Borrowing Powers
[Debentures and Charges]

Dr. Bharat G. Kaurani
Asstt. Professor
N.B. Thakur Law College, Nasik.
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INTRODUCTION:

Any company running a business can raise either share capital or debt to meet its fund requirements.

A trading company has implied power to borrow but it is not so with companies which are non-trading. Such companies should have power to borrow in their memorandum of association.

A public company, which is collecting debt from the public through the issue of debt securities i.e. debentures, has to meet listing requirements along with the compliance of Company law provisions.
Debentures

- A company can borrow by splitting the loan amount into several units for the ease of borrowing large sum. The company may do so by issuing **debentures**. A debenture is a certificate of loan issued by a company. It is a type of security.

- **Definition: Section 2(30) of the Companies Act 2013**
  “**Debenture**” includes debenture stock, bonds and any other instrument of a company evidencing debt, whether constituting a charge on the assets of the company or not.
According to Topham, ‘debenture is a document given by a company as an evidence of a debt to the holder usually arising out of loan and most commonly secured by a charge’.

In Laxman Bharamji v. Emperor, AIR 1946 Bom 18: the Bombay High Court observed that debentures normally indicates the security against the loan taken by the co. and contain the conditions of repayment, date, rate of interest payable to the holder. They may even create a charge on the company’s property, but it is not always necessarily so.

Briefly speaking, debentures are the acknowledgement of debt, the promise to return it.
Characteristics/Features of Debentures

(i) debentures are generally issued in series but a single debenture may be issued in case of a sole lender of the company.

(ii) it is usually in the form of a certificate, which is an acknowledgement of indebtedness;

(iii) it usually specifies a particular period or date as the date of repayment of principal along with interest.

(iv) debentures generally creates a charge on the undertaking of the co. or on some of its assets. However, there may be debentures without charge.

(v) the holder of debentures is the creditor of the company and not its member,

(vi) a debenture carries no voting rights at any meeting of the co.
Distinction between Debenture and Share

1. A debenture-holder is a creditor of the company, whereas a shareholder is its member.

2. A debenture-holder does not have a right to vote at any meeting of the company, whereas a shareholder has a voting right.

3. A debenture-holder is entitled to a fixed rate of interest on his investment, whereas a shareholder gets dividend out of profits and the rate of dividend depends on the amount of profits. In case of preference shares, however, fixed rate of dividend may be payable.

4. Shares (except preference shares) cannot be paid back, or redeemed. Debentures can be redeemed.

5. Debenture-holders get priority in payment over the shareholders at the time winding up of the company.
Kinds of Debentures: Section 71:

1. Registered Debentures & Bearer Debentures:

- In case of registered debenture, the name, address, number of debentures and other details pertaining to holding are entered by the company in the register of debentures.

- Such debentures are transferable just like shares, by executing the instrument of transfer. The transfer of registered debenture is required to be registered with company.

Bearer debentures: These debentures, also known as unregistered debentures, are payable to its bearer. Unlike registered debentures, the company does not maintain the records of such debentures and the principal amount and the interest is paid to the bearer of the instrument.

- These are regarded as negotiable instruments and are transferable by delivery.
2. Redeemable & Irredeemable/Perpetual Debentures:

- **Redeemable Debentures:**
  These debentures are issued for a specified period of time. On the expiry of that specified time the company is legally bound to return the amount to the debenture holders and have its properties released from the mortgage or charge.

- **Irredeemable Debentures:**
  An irredeemable debenture is also known as a perpetual debenture and no time is fixed for the company to repay the loan, although it may choose to pay it back anytime it likes. Thus the holder of an irredeemable debenture cannot demand repayment of his money so long as the company is a going concern and does not make default in payment of interest.

However, all the debentures whether redeemable or irredeemable, become payable in the event of winding up of the company.
3. Secured and unsecured Debentures:

- **Secured Debentures:**
  When the debentures are issued by way of creation of charge over the assets of the co., then such debentures are called as secured debentures. The charge created over the debentures may be fixed or may be floating. Such charge created has to be registered with the Registrar within 30 days of such creation.

- **Unsecured Debentures:**
  Unlike secured debentures, unsecured debentures or naked debentures are issued by the company without creation of charge over the assets of the company. They are mere acknowledgment of a debt due from the company, creating no rights beyond those of unsecured creditors.
4. Convertible and Non-convertible Debentures:

- **Convertible Debentures**: These debentures give an option to the holders to convert them into preference or equity shares at stated rates of exchange, after a certain period. If the holders exercise the right of conversion, they cease to be lenders to the company and become members instead.

- **Section 71(1)** of the Companies Act permits the conversion of convertible debentures into shares by special resolution of the company. The convertible debentures may be fully convertible [FCD] or partly convertible [PCD].

- **Non-convertible debentures**: These debentures do not give any option to their holders to convert them into preference or equity shares. They are to be duly paid at the time of maturity.
Rights Debentures:

- Rights Debentures means to offer debentures to the existing equity shareholders on right basis, in proportion to their shareholdings subject to a minimum of one debenture to each equity shareholder.

- The debenture-holders are usually given option to apply for additional debentures in addition to the number of debentures they are entitled to subscribe. The allotment is, however, made on equitable basis with reference to equity shares held by the applicants.

- The shareholders may renounce the offer of rights debenture in favour of some other person or persons.
Creation of Charges:

- A charge may be defined as a security given for securing loans or debentures by a mortgage on the assets of a company.

