure projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum 10% of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

   3. Where a company is not in a position to redeem any preferences shares or to pay dividend, if any, on such shares in accordance with the terms of issue, it may with the consent of the holders of three-fourths in value of such preference shares and with the approval of

the Tribunal, on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

However, the Tribunal shall, while giving the approval, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

It may be further noted that notice of redemption of preference shares must be sent to the Registrar under Section 64 of the Act within 30 days.

Conditions for issue of Redeemable Preference Shares

a) No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

b) no such shares shall be redeemed unless they are fully paid;

c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account;

d) 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.

e) the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

f) the issue of further redeemable preference shares or the redemption of preference shares shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

As noted before, Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. The preference shares may be redeemed:

a) at a fixed time or on the happening of a particular event;

b) any time at the company's option; or

c) any time at the shareholder's option.

Difference between Preference Share and Equity Share

1) Preference shares are entitled to a fixed rate/amount of dividend. The rate of dividend on equity shares depends upon the amount of net profit available after payment of dividend to preference share-holders and the fund requirements of the company for future expansion, etc.

2) Dividend on the preference shares is paid in preference to the equity shares. In other words, the dividend on equity shares is paid only after the preference dividend has been paid.

3) The preference shares have preference in relation to equity shares with regard to the repayment of capital on winding-up.

4) If the preference shares are cumulative, the dividend not paid in any year is accumulated and until such arrears of dividend are paid, equity shareholders are not paid any dividend.

5) Redeemable preference shares are redeemed by the company on expiry of the stipulated period, but equity shares cannot be redeemed.

6) The voting rights of preference shareholders are restricted. An equity shareholder can vote on all matters affecting the company but a preference shareholder can vote only when his special rights as a preference shareholder are being varied or on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital or where preference shares dividend is in arrears for at least two years.

7) A company may issue rights shares to the company's existing equity shareholders whereas it is not so allowed in case of preference shares (Section 62).

Sweat Equity Shares

"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 (Section 2(88)).

As per Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014, 'employee' means a permanent employee of the company who has been working in India or outside India, for at least last one year. Further, it includes an employee, as aforesaid, of a subsidiary, in India or outside India, or of a holding company of the company.

A director of the company includes a whole time director as well as other directors of the company as well as its subsidiary or holding company, in India or outside India

A company can issue sweat equity shares only of a class of shares already issued.

Besides, for issue of sweat equity shares, Section 54, inter alia, requires to ensure that:

1) The issue is authorized by a special resolution passed by the company. The special resolution must specify 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. As per Rule 8, 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 of the special resolution.

   In case of a listed company, the sweat equity shares are issued in accordance with the SEBI regulations made in this behalf and in case of an unlisted company, the sweat equity shares are issued in accordance with such rules as may be prescribed.

2) Rule 8 provides that a company shall not issue sweat equity shares for more than 15% of the existing paid-up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. In no case the issuance of sweat equity shares in the company can exceed 25% of the paid-up equity capital of the company at any time.

3) Sweat equity shares issued to directors or employees shall be locked in/ non transferable for a period of three years from the date of allotment. The fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

4) The 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.

5) 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.

6) The rights, limitations, restrictions applicable to the sweat equity shares shall be the same as applicable to equity shares.

9.4 MEANING OF STOCK

Stock is the aggregate consolidated holdings of the share capital of a person. In simple words, it means a number of shares put together in a bundle. The stock is expressed in terms of money and not as so many shares. Stock can be split into fractions of any amount without regard to the original face value of the share. The main advantage of stock is that the shareholder can transfer any portion of it as he likes.

You have learnt that as per Section 2(84) of the Act a share includes stock. Thus, a company, if authorised by its articles, can convert its fully paid-up shares into stock by passing an ordinary resolution (Section 61). From this, it should be clear to you that a company cannot make an original issue of the stock. When the shares are converted into stock, the company must give a notice to the Registrar of such conversion within thirty days of doing so (Section 64). On conversion of shares into stock, the register of members must show the amount of stock held by each member instead of the number of shares. For example, a member may be holding one thousand equity shares of Rs.10 each, fully paid-up. When these shares are converted into stock, he becomes the stockholder owning Rs.10,000 worth of stock.

Conversion of shares into stock does not alter the relationship between the holder and the company, the stockholder still remains a member. The holders of stock shall have the same rights as regards dividends, voting at meetings of the company as if they held the shares from which the stock arose. The stock is also transferable like shares. You should note that stock can also be reconverted into fully paid-up shares by an ordinary resolution (Section 61).

Distinction between shares and stock

In this section, you have learnt that stock possesses all the features of a share, but there are many points of difference between the two. These are as follows:

	Share	Stock
1.	A share has a nominal value	1. A stock has no nominal value.
2.	A share has a distinctive number which distinguishes it from other shares.	2. A stock bears no such number.
3.	Originally shares can only be issued.	3. A company cannot make an original issue of stock. Stock can be issued by an existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid up.	4. A stock can never be partly paid up, it is always fully paid-up.
5.	A share cannot be transferred in fractions. It is transferred as a whole.	5. A stock may be transferred in any fractions
6.	All the shares of a class are of equal denomination.	6. Stock may be of different denominations.

Check Your Progress A

1. What is the meaning of share capital of a company?

....

....

....

2. What is the difference between called-up capital and paid-up capital ?

....

....

....

3. Which of the following statements is correct ?

   i) The subscribed capital of a company is:

      a) never more than the issued capital.

      b) never less than the issued capital.

      c) always equal to the issued capital.

   ii) A company may convert all or any of its fully paid up shares into stock:

      a) by passing a special resolution.

      b) by passing an ordinary resolution.

      c) with the approval of the Tribunal.

4. State whether the following statements are True or False.
   i) Shares and stock can be directly issued to the public.
   ii) Only a public company can convert its shares into stock by passing an ordinary resolution.
   iii) Equity shareholders have a right to receive dividend at a fixed rate.
   iv) Preference shareholders have generally, no voting rights.
   v) A company cannot issue irredeemable preference shares.
   vi) Redeemable preference shares cannot be redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption.

9.5 MEANING AND TYPES OF DEBENTURES

9.5.1 Meaning and Definition

When company needs Funds for its project or for the extension and development purpose without increasing its share capital, it borrows from the public. The most common form of raising loan from the public is by issue of debentures.

Section 2(30) of the Companies Act, 2013 defines the term debenture as follows:

"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."

If we go by the aforesaid definition of 'debenture', bills of exchange or other negotiable instruments, deeds of covenant and many other documents in which a company stipulates to pay a sum of money will also qualify to be called as debentures.

9.5.2 Characteristic Features of a Debenture

The characteristic features of a debenture are as follows:

1. It is a movable property (Section 44).
2. It is issued by the company and is in the form of a certificate of indebtedness.
3. It usually specifies the date of redemption. It also provides for the re-payment of principal and interest at specified date or dates.
4. It generally creates a charge on the undertaking or undertakings of the company.

Usually the words 'pari passu' appear in the terms and conditions of debentures. This means that all the debentures of a particular class will receive the money proportionately in case the company is unable to discharge the whole obligation. In the absence of this clause the debenture-holders would rank in accordance with the rank of the issue and if issued on the same date then in the order of time when they were issued (which may be known by the serial number of the debenture).

9.5.3 Types of Debentures

Debentures may be of the following kinds:

1. **Bearer Debentures** - Bearer debentures are negotiable instruments, transferable by delivery. According to Perrins and Jeffreys, "By making debentures payable to bearer they are invested with the character of a negotiable instrument, so as to :

   a) make them transferable free from equities;

   b) render the delivery of a debenture and any interest coupon a good discharge to the company;

   c) enable the bearer to sue the company in his own name, if necessary;

   d) ensure a good title to any person who acquires the debenture bona fide for valuable consideration, notwithstanding any defect in the title of the person from whom he acquires it."

   The interest on 'bearer debentures' is paid by means of attached coupons. On maturity, the principal sum is paid to the bearer.

2. **Registered Debentures** - These are debentures which are payable to the registered holders, i.e., persons whose names appear in the Register of debenture-holders. Such debentures are transferable in the same way as shares or in accordance with the conditions endorsed on their back. The debenture itself consists of two parts:

   a) The covenants by the company to pay the principal and interest, and

   b) The endorsed conditions, e.g., the term of the loan.

   The endorsed conditions vary, but they normally contain a provision that the debenture is one of a series all ranking pari passu.

3. **Perpetual or Irredeemable Debentures** - A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is called a perpetual or irredeemable debenture. Though irredeemable debentures were allowed under Section 120 of the Companies Act, 1956, no corresponding provision has been made under the Act of 2013. Thus, no fresh irredeemable debentures may be issued by the companies.

4. **Redeemable Debentures** - Redeemable debentures are issued for a specified period of time. On the expiry of that specified time the company has the right to pay back the debenture-holders and have its properties released from the mortgage or charge. As per Companies Act, 2013 only redeemable debentures can be issued.

   Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, inter alia, provides that no company shall issue secured debentures unless it complies with the following conditions:

   a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue. However, a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;

   b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;

c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and

d) security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on-

   i) any specific movable property of the company (not being in the nature of pledge), and/or

   ii) any specific immovable property wherever situate, or any interest therein.

e) No person shall be appointed as a debenture trustee, if he-

   i) beneficially holds shares in the company;

   ii) is 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) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

   iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

   v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

   vi) has any pecuniary (monetary) 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;

   vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

f) The trust deed, as aforesaid, shall be executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.

g) The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions prescribed under the Rules.

5. **Secured and Naked Debentures** - Normally, debentures are secured by a mortgage or a charge on the company's assets. However, debentures may be issued without any charge on the assets of the company. Such debentures are called 'Naked or unsecured debentures'. They are mere acknowledgements of a debt due from the company, creating no rights beyond those of ordinary unsecured creditors. Unsecured debentures are treated as deposits and should, therefore, conform to requirements applicable to public deposits accepted by a company.

6. **Convertible Debentures** - A company may also issue convertible debentures, either wholly or partly. In case of convertible debentures, an option is given to the debenture-holders to convert them into equity or preference shares at stated rates of exchange, after a certain period. Section 71 requires the company to pass a special resolution for issue of convertible debentures whether wholly or partly. Such debentures once converted into shares cannot be reconverted into debentures.

9.6 DIFFERENCE BETWEEN A SHARE AND A DEBENTURE

The points of distinction between 'share' and 'debenture' may be noted as follows:

1. A holder of a share is a member of the company. A debenture-holder, on the other hand, is a lender to the company.
2. A shareholder has a right to vote. A debenture-holder does not enjoy such a right. Sub-section (2) of Section 71 of the Companies Act, 2013 declares that no company shall issue any debentures carrying voting rights.
3. Income on shares depends on the profits. Shareholders are entitled to get dividend only out of profits. Debenture holders are entitled to a fixed rate of interest which the company must pay irrespective of profits, i.e., profits or no profits.
4. Shareholders cannot be paid back (except in case of redeemable preference shares) until its winding-up. Debenture holders may be paid back on the expiry of the specified time.
5. In the event of winding-up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture holders, normally, being secured lenders, have prior claim for repayment.
6. Dividend on shares is not a charge against profit. Interest on debentures, on the other hand, is a charge against the profits and is deducted from revenues for the purpose of calculating tax liability.

9.7 PUBLIC DEPOSITS

You have learnt about the two main sources of raising funds by a Company i.e. shares and debentures. Public deposit is another important source of meeting short term capital requirements.

9.7.1 Meaning of Deposit

Section 2 (31) of the Companies Act, 2013 defines the term 'deposit' as follows:

"Deposit" includes any receipt of money by way of deposit or loan or in any other form by a company. However, as per **the Companies (Acceptance of Deposits) Rules, 2014**, **"Deposit" does not include-**

i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government;

ii) any amount received from the notified foreign Governments and foreign/international banks and multilateral financial institutions;

iii) any amount received as a loan or facility from any banking company or from a banking institution notified by the Central Government or from a co-operative bank;

iv) any amount received as a loan or financial assistance from the notified public financial institutions, regional financial institutions, insurance Companies, scheduled Banks.

v) any amount received against issue of commercial paper or any other instrument issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

vi) any amount received by a company from any other company;

vii) any share application money or advance towards allotment of securities pending allotment;

However, if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company; except when a director has given money out of funds acquired by him by borrowing or accepting loans or deposits from others.

ix) any amount raised by the issue of secured bonds or debentures provided that the amount of such bonds or debentures does not exceed the market value of such assets as assessed by a registered valuer;

any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognized stock exchange.

x) any amount received from an employee not exceeding his annual salary, under a contract of employment with the company in the nature of non-interest bearing security deposit;

xi) any non-interest bearing amount received or held in trust;

xii) any amount received in the course of or for the purposes of the business of the company:

a) as an advance for the supply of goods or provision of services provided that such advance is appropriated against supply of goods or provision of services within a period of 365 days from acceptance of such advance;

b) as advance received under an agreement for sale of property provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement;

c) as security deposit for the performance of the contract for supply of goods or provision of services;

d) as advance received under long term projects or for supply of capital goods.

e) as an advance towards consideration for providing future services in the form of warranty or maintenance contract as per written contract or arrangement, if the period for providing such services does not exceed the prevalent as per common business practices or five years, from the date of acceptance of such service whichever is less;

f) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

g) as an advance of subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of certain conditions.

xiv) any amount accepted by a Nidhi company in accordance with the prescribed rules;

xv) any amount received by way of subscription in respect of chit under the Chit Fund Act, 1982;

xvi) any amount received by the company under collective investment scheme in compliance with the SEBI regulations.

xvii) any amount of Rs. 25 lakh or more received by a start-up company (i.e. a private company incorporated under Companies Act) by way of a note convertible into equity shares or repayable within a period of five years from the date of issue, in a single tranche, from a person;

xviii) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds, Mutual Funds registered with SEBI, Infra structure Investment Trusts and Real Estate Investment Trusts.

9.7.2 Deposit and Loan

As per Section 2 (31) of the Companies Act, 2013 as well as the Companies (Acceptance of Deposits) Rules, 2014, referred to above, the expression 'deposit' includes 'loan' i.e, any amount borrowed by a company. However, there had been a number of judicial decisions in the past bringing out distinction between a loan and a deposit. In **Abdul Hamid Sahib v. Rahmat Bi** AIR 1965 Mad. 417, it was observed that in a sense, deposit is also a loan with the difference that a loan is repayable the minute it is incurred. In the case of deposits, repayment will depend on the maturity date fixed therein or the terms of agreement relating to the demand on the making of which the deposit becomes payable. In other words, unlike a loan which may become repayable instantly or on notice, there is no immediate obligation to repay in the case of deposits. It is repayable only on the basis provided in the Companies (Acceptance of Deposits) Rules, 2014.

In another case, the Supreme Court observed that the terms 'deposit' and 'loan' are not synonymous and whether a transaction is a deposit or a loan does not merely depend on the terms of documents, but has to be judged from the intention of the parties - **Annamalai v. Veerappa AIR 1956 SC 12.** Even the Limitation Act, 1963 provides for different periods of limitation for loan and deposit. In the case of a loan the period of limitation commences from

the date when the loan is made, whereas in the case of deposits, it commences from the date when the demand is made.

9.7.3 Deposit and Debenture

According to section 2(30) of the Companies Act, 2013, debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. A debenture is thus a document which either creates or acknowledges a debt. A debenture may be secured or unsecured. **Where the debenture is unsecured, it will squarely fall within the definition of deposit.** It is only the debentures which satisfy the conditions stipulated in Rule 2 (1) (c) (ix) of the Companies (Acceptance of Deposits) Rules, 2014 (discussed earlier), which are excluded from the definition of deposits.

