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An e-newsletter from Lakshmikumaran & Sridharan, New Delhi, India

April, 2013 / Issue–21

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April
2013

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Laws governing issuance of sweat equity shares

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Issue of sweat equity is governed by the provisions of Section 79A of the Companies Act, 1956 ('the Act'), relevant rules and regulations issued by SEBI. SEBI has issued the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002 (the "Regulations") that is applicable to issue of sweat equity shares by listed companies and Unlisted Companies (Issue of Sweat Equity) Rules, 2003 (the "Rules") for unlisted companies, both to be read in conjunction with the provisions of Section 79A of the Act. As per the said provisions, sweat equity shares may be issued by a company incorporated under the Companies Act, 1956 or its subsidiaries incorporated in a country outside India. Such shares can be issued only after one year from the date when the company became eligible to commence its business, which for a private company is one year from its incorporation and a public company a year after it received the certificate for commencement of business as required under Section 149 of the Act. These shares shall be of a class already issued by the company.

Understanding sweat equity shares

Explanation II to Section 79A of the Act defines "sweat equity" to mean *equity share capital issued by the company to employees or directors (hereinafter referred to as the "recipients"), at a discount or for consideration other than cash for providing the know-how or making value additions, by whatever name called.*

Persons eligible: These shares may be issued to an employee, directors or a promoter of the company. It may be noted here that 'promoters' are eligible to be issued sweat equity shares pursuant to the provisions of the rules and regulations.

Issue at a discount: In general, issuance of shares by a company at a discount can be done only with the approval of the Central Government. The exception is for issue of sweat equity shares at a discount without government approval. . The proposed Companies Bill, 2012 does not permit issuance of equity shares at a discount except sweat equity shares.

For consideration other than cash: Sweat equity shares may be issued for consideration other than cash, *i.e.*, for acquisition of an asset, whether tangible or intangible. It is issued in the form of compensation to the employees or directors for contributing an intangible asset which is for the benefit of the company for a long period *eg.*, technical know-how, intellectual property rights or other value additions.

Technical know-how: The sweat equity shares may be issued to the eligible persons for providing technical know-how or intellectual property such as patents, copyrights, trademarks, drawings, designs, development technology, software etc., to the company.

Value additions: Apart from the technical know-how, the sweat equity shares may also be issued for other value additions, *viz.*, an increase in the value of the company's products, in economic terms, which are attributable to the efforts of an employee or a director. In a tangible form it would denote that the employee's contribution brings about a better surplus in working results for the company.

Procedure for issuance

The authorization to issue sweat equity shares need not be provided under the Articles of Association of the company, but if the shares are being issued for consideration other than cash, the Articles should permit the same. In terms of Section 79A of the Act, a special resolution is required to be passed in a general meeting of the shareholders of the company, specifying the number of shares, current market price, consideration, if any, and the class or classes of persons to whom the sweat equity shares are proposed to be issued.

S.No.	Criterion	Statute		Provision	
1	Quantum	Rule 6 of the Rules		Not more than 15% of its total paid up equity share capital in a year or shares of value of Rs. 5 crores, whichever is higher. For any larger issue, Central Government's approval is required.	
2	Pricing	***Listed Companies*** Regulation 7 of the Regulations	***Unlisted Companies*** Rule 8 of the Rules	***Listed Companies*** On the basis of weekly high and low of the related equity shares on a stock exchange	***Unlisted Companies*** Fair market value calculated by an independent valuer
3	Lock-in Period	Rule 10 of the Rules and Regulation 12(1) of the Regulations		Sweat equity shares shall be locked in for a period of 3 years from the date of allotment.	
4	Disclosure in the Directors' Report (only for unlisted companies)	Rule 7 of the Rules		The Board of Directors shall disclose either in their Directors' Report or in its annexure the details regarding the sweat equity shares held by them during the year. In addition, shares issued against consideration other than cash or pursuant to a contract shall be disclosed in the balance sheet of the company in terms of Schedule VI under the heading 'Share Capital'.	

