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REDUCTION OF CAPITAL

14.1 Introduction

A company may reduce its share capital for several reasons, e.g., to write-off heavy losses, to rehabilitate a sick company, to pay off capital which is far in excess of its wants, etc. A company may also undertake a reduction of capital as a part of its Balance Sheet Restructuring. Thus, a company which has a large share premium account, capital reserves, etc., on one side and debit balance in profit & loss account, miscellaneous/ deferred expenditure of the other side, may set-off the two by undergoing a reduction of capital. Several companies have recently adopted this mode to have a leaner balance sheet.

Reduction of capital means reducing the paid-up amount of the shares of a company. Thus, a company with a share having a face value of Rs. 10 per share may reduce it to Re. 1 per share. Thus, an amount equal to Rs. 9 per share is either returned to the shareholders or written-off. Reduction is an important event in the company's history since the creditors of the company get impacted by such a move. It is important to note that reduction is different from a stock split. In a stock split, the company only divides the face value over a larger number of shares, e.g., a company with a share having a face value of Rs. 10 per share may split it to 10 shares of Re. 1 each. In this case the value of the shareholders remains intact and only the number of shares increases. In case of a reduction, the value of the shareholders reduces.

14.2 Companies Act

14.2.1 Reduction of capital must be done by a High Court approved process specified u/ss. 100-104 of the Act. Once the Second Amendment Act of 2002 gets notified, the court approval would be replaced by the approval of the National Company Law Tribunal.

14.2.2 A company may reduce its capital in a variety of ways. S.100 provides for the following ways:

(a) By extinguishing or reducing the liability on any of its shares in respect of the share capital which has not been paid-up;

(b) By cancelling any paid-up share capital which is lost or is not represented by available assets. This may or may not be accompanied by the extinguishment or reduction of liability of its shares;

(c) By paying off any paid-up share capital which is in excess of the wants of the company. This may or may not be accompanied by the extinguishment or reduction of liability of its shares;

A buyback of shares would ordinarily have been covered within the purview of reduction of capital, however, s.77A dealing with buyback of shares expressly overrides all other sections of the Act.

14.2.3 The important steps which a company needs to follow are as follows:

(a) The provisions of the Companies Act apply to a reduction of capital by any company limited by shares or by guarantee and having a share capital. An unlimited liability company need not follow the procedure laid down under the Act.

(b) The reduction must be authorised by the Articles of Association of the company.

(c) The reduction must be authorised by a Special Resolution of the company.

(d) An application must be made to the High Court u/s. 100-104 for its approval.

(e) The company must settle a list of creditors as on a specified date and invite objections, if any, from them to the proposed reduction. The court would then decide the amount payable to such creditor. The court may, at its discretion, dispense with this requirement. This is the most crucial step in the entire reduction process and more often than not the success hinges on this step.

(f) Once the court is satisfied with respect to every creditor entitled to object, then it may pass an order confirming the reduction. It may impose such terms and conditions as it deems appropriate. It may order that the company would use the words "and reduced" after its name till such time as directed. In several cases, the court directs the use of such words for a period of 5 years.

(g) The court order and a court approved minute is then to be registered with the Registrar of Companies. This registration signifies that the reduction is complete and it takes effect from the date of registration. The registrar's certificate is conclusive evidence that all the requirements have been complied with. The memorandum of association may then be suitably amended.

14.2.4 The process laid down for the reduction of capital also extends to the reduction of securities premium account, capital redemption reserve account, etc. Even preference shares can be subject to reduction u/s. 100. Thus, they may either be redeemed by following the procedure laid down u/s. 78 or they may be the

subject matter of a reduction u/s. 100. It may be noted that in case the reduction is a part and parcel of a scheme of arrangement, merger, reconstruction, demerger, etc., u/ss. 391–394 of the Act, then various court decisions have held that the separate procedure laid down u/ss. 100-104 of the Act need not be followed. This is because ss. 391–394 of the Act is a complete code by itself.

14.3 SEBI Guidelines

There are no express guidelines or regulations by the SEBI on reduction of capital. However, SEBI has amended the Listing Agreement to provide that any reduction must be approved by the Stock Exchange in addition to the court approval. Thus, a listed company cannot reduce its capital if the court grants an approval but the exchange refuses the same. This amendment in the Listing Agreement was a result of the reduction followed by Sterlite and several other companies which followed suit. In Sterlite's case, the company followed a negative consent method for the reduction wherein the shareholders' consent to the reduction was deemed to have been given unless he stated otherwise. This case was very keenly contested in the courts by Sterlite, SEBI and investors associations. The key requirements of the listing agreement are as follows:

(a) The company must file any scheme/ petition proposed to be filed before any Court or Tribunal under sections 101 of the Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal.

(b) The company must ensure that any scheme of reduction of capital, etc., to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the stock exchange requirements. Securities laws mean the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the provisions of the Companies Act, 1956 which are administered by SEBI under section 55A thereof, the rules, regulations, guidelines etc. made under these Acts and the Listing Agreement.

(c) In the explanatory statement, accompanying a proposed resolution to be passed u/s 100 of the Companies Act, which is forwarded by the company to the shareholders, it must disclose the pre and post-arrangement capital structure and shareholding pattern.

14.4 FEMA Guidelines

If a reduction of shares involves foreign shareholders, NRIs, FIIs, etc., then the FEMA Regulations would apply. Earlier the same required the prior permission of the RBI. However, the Reserve Bank of India has now put the reduction of shares from foreign investors on an automatic route. Thus, prior permission of the FIPB and the RBI would not be required for reduction by an Indian company. The key

conditions to be fulfilled in order to avail of this automatic route transfer are as follows:

(a) the company must be eligible for automatic route investment under the FDI policy, i.e., it must not be in a restricted sector;

(b) the pricing guidelines specified by the RBI are adhered to;

(c) Form FC-TRS along with the relevant annexures is filed with the Authorised Dealer;

(d) this route is not available for companies operating in the financial service sector, e.g., banks, insurances, NBFCs, etc.