9.8 GLOBAL DEPOSITORY RECEIPTS

Global Depository Receipts (GDR) is an instrument in which a company located in a country issues one or more of its shares or convertible debentures/bonds outside the domestic country. A company can raise foreign currency funds by issuing equity shares.

As per Section 2 (44) of the Companies Act (2013) "Global Depository Receipt (GDR) means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company (in India) making an issue of such depository receipts". Similarly, as per Section 2 (48) Indian Depository Receipt means "only instrument in the form of depository receipt created by a domestic depository in India and authorized by a company incorporated outside India making an issue of such depository receipts".

The main reason why Indian companies issue the depository receipts is that they are prohibited from issuing rupee denominated securities which can be listed on foreign stock exchanges. Apart from this raising funds through depository receipt, result in diversifying of investor base, enhanced visibility, global presence, increased liquidity, better disclosures and other associated benefits.

Section 41 read along with Companies (Issue of Global depository Receipts) Rules 2014 allows a company which is eligible to do so in terms of scheme and relevant provisions of Foreign Exchange Management Rules and Regulation to issue depository receipts in any foreign country. The depository receipts can be issued by way of public offering or private placement or in any of other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

Condition for issue of GDRs, interalia include passing of a resolution by the Board as well as special resolution at a general meeting; the GDRs shall be issued by an overseas bank appointed by the Company and the underlying shares shall be kept in the custody of a domestic custodian bank; the company shall appoint a merchant banker or a practicing chartered accountant, practicing cost accountant practicing company secretary to oversee all the compliances relating to issue of depository receipts and take the compliance relating to issue of depositary receipts and take the compliance report from them. The provisions of the Act and any rules issued there under in so far as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

The issuance of depository receipts (ADR/GDR) in India are governed by Reserve Bank of India the Depository Receipts Scheme 2014. Some of the main features of the scheme are as follows :

1. No prior approval of the Finance Ministry is required to issue depository receipts, however, if the provisions of Foreign Exchange Management Act, 1999 are attracted on issuance and transfer of permissible securities constituting the underlying for DRs to a non-resident outside India, then the approval, if any, required under the Act would be required.

2. **Eligibility Criteria :** As per 2014 Scheme, any Indian company whether listed or unlisted, private or public or any other issuer or person holding permissible securities is eligible to issue or transfer (as the case may be) such securities to a foreign depository for issuance of depository receipts. Persons or companies debarred from accessing the capital market cannot issue or transfer securities for issuance of depository receipts.

   The depository receipts can be issued by a regulated entity having the legal capacity to issue DRs and operating in permissible jurisdiction.

3. **Kind of Issue of DRs :** There are two kinds of issue of depository receipts. The sponsored issue and the unsponsored issue. In an sponsored ADR programme, the company sponsors an ADR/GDR against the existing shares held by the existing shareholders. The price at which these shares would be converted to ADR/GDR is arrived by the lead book running managers. In sponsored ADR/GDR progrmame the company/issuer is a party to the deposit agreement and only one such ADR/GDR progrmame can exist at a time. In case of unsponsored issue the issuer is not a party to the deposit agreement and multiple programmes can run simultaneously. The unsponsored DRs can be issued on the back of listed permissible securities only if two conditions are fulfilled viz :

   i) DRs are listed on International Exchange

   ii) DRs give the holder the right to issue voting instructions

4. **Permissible Security:** The DRs can be issued on back of any permissible securities issued by government, companies, mutual funds etc. The permissible securities are required to be in dematerialized form before they can be used for issuance of depository receipts.

5. **End Use Restrictions:** Scheme 2014 puts no restriction on the end use of proceeds from the issue of DRs however restrictions as applicable under FEMA (1990) are still applicable.

Global Depository Receipt/American Depository Receipt and Indian Depository Receipt are identical from legal, operational technical and administrative point of view. The only difference is that GDR, ADR and IDR are issued in global, American and Indian Financial markets respectively.

9.9 LET US SUM-UP

Money raised through issue of shares is called share capital. The amount of capital stated in the Memorandum of Association of the company is called 'Nominal Capital' or Authorised Capital. Whole of the authorized capital need not be offered for subscription. The amount offered to the public for subscription

is called the 'Offered Capital' or Issued Capital'. That part of the Issued Capital which is actually subscribed is called the 'Subscribed Capital'. The entire subscribed capital need not be called up by the company. The portion of the subscribed capital for which calls have been made is called as the "called up Capital'.

"A share is a share in the share capital of a company and includes stock." However, Supreme Court has accorded a much wider meaning to the term 'share'. It observed "By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company".

In another case, Supreme Court defined a share as "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound-up".

A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. It's, however, not a negotiable instrument.

Only two kinds of shares can be issued by a company, namely, equity and preference shares. Equity shares may be with voting rights or with differential rights as to dividend, voting or otherwise.

Preference shares carry a right of dividend either of a fixed amount or at a fixed rate and in case of winding up, it also carries a right to be paid back the capital before anything is paid to the equity shareholders. A company may issue redeemable preference shares which are participating or non-participating, cumulative or non cumulative. Under Companies Act, 2013, a company cannot issue irredeemable preference shares.

A company may issue "Sweat equity shares" 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. A company can issue sweat equity shares only of a class of shares already issued and after passing a special resolution. Further, the issue of sweat equity shares in the company cannot exceed 25% of the paid up equity capital of the company at any time.

Stock is the aggregate consolidated holdings of the share capital of a person. In simple words, it means a number of shares put together in a bundle. The stock is expressed in terms of money and not as so many shares.

A company, if authorised by its articles, can, by passing an ordinary resolution, convert its fully paid-up shares into stock and vice versa.

Debenture is an instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. It includes 'bond' and 'debenture stock'.

Different types of debentures may be issued by a company including bearer debentures, registered debentures, naked debentures, convertible debentures or redeemable debentures. Companies Act, 2013, however, disallows a company to issue irredeemable debentures.

"Deposit" includes any receipt of money by way of deposit or loan or in any

other form by a company. It, however, does not include amounts so notified under the Companies (Acceptance of Deposits) Rules, 2014.

Global Depository Receipt is an instrument in which a company located in a country issues one or more of its shares/convertible debentures/bonds outside the domestic country. A company can raise foreign currency funds by issuing equity shares. The issuance of depository Receipts in India are governed by Reserve Bank of India's depository Receipt scheme 2014.

9.10 KEY WORDS

Share : A unit into which the capital of the company is divided.

Issued Capital : The amount of capital that is issued by a company to public.

Preference Shares : Shares which carry preferential rights with reference to dividend and the repayment of capital in the event of winding up of the company.

Stock : Aggregate of fully paid-up shares of a member.

Reserve Capital : That part of uncalled capital which can be called up only in the event of winding up of the company.

Debentures : A document acknowledging a debt by a company.

Bearer Debentures : Debentures which are transferable by delivery only.

Naked Debentures : Debentures which are not secured by any mortgage of asset.

Secured Debentures : Debentures which are secured by the mortgage of some assets of the company.

Convertible Debentures : Debentures that are fully or partly convertible into equity shares of the company.

Redeemable Debentures : Debentures which are repayable after the stipulated period.

Sweat Equity Shares : 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

Deposit : Any deposit of money with, and includes any amount borrowed by a company.

Global Depository Receipt: An instrument by which a company raises capital in foreign country through depository.

9.11 ANSWERS TO CHECK YOUR PROGRESS

A. 1. i) a) ii) b)

2. i) False, ii) False, iii) False, iv) True, v) True, vi) False,

9.12 TERMINAL QUESTIONS

1. Define the term 'share'. What is the nature of a share? Is share a negotiable instrument?

2. What are the different types of shares which a company can issue?
3. Distinguish between 'equity shares' and 'preference shares'.
4. Write a note on 'Equity shares with differential rights as to dividend, voting or otherwise'. Can a company issue non voting shares?
5. State the rules subject to which preference shares may be issued and redeemed.
6. What are the different kinds of preference shares that a company may issue? Can a company issue irredeemable preference shares?
7. What is a debenture? What are the characteristic features of a debenture?
8. What are the different kinds of debentures that may be issued by a company?
9. Distinguish between a 'Share' and a "Debenture'.
10. Define the term 'Deposit'. State as to what is not a deposit as per the Companies (Acceptance of Deposits) Rules, 2014.
11. Distinguish between:
    (a) Deposit and Loan
    (b) Deposit and Debenture
12. What are sweat equity shares ? what are the conditions for issuing the sweat equity shares.
13. What are Global Depository Receipts? Discuss the main features of Reserve Bank of India's Depository Receipts Scheme 2014 for their issuance.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

UNIT 10 ISSUE AND ALLOTMENT OF SHARES

Structure

10.0 Objectives

10.1 Introduction

10.2 Issue of Shares at Par

10.3 Private Placement of Shares

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- 10.4.1 Initial Public Offer
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10.5 Rights Shares

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10.8 Issue of Shares at a Discount

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10.10 Allotment of Shares

- 10.10.1 Notice of Allotment
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10.11 Share Certificate

- 10.11.1 Issue of Share Certificates
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10.12 Calls on Shares

- 10.12.1 Essentials of a Valid Call
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- 10.12.4 Interest on Calls due but not Paid

10.13 Forfeiture of Shares

10.14 Re-issue of Forfeited Shares

10.15 Surrender of Shares

10.16 Buy back of Shares

- 10.16.1 Sources of Buy-Back

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10.16.2 Conditions for Buy-Back

10.16.3 Prohibition for Buy-Back in Certain Circumstances

10.16.4 Financial Assistance for Purchase of its Own Shares

10.17 Book Building

10.18 Let Us Sum Up

10.19 Key Words

10.20 Answers to Check Your Progress

10.21 Terminal Questions

10.0 OBJECTIVES

After studying this Unit, you should be able to:

- describe the issue of shares at par;
- explain the meaning and rules relating to private placement of shares;
- explain the meaning and rules relating to rights shares and bonus shares;
- distinguish between rights shares and bonus shares;
- discuss initial public offering and further public offering;
- list the circumstances under which the shares can be issued at a discount and at a premium;
- explain the meaning of allotment of shares;
- describe the rules relating to allotment of shares;
- explain the meaning of a share certificate;
- explain the essentials of a valid call;
- describe the circumstances under which the shares can be forfeited and reissued;
- explain the rules for the surrender of shares and buy back of shares; and
- describe book building process.

10.1 INTRODUCTION

In Unit 9 you learnt about the various kinds of shares and debentures that can be issued by a company. The Companies Act 2013 has laid down detailed procedure for the issue and allotment of shares which a company has to follow. In this unit, you will learn about issue of shares at par, private placement of shares, public issue of shares, initial public offer and further public offer, rights shares and bonus shares You will also learn about that procedure including the detailed rules relating to the allotment of shares. In addition, you will study the rules relating to the issue of shares at a premium or at a discount, and the procedure for the forfeiture and reissue of forfeited shares and surrender of shares, buy back of shares and book building.

10.2 ISSUE OF SHARES AT PAR

A company may issue shares at their face value or at a price other than the face value. When shares are issued at a price equal to their face value, it is termed as shares issued at par. It means when the issue price is equal to the face value it is called the issue of shares at par.

The term is not defined in the Act. The company may sell share less or more than par value, called sale of share of a discount or premium respectively.

Shares may be issued by a company by (a) public offer (b) rights issue / bonus issue and (c) private placement. Public offer may be (1) initial public offer (IPO) or (2) further public offer (FPO). They are discussed in this unit.

10.3 PRIVATE PLACEMENT OF SHARES

A company may make a private placement of securities. As per explanation 1 to Section 42 (3) private placement means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application which satisfies the conditions specified in this section.

Conditions

a) i) A private placement is to be made only to a select group of persons who have been identified by the Board, whose number shall not exceed fifty or such higher number as may be prescribed (presently, 200) (excluding the qualified institutional buyers and employees of the company being offered securities under the scheme of employees stock option in a financial year subject to such conditions as may be prescribed).

Qualified institutional buyer means the qualified institutional buyer as defined in the Securities and Exchange Board of India (issue of capital and disclosure requirement) Regulations 2009.

ii) Private placement shall be made through private placement offer and application in the prescribed form. However, the private placement offer and application shall not carry any right of renunciation.

In Mrs. Proddaturi Malathi vs. SRP Logistics (P) Ltd [2018] 96 taxmann.com 565 (NCL-AT), respondent directors increased share capital of company and further allotted shares of company to R2-director and to outsider at par by preferential allotment/private placement without following necessary procedure, said increase in share capital and subsequent allotment of shares was held to be invalid and thus same was to be set aside.

b) Every identified person willing to subscribe to private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking financial channel and not by cash.

Provided that a company shall not utilise money raised through private placement unless the allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (8).

c) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

d) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to replay the application money within the aforesaid period, it shall be liable to replay that money with interest at the rate of twelve percent per annum from the expiry of the sixteeth day.

   Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilized for any purpose other than

   a) for adjustment against allotment of securities; or

   b) for the repayment of monies where the company is unable to allot securities.

e) No company issuing securities under this section shall release any public advertisement or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

f) A company making any allotment of securities under this section shall file with the Registrar a return of allotment within fifteen days from the date of the allotment in such a manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Penalty

i) If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty five lakh rupees.

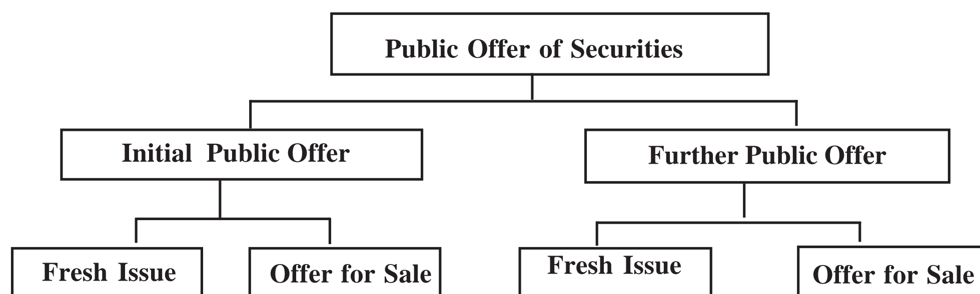
ii) Subject to sub-section (ii), if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or rupees two crores, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

10.4 PUBLIC ISSUE OF SHARES

The word “issue” here obviously means issued to public which further means issued generally and not merely to a set of selected persons. Issued generally in relation to prospectus means issued to persons irrespective of their being existing members or debenture holders of the body corporate to which prospectus relates. So word public shall include any section of public.

Issues can be classified as a public offer, rights or bonus issue and private placement. Public offer may be (a) initial public offer (IPO) (b) further public offer (FPO). Both of them may be a fresh issue or offer for sale. It should be in a dematerialised form. Certain members of the company, in consultation with the Board can offer sale of shares to the public.

10.4.1 Initial Public Offer



A public company limited by share may issue securities to public through prospectus called public offer. The word "securities" is a wider term and includes share and other instruments. A public company may issue securities by a public offer or rights/bonus issue or private placement. Public offer has been defined by explanation to Section 23 "public offer includes initial public offer or further public offer of securities to the public by a company or an offer for sale of securities to the public by existing shareholder, through issue of prospectus".

When company makes either a fresh issue of securities or offer its existing securities for sale or both for the first time to public, its called initial public offer (IPO), whereas after the first issue, whenever a company makes either a fresh issue of securities to public or an offer for sale to public, its called further public offer (FPO).

SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 with respect to public issue of equity shares or any other security convertible into equity shares.

Initial Public Offer (IPO)

1) **Entities not eligible to make an initial public offer**

1) An issuer shall not be eligible to make an initial public offer

   a) if the issuer, any of its promoter, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board (SEBI).

   b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

   c) if the issuer or any of its promoters or directors is a wilful defaulter.

   d) if any of its promoters or directors is a fugitive economic offender.