S.No.	Criterion	Statute	Provision
5	Auditor's Certificate (only for listed companies)	Regulation 10 of the Regulations	A certificate from the auditors of the company that the issue of sweat equity shares has been made in accordance with the Regulations and in accordance with the resolution passed by the company authorizing the issue of such sweat equity shares.
6	Register of Sweat Equity Shares	Rule 5 of the Rules	Maintenance of a register of sweat equity shares

In the case of listed companies, these shares can be listed on a recognized stock exchange. According to Accounting Standard 26, if any intangible asset comes into existence as a result of sweat equity, such an asset may be written off as stipulated.

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Notifications & Circulars

Revised FDI Policy released: The Department of Industrial Policy and Promotion in the Ministry of Commerce & Industry has issued consolidated revised Foreign Direct Investment (FDI) Policy to be effective from April 5, 2013. Circular No. 1 of 2013 incorporates the policy changes in multi brand retailing, civil aviation, investment from Pakistan etc. in the main policy. Some of the key changes made by this circular are: (a) The earlier requirement that the foreign investor in single brand retailing shall also be the owner of the international brand has been done away with. The Policy stipulates that only one non-resident entity with a valid agreement with the brand owner shall be allowed to undertake single brand retailing. Further, local sourcing of 30% of the value of goods purchased has been made mandatory for foreign investment of more than 51% in single brand retailing. (b) Investment limit (including FDI and FII) in Asset Reconstruction Companies (ARCs) has been raised from 49% to 74% under government approval route.(c) FDI in various services in the broadcasting sector such as DTH and cable network has been raised to 74% subject to certain security conditions. Investment upto 49% in this sector will be under automatic route and between 49-74% after government approval. (d) NBFCs with 75% to 100% FDI and minimum capitalization of $50 million, can set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital. Earlier, this was available only to NBFCs with 100% FDI. (e) The mandatory requirement that foreign capital participation in LLPs shall only be through cash consideration or through normal banking channels shall be considered optional in the event of conversion of a company with FDI to an LLP.

Corporate loans and investments under Companies Act: Ministry of Corporate Affairs (MCA) has clarified that where the effective rate of return (effective yield) on tax free bonds is greater than the yield on prevailing bank rate, purchase of tax free bonds shall not be a violation of the Companies Act, 1956. General Circular No. 6/2013, dated 14-3-2013 issued for this purpose notes that the response of Govt. of India's tax free bond, which carries lower rate of interest, was poor in 2012-13 due to the restrictions of Section 372A(3) of the Companies Act, 1956. The said section provides that loans to a body corporate cannot be made under interest rate lower than the prevailing market rate made public under the Reserve Bank of India Act, 1934.

Investment in govt. securities & corporate debt - Uniform limits specified for FII, QFI and long term investors: Government debt limits and corporate debt limits for foreign institutional investors, qualified foreign investors and long term investors have been simplified by doing away with sub-limits for the different categories of investors. The uniform limit has been set at USD 25 billion for government securities and USD 51 billion for corporate debt. Reserve Bank of India A.P. (DIR Series) Circular No. 94, dated 1-4-2013 has been issued for the purpose.

Cancellation or deactivation of DIN: Central Government, Regional Director (Northern Region) or any officer authorized by the Regional Director can upon application, verify and cancel or deactivate a Director Identification Number (DIN) if it is: (a) found to be duplicate; or (b) was obtained by wrongful manner or fraudulent means; or (c) on death, insolvency or lunacy of the concerned individual. MCA has amended Companies (Directors Identification Number) Rules, 2006 with effect from 15-3-2013 in this regard.

