

Legal Update - Indian Companies Act 2013

The Government of India *vide* notification dated 16 August 2019 made crucial changes in the Companies Act, 2013 that relaxed certain conditions with respect to issue of shares with differential voting rights (DVRs).

Fresh amendments made in the Companies (Share Capital & Debentures) Rules, 2014 of the Companies Act, 2013 will permit Indian companies to issue up to seventy-four (74%) per cent shares of the total post issue paid-up share capital with differential voting rights. Additionally, the requirement of distributable profits in the last three (3) years before Indian companies can issue this kind of shares has been done away with.

The concept of differential voting rights or dividend underlying a share is not alien under the Indian company law. The Companies Act, 1956 (which was thereafter succeeded by the Companies Act, 2013) provided flexibility to a private company, which was not a subsidiary of a public company, to issue such shares.

In case of a private company being a subsidiary of a public company and public companies, certain terms and conditions were required to be complied with before they could issue such hybrid securities. These conditions *inter alia* included that (a) the shares with differential rights shall not exceed twenty-six (26%) per cent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time; and (b) the company having consistent track record of distributable profits for the last three (3) years.

The Indian Companies Act, 2013 and the rules framed thereunder continued with compliance of the above two conditions as a precursor to public companies (which include private companies which are subsidiaries of a public company) issuing such hybrid shares. However, recent developments have greatly relaxed the aforesaid conditions.

Firstly, the limit of twenty-six (26%) per cent has been increased to seventy-four (74%) per cent and secondly the requirement of having a consistent track record of distributable profits for the last three (3) years has been entirely done away with.

The above changes provide significant structuring options in diverse M&A and other investment transactions, for private, public and listed companies. Particularly, these amendments would be attractive for investments in tech companies & start-ups looking for private equity and strategic investments. These provisions can be used for structuring targeted benefits for the investors, as well as promoters. DVR class of shares may attract a certain class of private equity and strategic investors who are largely interested in the economic benefits (i.e. dividend etc.) of a company without the underlying voting rights. Conversely, financial and strategic investors may be able to get voting rights and/or control disproportionate to their financial investment.

In our view, this is an important amendment, that brings the Indian law in line with diverse international practices and is particularly designed to address key concerns of startups and younger tech companies that require growth capital yet cannot dispense with the ongoing meaningful involvement of the promoters who conceptualized the idea and/or tech. It assists management in deterring potential rivals from winning a control and allows raising fresh capital for growth without giving up control.

Start ups and Tech companies continue to be vibrant and attract significant domestic and foreign investment. These amendments enable innovative structuring options without compromising on the fundamental economic principles for the investments.