   The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

2) An issuer shall not be eligible to make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer.

However, the provisions of this sub-regulation shall not apply to:

a) Outstanding options granted to employees, whether currently an employee or not, pursuant to an employee stock option scheme in compliance with the Companies Act, 2013;

b) Fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) or the prospectus (in case of fixed issues), as the case may be.

(B) Eligibility requirements for an initial public offer

(1) An issuer shall be eligible to make an initial public offer only if:

a) it has net tangible assets of at least three crore rupees, calculated on a restated and consolidated basis, in each of the preceding three full years of (of twelve months each), of which not more than fifty per cent are held in monetary assets.

If more than fifty percent of the net tangible assets are held in monetary assets, the issuer should have utilized or made firm commitments to utilize such excess monetary assets in its business or project.

Further, the limit of fifty per cent on monetary assets shall not be applicable in case the initial public offer is made entirely through an offer for sale.

b) it has an average operating profit of at least fifteen crore rupees, calculated on a restated and consolidated basis, during the preceding three years (of twelve months each), with operating profit in each of these preceding three years;

c) it has a networth of at least one crore rupee in each of the proceeding three full years (of twelve months each), calculated on a restated and consolidated basis;

d) if it has changed its name within the last one year, at least fifty percent of the revenue, calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by its new name.

2) An issuer not satisfying the condition stipulated in sub-regulation (1) shall be eligible to make an initial public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer to qualified institutional buyers and to refund the full subscription money if it fails to do so.

C) General Conditions

1) An issuer making an initial public offer shall ensure that:

a) it has make an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities

on such stock exchanges and has chosen one of them as the designated stock exchange.

b) it has entered into an agreement with a depository for dematerialization of the specified securities already issued and proposed to be issued.

c) all its specified securities held by the promoters are in dematerialized form prior to filing of an offer document.

d) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited.

e) it has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for a specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through identifiable internal accruals.

2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed twenty five per cent of the amount being raised by the issuer.

10.4.2 Further Public Offer

Eligibility Requirements

Entities not eligible to make a further public offer.

An issuer shall not be eligible to make a further public offer:

a) If the issuer, any of its promoters, promoter group or directors, selling shareholders are debarred from accessing the capital market by the Board.

b) If any of the promoter or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

c) If the issuer or any of its promoters or directors is a wilful defaulter.

d) If any of its promoters or directors is fugitive economic offender.

The restrictions under (a) and (b) above shall not apply to persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarrment is already over as on the date of filing of the draft offer document with the board.

Eligibility requirement for further public offer

1) An issuer may make a further public offer, if it has changed its name within the last year, at least fifty per cent of the revenue for the preceding one full year has been earned by it from the activity indicated by its new name.

2) An issuer not satisfying the condition stipulated in sub-regulation (1) may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

General Conditions

1) An issuer making a further public offer shall ensure that:

   a) It has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of schedule XIX of SBI Regulations, 2018;

   b) It has entered into an agreement with a depository for dematerialisation of specified securities already issued and proposed to be issued;

   c) All its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

   d) It has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

2) The amount for general corporate purposes as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed twenty five per cent of the amount being raised by the issuer.

10.5 RIGHTS SHARES

When a company, having share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to the existing share holders under Section [62(1) (a)]. It is called “Rights Issue”. If such shares are offered to employees, it is called “Employees Stock Option” under Section [62 (1) (b)]. Such shares can be offered other than existing share holders or employees, on preferential basis.

Section 62 (1) reads “where at any time, 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, at the date of offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to following conditions namely –

   i) the offer shall be made by **notice** specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of offer within which the offer, if not accepted, shall be deemed to have been declined.

   ii) unless the articles of the company otherwise provide, the existing shareholder shall have a right to renounce the shares offered to him in favour any other person who need not be a member of the company.

   iii) after the expiry of the time specified in the notice or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the share offered, “the Board of Directors may dispose off them in such a manner which is not disadvantageous to the shareholders and the company”.

10.6 BONUS SHARES

As per section 63, a company may issue fully paid-up shares to its members, in any manner whatsoever, out of :

i) its free reserves;

ii) the securities premium account;

iii) the capital redemption reserve account;

provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless–

a) it is authorised by its articles;

b) it has, on the recommendations of the Board, been authorised 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 been defaulted in respect of the repayment 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.

The Bonus Shares shall not be issued in lieu of Dividend.

Bonus shares are not taxable in the hands of shareholders. Paid-up share capital increases with issue of bonus shares.

According to Rule 14 of Companies (share capital and debentures) Rules 2014, once the Board has recommended a bonus issue, it can not be withdrawn afterwards.

10.7 DISTINCTION BETWEEN RIGHTS SHARES AND BONUS SHARES

Rights Shares	Bonus Shares
1. They are issued when a company having share capital proposes to increase its subscribed capital by further issue of shares.	1. They are issued when a company decides to capitalise its free reserves, securities premium account or capital redemption reserve account.
2. It only confer a privilege on the existing shareholders to have a claim on the shares offered after the first public issue.	2. They are issued to the existing members free of charge.
3. A letter of offer is sent to the equity shareholders, specifying the	3. No such letter of offer need be sent to the shareholders since the

number of shares in proportion to the paid-up share capital of those shares.	company capitalises profits or reserves if it is authorised by articles and on the recommendation of Board has been authorised in general meeting.
4. If equity shareholder accepts the offer, he has to pay the specified amount.	4. Members do not have to pay any amount for such shares.
5. If the equity shareholder does not accept the offer, the Board of Directors may dispose them off in such a manner as it is advantageous to company and shareholders.	5. The company which has announced the decision of its Board recommending bonus issue, shall not subsequently withdraw the same.
6. The existing shareholding of the members as well as rights shares may be partly paid.	6. Bonus shares are always fully paid.
7. Rights shares may be renounced in favour of his nominee.	7. No such facility is available in case of bonus shares.

Check Your Progress A

1) What do you mean by issue of shares at par?

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2) What is meant by private placement of shares?

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3) List the conditions to be satisfied by the company before issuing bonus shares.

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4) What is meant by Rights Share?

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10.8 ISSUE OF SHARES AT A DISCOUNT

If the buyer of shares is required to pay less than face value of the share, for example, Rs. 9 on a share of Rs. 10, then the share is said to be issued or sold at a discount. The issue of shares at a discount is regulated by law and Section 53 provides that except as provided in section 54, a company shall not issue shares at a discount. **Section 54 allows only 'sweat equity shares' to be issued at a discount and that too subject to compliance of the specified conditions.**

Any share issued by a company at a discounted price shall be void. A company may, however, issue shares at a discount to its creditors, when debt is converted into shares or debt restructuring scheme as per RBI regulations.

Thus, if a company issues any shares, except sweat equity shares, as aforesaid, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both (Section 53 (3)).

10.9 ISSUE OF SHARES AT A PREMIUM

A company may issue securities at a premium when it is able to sell them at a price above par or above face value, for example, Rs. 100 per share at a price of Rs. 120, thereby earning a premium of Rs. 20 per share. The Act, does not stipulate any conditions or restrictions regulating the issue of shares by a company at a premium. However, the Act does impose conditions regarding the utilisation of the amount of premium collected on securities.

Firstly, the premium cannot be treated as profit and, therefore, cannot be distributed as dividend. However, the same can be capitalised and distributed in the form of bonus shares.

Secondly, the amount of premium, whether received in cash or in kind, must be recorded in a separate account, known as the "securities premium A/c".

Thirdly, the amount of share premium is to be maintained with the same sanctity as the share capital.

According to Section 52 (2), the share premium can be utilised only for:

a) issuing fully paid bonus shares to members.

b) writing off the balance of the preliminary expenses of the company;

c) writing off the commission paid or discount allowed, or expenses incurred on issue of shares or debentures of the company;

d) providing for the premium payable on redemption of any redeemable preference shares or debentures of the company.

e) for the purchase of its own shares or other securities under section 68.

Unless articles of association of company permit utilization of share premium account for purposes other than mentioned in section 78(2) [now section 53], company court cannot approve resolution to that effect - **Hyderabad Industries**

Ltd., In re [2004] 53 SCL 376 (AP).

However, Rajasthan High Court has held that a company can utilize credit balance in securities premium account for purpose of meeting deferred tax liability- **Mangalam Cement Ltd., In re [2008] 86 SCL 153 (Raj.).**

Unless and until there is diminution of the share capital and corresponding reduction of the share premium account, no company can be allowed to write off or adjust the loss against share premium account - **Hyderabad Industries Ltd., In re [2004] 53 SCL 376 (AP).**

Also in this case for utilization of the share premium account for purposes mentioned in section 78(2) [now section 53], no approval or sanction of the Court is required.

10.10 ALLOTMENT OF SHARES

You know that a public limited company invites subscriptions from the public and for this purpose a prospectus is issued. In response to this invitation, the prospective investors offer to buy shares by submitting the prescribed application form. If the application is accepted by the company, it proceeds to allot the shares. With the issue of the letter of allotment, the offer stands accepted thereby giving rise to a legally binding contract between the company and the shareholder. Thus, an allotment is the acceptance by the company of the offer to purchase shares.

The term 'Allotment' has nowhere been defined in the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons (**Re. Calcutta Stock Exchange Association Ltd. [1957]**. The Supreme Court in **Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. (1964)** defined allotment as "the appropriation out of the previously unappropriated capital of the company of a certain number of shares to a person."

Since re-issue of forfeited shares does not constitute appropriation out of unappropriated capital, it does not constitute allotment.

What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares - per Chetty, J. in **re Florence Land & Public Works Ltd. [1955]**.

10.10.1 Notice of Allotment

An allotment is the acceptance of an offer to take shares by an applicant, and like any other acceptance, it must be communicated. There can be no binding contract unless the acceptance of the offer is properly communicated. Thus, notice of allotment must be given to the allottee. If the letter of allotment is properly posted i.e., it is correctly addressed and stamped, a contract will arise even if the letter of allotment is delayed or lost in the course of transit. In this letter of allotment, besides details like number of shares applied for, the number of shares allotted, etc., the allottee is asked to pay the money due on allotment to the company's bankers within a specified time unless there is partial allotment and the allotment money is appropriated out of the excess application money.

10.10.2 Rules Regarding Allotment of Shares

The rules regarding allotment of shares can be discussed under two broad heads- (a) general rules and (b) the legal rules.

General Rules

You know that the allotment is the acceptance of an offer to purchase certain number of shares. Therefore, the general rules relating to valid acceptance of an offer must be followed. The general rules regarding allotment of shares are as follows:

i) **Proper authority:** It is the duty of the Board of' directors to allot the shares. However, the Board may delegate this authority to some other person or persons as per the provisions of the articles of association. The power to allot shares is generally given to a Committee constituted for the purpose, usually called "Allotment Committee". Allotment of shares made by an improper authority will make it void.

ii) **Reasonable time:** The offer to purchase shares of the company must be accepted within a reasonable time otherwise the applicants may refuse to take shares because after a reasonable time the offer lapses. What is the 'reasonable time' is a question of fact in each case.

ii) **Communication:** The allotment of shares should be communicated to the applicants. As noted above, the posting of a properly addressed and stamped letter of allotment will be taken as a valid communication. Even if this letter of allotment is delayed or lost in transit, the allottee will be liable. 'G' applied for certain shares in a company. The letter of allotment was despatched to him but it never reached. It was held that 'G' was liable as a shareholder (**Household Fire Insurance Co. Ltd. v. Grant**).

iv) **Absolute and unconditional:** The allotment of shares must conform to the terms and conditions of the application. If the allotment is not according to the terms and conditions, the applicant may refuse to accept the shares even though allotment has been made to him.

   Thus, where the applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company and shares were allotted to him but he was not appointed the branch manager. Held, he was not bound by the allotment - **Ramanbhai v. Ghasi Ram [1918].**

   If the conditions are not fulfilled, the applicant must reject the shares promptly. His silence or acceptance will debar him from this right.

v) **Allotment against application only:** An allotment can be made only against application in writing and no oral application/allotment can be made.

Legal Rules

You should note that so far as the private companies are concerned, the Act does not lay down any restrictions as to the allotment of shares. But the Act has laid down certain restrictions regarding the allotment of shares by public companies.

When no public offer is made: Where a public company does not offer its shares to the public but arranges the capital privately, the company can proceed with the allotment forthwith.

When an offer is made to the Public: Where a company offers the shares to the public:

1. **Registration of prospectus [Section 26(4)]** - A copy of the prospectus signed by every person who is named therein as a director or proposed director of the company or by his duly authorized attorney shall be duly filed with the Registrar for registration on or before the date of its publication.

   In case of contravention, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

2. **Application money [Sec. 39(2)]** - An amount payable on application on each share shall not be less than 5% of the nominal amount of the share or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf. However, as per SEBI Regulations, 2018, application money must not be less than 25% of the nominal amount of the share.

3. **Minimum subscription [Section 39(1 &3)]** - No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the 'minimum subscriptions' has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

4. **Closing of the subscription list** - Although Companies Act is silent as to the time for which the subscription list must be kept open, SEBI's regulations, 2018 provide that the subscription list for public issue must be kept open for at least 3 working days and for not more than 10 working days .In case of revision in price band, the issuer shall extend the bidding (issue) period for a minimum period of three working days.

   In case of rights issue, the issue shall remain open for a minimum period of 15 days and cannot remain open beyond 30 days.

5. **Permission to deal on a stock exchange [Sec. 40]** - Every company making public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

Where a prospectus states that an application under sub-section (1) has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

Unless permission is granted by each or every one of all the stock exchanges named in the prospectus for listing of shares to which application is made by the company the consequence is to render the entire allotment void. In other words, if permission has not been granted by any one of the several stock exchanges named in the prospectus for listing of shares, the consequence is to render the entire allotment void and the grant of permission by one or more of them is inconsequential. **[Supreme Court in Rishyashringa Jewellery Ltd. v. Stock Exchange (1995); Smt. Urmila Bharuka v. Coventry Spring and Engineering Co. Ltd. & Ors. [1997]]**.

However, where an appeal is preferred against the decision of the stock exchange, the allotment shall not be void till the appeal has been disposed off.

All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

a) for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

b) for the repayment of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

If a default is made in complying with the aforesaid provisions, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both [Section 40 (5)].

10.10.3 Procedure of Allotment

When the company receives from bankers all the share applications, a share application list is prepared. You should remember that only the names of such applicants should be recorded who have paid the application money because an application without application money is void. The directors will see that all the legal rules regarding allotment have been complied with, and then they will proceed with the allotment of shares. If the issue has been just fully subscribed, then there is no problem in allotment, the directors can allot to each applicant the number of shares asked for.

But the real difficulty arises in case of over-subscription. An issue is said to be over-subscribed if the number of shares applied for is greater than the number of share available for allotment. In case of over-subscription, the applicants will have to be allotted less number of shares than applied for, it is known as partial allotment. A scheme of basis of allotment in consultation with the designated stock exchange and conforming to SEBI Regulations, 2018, is framed. You may note that SEBI Regulations, 2018, provide for allotment on proportionate basis subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

SEBI Regulations, 2018, disallow retention of **over-subscription** under any circumstances except to the extent necessary because of proportional allotment, but not exceeding 10%.

You should remember that when lesser number of shares are allotted to an applicant, the excess application money may not be refunded to him but instead adjusted against the allotment money due from him.

In case of under-subscription, the Board of directors has only to ensure that the minimum subscription including underwriters' devolvement has been received, then they can proceed with the allotment. When the Board of directors pass a resolution confirming the allotment and, if for some reason, no shares are allotted to an applicant, then a letter of regret is sent to him along with a crossed

cheque for the refund of the share application money. Alternatively, money may be transferred to his bank account through Electronic Clearance Series (ECS).