Takeover Regulations amended: SEBI has amended SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011. The major changes are in relation to timing of making a public announcement in case of successive and connected acquisitions of shares or voting rights in the target company. Some of the other amendments include changes in disclosures and reference date in buyback of shares by the target company. New Regulation 22(2A) has been inserted providing that where the acquisition is proposed through preferential issue or through stock market settlement process other than bulk/block deals, the acquirer can acquire such shares while the open offer is in process, subject to conditions. Further, Regulation 23(1)(c) has been amended by adding a proviso which provides that in case the acquisition through preferential issue is not successful, the open offer would still not be withdrawn. Notification No. LAD-NRO/GN/2012-13/36/7368, dated

26-3-2013 issued in this regard also amends Regulation 29(2) to provide for disclosure of shareholding even in case of a change in the shareholding or voting rights of the acquirer falling below 5% in the target company.

TRAI caps duration of TV advertisements: The Telecom Regulatory Authority of India (TRAI) has amended the Standards of Quality of Service (Duration of Advertisements in Television Channels) Regulations, 2012 to impose a cap of twelve minutes per hour on commercial advertisements. TRAI had earlier issued the regulations in May 2012 but the broadcasters had obtained a stay on its implementation by challenging the regulations before the Telecom Disputes Settlement and Appellate Tribunal (TDSAT). TRAI has however now amended the regulations with effect from 22-3-2013 and aligned them with the Advertising Code contained in the Cable Television Networks Rules, 1994 which provides an overall cap of twelve minutes and further restricts commercial advertisements to 10 minutes per hour and channel's self-promotional programmes to two minutes per hour. Further, to monitor and ensure compliance, broadcasters are required to report the duration of advertisements carried in their channels on quarterly basis in the prescribed proforma.

News Nuggets

Environment and forest clearances for infrastructure road projects delinked: Resolving the two year deadlock between the Ministry of Environment and Forest and the National Highway Authority of India (NHAI), the Supreme Court of India has approved the scheme for delinking environment and forest clearances for road projects. As per reports, projects worth INR 25,000 crore were stalled when the Ministry issued a notification in 2011 on the basis of the Apex Court decision in *Lafarge Umiam Mining Pvt. Ltd.* requiring forest clearance for road projects before environmental approval. These directions were challenged by NHAI through a writ petition at the Supreme Court. However, the matter between the two government bodies was resolved by Prime Minister's Office when the Ministry agreed to exclude linear projects such as road rail and power transmission lines from the scope of the linked 'green clearance'. Following such agreement, the Supreme Court has now allowed withdrawal of the objections filed by both the parties.

Censorship in cinema - Certification norms to be revisited: The Union Information and Broadcasting Ministry has constituted a panel to examine the issues of certification under the Cinematography Act, 1952. The panel will review the functioning of the CBFC in view of the contemporary requirements and special categories of certification for broadcasting on television and radio channels. Further, the Central Government has asked the committee to suggest measures to make the Cinematograph Act more stringent so as to tackle piracy, camcording, etc. Earlier, the Ministry in 2010, had prepared a draft Cinematograph Bill, 2010 to replace the 60 year old Cinematograph Act, 1952. This bill which included a variety of certifications according to progressive ages and classes, was however never laid before the Parliament.

Ratio Decidendi

Arbitration and public policy – Indian laws cannot be ignored: Arbitrability is not a pure question of arbitration law but a larger question of public policy involving rights in rem or rights in personam and violation of laws of the state. On the question of jurisdiction of Indian Courts when English law was the governing law of the arbitration agreement, the Delhi High Court has held that laws of the state including India cannot be altogether ignored even if there is a choice of law in agreement to arbitrate when it comes to question of arbitrability. In the present case, the parties had agreed that the arbitration agreement would be governed by laws of England and the interim decision of the arbitral tribunal was in regard to matters relating to royalties, cess, service tax and CAG Audit for which statutory framework was provided under Indian laws. The court, noting various clauses of the agreement, held that the parties never intended to altogether exclude the laws of India as far as contractual rights are concerned and that it was intention of the parties to adhere to Indian law and not exercise any rights or privilege which would contravene laws of India. According to the court, what was governed by the laws of the England was the arbitration agreement which was in effect to matters of curial law for conducting the proceedings, and not all others matters for which one had to revert back to another clause, which was the proper law of contract and the same was laws of India. It was held that the parties had delimited the applicability of laws of England to the extent of the stipulations as contained in the article containing arbitration clause and that exclusion of Indian public policy was not passing through the parties' mind at the time of entering the contract.

