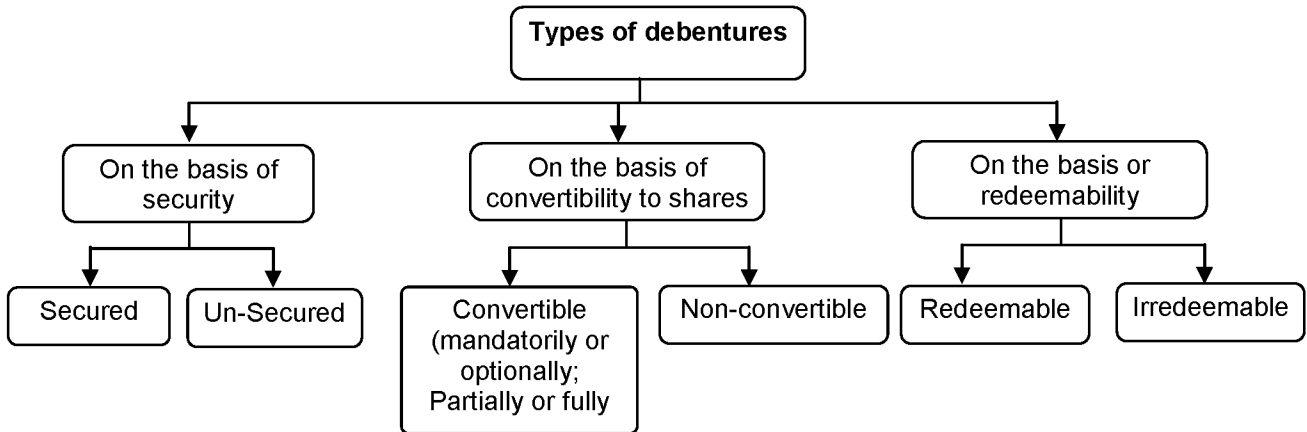


## 12. DEBENTURES

### INTRODUCTION:



**Q.No.1. Define Debenture. What are its basic features?**

(C)

(NEW SM, OLD SM)

### DEBENTURE [Sec 2(30)]:

- 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.
- Debenture excludes:
  - a. Instruments referred to in Chapter-III D of the Reserve Bank of India Act, 1934; and
  - b. Such other instrument, as may be prescribed by the Central Government in consultation with RBI, issued by a company.

### DEBENTURE STOCK:

A debenture stock is called perpetual because the principal amount of debt is not payable at any fixed time but is payable only in the case of winding up or in case of default in paying interest.

### FEATURES:

- a) Debenture is a movable property transferable in the manner provided by AOA of the company.
- b) A debenture holder is not a member of company but creditor.
- c) Debenture is a document issued in acknowledgement of indebtedness.
- d) Debenture is constituted generally by a deed of covenant with trustees and the stockholder obtains a certificate of title.
- e) Debentures may be secured or unsecured.
- f) Debenture carrying voting rights cannot be issued.
- g) Debentures may be secured by a fixed charge or by a floating charge or by a combination of both.

### SIMILAR QUESTION:

1. Which of the following documents can be treated as debenture?

- i. A legal mortgage of freehold and leasehold land
- ii. A note by which Company undertook to pay a loan but gave no security.
- iii. A series of income bonds by which a loan to the Company was repayable only out of its profits.

A. i. Yes. ii. Yes. iii. Yes.

Q.No.2. Discuss the manner in which a Company may issue Debentures according to the provisions of the Companies Act, 2013. (A) (NEW SM, OLD SM)

**MANNER OF ISSUE OF DEBENTURES OF A COMPANY [SEC 71]:**

**1. Issue of debentures with an option to convert:**

- a. A Company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.
- b. However, the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a 'SR' passed at a 'GM'.

**2. Voting Rights:** A company shall not issue debentures with voting right.

**3. Issue of Secured Debentures:** Secured Debentures may be issued by a company subject to such terms and conditions as may be prescribed

**4. Creation of Debenture Redemption Reserve (DRR) account:**

- a. If company has issued debentures as per section 71, it shall create DRR out of the profits of the company which are available for payment of dividend.
- b. Amount credited to DRR shall not be utilized by the company except for redemption of debentures.

