



OPINION—SWEAT EQUITY

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The Curious Case of No-sweat Equity

Section 79A of the Companies Act 1956 defines sweat equity as shares issued by a company to its employees or directors at a discount or for consideration other than cash. The favourable terms are meant to reflect the value executives have, and will continue to add to it. Every company can issue sweat equity. Issuance by unlisted companies is governed by the provisions of Section 79A of the Companies Act 1956 and Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003. For listed companies such an exercise is governed by the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

The reported facts of the recent controversy are: Rendezvous Consortium, an unregistered venture, had won the franchise for the Kochi Indian Premier League (IPL) team for \$333 million in March. Rendezvous Sports World, in turn, agreed later on to issue its 19 per cent equity stake—which ensures 4.75 per cent stake in the Kochi team—valued at around Rs 70 crore, to Dubai-based businesswoman, Sunanda Pushkar, a friend of Shashi Tharoor, the then Minister of State for Foreign Affairs.

The transaction of 4.75 per cent stake of the Kochi IPL team by Rendezvous Sports World to Ms. Pushkar clearly flouts norms for the issue of sweat equity. Also, the Rs 70-crore valuation was fixed without the mandatory independent valuation.

To begin with, Rendezvous Sports World was incorporated in August 2009 and the Kochi franchisee agreement was signed on March 17, 2010. According to the rules, a company can issue sweat equity shares only on the completion of a year after being entitled to commence its business. Therefore, as one year has not passed, the company is not even

permitted to issue sweat equity shares.

Two, the value of the shares at Rs 70 crore exceeds a cap of Rs 5 crore. The rules stipulate that issuance of sweat equity shares during a year cannot exceed 15 per cent of the total paid-up equity share capital or Rs 5 crore, whichever is higher, unless approved by the Central government. It is not clear that approval was sought. Then, a separate resolution has to be passed if the shares to be issued are equal to or exceed one per cent of the issued capital as on the day of grant of sweat equity shares. According to the papers submitted to the Registrar of Companies (ROC), the company's current paid-up share capital is Rs 1,00,000. Yet, no special resolution was passed.

More fundamentally, if it is presumed that the allotment has been made to Ms. Pushkar as sweat equity but no statutory forms have been filed (to be done within 30 days from the date of transaction), then the transaction is clearly in violation of the applicable legal regime of sweat equity as under the Companies Act, 1956.

The surrender of shares is also controversial due to the mandated 3-year lock-in period and because no information about its legal allotment is available in the public domain or the online records of ROC.

In case of non-compliance, the company and all those in default are punishable with a maximum fine of Rs 5,000. The offence is compoundable under section 621A of the Companies Act, 1956. Clearly, the penal provisions must be more stringent. Further, no valuation norms have been laid down in the guidelines. Though the valuation of tangible assets can be structured, intangibles are a grey area for which no proper methodology has yet been framed in India. ☉



Prima facie, the issue of sweat equity to Sunanda Pushkar by Rendezvous is in clear violation of the Companies Act. The penalty, though, may be a paltry fine.



Disclaimer: The analysis of the above transaction has been made on basis of limited information as available in public domain.