10.10.4 Return as to Allotment

You learnt the rules and the procedure of allotment of shares. Whenever a company having a share capital makes any allotment of securities**,** it shall file with the Registrar a return of allotment in such manner as may be prescribed (Section 39 (4)).

As per Rule 12 of the Companies (Prospectus and Allotment of Securities) Rules, 2014:

1) Whenever a company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form **PAS-3**, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.
2) There shall be attached to the Form a list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form as being complete and correct as per the records of the company.
3) In the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.
4) In case the contract is not reduced to writing, the company shall furnish along with the Form complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899.
5) A report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract.
6) In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form.
7) In case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form **PAS-3**, the valuation report of the registered valuer.

Penalty:

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Check Your Progress B

1) What is meant by allotment of shares?

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2) List four important conditions which must be satisfied before a company can proceed to allot the shares.

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3) List the purposes for which the share premium amount may be utilised.

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4) Fill in the blanks:

   i) The allotment of shares in a company must be made by a resolution of ....

   ii) The amount payable on application on each share must not be less than .... per cent of the nominal value of share.

   iii) If a company does not receive .... per cent of the issue amount, it cannot allot the shares.

   iv) If the company does not receive the amount of minimum subscription within .... days from the date of closure of issue, it must return the amount within .... days.

   v) Reissue of forfeited shares .... be termed as allotment of shares.

5) State whether the following statements are true or false.

   i) A company can allot shares immediately after the issue of prospectus.

   ii) A company cannot allot shares unless the minimum subscription has been subscribed.

   iii) When an issue is over-subscribed, the directors may allot all the shares applied for.

   iv) A company cannot issue shares for consideration other than cash.

   v) There are no restrictions on the issue of shares at a premium.

   vi) Dividend can be paid out of the share premium amount.

   vii) A company cannot issue shares at a discount.

10.11 SHARE CERTIFICATE

A share certificate is a certificate issued by the company under its common seal specifying the shares held by any member and the amount paid on each

share. A share certificate is an evidence of title of the allottee or transferee to the shares. It is a declaration that the person in whose name the certificate is made out and to whom it is given, is a shareholder in the company. However, it should be remembered that it is not a negotiable instrument.

The share certificate may be in any form but a valid share certificate must have the following contents:

i) Name of the company; ii) Name and address of the shareholder; iii) Number of shares held by him; iv) Distinctive number of shares; v) Amount paid on each share; vi) Date of issue; vii) Share certificate number; viii) Stamp; ix) Signatures of two directors and the Secretary.

Every person whose name is entered as a member in the Register of members is entitled to receive share certificate(s) for his shares without payment. A share certificate is considered to be the prima facie evidence of the title of the member to the shares mentioned in the certificate.

10.11.1 Issue of Share Certificates

The Companies Act has laid down time limits within which the share certificate must be delivered. Section 56 (4) provides that 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—

a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;

b) within a period of two months from the date of allotment, in the case of allotment of any of its shares;

c) within a period of one month from the date of receipt by the company of the instrument of transfer, or of the intimation of transmission.

d) Within a period of six months from the date of allotment in the case of allotment of debentures.

Where the securities are dealt within a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

Penalty

In case of default, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

10.11.2 Effects of a Share Certificate (Section 46)

You have learnt that share certificate is prima facie evidence of the title of the member to the shares specified therein. Following are the effects of a share certificate:

i) **Evidence of title:** When the share certificate is issued, the company is estopped from denying the title of the person to the shares whose name is mentioned in the certificate, provided that person has acquired the shares in good faith and under a genuine transfer for value. However, it is not

a conclusive proof of the title of the holder. If a person has obtained some shares on the basis of a forged transfer, the company can refuse to register the transfer of shares. You should remember that share certificate is only an evidence of title and is not a document of title. It is not a negotiable instrument which can be transferred by mere 'delivery' or by 'endorsement and delivery'.

ii) **Estoppel as to payment:** You know that the share certificate states the amount paid on them. A company is estopped from stating that the amount stated as having been paid on the shares has not been paid. For example, if the share certificate states that the full amount on the shares has been paid, then the company is prevented from saying that the shares are not fully paid.

10.11.3 Duplicate Share Certificate

Section 46 (2) provides that a duplicate certificate of shares may be issued, if such certificate —

a) is proved to have been lost or destroyed; or

b) has been defaced, mutilated or torn and is surrendered to the company.

As per **the Companies (Share Capital and Debentures) Rules, 2014,Sub Rule 6 (2) says w**here a duplicate certificate is issued, it shall be stated prominently on the face of it and be recorded in the Register maintained for the purpose, that it is "duplicate issued in lieu of share certificate No…. " and the word "duplicate" shall be stamped or printed prominently on the face of the share certificate.

If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

If any person impersonates or obtains certificate fraudulently, he may be liable for punishment with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees (Section 57).

In case of dispute about the transfer of shares, duplicate shares cannot be ordered to be issued in favour of the transferee - **S. Sundaram Pillai v. P. Govindaswami [1987].**

A company can issue duplicate share certificate only to a registered shareholder.

Check Your Progress C

1) What is a share certificate?

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2) What is the purpose of issuing a share certificate?

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3) A share certificate creates two kinds of estoppel against a company. List them.

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4) Fill in the blanks:

   i) A share certificate is a ....

   ii) Every company shall issue share certificates within .... months of the date of allotment.

   iii) A Company can issue duplicate share certificate to ……………….. only.

5) State whether the following statements are true or false:

   i) The approval of Central Government is necessary for issuing share certificate.

   ii) A share certificate may be partly or fully paid.

   iii) A share certificate can be transferred by delivery alone.

   iv) A shareholder is entitled to a duplicate share certificate if it is proved that the original certificate has been lost or destroyed.

10.12 CALLS ON SHARES

When a company issues shares, the applicants are generally not required to pay the full value of the shares in one instalment. They are required to pay the application money only which should not be less than 5% of nominal amount of the share (Section 39).

The balance amount is to be paid later on. Some amount is payable at the time of allotment. It is termed as 'allotment money'. The balance amount is called by the company in instalments. Each instalment is termed as a 'call'. You must remember that the amount paid on application and allotment are not termed as calls.

A call may be defined as a demand by the company on the shareholders to pay whole or part of the balance remaining unpaid on each share, at any time during the life-time of the company.

10.12.1 Essentials of a Valid Call

In making a call, care must be taken that:

1. i) the directors making it are duly appointed and duly qualified;

   ii) the meeting of the Board of directors has been duly convened;

   iii) the proper quorum is present;

   iv) the resolution making the call is duly passed and specifies the amount of the call, and the time and place of payment;

   v) A proper entry is made in the minutes.

Unless the aforesaid matters are attended to, the call may be invalid.

2. **Calls on shares of same class must be made on uniform basis [Sec. 49]** - For the purpose of this section, shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class (Explanation to section 49).

3. **Call to be made bona fide in the interest of the company** - Directors are the trustees of the capital of a company. Accordingly, the amount called up has to be used for the benefit of the company, and it should also be called only in the interest of the company. Thus, where the company was in difficult circumstances and the directors made a call only to enable them to draw their own remuneration, the call was held to be an abuse of power and the directors were bound to refund the remuneration drawn by them - **Alexander v. Automatic Telephone Co. [1900] 2 Ch. 56 (CA).**

4. **Notice of call** - A call must be made by serving upon members a notice of payment in accordance with the provisions of section 20. It should be a formal notice and not mere demand or request for payment. Every shareholder is under a statutory obligation to pay the full amount of his shares. Section 10 (2) of the Companies Act, 2013 declares that all money payable by any member to the company on the shares held by him under the Memorandum or Articles is a debt due from him to the company. But the liability to pay this debt arises only when a valid call has been made. Thus, where a company acquired the rights of another company in respect of its uncalled capital and demanded payments from members, it was held that such a demand could not take the place of a formal call notice - **Pabna Dhana Bhandar Co. Ltd. v.Foyezudin Mia AIR 1932 Cal. 716.**

The notice must specify the exact amount and the time of payment **- E and W Insurance Co. Ltd. v. Kamala Mehta (supra).** However, if the contents of the notice are certain in terms of money demanded and time allowed for payment, the notice will be valid even if its form is inaccurate - **Shackleford, Ford & Co. v.Dangerfield [1868] LR 3 CP 407.**

The liability of the joint shareholders shall be joint and several (section 43 of the Indian Contract Act).

10.12.2 Payment of Calls Otherwise than in Cash

Shares may be paid for in cash or in kind or in any manner that has the effect of actual cash being received by the company.

A debt due and owing by a banking company to a shareholder can be set off against outstanding calls so long as banking company is a going concern - **Hind Iran Bank Ltd. v. Raizada Jagan Nath Bali [1959].**

10.12.3 Payment of Calls in Advance

Section 50 of the Act provides that the directors may, if authorised by the Articles, allow shareholder to pay 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.

According to Section 50 (2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the moneys so paid in advance by him until the same becomes payable.

However, Section 51 provides that dividends may be paid in proportion to the amount paid upon each share, if so authorised by the Articles.

10.12.4 Interest on Calls Due but Not Paid

A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table F provides for interest at the rate of 10% per annum or at such lower rate, if any, as the Board may determine. The Board shall, however, be at liberty to waive payment of any such interest wholly or in part.

10.13 FORFEITURE OF SHARES

You have learnt that the company does not require the shareholders to pay the full amount of shares in one instalment. It makes calls on them as and when the money is needed. If a shareholder fails to pay a valid call within the stipulated time, the company has two options: (1) the company may file a suit for the recovery of the amount, or (2) the company may forfeit the shares. The first option is a lengthy process. Therefore, the company generally decides to forfeit such shares.

The term 'forfeiture' means taking them away from the member. It deprives the shareholder of his property. The shares can be forfeited only if there is a provision to this effect in the articles of the company. You should note that as per Regulation 28 of Table 'F', shares can be forfeited only for non-payment of any call or instalment of a call and not for any other debt due from a member. However, the Articles of a company may lawfully incorporate any other grounds of the forfeiture **– Naresh Chandra Sanyal vs. Calcutta Stock Exchange (1971).**

Table 'F', which is generally adopted by the companies with respect to forfeiture of shares, contains the following rules:

i) The power to forfeit shares must be given in the Articles of the company.

ii) Shares can be forfeited only for non-payment of calls.

iii) The company must serve a proper notice on the defaulting member asking him to pay the amount within a fixed period, failing which the shares shall be forfeited. The shareholder must be given at least fourteen days notice to pay the amount, notice must indicate the exact amount to be paid. If there is a slight defect in the notice, the forfeiture will become invalid.

iv) The Board of directors must pass a resolution for the forfeiture of shares.

v) The power for forfeiture must be exercised in good faith and for the benefit of the company. Thus, forfeiture for the purpose of relieving a friend from liability shall be invalid.

Effects of Forfeiture

1. **Cessation of membership -** A person whose shares have been forfeited ceases to be a member in respect of the forfeited shares [Regulation 32(1) of Table F].

2. **Cessation of liability -** The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares forfeited [Regulation 32(2) of Table F]. However, notwithstanding the forfeiture, he remains liable to pay to the company all moneys which, at the date of forfeiture, were payable by him to the company in respect of the shares forfeited [Regulation 32(1) of Table F]. Thus, liability for unpaid calls remains even after forfeiture of shares.

3. **Liability as past member** - The former holder shall remain liable as a past member to pay calls if liquidation takes place within one year of the forfeiture.

4. **On forfeiture, the forfeited shares become the property of the company.** Accordingly, these may be re-issued or otherwise disposed of on such terms and in such manner as the Board thinks fit [Regulation 31(1) of Table F]. However, at any time before a sale or disposal of the forfeited shares, the Board may cancel the forfeiture on such terms as it thinks fit [Regulation 31(2) of Table F].

The right of the company upon forfeiture is only to dispose of the share and use the proceeds for discharging the liability for which the forfeiture was effected, and if there is any balance it belongs to the defaulter and, cannot be appropriated by the company **- Naresh Chandra Sanyal vs. Calcutta Stock Exchange Assn. Ltd. AIR 1971 SC 422.**

10.14 RE-ISSUE OF FORFEITED SHARES

When the shares are forfeited, they become the property of the company and, to that extent, the paid-up capital of the company stands reduced. Therefore, the forfeited shares are generally reissued by the company. The total sum paid by former holder of shares, together with amount paid on reissue and the amount unpaid on shares is not less than par value. **The forfeited shares can be reissued at any price i.e., even at discount. But the amount of discount must not exceed the amount forfeited on such shares.** The reissue is done by a resolution of the Board of directors. After the reissue, the buyer of such shares shall become liable to pay all the future calls due on shares, including the calls for which the shares were forfeited. The name of the buyer shall be recorded in the register of members and if the original shareholder has surrendered the share certificate, the same shall be transferred in the name of the buyer, otherwise a new share certificate shall be issued.

The title of the buyer shall not be affected by any irregularity or invalidity in proceedings with reference to forfeiture. It should, however, be noted that reissue

of forfeited shares is a sale of shares and it does not amount to an allotment. Therefore, return of allotment need not be filed with the Registrar.

10.15 SURRENDER OF SHARES

Surrender is a voluntary act of the shareholder under which the shares are returned to the company for purposes of cancellation. Neither the Companies Act nor Table 'F' provides for the surrender of shares. But, the articles may provide for the surrender of the partly paid-up shares under circumstances where forfeiture seems to be justified.

You must note that when shares are surrendered to the company, no amount is refunded to the shareholder. It is so, because if some money is refunded it will amount to a purchase by the company of its own shares which is prohibited by Section 67 of the Companies Act.

Surrender of shares may be allowed in the following cases if its acceptance is authorised by the Articles of the company:

i) When shares are surrendered in exchange for new shares of the same nominal value, as it does not amount to any reduction of capital.

ii) When the circumstances are such where forfeiture is justified, because surrender is a short-cut to forfeiture.

If the surrender of shares is accepted by the company for any other reason, other than the reasons given above, it will be invalid.

On a valid surrender of shares, the member ceases to be a member of the company, but his name can be placed on list of contributories. Thus, if the company is wound up within twelve months of the surrender of shares, he shall be liable as a past member. If the surrender of shares is proved to be illegal, the shareholder may apply for the rectification of register of members after lapse of any number of years, provided the shares have not been reissued in the meantime.

Forfeiture and surrender of shares, both lead to the termination of membership. But in case of forfeiture it is compulsory or a forced action, while in case of surrender it is a voluntary act on the part of the member to avoid the disgrace of forfeiture.

10.16 BUY BACK OF SHARES

Section 67(1) of the Companies Act, 2013 provides that a company limited by shares or a company limited by guarantee having a share capital cannot buy its own shares. The restriction is applicable to all companies having share capital, whether public or private.

The prohibition to buy back its own shares shall not apply to a private company;

a) in whose share capital no other body corporate has invested any money;

b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or 50 crore rupee, whichever is lower; and

c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section – vide MCA notification dated 5.6.2015.

However, Section 68 allows a company to purchase its own shares or other securities subject to certain conditions. The provisions of Section 68 are as follows:

10.16.1 Sources to Buy-Back

A company can buy its own shares and other specified securities out of:

i) its free reserves; or

ii) the securities premium account; or

iii) the proceeds of any shares or other specified securities.

However, no buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

In case shares are bought back out of free reserves or securities premium account then Section 69 stipulates that a sum equal to the nominal value of shares bought back shall be transferred to a reserve account to be called the 'Capital Redemption Reserve Account' and details of such transfer shall be disclosed in the balance-sheet. This account may be applied by the company for issue of fully paid bonus shares.