**5. Limitation on the issue of prospectus/ offer / invitation to the public:**

- a. Company cannot –
  - issue a prospectus or
  - make an offer or
  - invitation to the public or to its members **exceeding 500**
- b. for the subscription of its debentures, unless the company has appointed one or more **debenture trustees** before such issue or offer.

**6. Debenture trustee to protect the interest of debenture holders:**

- 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.

**7. Liability of debenture trustee:**

- a. If the debenture trustee -
  - is guilty of breach of trust or fails to show the degree of care and negligence expected out of him,
  - then the debenture trustee shall be liable for damages.
- b. A trust deed cannot exempt trustee or provide indemnify him from liability of breach of trust.
- c. However, liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by not less than 3/4<sup>th</sup> in value of debenture holders at meeting held for that purpose.

**8. To pay interest and redeem the debentures:** A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

**9. Filing of petition before the Tribunal by the debenture trustee:**

- a. The trustee may file petition to NCLT, if they are of the opinion that:
  - The assets of company are insufficient; or
  - Are likely to become insufficient to discharge the principal amount as and when it becomes due.

- b. The Tribunal will hear the company and any other person interested in the matter.
- c. The tribunal may, by order, impose such restrictions on incurring further liabilities as it think necessary in the interests of the debenture-holders.

**10. On failure to redeem the debentures/ to pay interest on the debentures:**

- a. If a company fails to -
  - redeem the debentures on the date of their maturity or
  - pay interest on the debentures when it is due,
- b. then any or all of the debenture-holders, or debenture trustee may make an application to Tribunal.
- c. The Tribunal may, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by payment of principal and interest due thereon.

**11. Default in compliance of order of the Tribunal:** 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 3 years or
- Fine which shall not be less than Rs. 2,00,000 but which may extend to Rs. 5,00,000, or
- Both.

**12. Specific performance of the contract:** 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**.

**13. Procedure to be prescribed by the Central Government:** C.G may prescribe –

- the procedure, for securing the issue of debentures,
- the form of debenture trust deed,
- the procedure for inspection of trust deed and to obtain copies thereof,
- quantum of debenture redemption reserve required to be created and
- such other matters.

*(IMMEDIATELY REFER PRACTICAL QUESTION NO. 1)*

**Q.No.3. Provisions of companies rules relating to secured Debentures (B) (OLDSM)**

Secured debentures may be issued by a Company subject to such terms and conditions prescribed.

**Rule 18 of Companies (Share Capital and Debentures) Rules, 2014:**

- a) Date of its redemption of secured debentures shall not exceed 10 years from the date of issue  
However, the following classes of companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years:
  - i) Companies engaged in setting up of infrastructure projects;
  - ii) Infrastructure Finance Companies.
  - iii) Infrastructure debt fund Non-Banking Financial Companies.
  - iv) Companies permitted by a Ministry or department of the C.G. or by RBI or by National Housing Bank or by any other statutory authority to issue debentures for a period exceeding 10 years.
- b) The Secured debentures shall be secured by the creation of a charge on the assets of the Company or its subsidiaries or its holding company or its associate companies, having a value which is sufficient for repayment of debentures and interest;

- c) The Company shall appoint a debenture trustee execute a debenture trust deed to protect the interest of the debenture holders; and
- d) The security for the debentures by way of charge or mortgage shall be created in favour of the debenture trustee on-
- Any specific movable property of the Company or holding company or subsidiary company or associate company or otherwise.
  - Any specific immovable property wherever situated.
- However, in case of NBFC, the charge or mortgage may be created on any movable property.
- e) **Exemption for creation of charge:** Any issue of debentures by a Government Company which is fully secured by the guarantee given by the CG or one / more SG(s) or by both.
- Provided that in case of any loan taken by a subsidiary Company from any bank or financial institution the charge or mortgage (as specified above) may also be created on the properties or assets of the holding Company.

