

OPINION

===== **Ex- parte.**

M/s _____ is a company incorporated under the Companies Act, 1956 (hereinafter called the Querist Company) has provided me the following factual matrix and desired to have my opinion on the query raised in para below:-

2. The Querist Company has issued 80,50,000 Cumulative Redeemable Preference Shares of Rs.100 each aggregating to Rs.80.50 crore. Out of above preference shares, 75% would be redeemed in 2018 and 25% would be redeemed in 2019. The query has been raised to me :-

“Whether Preference Share Capital (Cumulative Redeemable Preference Share Capital) would be included in calculation of the Net Worth”.

3: In order to examine the aforesaid issue, it would be prudent to look into the relevant provisions of Companies Act 2013, Guidance Note issued by Institute of Chartered Accountants of India (ICAI) and Notification issued by SEBI dated 21st January 2013.

4: First of all, let us look at the relevant provisions of Companies Act, 2013.

I): Section 2(57) of Companies Act 2013, inter-alia, provides definition of Net Worth “net worth means aggregate value of the paid up share capital and all reserves created out of profits and securities premium, after deducting the aggregate value of accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but

does not include reserves created out of revaluation of assets, write back of depreciation and amalgamation”.

5: The aforesaid issue raised by the querist company in respect of inclusion of Preference Share Capital in net-worth can be answered if it can be concluded that Paid up Share Capital include Preference Share Capital and Share include Preference Shares. The Section 2(64) of the Companies Act, 2013 defines Paid up Share Capital.

Section 2(64) of Companies Act 2013 defines paid-up share capital “paid-up share capital” or “share capital paid-up” which means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

6: The conjoint reading of Section 2(57) & 2(64) of Companies Act, 2013 do not specifically rule out inclusion of Preference Share Capital from the ambit of Net Worth. In definition of Paid up Share Capital (supra), the word used is the ‘Share’ which literally includes both type of share i.e. Equity as well as Preference Shares. Thus, a logical and plausible interpretation shall lead to an irresistible conclusion that Paid up Share Capital includes both Equity Capital as well as Preference Share Capital irrespective of the further classification of both Equity Shares as well as Preference Shares. I am fortified by a judgment of the Hon’ble Bombay High Court (Goa Bench) where the Hon’ble Court in the case of Northern Projects Ltd Vs. Blue Coast Hotels & Resorts Limited MANU/MH/1181/2008 has held as under:-

From the aforesaid discussion, and from whatever angle one looks at the expression "issued share capital" of the Company it is very

clear that the expression "issued share capital" can only refer to the preference share capital as well as equity share capital of the Company and the appellant was required to hold one-tenth of the total of this issued share capital before he became eligible to maintain a petition under Section [397/398](#) of the Act. The appellant at no time held more than 2.01% of issued share capital. It did not have it when it became a member or shareholder. It did not have the requisite percentage on the date of filing of the petition. The appellant might be having 14.8% of equity shares, but that is not the criterion to make an application. The petition was therefore rightly dismissed.

7: In addition thereto, Section 2(84) of the Companies Act 2013, inter-alia, defines Share "Share" means a share in the Share Capital of a company and includes stock. The Share by virtue of Section 2(84) thus means any kind of share, as it does not specifically exclude any type of share from its ambit and legally defined scope.

8: The view that I have taken is supported by the wording of Section 43 of Companies Act, 2013, the extracts of which are given below:-

The share capital of a company limited by shares shall be of two kinds, namely:—

(a) equity share capital—

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

(b) preference share capital:

Provided that nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

Explanation.—For the purposes of this section,—

“equity share capital”, with reference to any company limited by shares, means all share capital which is not preference share capital;

(ii) “preference share capital”, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

(iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

9: Now, let us look at the provisions of Guidance Note issued on Revised Schedule VI by the Institute of Chartered Accountants of India, New Delhi, the same, as are relevant for our purpose, are reproduced below for ready reference:-

Para 8.1.1.4. In respect of disclosure requirements for Share Capital, the Revised Schedule VI states “different classes of preference share capital to be treated separately”. A question arises whether the preference shares should be presented as share capital only or does it mean that a company compulsorily needs to decide whether preference shares are liability or equity based on its economic substance using AS 31 Financial Instruments: Presentation principles and present the same accordingly. The Revised Schedule VI deals only with presentation and disclosure requirements. Accounting for various items is governed by the applicable Accounting Standards. However, since Accounting Standards AS 30 Financial Instruments: Recognition and Measurement, AS 31 and AS 32 Financial Instruments: Disclosures are yet to be notified and Section 85(1) of the Act refers to Preference Shares as a kind of share capital, Preference Shares will have to be classified as Share Capital. The respective provision in companies act 2013 is Section 43 which also uphold the position as provided in Section 85(1) of companies act 1956.

Para 8.1.1.5. Presently, in the Indian context, generally, there are two kinds of share capital namely - Equity and Preference. Within Equity/Preference Share Capital, there could be different classes of shares, say, Equity Shares with or without voting rights, Compulsorily Convertible Preference Shares, Optionally Convertible Preference Shares, etc. If the preference shares are to be disclosed under the head 'Share Capital', until the same are actually redeemed, they should continue to be shown under the head 'Share Capital'. Preference shares of which redemption is overdue should continue to be disclosed under the head 'Share Capital'.

10: I am also buttressed with the explanation provided in Clause 8 of the Notification dated 21st January 2013 issued by SEBI i.e. Investment Advisor Regulations, 2013 which also defines Net Worth as follows:

Explanation.— For the purposes of this regulation, "net-worth" means the aggregate value of paid up share capital plus free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses, deferred expenditure not written off, including miscellaneous expenses not written off, and capital adequacy requirement for other services offered by the advisers in accordance with the applicable rules and regulations.

10.1: The definition provided in the Notification issued by SEBI is similar to the definition as provided in the companies' Act 2013.

11: Lastly I would reply on another judgment of the Division Bench of the Karnataka High Court in the case of Miss Chandra Pardhanani Major Vs. Mac Charles India (P) Ltd MANU/KA/1650/2010 wherein the Court has observed as under:-

23. In fact in the case of Northern Projects Ltd. v. Blue Coast Hotels and Resorts Ltd. and Ors. (2010) 2 LJ 361 (Bom), the Mumbai High Court has held that the parliament has used the words "issued share capital" which is a wide expression deliberately used with a view to include both equity and preference share capital issued by the company. In the said case, since the Petitioner had at no point of time held more than 2.01% of the issued share capital, it did not have the requisite percentage on the date of filing the petition. Though the Petitioner may have 14.8% of equity shares that was not the criterion to maintain petition under Section [397](#) read with Section [398](#) of the Companies Act and the petition was dismissed. In the case of S. Varadarajan v. Venkateswara Solvent Extraction (P) Ltd. and Ors. Vol.80 1994 C.C. 693, it has been held that the requirement as to the share qualification was relevant and material only at the time of filing the petition which is the crucial date for the maintainability of the petition under Section [397](#) read with Section [398](#) of the Act.

12: In the light of the above, there is absolutely no manner of doubt that in the face of the provisions of (i) Companies Act, 2013, (ii) Guidance note of ICAI and (iii) Notification issued by the SEBI, that the Preference Share Capital issued by the Querist Company of Rs. 80.50 Crore shall be entitled to be included in the net worth of the Company.

13: Notwithstanding the above, if you require any further clarification, I may be contacted and I would be too willing to furnish the same.

For PKMG LAW CHAMBERS,

(P K MITTAL)

ADVOCATE. DATE:09.05.2015