- A charge is created when a property, whether existing or future, is agreed to be made available as a security for the repayment of debt.

- However, the creditors get no legal right over the property so charged but only get a right to have the security made available by an order of the tribunal in the event of non-payment of debt.

- Such charge may be fixed charge or floating charge and are classed as secured creditors.
Fixed Charge:

- A fixed or specific charge is created on some specific and definite assets of the company, e.g., land, buildings, heavy machinery, Intellectual property, etc. A fixed charge is therefore against security of certain ascertainable specific property.

- The company’s right to dispose off the property is temporarily suspended during the period it is charged or encumbered.

- In the event of winding up of the company the holder of debenture secured by a fixed charge ranks as a secured creditor and gets priority in repayment of debt over the other creditors.
Floating Charge:

- A floating charge is an equitable charge, which is created on some class of property, which is constantly changing, e.g., a charge on stock in trade, trade debtors, investments, etc.

- It means all the property, present or future, of the company, since it is an unstable property, a charge created thereon will be floating.

- The main idea behind a floating charge is to allow to the company to carry on its business in the ordinary course as if no charge had been created.

- The company can use such assets in the usual way until the charge becomes a fixed charge or crystallizes.
Crystallisation of Floating Charge:

- A floating charge generally remains dormant till it crystallises or becomes a fixed charge. A floating charge crystallises into a fixed security under the following circumstances:
  - (i) when company goes into liquidation,
  - (ii) when company ceases to carry on business,
  - (iii) when debenture-holders or creditors take steps to enforce this security, e.g. by appointing a receiver to take possession of the charged property; i.e. when the company makes a default in the re-payment of loan, the debenture holder could enforce the security for the recovery of the amount due, by seizing the assets which are subject to the floating charge. When this happens the charge crystallises and becomes a fixed charge.
  - (iv) on happening of an event specified in the deed.
Effect of winding up on floating charge (Sec. 332):

- A floating charge gets priority over the unsecured creditors of the company, whether there is winding up or not.

- Section 332 however, provides that a floating charge which has been created within 12 months immediately preceding the commencement of winding up shall be invalid, except in the following cases:

  1. When it is proved that immediately after the creation of the charge the company was solvent, in spite of its having been created within 12 months immediately preceding the commencement of winding up.

  2. If any cash has been paid to the company under the charge, the charge would be valid in respect of such amount and interest thereon @5% p.a. or such other rate as may be notified by the Central Government.
Registration of Charges:

Duty to Register Charges, etc: 77:

(1) It is the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, -

to register the particulars of the charge signed by the company and the charge-holder together with the instruments, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within 30 days of its creation:

Provided that the Registrar may, on an application by the company, allow such registration to be made within a period of 300 days of such creation on payment of additional fees.

If company fails to register with in period of 300 days, then it has to seek extension from Central Government (Regional Director) & file approval with the Registrar.

If Registrar is satisfied, he shall issue a certificate of registration
Application for registration of charge: Section 78:

Where a company fails to register the charge within the period specified in sec. 77, without prejudice to its liability in respect of any offence under this Chapter, the person in whose favour the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge, within such time and in such form and manner as may be prescribed and the Registrar may, on such application, within a period of 14 days after giving notice to the company, unless the company itself registers the charge or shows sufficient cause why such charge should not be registered, allow such registration on payment of fees:

Provided that where registration is effected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.
Registration of Charges: cont..

- **Section 81 Register of charges to be kept by Registrar:**

  1. The Registrar shall, in respect of every company, keep a register containing particulars of the charges so registered.

  2. A register kept in pursuance of this section shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

- **Rule 6.5:** The particulars of charges maintained on the MCA portal shall be deemed to be the **register of charges** for the purposes of section 81.
Registration of Charges: cont..

- **Sec. 82 Company to report satisfaction of charge:**

- A company shall intimate to Registrar about the payment or satisfaction in full of any charge so registered within 30 days from the date of such satisfaction.

- The Registrar shall issue notice to holder of the charge calling a show cause why payment or satisfaction should not be recorded and in case of no reply, the memorandum of satisfaction shall be entered in the register of charges.
Sec 83: Power of Registrar to make entries of satisfaction and release in absence of intimation from company:

Sometime, it may be possible that company fails to send intimation of satisfaction of charge to the Registrar but registrar receive evidence of satisfaction from any other person i.e. charge-holder, shareholder, purchaser or any one.

This is a new section, which seeks to provide that the Registrar on being satisfied may enter in the register of charges that the charges are satisfied and also inform affected parties about the satisfaction in the absence of intimation from the company.
Sec. 85: Company’s register of charges:

Every company shall keep a **register of charges** at its registered office and this register shall be open for inspection during business hours by members or creditors without fees and by any other person with fees as may be prescribed.

A copy of instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

**Rule 6.8**: The register of charges shall be in Form no. 6.7 and enter therein particulars of all the charges registered with the Registrar as well as particulars of any modification of charge and that of satisfaction of charge.
Registration of Charges: cont..

- **Section 86 Punishment for contravention:**
  - If any company contravenes any provision of this Chapter, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to 10 lakhs rupees and
  
  - every officer of the co. who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than 25000/- but which may extend to 100000/-, or with both.
1. Company Law: Dr. Avtar Singh, EBC.
7. https://blog.ipleaders.in/different-types-of-debentures-use/
THANK YOU