**Q.No.4. Elaborately discuss the provisions relating to Debenture trustee under the Companies Act, 2013? (C)** **(NEW SM, OLD SM, OLD PM)**

1. **APPOINTMENT OF DEBENTURE TRUSTEE [Sec71(5)]:**
  - a. Appointment of one or more debenture trustee is mandatory, if –
    - the company issues a prospectus; or the company makes an offer or invitation to the public; or
    - the company makes an offer to its members exceeding 500 in number.
  - b. Appointment of debenture trustee or trustees shall be made –
    - Before issue of prospectus or before making such offer or invitation; and
    - By complying with such terms and conditions as may be prescribed.
2. **RULES FOR APPOINTMENT OF DEBENTURE TRUSTEE:** Before the appointment of debenture trustee or trustees,
  - a) A written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and
  - b) A statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.
3. **Disqualifications:** No person shall be appointed as a debenture trustee, if he:
  - a) Beneficially holds shares in the Company;
  - b) Is a promoter, director or KMP or any other officer or an employee of the Company or its holding, subsidiary or associate Company;
  - c) Is beneficially entitled to moneys which are to be paid by the Company otherwise than as remuneration payable to the debenture trustee;
  - d) Is indebted to the Company, or its subsidiary or its holding or associate Company or a subsidiary of such holding Company;
  - e) Has given guarantee in respect of the principal debts secured by the debentures or interest thereon;
  - f) Has any financial relationship with the Company amounting to -
    - 2% or more of its gross turnover or total income or
    - Rs.50 lakhs or such higher amount as may be prescribed,

Whichever is lower, during the 2 immediately preceding financial years (or) in current financial year;

- g) Is a relative of any promoter or any person who is in the employment of the Company as a director or KMP;

**4. Casual vacancy:**

- The board may fill casual vacancy of trustee.
- If casual vacancy is due to resignation, it can only be filled with the written consent of majority of the debenture holders.

5. **Removal:** Debenture trustee may be removed before expiry of his term only with approval of minimum 3/4<sup>th</sup> majority debenture holders in their meeting.

**SIMILAR QUESTION:**

1. **What are the provisions of the Companies Act, 2013 relating to 'Debenture Trustee' by a Company?**  
(N16 – 4M)

A. Refer point 1 in the above answer.

2. **Write short notes on the following in respect of the provisions of the Companies Act, 2013 Appointment of 'Debenture Trustee' by a company**  
(MTP- N18 (N&O))

A. Refer point 2 in the above answer

(IMMEDIATELY REFER PRACTICAL QUESTION NO. 2)

**Q.No.5. Write the rules relating to duty of the Company to create Debenture redemption reserve [DRR] (B)**  
(OLD SM, OLD PM)

**CREATION OF DEBENTURE REDEMPTION RESERVE (DRR) A/C:**

1. The Debenture Redemption Reserve (DRR) shall be created out of the profits of the Company available for payment of dividend;
2. The Company shall create DRR in accordance with following conditions:

	Public Issue	Private Placement
All India Financial Institutions regulated by RBI and Banking Companies	-	-
NBFC's including Financial Institutions	25% on Outstanding value of Debentures	-
Other Companies	25% on Outstanding value of Debentures	25% on Outstanding value of Debentures

3. In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture.
4. The amount credited to the Debenture Redemption Reserve shall not be utilised by the Company except for the purpose of redemption of debentures.

**SIMILAR QUESTION:**

1. **Board of directors of PQR Ltd., want to create a 'Debenture Redemption Reserve' (DRR) for the redemption of debentures issued by the Company under the provision of Companies (Share capital and Debenture) Rule, 2014 in this regard.**  
(OLD PM) (M15 - 8M)

A. Refer above answer and Q. No.12

2. **Write short notes on the following in respect of the provisions of the Companies Act, 2013 Creation of debenture redemption reserve account.**  
(MTP - N18(N & O))

A. Refer above answer

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**QUESTIONS FOR ACADEMIC INTEREST – FOR STUDENTS SELF STUDY****Q.No.6. Explain the provisions relating to maintenance of liquid assets (B) (OLD SM, OLD PM)**

**Maintenance of Liquid Assets:** Every Company shall create (*invest or deposit*, as the case may be) DRR on or before 30<sup>th</sup> day of April in each year,

A sum not less than 15% 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:

- a) In deposits with any scheduled bank, free from any charge or lien;
- b) In unencumbered securities of the CG or of any SG;
- c) In unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
- d) In unencumbered bonds issued by any other Company which is notified u/s 20 (f) of the Indian Trusts Act, 1882;
- e) 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.
- f) The amount remaining invested or deposited, shall not fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year

**Q.No.7. Explain the meaning and significance of the 'Pari Passu' clause in a Debenture. (B) (OLD PM)****PARI PASSU:**

- Pari Passu clause in relating to debenture means that all the debentures of that particular series are to be paid rateably.
- If, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately.