The court noted that public policy is more of question of other laws of state rather than arbitration law and that the laws of England shall operate in relation to matters contained in the arbitration article in so far as the same are not inconsistent with the laws of India. The court in this regard, relied upon Apex Court order in the case of *Venture Global* while it distinguished the judgments in the cases of *Videocon* and *Bharat Aluminium*. The contention of the appellant that the courts in England would decide the question of the arbitrability of the dispute by taking into the consideration public policy in India, was rejected. [*Union of India* v. *Reliance Industries*

Ltd. – Delhi High Court Judgment dated 22-3-2013 in OMP No. 46/2013].

Competition law - Tie-in arrangement and adverse effect on competition: The Competition Commission of India (CCI) has held that the tie-in arrangement of Apple with Airtel/Vodafone for sale of its iPhones in India, even prior to its launch here, has no anti-competitive effect. The Commission did not find any entry barriers or market foreclosure or that the existing competitors were driven out in this case where iPhones sold by these service providers were compulsorily locked, thereby meaning that the handset purchased from either of them shall work only on their respective networks and none other. The informant had alleged that there was abuse of dominance through an exclusive rights agreement and that the service providers were offering costlier subscription plans for iPhone in comparison to plans for other smart phones. The CCI, after noting that the relevant market cannot be limited to a single manufacturer's products, identified two relevant markets in the present case viz., market for smart phones in India and market for mobile services in India. On dominance, it noted that no operator has market share exceeding 30%, that smart phone market in India is less than a tenth of the entire handset market and that Apple iPhone has less than 3% share in the smart phone market in India. It held that there was no appreciable adverse effect on competition in the market of smart phones and/or mobile services. The CCI further, noting that the case was of contractual tying and that for a vertical agreement to be anti-competitive requires monopolization, dismissed argument on monopolization given the minuscule market share of the tying party. [*Sonam Sharma* v. *Apple Inc.* – CCI Order dated 19-3-2013 in Case No. 24/2011].

Official Liquidator aggrieved by decision of recovery officer can approach DRT only: Any person, aggrieved by any act of the Recovery Officer, under the Recovery of Debts due to Banks and Financial Institutions Act, 1993, can prefer an appeal to the Debt Recovery Tribunal. The Supreme Court has held that there is no option available with the Official Liquidator to approach the company judge under the Companies Act as the Official Liquidator whose association is mandatorily required can be regarded as a person aggrieved relating to the action taken by the Recovery Officer which would include the manner in which the auction is conducted or the sale is confirmed. The court also noted that DRT has exclusive jurisdiction to sell the properties in a proceeding instituted by the banks or financial institutions, but at the time of auction and sale, it is required to associate the Official Liquidator who has to see that there is no irregularity in conducting the auction and appropriate price is obtained by holding an auction in a fair, transparent and non-arbitrary manner. [*Official Liquidator* v. *Allahabad Bank* – Supreme Court decision dated 12-3-2013 in Civil Appeal No. 2511/2013].

Appeal to COMPAT against CCI Order when not maintainable: No appeal lies with Competition Appellate Tribunal in cases where competition law was found to be violated as per the Director General but the Competition Commission of India had held otherwise and chosen not to proceed. Noting the Apex Court order in the case of *SAIL* [(2010) 10 SCC 744], the COMPAT held that orders which are appealable are only those mentioned in Section 53A(1)(a) of the Competition Act. It held that present order of the Commission passed under Section 26(8), after the DG had found contravention of some provisions, was specifically excluded in Section 53A(1)(a). The Tribunal also rejected the contention that the said relied upon order of the Supreme Court was only in reference to Section 26(1) and not Section 26(8). [*Jindal Steel & Power Ltd.* v. *Competition Commission of India* – COMPAT Order dated 3-4-2013 in Appeal No. 45 of 2012].