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The Companies Act, 2013 has provided various new definitions and new provisions which did not exist in the erstwhile Companies Act, 1956. Such new concepts have been introduced in view of the global corporate governance trends and to make the Companies accountable for their stakeholders.

This issue of **InSync** aims at explaining few such concepts introduced for the first time in the Companies Act, 2013.

### **ESOP**

The erstwhile Companies Act, 1956 did not define the term Employee Stock Options. If any Listed Company wished to grant options to its employees it required to comply with the guidelines issued by SEBI in this regard. Apart from Listed Companies, the unlisted public companies and private companies used to comply with the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003. However, the new Companies Act, 2013 not only defines the term Employee Stock Option but provides a clear cut mandate for the disclosures, lock-in period and pricing of the options.

**Section 2(38)** of the Companies Act, 2013 defines ESOP as the option given to the directors, officers or employees of a company or of its holding company or subsidiary

**Section 2(38) of the Companies Act, 2013 defines ESOP as the option given to the directors, officers or employees etc to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.**

**ESOP not defined under Companies Act, 1956.**

**ESOP by Listed**

company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

The present issue of *InSync* deals with the issue of ESOP's by a private company.

**Company governed by SEBI guidelines. ESOP by unlisted public and private companies governed by Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003.**

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**Erstwhile Companies Act, 1956 did not distinguish between sweat equity and employee stock options.**

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**A private company issued shares to its employees with an option to purchase them at a future date under the provisions of Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003.**

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**Companies Act, 2013 not only distinguishes between Sweat Equity and Employee Stock Options but also prescribes a set mandate under Section**

### **ESOP by a Private Company to its Employees**

Companies especially startups have used various means to please their employees. Increases in their remuneration, bonus package are the usual means to retain the talent. However, as a means of long term policy, companies have been issuing shares to their employees which would enhance their warmth with the company.

The erstwhile Companies Act gave ample freedom to the private companies in the matter of procurement of capital. This was due to the fact that erstwhile companies act recognized private companies at par with a proprietorship concern. However, this posed difficulties also at places when companies which needed to move ahead in a more corporate format while maintaining their private limited status. The erstwhile Companies Act did not distinguish between sweat equity and employee stock options. If a private company wished to issue shares to its employees with an option to purchase them at a future date they had to adhere to the guidelines mandated under Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003.

However, the new Companies Act, 2013 not only

**62(b) read with Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014.**

Subsequent to the exemptions granted vide notification dated 5<sup>th</sup> June 2015, a private company can issue ESOPs to its employees by passing an Ordinary Resolution in its general meeting.

**Rule 12(1) of the Companies (Share Capital and Debentures) Rules, 2014 defines “Employee” as (a) a permanent employee; or (b) a director of the company, excluding an independent director; or (c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company.**

**Employee specifically excludes a person even being an employee to be entitled for ESOP if**

distinguishes between Sweat Equity and Employee Stock Options but it also prescribes a set mandate under the **Section 62(b) read with Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014.** Subsequent to the exemptions granted vide notification dated 5<sup>th</sup> June 2015 a private company can issue ESOPs to its employees by passing an Ordinary Resolution in its general meeting.

Who will be termed as employees for an ESOP Scheme? The answer to this question lies in the explanation to sub-rule 1 of **Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014** which says that **“Employee”** means-

- (a) a permanent employee of the company who has been working in India or outside India; or
- (b) a director of the company, excluding an independent director; or
- (c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company.

However, it **specifically excludes a person** even being an employee to be entitled for ESOP if he is a:

- i. promoter or a person belonging to the promoter group; or
- ii. a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

The **notice of the meeting** where approval for ESOP is to be taken shall make the following disclosures:

- i. the total number of stock options to be granted;
- ii. identification of classes of employees entitled to

**he is (a) promoter or a person belonging to the promoter group; or (b) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.**

**Notice of meeting where approval for ESOP is to be taken shall disclose information such as total number of stock options to be granted, requirements of vesting, maximum number of options per employee, lock - in etc.**

**Rules grant complete freedom to a Company to decide the exercise price; however, the same to be in accordance with the applicable accounting policies.**

**The employees shall not have any right to receive dividend or to**

- participate in the Employees Stock Option Scheme;
- iii. the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;
- iv. the requirements of vesting and period of vesting;
- v. the maximum period within which the options shall be vested;
- vi. the exercise price or the formula for arriving at the same;
- vii. the exercise period and process of exercise;
- viii. the Lock-in period, if any ;
- ix. the maximum number of options to be granted per employee and in aggregate;
- x. the method which the company shall use to value its options;
- xi. the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
- xii. the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee;
- xiii. a statement to the effect that the company shall comply with the applicable accounting standards .

The Rules grant complete freedom to the Company to decide the exercise price; however, the same shall be in accordance with the applicable accounting policies, if any. Rule 12 further says that the approval of shareholders by way of a *separate resolution* shall be obtained by the Company in case of:-

- a. grant of option to employees of subsidiary or holding company; or
- b. grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

vote or in any manner enjoy the benefits of a shareholder unless shares are issued on the exercise of options vested to them.

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The option granted to the shareholder is non-transferable to any other person.

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**Rule 12 mandates disclosure of the ESOP's in the Board Report and maintenance of a Register of Employee Stock Options in Form No SH-6.**

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Board of Directors shall *inter-alia* disclose in the Director's Report for the year, various details of ESOP including (a) Options granted, Vested, Exercised; (b) Total number of shares arising as a result of exercise of option, options lapsed, (c) Exercise Price, (d) Variation in terms of options; (e) Money realized by exercise of options, total number of options in force and

However, it puts a restriction in the form of a minimum period of one year between the grant of options and vesting of option. Moreover, the Rules grant complete freedom to the Company to prescribe a lock-in-period as it may deem fit subsequent to the exercise of option.

The employees shall not have any right to receive dividend or to vote or in any manner enjoy the benefits of a shareholder unless shares are issued on the exercise of options vested to them. Moreover, the option granted to the shareholder is non-transferable to any other person. In the event of death of the employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

Rule 12 mandates disclosure of the ESOP's in the Board Report and maintenance of a **Register of Employee Stock Options in Form No SH-6**. The Board of Directors shall *inter-alia* disclose in the Director's Report for the year, the following details of ESOP:

- a. Options granted, Vested, Exercised
- b. Total number of shares arising as a result of exercise of option, options lapsed
- c. Exercise Price

**(f) Employee wise details of options.**

**In the event of death of the employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee**

- d. Variation in terms of options
- e. Money realized by exercise of options, total number of options in force
- f. Employee wise details of options granted to:-
  - i. Key managerial personnel
  - ii. Any other employee who receives a grant of options in any one year of option amounting to 5% or more of options granted during that year
  - iii. Identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant.

**For any clarification or delineation, feel free to contact us.**



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