10.16.2 Conditions for Buy-Back

1) Section 68 (2) provides that no company shall purchase its own shares or other specified securities unless:

   a) the buy-back is authorised by its articles;

   b) a special resolution has been passed at a general meeting of the company authorising the buy-back. The buy-back must not exceed twenty-five per cent of the aggregate of paid-up capital and free reserves of the company. In case of buy-back of equity shares in any financial year, buy-back cannot exceed 25% of its total paid-up equity capital in that financial year.

      However, buy-back up to ten per cent of the total paid-up equity capital and free reserves of the company may be affected by passing a resolution at a meeting of the Board of directors of the company;

   c) There cannot be more than one buy-back within a period of one year from the date of the closure of the preceding offer of buy-back.

   d) the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

   e) all the shares or other specified securities for buy-back are fully paid-up;

   f) buy back of securities by a listed company shall be as per SEBI regulations.

2) Every buy-back shall be completed within a period of one year from the date of passing the Special resolution /Board's resolution under sub-section (2) of Section 68.

3) Buy-back shall be permissible:

   a) from the existing shareholders or security holders on a proportionate basis;

   b) from the open market;

   c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

4) The company must file with the Registrar and the Securities and Exchange Board, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board.

   No declaration of solvency shall be required to be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange.

5) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

6) Where a company completes a buy-back of its shares and other specified securities under this Section, it shall not make further issue of the same kind of shares including by way of rights or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

7) A company shall after the completion of the buy-back file with the ROC and SEBI a return containing such particulars relating to the buy-back within 30 days of such completion, as may be prescribed.

However, the aforesaid return shall not be required to be filed with SEBI if the company's shares are not listed on any recognized stock exchange.

Penalty

If a company makes default in complying with the provisions of Section 68 or any rules and regulations made thereunder, 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 imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

10.16.3 Prohibition for Buy-Back in Certain Circumstances [Section 70]

No company shall, directly or indirectly, purchase its own shares or other specified securities:

a) through any subsidiary company including its own subsidiary companies;

b) through any investment company or group of investment companies; or

c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of the Companies Act, 2013, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. However, the buy-back shall be permissible after a period of three years from the date such default ceased to subsist.

In the following cases, however, a company is not taken to have purchased its own shares:

a) where it redeems its preference shares;

b) forfeits its shares for non-payment of calls;

c) accepts a valid surrender of shares.

10.16.4 Financial Assistance for Purchase of its Own Shares

Sub-section (2) of Section 67 further disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company.

However, the aforesaid provisions regarding the prohibition to buy its own shares or give loans or provide financial assistance shall not affect:

a) The lending of money by a banking company in the ordinary course of its business.

b) the provision by a company of money in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid-up shares in the company or its holding company, if the purchase of, or the subscription is for, the shares held by trustees for the benefit of the employees or such shares are held by the employees of the company;

c) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership. However, the amount so advanced must not exceed their salary or wages for a period of six months.

d) A company may buy its own shares from any member for prevention of oppression and mismanagement in pursuance of the Tribunal order under Section 242 of the Act.

e) A private company not being a subsidiary of a public company though not allowed to buy its own shares may advance loan or financial assistance for purchase of its shares or shares of its holding company.

f) The Section does not apply to the case of any holding company purchasing the shares of or lending money to any person for purchasing shares of its subsidiary.

If a company contravenes the provisions of section 67, it shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

10.17 BOOK BUILDING

Book Building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement or other document. It is a method of equity under-writing.

Thus, in case of public issue through the process of book building, though the total size of the issue is known, the number of shares is not known. It is because the price is at which shares will be allotted is not known, it's determined through the process of book-building only. The prospectus only mentions the price band [i.e., the lowest (floor price) and the highest (maximum price)]. As per SEBI Regulations, 2018 the maximum price cannot be more than 20% of the floor price. As part of the process, bids are invited from the prospective investors and final price is determined (that is, the price at which the issue is likely to be fully subscribed). By dividing the total issue size by the price so determined, the number of shares to be issued is arrived at. As per SEBI Regulations, 2018, an issuer company may make an issue of securities to the public through a prospectus by making 100% of the net offer to the public through book-building process.

Advantages of Book–building – Advantages of book-building include:

i) the demand for security proposed to be issued by a body corporate may be created and built-up.

ii) the quantum of security to be issued may be determined with a certain degree of accuracy.

iii) The price at which the issue is likely to be fully subscribed may be ascertained.

iv) This is the most efficient method to price the shares in IPO market.

v) This process gives investors the confidence leading to a large investor universe.

vi) As the issue is pre-sold these is no uncertainties relating to the fate of the issue.

Book building is an alternative method for allotment of securities through public offer.

Offer to Public through Book Building Process

An issuer proposing to issue specified securities through the book building process shall comply with the requirements of Schedule XIII of SEBI Regulations, 2018

Check Your Progress D

1) What is meant by a call?

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2) List three essentials of a valid call.

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3) Give the reason for forfeiting shares.

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4) When is surrender of shares lawful?

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5) What is buy-back of shares?

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6) State whether the following statemnts are true or false:

i) Any director of a company can make a call on his own.

ii) The call notice must specify the amount payable, the date and place of payment.

iii) The calls on shares should be made on a uniform basis.

iv) Forfeiture of shares does not amount to reduction of capital.

v) Shares can be forfeited for non payment of call or any other debt.

vi) Forfeited shares may either be cancelled or reissued at the discretion of the Board of directors.

vii) Forfeited shares can be reissued at a discount, but the amount of discount must not exceed the amount forfeited on such shares.

viii) Surrender of shares is the same thing as forfeiture of shares.

10.18 LET US SUM UP

A company may issue shares at face value or at a price other than the face value. When shares are issued at face value, it is termed as shares issued at par.

Shares may issued either by (a) public offer (b) right issue /bonus issue or (c) private placement Public offer of shares may be initial public offer or further public offer.

By private placement of shares, a company may offer or invite to subscribe or issue of securities to a select group of person with certain conditions to be satisfied.

Shares can be issued at par or at a premium. Only sweat-equity shares can be issued at a discount, if certain conditions are satisfied. When shares are issued at a premium, the premium amount can be utilised only for writing off preliminary expenses or for writing off capital losses or for issuing bonus shares.

Allotment of shares is an important step in the process of raising the funds by the issue of shares or debentures. When a person applied tor a certain number of shares of the company in response to an advertisement or prospectus and the company accepts his offer; and allot him the shares, it results in a valid contract between the company and the applicant. The allotment must not be made until the minimum subscription has been received by the company.

The allotment should not be made unless the application money is at least five per cent of the nominal value of shares and the money is deposited in a scheduled bank. The shares of the company should be listed in one or more recognised stock exchanges.

Share certificate is the evidence of title of the member to such shares. When the shares are allotted to a person, he is entitled to receive a share certificate from the company. The share certificate is issued under the seal of the company and it contains the name and address of the member, certificate number, number of shares, amount paid up in respect of them etc.

If the original share certificate is lost, destroyed or torn, the company may issue a duplicate share certificate on certain conditions.

The entire amount in respect of shares is not demanded in one instalment. After the shares have been allotted, the company requires the members to pay the remaining money in one or two instalments known as 'calls'. The call must be made under a resolution of the Board of directors, on a uniform basis, for the benefit of the company and in accordance with the provisions of the articles of the company.

If a shareholder fails to pay the call money within the stipulated time, the shares can be forfeited. Before forfeiting the shares, the company must send a proper notice to the member. Forfeiture shall be valid only when it is made under a resolution of the Board of directors. Forfeited shares can be reissued, it does not amount to allotment but it is simply a sale of shares already issued. Surrender of shares means voluntary return of shares by the shareholder to the company for cancellation. Surrender of shares may be accepted only when forfeiture is justified. Section 67 prohibits a company from buying its own shares except on compliance of the provisions of section 68 and the SEBI Regulations.

Book building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is solicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement or other documents.

10.19 KEY WORDS

Issue of Shares at par: Shares issued at a face value.

Bonus Share: The shares issued to the existing members free of charge.

Rights Share: The shares issued by a company to its existing shareholders.

Allotment: An appropriation of a certain number of shares to a specified person in response to his application.

Issue of shares at a discount: Issue of shares at a price which is less than the nominal value of the share.

Issue of shares at a premium: Issue of shares at a price which is more than its face value.

Share Certificate: A certificate issued under the seal of the company, specifying the shares held by any member and the amount paid.

Call: An installment which a shareholder is required to pay to the company.

Forfeiture: Taking back the share for non-payment of calls thereby depriving the shareholder of his right to the shares.

Surrender of Shares: Voluntary return of the shares to the company.

Share buy-back: Act of the company to purchase its own shares.

Book-Building: The process by which an underwriter attempts to determine the price at which an IPO will be offered.

10.20 ANSWERS TO CHECK YOUR PROGRESS

B 4. i) Board of directors ii) five iii) 90%

iv) 30, next 15 v) cannot

5. i) False ii) True iii) False iv) False

v) True vi) True vii) True

C 4. i) evidence of title ii) one iii) Registered shareholder

5. i) False ii) True iii) False iv) True

D 6. i) False ii) True iii) True iv) True

v) False vi) True vii) True viii) False

10.21 TERMINAL QUESTIONS

1) What is private placement of securities ? Discuss the conditions to be satisfied for private placement of shares.

2) Distinguish between Rights shares and Bonus shares.

3) Explain the procedure of allotment of shares.
4) What is meant by return of allotment?
5) Under what circumstances can a company issue sweat equity shares at a discount?
6) State the purposes for which the securities premium amount can be utilized.
7) What is a share certificate? When must it be issued? Can a company issue a duplicate share certificate; if so, when?
8) What is meant by 'call'? What are the requisites of a valid call?
9) Explain the procedure of forfeiting the shares. What is the effect of forfeiture? How forfeiture is different from surrender of shares?
10) Discuss the eligibility requirements for an initial public offer.
11) What is Book Building? What are its advantages?

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

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UNIT 11 TRANSFER AND TRANSMISSION OF SHARES

Structure

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11.0 OBJECTIVES

After studying this Unit, you should be able to:

- discuss the free transferability of shares of a company;
- learn the procedure to effect transfer of shares;
- explain the concept of blank transfer;
- note as to what constitutes a forged transfer and what are its consequences;
- describe the procedure regarding transfer of shares under Depository System;
- learn about the nomination facility;

- know about transmission of shares in case of death of a shareholders;
- distinguish between transfer and transmission of shares; and
- explain insider trading and whistle Blowing.

11.1 INTRODUCTION

You know that one of the most important features of a company is that its shares are freely transferable. Section 44 of the Companies Act, 2013 provides that the shares of a company shall be a movable property, transferable in the manner provided by the articles of the company. The Section thus empowers every shareholder to transfer his shares in the manner laid down in the Articles and in accordance with the various provisions of law. However, a private company is statutorily under obligation to place certain restrictions on the right of its members to transfer shares. One of the most common restrictions on transfer of shares in a private company is the "Pre-emption clause", which states that the intending transferor must offer his shares to the existing members of the company, before offering them to non-members. In case, no member is prepared to purchase those shares at a fair price to be determined as per Articles, then he may transfer those shares to any outsider.

In the case of public companies also, there may be some restrictions on the right of members to transfer shares. Regulation 20 (Table F) provides that the Board of directors may refuse to register the transfer of partly paid shares to a person of whom they do not approve. Further, the Board of directors may refuse to register the transfer of any share on which the company has a lien. Regulation 21 also envisages certain conditions which may be introduced by a company in its Articles to restrict transfer of shares. It provides that the Board may also decline to recognise any instrument of transfer unless:

a) the instrument of transfer is in the form as prescribed in rules made under sub-section (1) of section 56;

b) the instrument of transfer is accompanied by the certificate of the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer; and

c) the instrument of transfer is in respect of only one class of shares.

Right of a shareholder to transfer his share is always subject to provisions in Articles of Association **- Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd. [1992] 73 Comp. Cas. 150 (Ker.).**

The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse mala fide, i.e., they act oppressively, or corruptly, the Tribunal will interfere and order registration.

Time within which transfer must be registered: As per Section 56, a company is required, within one month after the application of transfer, to deliver the share certificates duly transferred.

Can refusal to effect transfer be made on grounds other than those stated in the Articles? - The Articles should, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. Thus a provision in the Articles empowering the Board of directors to refuse

to register transfer without assigning any reasons will not be maintainable. In **Hemangini Finance & Leasing (P.) Ltd. v. Tamilnad Mercantile Bank Ltd. [1996]**, the Company Law Board (now Tribunal) held that there is no blanket authority available to a company to refuse registration of transfer, even if the articles provide absolute discretion. When the articles do not provide for any powers for refusal, the company cannot refuse. If it has restrictive power as per articles, the powers could be exercised only in regard to those matters.

Refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable **[Pawan Gupta v. Hicks Thermometers (India) Ltd. (1999)]**.

Again, merely because, with registration of transfer of shares, total holding of transferee would become dangerously close to 25%, company cannot refuse to transfer **[Bajaj Auto Ltd. v. CLB (1998)].**

11.2 PROCEDURE OF TRANSFER OF SHARES

Section 56 has laid down the following procedure for effecting transfer of shares:

1. A company shall not register a transfer of securities of the company unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee.

2. The instrument of transfer, as aforesaid, must have been delivered to the company within a period of sixty days from the date of execution.

3. The instrument of transfer must be accompanied by the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

   However, where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

   A reading of Section 56 of the Companies Act, 2013 and Section 12 of the Indian Stamp Act, 1899, clearly shows that the instrument of transfer of shares should bear the requisite stamps and the adhesive stamps should be cancelled at the time of affixation of such stamps and execution of the document.

   If these requirements are not complied with, then the instrument, although bearing an adhesive stamp but not cancelled, cannot be said to be an instrument 'duly stamped'. Accordingly, transfer shall not be valid - **Nuddea Tea Co. Ltd. vs. Ashok Kumar Saha [1988]**. Similarly view was held in **Kothari Industrial Corpn. Ltd. vs. Lazor Detergent (P.) Ltd. (1993)**.

   Cancellation of the stamps by the staff of the company does not make the transfer instrument duly stamped. The contention of the company that stamps were cancelled by them (the company) before the Board of directors considered the transfer shall not be upheld as valid - **Subhash Chander vs. Vardhaman Spg. & Gen. Mills Ltd. (1993)**.

4. The company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates within a period of one month from the date of receipt by the company of the instrument of transfer.

Transfer of Partly-paid Shares

Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice (Section 56 (3)).

Transfer of Shares Held in Joint Names

In the case of shares held in joint names, the transfer form must be signed by all of them, unless a specific authorisation is made in favour of any or some of them.

Thus, in **Shanta G. Pommerat v. Sakal Papers (P.) Ltd. [1990]** where four persons were shown as transferors of shares and only three had signed the share transfer form and fourth had not authorised the others to sign on his behalf, it was held that transfer of shares was not valid.

Transfer When Complete

Transfer becomes complete and the transferee becomes a shareholder, only when the transfer is registered in the company's register - **Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd. [1992]**

In a plea that the names of certain persons entered in the Register of Members were done without following the complete procedure prescribed under Section 108, now (56) the Delhi High Court held that the onus of proof will lie on the party making such allegation **[Radhey Shyam Gupta v. Kamal Oil & Allied Industries Ltd. [1999]**.