**SIGNIFICANCE:**

- a) If this clause is not included:
  - The debentures will rank in priority for payment in accordance with the date of issue, and
  - If they are all issued on the same date they will be payable according to their numerical order.
- b) A Company cannot issue new debentures 'Pari Passu' with prior debentures unless permitted by document of offer of earlier issue.

**Q.No.8. Difference between Debenture and Loan (A)**

Debenture	Loan
Debenture represents debt to the debenture holder owed by a Company usually arising of loan.	A loan creates a right on the creditor to demand repayment.
Company can issue debenture.	Loan can be given to anyone
Debenture can be classified as secured or unsecured; convertible or non-convertible; redeemable or perpetual.	Loan can be classified as secured or unsecured; short term or long term.
Debenture trust deed is executed at the time of issue of debenture.	No trust deed is executed at the time of granting loan but loan agreement is entered into between borrower and creditor.
Debenture trustee is appointed	No requirement to appoint trustee.

**Q.No.9. What are the provisions relating to rights of Debenture holder under companies Act, 2013. (C)**

**Rights of Debenture holder:**

Debenture holder has following rights:

- To receive interest and/or redemption when due
- To receive a copy of trust deed on request
- To apply for winding up, if the Company fails to pay its debt
- To approach debenture trustee with grievance, if any
- To inspect register of charges, copy of instrument creating charges, Register of Investment in shares and securities not held in Company's name,
- Copy of trust deed, Register of members, debenture holders and indexes.

These rights are not absolute. These are subject to provisions of the Companies Act, Memorandum and Articles of the Company.

**PRACTICAL QUESTIONS**

**Q.No.1. Issue of debentures with voting rights is not permissible. (M10 - 1M, M13 – 2M)**

**Correct:** As per sec. 71 of the Companies Act, 2013, no Company can issue any debentures carrying voting rights at any meeting of the Company, whether generally or in respect of any particular classes of business.

**Q.No.2. Whether the following can be appointed as 'Debenture Trustee':**

- a) A shareholder who has no beneficial interest
  - b) A creditor to whom the Company owes Rs 499 only.
  - c) A person who has given a guarantee for repayment of amount of debentures issued by the Company.
- (OLD PM)**

- a) A shareholder who has no beneficial interest can be appointed as a debenture trustee.
- b) A creditor to whom Company owes cannot be appointed, irrespective of the amount owed.
- c) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

**SECTION NUMBER**

S.No	CONCEPT	Sec. No.
1.	Debenture	2(30)
2.	Issue of debentures	71

**PENALTIES AND PUNISHMENT**

S. No	CONCEPT	PENALTIES AND PUNISHMENTS
1.	Non-compliance of orders of Tribunal by a Company u/s 71.	Every officer of the Company who is in default shall be punishable with – <ul style="list-style-type: none"> <li>• Imprisonment for a term which may extend to 3 years or</li> <li>• Fine which shall not be less than Rs.2 lakhs but which may extend to Rs.5 lakhs or</li> <li>• Both</li> </ul>

**DURATION**

1.	Time limit for creation of DRR A/c for maintenance of liquid assets with an amount equal to its debentures maturing during the year ending on the 31st day of March of the next year.	On or before the 30th day of April in each year.
2.	Time limit for repayment of redeemable debentures	<ol style="list-style-type: none"><li>a. Within a maximum period of 30 years from the date of issue of redeemable debentures by companies engaged in Infrastructure projects, infrastructure finance Company, infrastructure Debt fund NBFC.</li><li>b. Within a maximum period of 10 years in case of other companies.</li></ol>

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**THE END**

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