

Can a Private Limited Company do a Treasury Buy Back of Shares?

Treasury buy back is a kind of buy back in which the shares although purchased (bought back) by the issuing company, are not extinguished and are retained with an idea to sell it at an opportune time. Section 67 of Companies Act, 2013 (“the Act”) puts a prohibition on company to purchase its own shares. Section 68 of the Act specifically allows companies, both and private and public, to purchase their own shares subject to certain conditions, one of which is mandatory extinguishment of bought back shares. On 5 June 2015, Ministry of Corporate Affairs (MCA) granted certain exemptions to private limited companies, and one of those exemptions granted for private companies is exemption from compliance of section 67. Therefore, in case of private companies, there can be a possibility that it may do a treasury buy back, as there is no longer restriction on private companies under section 67 from purchasing its own shares. In this background, what can be the interplay between section 66, 67, 68 and MCA exemption notification dated 5 June 2015 and how one can interpret these provisions in the light of earlier Working Group Reports / Expert Committee Reports of Department of Company Affairs (DCA) are some questions deliberated in this article.



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INTRODUCTION

WHAT IS TREASURY BUY BACK?

As per Collins dictionary, ‘treasury buy back’ means ‘shares of issued stock are re-acquired by the issuing corporation and held by it’. There are two things (1) re-acquisition of issued shares by issuing company; and (2) holding those shares in its name. That means, those shares although purchased (bought) by the issuing company, are not extinguished and are retained

with an idea to sell it at an opportune time. To put it in simple words, in treasury buy back, on the liability side of balance sheet, paid up share capital appears and on the asset side of balance sheet, under investment head, investment in its own shares can appear.

However, Section 67 of Companies Act, 2013 (“the Act”) puts a prohibition on company to purchase its own shares. Section 68 of the Act specifically allows companies, both private and public, to purchase their own shares subject to certain conditions. Though Section 68 allows purchasing its own shares, it does not allow to retain it as investment. Further, sub section (7) of Section 68 requires all companies doing purchase of its shares to extinguish those shares from its capital and physical share certificates too. This type of purchase is called as buy back of shares under the Act. This is not same as ‘treasury buy back’ mentioned above.

On 5 June 2015, private limited companies have been granted exemption from compliance of Section 67 and therefore there is a possibility that private limited companies may do a treasury buy back.

WHAT IS 5 JUNE 2015 NOTIFICATION?

In exercise of power conferred under Section 462 in the Act, a notification was issued by Central Government on 5 June 2015 granting exemptions to private limited companies from compliance of sixteen Sections of the Act (“exemption notification”). One of the exemptions in that notification is from Section 67 of the Act. As a result of this notification, certain private companies, which fulfil the below requirements, are exempted from compliance of Section 67 –

- *In whose share capital no other body corporate has invested any money;*
- *If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or fifty crore rupees, whichever is lower; and*

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- *Such company is not in default in repayment of such borrowings subsisting at the time of making transactions under this Section.*

This means, if any private company fulfils these 3 conditions, prohibition under Section 67 will not apply.

INTERPLAY BETWEEN SECTION 66, 67 & 68

Since company is an artificial entity, stakeholders' protection has to be ensured. As a structure, this protection and fairness is ensured via principles of doctrine of constructive notice, ultra vires and indoor management. Similarly, concept of capital also gives lot of confidence to creditors. The capital once brought in, should remain in the company and be utilised for its business, is one essential condition to give confidence to creditors. This confidence is given by Section 66 of the Act, which mandates any company wanting to reduce its share capital to take prior approval of shareholders. Section 66 also mandates approval of National Company Law Tribunal for reduction of capital. Whereas Section 68 starts with a non obstante clause saying, *"notwithstanding anything contained in this act, but subject to provisions of sub section (2), a company may purchase its own shares"*. Section 68 also provides a detailed framework subject to which this non-obstante clause functions. Sub section (7) requires every company doing purchase of shares to extinguish and physically destroy the shares or securities so bought back.

Section 66 talks about reduction of capital, which essentially means cancellation of share capital, Section 68 has a non obstante clause which overrides Section 66, however it requires extinguishment of shares. Both Section 66 and 68 are talking about cancellation of share capital.

Section 67 prohibits any company to purchase its own shares. Section 67 does not use word cancellation or reduction but uses word purchase. Heading of Section 67 is – *'Restriction on purchase by the Company or giving of loans by it for purchase of its shares'*. Sub section (1) of Section 67 is a negative provision which says *'No company limited by shares or by guarantee and having share capital shall have power to buy its own shares unless the consequent reduction of share capital is effected under provisions of this Act'*. Section 66-67-68 trio makes this subject complete. Section 66 provides framework for reduction of capital, Section 67 prohibits any purchase of shares by company unless process under Section 66 is followed, and Section 68 overrides these two Sections subject to value equivalent to share capital to be bought back is either issued by the company or capital redemption reserve is created of that value¹. As mentioned above, Section 68 also expects extinguishment of bought back/purchased shares. So a combined reading of these Sections makes it clear that once capital brought in the company, it has to be deployed in the company and no round tripping is allowed. This framework got disturbed after the said exemption notification.