Power of the Board of Directors to Refuse Registration of Transfer of Shares: Where the Articles of association of a company give power to the Board to refuse registration of a transfer of shares such power must be exercised by a resolution of the Board. The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse mala fide, i.e., they act oppressively, or corruptly, Tribunal will interfere and order registration. The Articles may, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. Thus, where the Articles of Association of a private company contain a provision to the effect that "no share shall be transferred to an outsider if any member of the company was willing to purchase the same at fair price to be determined by the directors, and transfer to an outsider shall be allowed only when the Board of directors was unable to find a willing member within a stipulated period", the directors having offered to purchase those shares, the question of registering shares in favour of an outsider would not arise - **Satyanarayana Rathi v. Annamalaiar Textiles (P.) Ltd. [1999] 93 Comp. Cas. 386 (CLB - Chennai).**

Again in Pawan Gupta v. Hicks Thermometers (India) Ltd. [1999] 21 SCL 90 (CLB - New Delhi), it was held that the refusal to register transfer of shares of the company in the name of son of one of the collaborators of

the company on the ground that under an agreement the three collaborators had the pre-emptive right to acquire each other's shares in the event of any of them deciding to part with his holding, would not be permissible under the provisions of the Securities Contracts (Regulation) Act, 1956.

Similarly, the refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable - **Pawan Gupta vs. Hicks Thermometers (India) Ltd. (supra).**

Refusal of registration and Appeal against refusal

1. **In case of a private company**

   The company must send notice of the refusal to the transferor and the transferee or to the person giving intimation of transfer or transmission, as the case may be, giving reasons for such refusal. The **notice must be sent within a period of thirty days** from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company (Section 58 (1)).

   The **transferee may appeal** to the Tribunal against the refusal within **a period of thirty days** from the date of receipt of the notice or **in case no notice has been sent** by the company, **within a period of sixty days** from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company.

2. **In case of a Public company**

   The securities or other interest of any member in a public company shall be freely transferable. However, any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.

   Section 58 (4) provides that 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, as the case may be, is delivered to the company, **the transferee may**, within **a period of sixty days** of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

   The Tribunal, while dealing with an appeal, whether it relates to a private company or public company may, after hearing the parties, either dismiss the appeal, or by order—

   a) direct that the 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.

Penalty

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

11.3 BLANK TRANSFER

Where a shareholder signs a share transfer form without filling in the name of the transferee and hands it over along with the share certificate to the transferee thereby enabling him to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'. Blank transfer facilitates purchase and sale of shares by mere delivery of the share certificates along with the said blank transfer form. Because of the convenience associated with blank transfers, the shares are usually sold and purchased through blank transfer. Besides easy transferability, blank transfers results in saving on stamp duty. Stamp duty is to be affixed only by the last transferee who lodges the shares with the company for the purpose of registration of transfer. Thus, all the intermediate transferees save stamp duty.

A blank transfer deed is not a negotiable instrument merely because it may be transferred by mere delivery. Accordingly, the title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor. Thus, a *bona fide* transferee from a person who has acquired a blank transfer deed by fraud does not acquire good title to the shares included in the deed.

A transfer in blank, when accompanied by a share certificate, carries to the transferee both the legal and equitable rights to the shares and also the right to call upon the company to register the transfer - **Colonial Bank v. Cady [1980]**. This right to get himself registered as a member is available to the transferee even after the death of the transferor - **In re Bengal Silk Mills Co. Ltd. [1942]**.

11.3.1 Ills Associated with Blank Transfer

1. **Loss of stamp duty** - The saving in stamp duty by the intermediate transferees is, in effect, a loss to the exchequer - the State Government (Stamp duty being a State subject).

2. **Loss of income-tax** - The facility of blank transfer enables any number of transfers till a transferee decides to become the registered shareholder of the company. Such a transferee shall fill up his name and other particulars before lodging the same with the company. From the entries in the transfer form, it will now appear as if the last transferee has purchased the shares directly from the registered shareholder. As a consequence the intermediate transferors who might have sold the shares for a gain may not report the same as a part of their income. Since the transaction has not been recorded, it may provide a convenient route to avoid the income-tax liability, thus, resulting in a loss to the exchequer.

11.4 FORGED TRANSFER

An instrument on which the signature of the transferor is forged is called a forged transfer. Forgery does not confer any title. It is because in case of forgery there is not merely an absence of free consent but there is no consent at all. Hence a forged transfer can never confer ownership upon the transferee thereof, howsoever genuine the transaction may appear. Thus, if a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and for his names to be placed back in the register.

11.4.1 Consequences of Forged Transfer

1. A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder with the consequential rights, viz., the right to receive dividends, right issue, bonus, etc. The company is bound to restore his name in the register of members - **Barton v. N. Staffordshire Rly. [1988]**.
2. If the company has issued a share certificate to the transferee and he has sold the share to an innocent purchaser, it cannot deny his title, for the certificate stops it from doing so. It will, therefore, be under a liability to compensate him if it refuses to register him as a shareholder - **Balkis Consolidated Co. Ltd. v. Fredrick Tomkinson [1893]**.
3. If the company has been put to loss by reason of the forged transfer, it may recover the loss from the person who procured registration, even though he might have acted in good faith.

A person who presents a transfer of shares for registration by a company thereby represents that the instrument of transfer is genuine and if it turns out to be a forgery, the company is not stopped from denying his title to the shares, even though he did not know that the transfer was forged when he presented it. Consequently, even if the company issues a share certificate to the person who presents the transfer, and he relies on it, the company may remove his name from the register of members, and he cannot claim damages for wrongful removal- **Sheffield Corpn. v. Barclay [1905]; Johnston v. Renton [1870].**

However, where the transfer is registered, the transferee who first secures registration will get priority over the rest irrespective of the date when his claim arose - **Moore v. North Western Bank [1891]**.

11.5 TRANSFER OF SHARES UNDER DEPOSITORY SYSTEM

The Depositories Act, 1996 provides for an alternate mode of effecting transfer of shares. Investors, however, have the choice of continuing with the existing share certificates (i.e., in physical form).

As per the available statistics at BSE and NSE, 99.9% transactions take place in dematerialised mode only. Therefore, in view of the convenience of trading in dematerialised mode, it is advisable to have a beneficial owner (BO) account for trading at the exchanges.

11.5.1 Benefits of Dematarialisation (Demat)

The benefits of Demat are enumerated below:-

- A safe and convenient way to hold securities;
- Immediate transfer of securities;
- No stamp duty on transfer of securities;
- Elimination of risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc.
- Reduction in paperwork involved in transfer of securities;
- Reduction in transaction cost;

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- No odd lot problem, even one share can be traded;
- Nomination facility;
- Change in address recorded with depository participant (DP) gets registered with all companies in which investor holds securities electronically eliminating the need to correspond with each of them separately;
- Transmission of securities is done by DP eliminating correspondence with companies;
- Automatic credit into demat account of shares, arising out of bonus/split/ consolidation/merger etc.
- Holding investments in equity and debt instruments in a single account.

The Depositories Act, 1996 provides for the establishment of one or more depositories. Every depository will be required to be registered with the SEBI and receive a certificate of commencement of business on fulfilment of such conditions as may be prescribed. At present two Depositories, viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are registered with SEBI. Investors opting to join the system will be required to be registered with one or more participants who will be agent for depositories. The participants will be custodial agencies like banks, financial institutions as well as large corporate brokerage firms. Upon entry into the system, share certificates belonging to the investor will be dematerialised and their names entered in the books of participants as beneficial owners. The investors' names in register of companies concerned will be replaced by the name of the Depository as the registered owner of the securities. The investors will, however, continue to enjoy the economic benefits, from the shares as well as voting rights on the shares concerned. Investors are called as the beneficial owners under this system.

Shares in the depository mode cease to have distinctive numbers. In fact, each security is assigned a unique 12 digit alphanumeric identification number called ISIN (International Securities Identification Number), e.g.- INE383C01018. Equity fully paid up, equity-partly paid up, equity with differential voting /dividend rights issued by the same issuer will have different ISINs.

Ownership changes in the depository system will be made automatically on the basis of delivery against payment. There will be a regular, mandatory flow of information about the details of ownership in the depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person on the grounds that the transfer of security conflicts with the provisions pertaining to substantial acquisition of shares and takeovers, the company will be entitled to make an application to the Company Law Tribunal (Tribunal) for rectification of the ownership records with the Depository. During the pendency of company's application with the Tribunal, the transferee would be entitled to all the rights and benefits of the shares except voting rights which will be subject to the orders of the Tribunal.

Any loss caused by the negligence of the Depository or the Participant will be required to be indemnified by the Depository.

It may be noted that the provisions of Section 56 are inapplicable to transfer

where transferee and transferor are entered as beneficial owners in records of Depository [**Finolex Industries Ltd. vs. Anil Ramchand Chhabria (2000)**].

Check Your Progress A

1) Shares of a public company are freely transferable. Comment

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2) What is a blank transfer?

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3) What is a forged transfer?

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4) State whether the following statements are True or False

i) The shares in a company are movable property transferable in the manner provided in the articles.

ii) The right to transfer shares can be curtailed by articles of the company.

iii) It is not necessary that the instrument of transfer should be in the prescribed form.

iv) An instrument of transfer need not be stamped.

v) If a company refuses to register transfer of shares, it must within a period of 30 days send notice of refusal to the transferor and the transferee.

vi) A transferee becomes a member of the company when the instrument of transfer is presented to the company.

vii) In case of forged transfer the owner can compel the company to get his name entered in the register of members.

11.6 NOMINATION

In order to allow nomination of shares and debentures, section 72 provides that

1) Every holder of shares in, or holder of debentures of, a company may, at any time, nominate, in the prescribed manner, a person to whom his shares in, or debentures, of the company shall vest in the event of his death [Sub-section (1)].

2) Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

3) The nomination will hold good in spite of any will or any other law containing an otherwise provision. Thus, nomination is overriding.

4) The security holder may change the nomination any time as per the procedure prescribed by the company.

5) Where the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

11.7 TRANSMISSION OF SHARES

Transmission of shares takes place (i) when the registered shareholder dies; or (ii) when he is adjudicated an insolvent; or (iii) where the shareholder is a company, it goes into liquida-tion.

On the death of a shareholder, his shares vest in his legal representative. The legal representative can sell the shares without being registered, if he does not wish to be registered as a member of the company. But, subject to the provisions of the Articles, he is entitled to be put on the Register of members, if he so desires. For this purpose, the company is bound to accept production of 'probate' or 'letter of administration' or 'succession certificate' as sufficient evidence of his title. In case of transmission of shares, a company has no powers to refuse registration of transmission of shares once the legal heir produces a proper legal representation to the estate by way of will/probate/succession certificate, etc., if the same is required in terms of the Articles, unless there is an injunction against acting in terms of the legal representation - **Anil R. Chhabria v. Finolex Industries Ltd. [1999] 22 SCL 437 (CLB - Mum.).**

Section 56 (2) provides that the company shall have the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Sub-section (4) further requires that the company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates duly transmitted within a period of one month from the date of receipt by the company of the intimation of transmission.

The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer [Sub-section (5)]

Appeal against Refusal and Penalty

Same provisions are contained in section 58 as relate to transfer of shares as discussed above.

Where petitioner filed a petition under section 111 (now section 56) seeking transmission of shares of his deceased mother on basis of succession certificate

which had been restrained by issuing competent authority, **CLB (now Tribunal) in Nirav Jhaveri vs. Mit-N-Mir (P.) Ltd. [2012] 20 taxmann.com 303, (CLB – Mum.),** held that the petition had to be dismissed since the petitioner could not be treated as a legal heir.

In case the legal representative elects to become a member, he must send a written and signed notice, called "Letter of Request" to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

Succession certificate covering shares held by a deceased member on the date of his death, would cover subsequent issue of bonus shares and no fresh succession certificate would be required in respect of subsequently issued shares- **Arjun Kumar Israni vs. Cipla Ltd. [1999] 35 CLA 339 (CLB - Mum.).**

In the aforesaid case, the CLB (now Tribunal) further observed that the respondent company would not be justified in not acting on the succession certificate issued by the competent court on account of insufficient court fee stamps.

11.7.1 Transmission of Shares - Where Shares are Held in Joint Names

Regulation 23 of Table F, in this regard, provides that on the death of a member, the survivor or survivors where the member was a joint holder, shall be the only persons recognised by the company as having any title to his interest in the shares.

Further, Sub-regulation (ii) states that the estate of a deceased joint holder shall not be released from any liability in respect of any share which had been jointly held by him with other persons.

11.7.2 Insolvency of a Member/Liquidation

On the insolvency of a shareholder, his shares vest in the Official Assignee or Official Receiver, who can sell and transfer the shares or get himself registered as a member.

Where a shareholding company goes into liquidation, the liquidator of the company in liquidation may sell and transfer the shares.

11.7.3 Transmission of Shares held in Depository (Demat) Mode

As you have learnt in the aforesaid paragraphs that transmission is the process by which shares of a deceased shareholder are transferred to his legal heirs/ nominee. Process of transmission in case of dematerialised holdings is more convenient as the transmission formalities for all securities held in a demat account can be completed by submitting documents to the DP, whereas in case of physical securities the legal heirs/nominee/surviving joint holder has to independently correspond with each company in which securities are held or with the registrar of that company.

In the event of death of the sole holder, the claimant should submit to the concerned DP an application i.e. Transmission Request Form (TRF) along with the following supporting documents -

1. In case of death of sole holder; where the sole holder has appointed a

nominee, the nominee should submit a notarised copy of the death certificate.

2. In case of death of the sole holder; where the sole holder has not appointed a nominee, the legal heir/successor should submit a notarised copy of the death certificate **And** any **one** of the below mentioned documents:
   - Succession certificate
   - Copy of probated will
   - Letter of Administration

The DP, after ensuring that the application is genuine, will transfer securities to the account of the claimant.

11.8 DISTINCTION BETWEEN TRANSFER AND TRANSMISSION

A transfer of shares is a voluntary act of the transferor, while a transmission is by operation of law. In both the cases the ultimate effect is that the ownership passes from one person to another. Following are the main points of distinction between transfer and transmission of shares:

S. No.	Transfer	S. No.	Transmission
i)	It is a deliberate act of the transferor	i)	It is the result of operation of law and takes place only on death or insolvency of a shareholder.
ii)	The transferor and the transferee have to execute an instrument of transfer.	ii)	Only proof of title is required.
iii)	Stamp duty is payable on its execution.	iii)	No Stamp duty is payable in this case.
iv)	Shares are transferred for some consideration.	iv)	Shares pass to the legal heir without any consideration.

11.9 INSIDER TRADING

Insider trading generally refers to "buying and selling of security in breach of fiduciary duty or other relationship of trust and confidence, while in possession of material, non public, price sensitive information about the company's security." It also includes tipping or misappropriation of such information. For example board members, auditors, internal staff who are in know of the extraordinary financial performance of the company trade securities of the company on their own account or pass this information to others before declaration of the results would constitute insider trading.

Section 195 of the Companies Act 2013 dealt with the prohibition on insider trading of securities. As per this section no person including any director or key managerial personnel of a company could enter into insider trading. Explanation in the section defined insider trading

a) i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

ii) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

b) 'price-sensitive information' means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Sections 65 of the Companies Amendment Act (2017) omitted section 195 of Companies Act (2013), and SEBI was empowered to comprehensively deal with insider trading under SEBI Act 1992 and regulations 2009. Following are some provisions:-

Disclosure of Trading by Insiders

General provisions

These provisions require that every public disclosure as required in these regulations shall be made in such form as may be specified. The disclosures required to be made by any person under this regulation shall include the trading activity of immediate relatives or any other person for whom such person takes trading decision. The disclosure shall also include trading of derivatives of securities and all such disclosures shall be maintained by company for a minimum period of five years in such form as may be specified.

Disclosures by certain persons.

1) **Initial Disclosures**

   a) Every promoter, member of the promoter group, key managerial personnel and director of every company whose securities are listed on any recognized stock exchange shall disclose his holding of securities of the company as on the date of these regulations taking effect, to the company within thirty days of these regulations taking effect;

   b) Every person on appointment as a key managerial personnel or a director of the company or upon becoming a promoter or member of the promoter group shall disclose his holding of securities of the company as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.

