

Companies Act Fundamentals

Debentures



2020 MHA Legal

Applicable Law

- Chapter IV- Share Capital and Debentures - Section 43-72 of the Companies Act 2013
 - The Companies (Share Capital and Debentures) Rules, 2014.
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- Act means – Companies Act 2013
 - Rules means - The Companies (Share Capital and Debentures) Rules, 2014.

Debentures

Issue of Debentures

Section 71 of the Act A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption, subject to comply with the following conditions:

- The issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.
- No company shall issue any debentures carrying any voting rights.
- Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.
- Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

Issue of Debentures

- No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.
- A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.
- Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

Issue of Debentures

- The liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.
- A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
- Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

Issue of Debentures

- Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.
- If any default is made in complying with the order of the Tribunal under this section, 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 two lakh rupees but which may extend to five lakh rupees, or with both.]
- A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

The Central Government has prescribed Rule 18 under the Rules which specify the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

Rule 18 provides that the company shall not issue secured debentures, unless it complies with the following conditions:

- An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten 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;
- 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;

Rules

- 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 sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and
- the 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); or
 - (ii) any specific immovable property wherever situate, or any interest therein.

Appointment of Debenture Trustee

The company shall appoint debenture trustees under section 71 (5), after complying with the following conditions:

- the names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;
- before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;
- (c) A person shall not 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;

Appointment of Debenture Trustee

- (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 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

Appointment of Debenture Trustee

- the Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act. Provided that where such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.
- any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

Duties of Debenture Trustee

It shall be the duty of every debenture trustee to-

- satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;
- satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;
- call for periodical status or performance reports from the company;
- communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor;
- appoint a nominee director on the Board of the company in the event of-
 - (i) two consecutive defaults in payment of interest to the debenture holders; or
 - (ii) default in creation of security for debentures; or
 - (iii) default in redemption of debentures.

Duties of Debenture Trustee

- ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the
- trust deed and take such reasonable steps as may be necessary to remedy any such breach;
- inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;
- ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;
- ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
- do such acts as are necessary in the event the security becomes enforceable;

Duties of Debenture Trustee

- call for reports on the utilization of funds raised by the issue of debentures;
- take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;
- ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;
- perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

Meeting of of Debenture Trustee

The meeting of all the debenture holders shall be convened by the debenture trustee on-

- requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;
- the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.
- The provisions of sub-rules (2) to (5) of rule 18 shall not be applicable to the public offer of debentures.

Debenture Redemption Reserve

The company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

- the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- (b) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:-
 - (i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.
 - (ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997, 'the adequacy' of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.

Debenture Redemption Reserve

- (iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.
- every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:-
 - (i) in deposits with any scheduled bank, free from any charge or lien;
 - (ii) in unencumbered securities of the Central Government or of any State Government;

Debenture Redemption Reserve

- (iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
- (iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882;
- (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above:
 - The amount remaining invested or deposited, as the case may be, shall not at anytime fall below fifteen per cent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;
 - in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.
 - the amount credited to the Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures.

Trust Deed

- For the purposes of section 71 (13) and sub-rule (1) a trust deed in Form No. SH.12 or as near thereto as possible shall be executed by the company issuing debentures in favour of the debenture trustees within sixty days of allotment of debentures.
- A trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company; and
- A copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee.

Thank you



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Passion, Integrity, Excellence**

Thank You

Please feel free to contact, if you need any further information or clarification:

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