¹ As per Section 69 of the Act

HOW TO INTERPRET WORD "NOTWITHSTANDING" USED IN SECTION 68?

Section 68 starts with the word *'notwithstanding anything contained in this act, but subject to provisions of sub section (2), a company may purchase its own shares'*. 'Notwithstanding' means, in spite of; without being opposed or prevented by; nevertheless; although, regardless of². There is no doubt that by non-obstante clause, the Legislature creates a means, which are usually applied to give effect to certain provisions over some contrary provision that may be found either in the same enactment or some other statute. Section 68 specifically confines to this Act and therefore it overrides over other Sections of the Act which may contradict.

Although the non obstante nature of a provision may be of a wide amplitude, the interpretative process thereof must be kept confined to the legislative policy³. While interpreting non obstante clause, the court is required to find out the extent to which the legislature intended to do so and the context in which non obstante clause is used.⁴

Clearly, the word 'notwithstanding' was used in Section 68 to create an exception to Section 66 which requires approval of NCLT for reduction of capital. And therefore, if Section 68 is followed, Section 66 need not be complied with i.e., if buy back is done in compliance with Section 68 and corresponding rules, provisions of Section 66 need not be complied with. Section 67, as such, is a negative provision and it prohibits any company from purchasing its own shares, however private companies have got an exemption from this Section. The question that remains to be answered is how to read Section 68 and the said exemption notification together? Can we give effect to both harmoniously? Do they contradict each other? If yes, which one will prevail?

It is a cardinal rule of construction that when there are in a Statute two provisions which are in conflict with each other such that both of them cannot stand, they should, if possible, be so interpreted that effect can be given to both, and that a construction which renders either of them inoperative and useless should not be adopted except in the last resort⁵. If one interprets that for every purchase of its own shares by a private limited company Section 68 will have to be followed, it may mean that exemption provided to private companies under Section 67 will become redundant, and therefore such interpretation should be avoided. Let us try to apply different principles of interpretation in this scenario:

A. Purposive interpretation principle

Purposive interpretation is applied when the plain words of a statute are ambiguous or lead to no intelligible results or if read literally, would nullify the very object of the statute.⁶

² Meaning of 'Notwithstanding' as per Collins Dictionary

³ *ICICI Bank Ltd V. Sidco Leathers Ltd (2006) 131 Comp Cas 451 (Cal).*

⁴ *Central Bank of India V. State of Kerala 2010 AIR SCW 2436*

⁵ *Bengal Immunity Co. Ltd. v. State of Bihar AIR 1955 SC 661*

⁶ *B. Premanand v. Mohan Koikal AIR 2011 SC 1925*

Looking at the historical background, buy-back provision was introduced in the year 1998-99 under Section 77A in the Companies Act, 1956. Section 77 relating to restrictions on purchase of its own shares by a Company was there under the former Companies Act, 1956 also. There was no exemption granted to private Companies then. It was very clear that a Company can either buy back its securities or reduce its share capital or forfeit its shares.

Historically, exemption from purchasing its own shares by a private Company wasn't there in the former Companies Act, 1956. However, the exemption has been introduced under the Companies Act, 2013. What would be the purpose for the same to be introduced under 2013 Act? Let us find out and understand the views of Working Group and Expert Committees.

Reports of Working Group/Committees on Treasury Buy-back - The Working Group on Companies Act, 1956, in its Report submitted on 12th February 1997 recommended that the Companies should have flexibility, after completion of buy-back, to retain shares as Treasury Stocks for being issued later. In response to the same, Department of Company Affairs (DCA) had initially considered this alternative. While views of experts, commercial and trade bodies were taken, they put forth that, if treasury option was adopted and the Companies were allowed to reissue the shares bought back, the Directors could be tempted to manipulate the stock market in a manner that their own relatives and friends would benefit by selling shares purchased by them at low price to the Company and gain significant personal profits. In this process, companies are likely to suffer. Hence, the DCA decided to permit cancellation / extinguishment of shares option only in the scheme of buy-back.

Further, the treasury stock concept was once again discussed by the Expert Committee, in the year 2004, as mentioned in its report. The report stated that while an enabling provision for treasury stocks or treasury buy-back could be incorporated in the new law, actual introduction of treasury stocks or treasury buy-back was required to be preceded by the preparatory action. It was suggested to introduce the concept only when the necessary framework was ready.