2) **Continual Disclosures**

   a) Every promoter member of the promoter group, designated person and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information.

Disclosures by other connected persons

3) Any company whose securities are listed on a stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

Institutional Mechanism for Prevention of Insider trading

1) The Chief Executive Officer, Managing Director of a listed company, intermediary or fiduciary shall put in place adequate and effective system of internal controls to ensure compliance with the requirements given in these regulations to prevent insider trading.

2) The internal controls shall include the following:

   a) all employees who have access to unpublished price sensitive information are identified as designated employee;

   b) all the unpublished price sensitive information shall be identified and its confidentiality shall be maintained as per the requirements of these regulations;

   c) adequate restrictions shall be placed on communication or procurement of unpublished price sensitive information as required by these regulations;

   d) lists of all employees and other persons with whom unpublished price sensitive information is shared shall be maintained and confidentiality agreements shall be signed or notice shall be served to all such employees and persons

   e) all other relevant requirements specified under these regulations shall be complied with;

   f) periodic process review to evaluate effectiveness of such internal controls.

3) The Audit Committee of a listed company or other analogous body for intermediary or fiduciary shall review compliance with the provisions of these regulations at least once in a financial year and shall verify that the systems for internal control are adequate and are operating effectively.

4) Every listed company shall formulate written policies and procedures for inquiry in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, which shall be approved by board of directors of the company and accordingly initiate appropriate inquiries on becoming aware of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information and inform the Board promptly of such leaks, inquiries and results of such inquiries.

5) The listed company shall have a whistle-blower policy and make employees aware of such policy to enable employees to report instances of leak of unpublished price sensitive information.

11.10 WHISTLE BLOWING

Whistle blowing is an act or action aimed to draw the attention of the statutory authorities/competent authorities towards instances of practices that are unlawful and may cause loss of revenue, pecuniary benefits to few, misconduct and other related offences. In India to protect the whistle blower from harassment from any other unintended consequences the Whistle Blowers Protection Act (2014) has been passed.

The Whistle Blower (complainant) can make disclosures under the Act. Here disclosure means complaint relating to:

i) an attempt to commit or commission of an offence under the Prevention of Corruption Act, 1988.

ii) willful misuse of power or willful misuse of discretion by virtue of which demonstrable loss is caused to the Government or demonstrable wrongful gain accrues to the public servant or to any third party;

iii) attempt to commit or commission of a criminal offence by a public servant, made in writing or by electronic mail or electronic mail message, against the public servant and includes public interest disclosure.

Requirement of public interest disclosure

1) Notwithstanding anything contained in the provisions of the Official Secrets Act, 1923 any public servant or any other person including any non-governmental organization, may make a public interest disclosure before the Competent Authority.

2) Any disclosure made under this Act shall be treated as public interest disclosure for the purposes of this Act and shall be made before the Competent Authority and the complaint making the disclosure shall, on behalf of the Competent Authority, be received by such authority, as may be specified by regulations made by the Competent Authority.

3) Every disclosure shall be made in good faith and the person making disclosure shall make a personal declaration stating that he reasonably believes that the information disclosed by him and allegation contained therein are substantially true.

4) Every disclosure shall be made in writing or by electronic mail or electronic mail message in accordance with the procedure, as may be prescribed and contain full particulars and be accompanied by supporting documents, or other materials, if any.

5) The Competent Authority may, if it deems fit, call for further information or particulars from the person making the disclosure.

6) No action shall be taken on public interest disclosure by the Competent Authority if the disclosure does not indicate the identity of the complainant or public servant making public interest disclosure or the identity of the complainant or public servant is found incorrect or false.

The Competent Authority on receipt of public interest disclosure under Section (4) of the Act shall:

a) ascertain from the complainant or the public servant whether he was the person or the public servant who made the disclosure or not;

b) conceal the identity of the complainant unless the complainant himself has revealed his identity to any other office or authority while making public interest disclosure or in his complaint or otherwise.

Clauses 5 (2), (3), (4) and (5) deal with the manner in which inquiry is to be conducted by the Competent Authority. Clause 5(6) deals with closing the matter as raised in public interest disclosure and clause 5 (7) deals with possible actions in case the inquiry report reveals either willful misuse of power or willful misuse of discretion or substantiates allegations of corruption.

If any of the above is established, the Competent Authority shall recommend to the public authority to take any one or more of the following measures namely:

i) initiating proceedings against the concerned public servant;

ii) taking appropriate administrative steps for redressing the loss caused to the Government as a result of the corrupt practice or misuse of office or misuse of discretion, as the case may be;

iii) recommend to the appropriate authority or agency for initiation of criminal proceedings under the relevant laws for the time being in force, if so warranted by the facts and circumstances of the case;

iv) recommend for taking of corrective measures;

v) take any other measures not falling under clauses (i) to (iv) which may be necessary for the purpose of this Act.

Clause (8) of the Act specifies certain matters which are exempt from disclosures during the conduct of inquiry. These matters are the ones which may likely to prejudicially affect the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign State, public order, decency or morality or in relation to contempt of court, defamation or incitement to an offence –

a) as might involve the disclosures of proceedings of the Cabinet of the Union Government or any Committee of the Cabinet;

b) as might involve the disclosure of proceedings of the Cabinet of the State Government or any Committee of that Cabinet;

Protection of the persons making disclosure. Under this Act, the Central Government should ensure that no person who has made disclosure under this Act or rendered assistance to conduct an inquiry be victimized by initiation of any proceeding or otherwise; If a person is being victimized or apprehensive about victimization he may file a complaint before the Competent Authority and such Authority shall take such action as deemed fit and may give directions to the concerned public servant/authority to protect such person from being victimized or avoid his victimization. The same amount of protection is also available to witness and persons rendering assistance in the inquiry including police protection.

Protection of identity of complainant is an important feature of this Act. The Competent Authority shall conceal the identity of the complainant and documents

or information furnished by him for the purpose of the enquiry unless so decided by the Competent Authority itself or as directed by the Court.

Offences and Penalty under this Act. When the Competent Authority is of the opinion that the organization or official concerned, without any reasonable cause, has not furnished the report within the specified time or malafidely refused to submit the report or knowingly given incomplete, incorrect or misleading or false report or destroyed record or information which was the subject of the disclosure or obstructed in any manner in furnishing the report, it shall impose –

a) a penalty which may extend to two hundred fifty rupees for each day till report is furnished, however, the total amount of such penalty shall not exceed fifty thousand rupees;

b) where the organization or official concerned, has knowingly given incomplete, incorrect or misleading or false report or destroyed record or information which was the subject of the disclosure or obstructed in any manner the furnishing of the report, a penalty which may extend to fifty thousand rupees.

In case the identity of the complainant is revealed either negligently or mala fidely, such person revealing the identity shall be punishable with imprisonment for a term which may extend upto 3 years and also fine which may extend upto Rs. Fifty thousand.

In case of false and frivolous complaints shall be punishable with imprisonment for a term which may extend to 2 years and also fined upto thirty thousand rupees.

Punishment to Head of Department in certain cases – (1) Where an offence under this Act has been committed by any Department of Government, the Head of the Department shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly unless he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a Department of Government and it is proved that the offence has been committed with the consent or connivance of, or is attributable, such officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Whistle Blowing provisions under the Company Act, 2013

The Companies Act 2013 lays emphasis on fraud elimination through an effective corporate vigilance mechanism; whistle blowing is an important component of an effective corporate vigilance mechanisms. Whistle blowing as such is not specifically incorporated in the Companies Act 2013, but the various sections of the Act incorporate detailed provisions related to inspection, investigation and inquiry. Section 177 (9) specifies that all public listed companies shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed. Further Section 177 (10) specifies to provide for adequate safeguards against victimization of persons who use such mechanism. In addition to this section, sections 206 to 229 of this Act provide a framework of inspection, investigation and inquiry regarding the functioning and compliance requirements of the company. Section 208 of the Act empowers the inspector

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(other than Registrar) to go through the records of the company and recommend further investigations in such matters of the doubt. Section 210 empowers the Central Government to order investigation and under Section 211 'Serious Fraud Investigation Office (SFIO)' has been established to investigate frauds relating to companies. Previously the auditors were not legally empowered to ascertain the fraud, they were just supposed to be primarily reporting such misappropriation, however, under this Act they are supposed to communicate the same to the Government or the appropriate concerned authorities.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 which makes it mandatory for listed companies to have a whistle blower policy for their employees and directors under regulation 22. The details of the whistle blower mechanism are to be provided on the company's website. The Audit Committee of the Board of Directors is responsible for reviewing the functioning of the whistle blower mechanism. The annual report of the companies in their corporate governance section must report about the establishment of the vigil mechanism and the whistle blower policy.

Offences by companies – (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he has exercised all due diligence to prevent the commission of such offence.

2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other office shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Check Your Progress B

1) What is meant by Nomination?

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2) What is Transmission of Shares?

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3) State three points of difference between 'Transfer' and 'Transmission' of Shares.

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4 What is Insider Trading?

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5 What do you understand by Whistle Blowing?

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6. State whether the following statements are True or False

i) Nomination can be made only by individual members.

ii) Nomination overrides 'will' or succession through status.

iii) A minor cannot be appointed as a nominee

iv) Nominee cannot transfer those shares; he must register them in his own name.

v) In case of transmission, the legal successor may elect to become the member of the company or sell those shares.

vi) Where shares are held in joint names, the survivor joint-holder shall become the member of the company.

11.11 LET US SUM UP

Shares of a public company are freely transferable in accordance with the provisions of the Articles and the Act. Shares can be transferred by executing an instrument of transfer, also known as 'transfer deed'. Share certificate should be deposited with the company along with the instrument of transfer. If everything is in order, the Board of directors shall pass a resolution and register the transfer. If the transfer is refused, the company shall within one month of the application for transfer, send notice of refusal to the transferee and the transferor, giving reasons for such refusal.

If a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and for his name to be placed back in the register.

Shares held in depository mode can be transferred by directing the Depository Participant (DP) with whom the shareholder, called beneficial owner, has an account.

Every holder of shares in a company may, at any time, nominate, in the prescribed manner, a person to whom his shares in the company shall vest in the event of his death. The nomination will hold good against any legal successor (whether by will or status). The nominee may elect, either to be registered himself as holder of the shares or transfer the same.

Transfer of shares by operation of law is known as transmission of shares. On the death, lunacy or insolvency of a member on furnishing the necessary proof about their title, the shares are transferred in the name of the legal heir. No stamp duty is payable in case of transmission of shares. There is no consideration either.

Insider trading generally refers to buying and selling of securities in breach of fiduciary duty or other relationship of trust and confidence, while possession of material non public, price sensitive information about company's securities. SEBI has been empowered to deal with insider trading under SEBI Act and regulations.

Whistle blowing is an act or action aimed to draw the attention of statutory authorities/competent authorities towards instances of practices that are unlawful and may cause loss of revenue, pecuniary benefits to few misconduct and other related offences. In India to protect the whistle blower from harassment from any other unintended consequences the Whistle Blowers Protection Act 2014 has been passed.

11.12 KEY WORDS

Transfer of Shares: Transfer of ownership of shares which is done voluntarily by executing the instrument of transfer.

Blank Transfer: Transferor signs the 'transfer instrument' leaving all other particulars blank.

Forged Transfer: Instrument of transfer bearing the forged signature of the transferor.

Demat: Shares held in depository mode.

Nomination: Declaration by the shareholder that, in the event of his death, his shares will stand transmitted in favour of the named person.

Transmission of Shares: Transfer of shares by operation of law.

Insider Trading: Buying and selling of securities in breach of fiduciary duty or other relationship of trust and confidence.

Whistle Blowing: An act or action aimed to draw attention of the statutory/ competent authorities towards instances of practices that are unlawful.

11.13 ANSWERS TO CHECK YOUR PROGRESS

A 4 i) True; ii) False; iii) False; iv) False;
v) True; vi) False; vii) True

B 6 i) True ii) True iii) False iv) False
v) True vi) True

11.14 TERMINAL QUESTIONS

1. Explain the procedure of transfer of shares.
2. When can a company refuse to register a transfer of shares?

3. State the evils associated with 'blank transfers'.
4. State the rights of a transferee in case of company's refusal to register a transfer.
5. Explain in brief transfer of shares held under Depository mode.
6. Distinguish between 'transfer' and 'transmission' of shares.
7. Discuss the provisions of the Companies Act, 2013 with respect to nomination of shares by a member. Can nomination be made in favour of a minor?
8 What is Insider Trading? Why is it illegal ?
9. What is Whistle Blowing? What are the protections available to a person making disclosure?
10. Discuss the penalties imposed on company and head of department, if found guilty under Whistle Blowing Act.

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

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UNIT 12 MEMBERSHIP OF A COMPANY

Structure

12.0 Objectives

12.1 Introduction

12.2 Member and Shareholder

12.2.1 Definition of a Member

12.2.2 Distinction between Member and Shareholder

12.2.3 Who can become a Member?

12.3 Modes of becoming a Member

12.4 Termination of Membership

12.5 Rights of Members

12.6 Liability of Members

12.7 Register of Members

12.8 Let Us Sum Up

12.9 Key Words

12.10 Answers to Check Your Progress

12.11 Terminal Questions

12.0 OBJECTIVES

After studying this Unit, you should be able to:

- explain the meaning of a member;
- distinguish between a member and a shareholder;
- describe the modes of becoming a member;
- discuss the circumstances when a person ceases to be a member;
- list of rights and liabilities of members; and
- explain the rules relating to the maintenance of the register of members.

12.1 INTRODUCTION

You have learnt that a registered company has a corporate entity of its own which is distinct from the members who constitute it. The terms 'member' and 'shareholder' are used interchangeably. But, in law, there is a fine distinction between the two. In this unit you will learn about the exact meaning of the term 'member', modes of becoming a member, the circumstances under which a person ceases to be a member, and the rights and liabilities of members. In addition, you will learn the rules regarding the maintenance of Register of Members.

12.2 MEMBER AND SHAREHOLDER

12.2.1 Definition of a Member

Section 2 (55) of the Companies Act, 2013 defines a member in the following words :

1. The subscribers to the Memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.

2. Every other person who agrees in writing to become a member of the company and whose name is entered in its register of members shall be a member of the company. In **Herdilia Unimers Ltd. v. Renu Jain [1995]**, it was held that the moment the shares were allotted and share certificate signed and the name entered in the register of members, the allottee became the shareholder, irrespective of the allottee receiving the shares or not.

3. Every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

On this basis, two pre-requisites for a person to become a member of a company are:

i) the agreement in writing to take shares of the company; and

ii) the registration of his name in its register of members.

Besides, a person may also become a member of a company through the depository system.

Thus, a person can agree to take shares of a company either as the subscriber at the initial stage of its formation or in any of the following manner :

a) by subscribing to its further or new shares;

b) on transfer of its shares from an existing member;

c) on acquisition or purchase of its shares (for example, take-over bid, renunciation of rights shares by an existing member); and

d) on acquisition of its shares by devolution (for example, transmission of shares to legal heirs of a deceased member, on insolvency, upon merger/ amalgamation through Tribunal's order);

e) on conversion of convertible debentures or loans pursuant to the terms of issue of such debenture or loan agreement respectively.

The fundamental difference between the subscribers who agree to take shares at the time of formation of the company and persons who agree to take shares later is that the former become members immediately on incorporation of the company, that is, they automatically become members. The latter, though having agreed to take shares, become members only after their names are entered in the register of members of the company.