From both the reports it becomes clear that law makers were concerned about possible manipulation in stock market. There was also a thought that once there is a framework, treasury buy back can be considered. Since shares of private limited companies are not freely tradable and there is no possibility manipulation in stock market, probably private limited companies were allowed to do treasury buy back. It also appears that three conditions mentioned in instant notification ensures that debt equity ratio is maintained and this exemption is not available for those who have defaulted in servicing debts. That means some framework is in place to ensure creditors don't suffer. It appears a very well thought out decision

Section 68 allows any company to purchase its own shares only out of sources permitted under sub section (1) of Section 68 and only under limits of sub section (2) and other conditions mentioned in Section 68. This section allows both private and public limited companies to purchase their own shares. If company wants to cancel its capital against losses or return the capital without complying with provisions of Section 68, it has to follow a process of Section 66 i.e. reduction of capital.

to allow private limited companies to purchase their own shares and hold it and not to extinguish those.

B. Former Vs. Later

Whenever there is any conflict between two provisions, the provision which was issued or notified at a later stage will prevail. In this case, Section 68 is effective from 1 April 2014 and exemption to private limited companies from compliance of Section 67 came later i.e., vide notification issued by Ministry of Corporate Affairs on 5 June 2015. Therefore, we cannot interpret Section 68 in a way that private company can purchase its shares but only in compliance with Section 68. By taking such view, we will make the said exemption notification redundant. And therefore, an effort has to be made to interpret harmoniously.

C. Harmonious construction

Harmonious Construction principle states that the provisions of a statute should be read so as to harmonize with one another and the provisions of one Section cannot be used to defeat those of another unless it is nearly impossible to effect reconciliation between them. When there are two conflicting provisions in an Act, which cannot be reconciled with each other, they should be so interpreted that, possible effect should be given to both. This means that no provision shall be null and void across all circumstances. It is only when the words of a statute are unclear or ambiguous that other aids to interpretation are to be resorted to. If the words of the statute are of themselves precise and unambiguous, then no more can be necessary than to expound those words in their natural and ordinary sense. The words themselves do, in such case, best declare the intention of the Legislature.⁷

If we read Section 68 and Section 67 read with the said exemption notification harmoniously, it appears that a private limited company has 3 options—

1. Follow reduction of capital process under Section 66,
2. Follow buy back process under Section 68, OR
3. Purchase its own shares under Section 67.

⁷ *Sussex Peerage case (1844) 11 Cl&F 85*



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WHETHER FRAMEWORK OF THE SAID EXEMPTION NOTIFICATION (5 JUNE 2015 NOTIFICATION) IS ADEQUATE?

If a private company fulfilling three conditions of the said notification purchases its own shares and hold it without extinguishing it, following conditions will not apply to it arising from Section 68 of the Act –

1. Requirement of shareholder approval will not apply; though provisions of Section 186 and even Section 188 may trigger if purchase is from a related party⁸.
2. No need for proportionate buy back; though decisions cannot be done to oppress minority and it has to be fair and in the best interest of the company⁹.
3. No restriction about source of finance, it need not be out of proceeds of fresh issue or free reserves; though company has to ensure that borrowing from bank and institution should not be more than twice of its paid up share capital¹⁰.
4. No need to create Capital Redemption Reserve because capital may not be getting extinguished.

⁸ Purchasing shares means purchase of goods or property and therefore will be one of the transactions covered under Section 188 of the Act

⁹ Section 166 - Duties of Director

¹⁰ One of the conditions of 5 June 2015 Notification

5. No need for letter of offer or return of buy back.

In addition to this some questions remain unanswered like, whether provisions of Section 179 will apply to such purchases made by private limited company? Generally, treasury investments are in liquid securities and shares of private limited company are illiquid and if that is so, why such purchase is allowed for private limited companies?

Role of Board of Directors of private limited companies doing such purchases is also very crucial. The Board will have to ensure that provisions of articles of association with respect to transfer of shares are followed. If there is any Foreign Direct Investment, whether it would be permissible? The Board will also have to ensure that transactions are not done to give any preference to related parties and it is in best interest of stakeholders.

Though there is some framework in the said exemption notification, it does not appear adequate. For example there is no restriction on maximum amount which can be deployed for such purchase, valuation at which such transaction can happen, how long company can retain such shares in its name? Whether company will receive dividend on those self-issued and self-held shares? How SBO will be determined? Will Directors be in compliance with their duties under Section 166? There is no duty cased on auditor or Company Secretary in practice to comment about this in their reports ...and so on ...

CONCLUSION

Undoubtedly, both private and public companies can do buy back in compliance with provisions of Section 68. But fact that private companies have been exempted from Section 67 (subject to certain conditions) will have to be given its respect. Careful reading of exemption notification, indicate that Section 66,67,68 are three options for a private company. Otherwise, exemption notification becomes meaningless.

Considering that this exemption notification is a well thought decision of law maker, a framework under Section 67 needs to be fortified addressing concerns raised in this article. Till then Board of a private limited company wanting to do such treasury buy back should adopt their own framework and ensure that it is documented properly to sustain any questions in future.