12.2.2 Distinction between Member and Shareholder

In normal usage the two terms 'member' and 'shareholder' are used synonymously. But, legally, there is a difference between the two. A shareholder is a person

who holds or owns the shares in a company, whereas a member is one whose name is recorded in the Register of Members. In some cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member. Following are the main points of difference:

i) A company limited by guarantee having no share capital will have only members but no shareholders.

ii) When a person transfers his shares, he ceases to be a holder of those shares but continues to be the member of the company until his name is replaced by the name of the transferee.

iii) the legal representatives of a deceased member become shareholders immediately on the death of the member but they do not become members until their names are entered in the Register of Members.

iv) A person whose shares are forfeited or who has surrendered his shares to the company may be held liable as a member to contribute to the assets of the company, if winding-up commences within twelve months of his ceasing to be a member, though he is no longer the shareholder of the company.

In **Kedarnath Agarwal v. Jay Engineering Works Ltd.** it was held that a member may be a shareholder, but a shareholder may not be a member.

From the above discussion, it should be clear to you that person holding shares of a company are shareholders, while members are persons who constitute the company as a corporate entity and whose names are entered in the Register of Members.

12.2.3 Who can become a Member?

The Companies Act does not specifically lay down as to who can be a member of a company. It also does not prescribe any disqualification for any person which would debar him from becoming a member of a company. The Act simply provides that any person who agrees in writing to become a member of a company can become a member. You know that a contract to purchase shares in a company is like any other contract. Therefore, only such persons can become members of a company who are competent to contract. However, as regards competency of a member, the provisions of the Indian Contract Act shall apply. **This means that minors, persons of unsound mind and those who have been disqualified by law from contracting cannot become members of a company.**

Let us now discuss the position of a few special types of members:

i) **Minor:** According to Section 11 of the Indian Contract Act, a minor is incompetent to contract, therefore, he cannot become a member of the company. **In Palaniappa vs. Official Liquidator, Pasupati Bank Ltd.,** an application was made by a father as guardian of his minor daughter describing her as minor. The company went into liquidation. It was held that the allotment was void and neither the minor nor her guardian could be held liable as contributories. But, if in ignorance of the fact of minority, a minor is allotted shares, the company can repudiate the allotment and remove his name from the Register of Members. The minor may also rescind the allotment any time during his minority. In either case, the company has to refund all moneys received from minor in respect of the shares allotted

to him. If neither party repudiates allotment, the name of the minor shall continue to appear on the Register of Members, but in that event a minor incurs no personal liability.

After the minor attains majority, he can still repudiate his liability even if he had received dividends during his minority (**Sadiq Ali v. Jai Kishori**). But, he cannot repudiate the same if he had received dividends after attaining majority and intentionally permitted the company to believe him to be a shareholder (**Fazalbhoy v. The Credit Bank of India Ltd.**). Thus, it is in the interest of the companies to allot only fully paid shares to the minor because otherwise he will not be liable for the unpaid amount of shares.

There is nothing in the Act to bar a minor from becoming a transferee of fully paid shares. In **Miss Nandita Jain v. Bennel Coleman and Company Ltd.,** the Company Law Board held that the contract entered into by a minor for registration of transfer of fully paid shares through the natural guardian was a valid and binding contract. In such a case the entry in the Register of Members will be made as follows: "A (a minor) through .... guardian".

If shares are transferred to a minor, the transferor will continue to remain liable for all future calls on such shares even if he was ignorant of the minority of the transferee. If the company is aware of the minority of the transferee at the time of transfer, it can refuse to register the transfer in favour of a minor unless the shares are fully paid.

ii) **Company:** A company, being a legal person, is competent to contract. Therefore, a company may become a member of another company if it is authorised by its memorandum or articles of association. However, a subsidiary company cannot become a member of its holding company (Section 19).

iii) **Partnership firm:** A partnership firm is not a legal person. Therefore, it cannot buy shares in its own name. A firm may hold shares in the names of individual partners who may be entered as joint holders in the Register of Members. However, it can become member of a non-profit making company licensed under Section 8 of the Act. A limited liability partnership created under Limited Liability Partnership Act, 2008 is a separate legal entity and, therefore, may become a member of a company.

iv) **Hindu Undivided Family (HUF):** A HUF can have shares in a company in the name of its Karta. Thus, the Karta will be a member of the company as his name alone will be entered in the register of members.

v) **Insolvent:** If any member is declared insolvent, he remains a member of the company till his name appears on company's Register of Members. He is entitled to vote in respect of shares held by him, but the dividend on shares will be paid to Official Assignee or Official Receiver.

vi) **Foreigners:** A foreigner may become a shareholder with the general or special permission of the Reserve Bank of India under the Foreign Exchange Management Act, 1999. But if he becomes an alien enemy, his rights as a member shall be suspended.

vii) **Joint Holders:** The shares of a company may also be held jointly by two or more persons. In a public company, even joint shareholders are

counted as separate members but in a private company, joint holders are treated as a single member for purposes of Section 2(68) of the Act. The joint holders of shares may get themselves registered in any order they like. The company may pay dividend to the person whose name is first written in the register of members. Similarly, a notice served by the company on the joint holder named first in the register of members will be deemed to have been served properly on all of them. You should, however, remember that joint holders are jointly and severally liable for payment of calls. The transfer of shares by the joint holders will be effective only if it is made by all of them jointly.

viii) **Public Office:** A public office like income tax department, sales tax department etc. cannot be a member of a company. It cannot register shares in its own name. A registered trade union or a registered society can hold shares in its own name.

ix) **President and Governor:** Shares in a government company can be held in the name of the President of India or Governor of a State.

12.3 MODES OF BECOMING A MEMBER

A person may become a member in a company in any of the following ways:

1) **By subscribing to the memorandum:** A signatory to the memorandum automatically becomes a member of the company on its incorporation. Neither application nor allotment of shares is necessary to constitute them members of the company. Even if his name is not entered in the register of members, he will still be treated as a member of the company.

2) **By application and allotment of shares:** A person who agrees in writing to become the member of the company and whose name is entered in the Register of Members is also a member of the company. An application for shares is an offer to take shares and allotment is the acceptance of that offer. The rules regarding offer and acceptance (Law of Contract) are applicable. Thus, if a person applies for shares subject to certain conditions, the allotment by the company must be made according to those conditions; otherwise the allottee shall not be bound to accept the shares.

3) **By transfer of shares:** You know that the shares of a public company are freely transferable. Thus, a person may buy shares in the open market and get those shares registered in his name. On the registration of transfer of shares, transferee becomes the member of the company.

4) **By transmission of shares:** A person may become a member by operation of law i.e. transmission. On the death of a member, his nominee/legal representatives have the right to get the shares of the deceased member registered in his/their names. No instrument of transfer is necessary in this case.

5) **By estoppels/holding out:** This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding-up, he will be liable, like other genuine members as a contributory (**Hans Raj v. Asthana**). But in view of the rule laid down in Section 2(55) of the Companies Act that the person must agree in writing to be a member,

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a person cannot be treated as a member of a company simply because his name is entered in the register of members. Thus, he enjoys no rights of a member though he may be held liable as a member. However, he may escape liability by applying to Tribunal for rectification of register of members under section 59.

12.4 TERMINATION OF MEMBERSHIP

You learnt that a person becomes a member of a company when his name appears in the Register of Members. Accordingly, a person ceases to be a member of a company when his name is removed from the Register of Members. A person may cease to be a member in any one of the following ways:

1) **Transfer of Shares:** When he transfers his shares to another person and the transfer is duly registered by the company, the name of the transferor is removed from the Register of Members.

2) **Transmission of Shares:** On the death of a member, his shares get transmitted to his nominee/legal representatives.

3) **Forfeiture of Shares:** Shares may be forfeited for non-payment of calls and other reasons contained in the articles. The membership terminates on share forfeiture.

4) **Surrender of Shares:** When a member validly surrenders his shares to the company, he ceases to be a member.

5) **Insolvency of Member:** When a member is declared insolvent, his shares vest in the Official Receiver or Official Assignee. The Assignee or Receiver may sell these shares and when the transferee's name is entered in the Register of Members, insolvent member cases to be a member.

6) **Winding up of Company:** Membership terminates on the winding-up of the company, but he continues to be liable as a contributory.

7) **Repudiation of Contract:** If he repudiates the contract to take shares on the ground of misrepresentation or mistake in the prospectus or on the ground of irregular allotment.

8) **Enforcement of Lien:** When the company has a lien on the shares and the shares are sold by the company to enforce this lien or if the shares are sold in the execution of a decree of the court, the membership terminates.

9) **Redemption of Shares:** If a member is holding redeemable preference shares, then on their redemption his membership terminates.

10) **Tribunal's Order:** When the Tribunal passes an order for the purchase of shares of a member under Section 242 of the Companies Act, his membership terminates.

12.5 RIGHTS OF MEMBERS

A number of rights have been conferred on the members by the Companies Act, 2013, some of the important rights are as under:

i) Right to receive copies of Memorandum and Articles of Association on request and on payment of the prescribed fee.

ii) Right to receive share certificate within the prescribed period of 3 months from the date of allotment.

iii) Right to transfer his shares according to the provisions of the Companies Act and Articles of Association.

iv) Right to have his name entered in the Register of Members.

v) Right of priority to have shares offered in case of increase of capital.

vi) Right to receive notice of meetings, to attend, to appoint a proxy and vote at the meeting.

vii) Right to participate in the appointment of directors, auditors, etc. at the annual general meeting.

viii) Right to inspect register of members, register of debenture holders and copies of annual returns.

ix) Right to apply to the Tribunal for rectification of register of members.

x) Right to request to the Tribunal for calling an annual general meeting when the Board of Directors fails to call such meeting or apply for an extraordinary meeting of the company, whenever necessary.

xi) Right to receive copies of the financial statements and Director's Report before the annual general meeting.

xii) Right to receive proper notice of resolutions requiring special notice.

xiii) Right to have, on request, minutes of proceedings at a general meeting.

xiv) Right to apply to the Tribunal for ordering an investigation into the affairs of the company.

xv) Right to present petition to the Tribunal for relief in cases of oppression and mismanagement.

xvi) Right to present petition to the Tribunal for the winding up the company.

xvii) Right to share in the surplus assets of the company on winding up.

xviii) In the case of a body corporate which is a member, the right to appoint a representative to attend a general meeting on its behalf.

xix) The right to require the company to circulate resolution under section 111.

xx) Right to apply to the Tribunal under section 48 to have any variation of shareholders' rights set aside.

xxi) Right to participate in the removal of directors by passing an ordinary resolution.

From the above you must have noted that these rights are very valuable to keep the management of the company on the right track. How far these rights are exercised effectively by members is a different question.

12.6 LIABILITY OF MEMBERS

Liability of members of a company depends upon the nature of the company. This is discussed accordingly as follows:

i) **Unlimited company:** Every member of such a company is liable for all debts contracted by the company during the period when he was a member. However, a company being a separate legal entity, no member/shareholder can be proceeded against directly by the claimants/ creditors. Their liability, unlike a partnership firm, is not joint and several.

ii) **Company limited by guarantee:** Every member is liable to contribute to the extent of the amount guaranteed by him which is given in the liability clause of the memorandum.

iii) **Company limited by shares:** The majority of the companies belong to this category. In the case of such companies, the liability of a member is limited to the amount unpaid on the shares held by him. If he has paid full amount on shares, his liability is nil.

You should remember that all money payable by any member of the company under the memorandum or articles are a debt due from him to the company. If a shareholder dies and he was holding partly paid-up shares, then his estate will be liable or the legal representatives will be liable for the unpaid amount.

Check Your Progress A

1) What do you mean by the term 'member' of a company?

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2) Distinguish between a 'member' and a 'shareholde'.

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3) List the different ways of becoming a member of the company.

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4) Give three cases when a person ceases to be the member of a company.

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5) State whether the following statements are True or False:

   i) The terms 'member' and 'shareholder' mean the same thing.

ii) A minor cannot become member of a company.

iii) A foreign national cannot become a member of a company.

iv) A person ceases to be a member of the company when his shares are forfeited.

v) A member has a right of priority to have shares offered in case of increase of capital.

vi) A member cannot repudiate the contract to take shares in the company on the ground that the prospectus was misleading.

12.7 REGISTER OF MEMBERS

Section 88 requires every company to maintain in the prescribed form and manner the register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India.

Every register, as aforesaid, shall include an index of the names included therein.

In case of shares held in depository mode, the register and index of beneficial owners maintained by a depository shall be deemed to be the corresponding register and index for the purposes of this Act.

Companies (Management and Administration) Rules, 2014, in this regard, inter alia, provide as follows:

1. **Entries in the Register:** The entries in the register maintained under section 88 shall be made **within seven days** after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares.

2. **Place of Keeping:** The register shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.

3. **Changes in the Entries:** Changes on account of forfeiture, buy-back, reduction, issue of sweat equity shares, transmission of shares, shares issued under employees stock option scheme, etc shall be recorded **within seven days** after approval by the Board or committee.

The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in the Register of members.

In case of shares held by a trustee,

A declaration specifying the name and other particulars of the person who holds the beneficial interest in such shares must be filed with the company. As per Rule 9 of the Companies (Management and Administration) Rules, 2014, the said declaration shall be filed within a period of thirty days from the date on which his name is entered

Penalty

If a company does not maintain a register of members or fails to maintain them

in accordance with the provisions of Act, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues [Section 88 (5)].

Check Your Progress B

1) What is meant by Register of Members?

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2) State whether the following statements are True or False:

   i) It is optional for a company to maintain a register of members.

   ii) Register of members may be maintained at a place other than the registered office by passing an ordinary resolution.

   iii) The entries in the register of members must be made within seven days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares.

12.8 LET US SUM UP

Any person whose name appears on the register of members of a company is known as a 'member'. The terms 'member' and 'shareholder' are used synonymously. But a shareholder may not necessarily be a member and a member may not necessarily be a shareholder. Companies having no share capital have members only.

Any person may become a member of a company in any of the following ways: (i) by subscribing to the memorandum; (ii) by agreeing in writing to take shares; (iii) by estoppe/holding out; (v) by transfer or transmission of shares.

A person may cease to be a member, if (i) he transfers his shares; (ii) he dies or becomes of unsound mind; (iii) his shares are forfeited; (iv) he surrenders his shares; (v) he is declared insolvent; (vi) the company is wound-up; (vii) he repudiates the contract; (viii) the company enforces the right of lien of shares; (ix) the shares are redeemed; and (xi) by an order of the Tribunal.

Every company is required to maintain a register of its members in the prescribed form, containing the prescribed information about the members. The register must be kept at its registered office of the company.

12.9 KEY WORDS

Member: Anyone whose name is entered in the register of members.

Shareholder: A person who holds or owns the shares.

Register of Members: A register containing the names, addresses and other particulars of all the members.

12.10 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) True; ii) True; iii) False; iv) True ;

v) True; vi) False

B 2 i) False; ii) False; iii) True

12.11 TERMINAL QUESTIONS

1) Distinguish between a 'share' and a 'shareholder'.
2) Who can become a member of the company? Can a 'minor', 'partnership firm' become member of the company?
3) Can a person become a member of a company without there being an agreement in writing?
4) When does a member cease to be a member of the company?
5) Explain briefly the rights and liabilities of a member.
6) Write a note on 'Register of Members'

Problems

1) A partnership firm of A,B, C and D, wants to register shares in the name of the firm. The company refuses. What is the way out ? (see pt. 12.2.3)
2) The name of X is found in the register of a company. But X contends that he is not a member of the company. But company contents that he orally agreed, so he is a member. Discuss (refer to pt.12.3).

Note: These questions will help you to understand the unit better. Try to write answers for them but do not submit your answers to the University. These are for your practice only.

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