

Based on the general and primary queries of numerous unlisted companies and our clients who approach India Juris for formulation and implementation of ESOP and other Employee Benefit Plans, we have prepared this paper to provide initial knowledge about such ESOP. This document should not in any manner be construed as legal advice.

Issuance of sweat equity shares or formulation and implementation of Employee Stock Option Plan or Scheme “**ESOP**” or “**ESOS**” by Unlisted Companies (public or private) is primarily governed by the relevant provisions of Companies Act, 1956 “**Act**” and Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 “**Rules**” issued under Companies Act, 1956.

In India the unlisted company cannot issue sweat equity shares (shares under ESOP) for more than 15% of total paid up equity share capital in a year or shares of the value of 5 crores of rupees, whichever is higher except with the prior approval of the Central Government. Sweat equity shares issued to employees or directors shall be locked in for a period of three years from the date of allotment. The price of sweat equity shares (shares under ESOP or such Plans) to be issued to employees and directors shall be at a fair price calculated by an independent valuer.

Where an unlisted company proposes to issue sweat equity shares (shares under ESOP or such Plans) for consideration other than cash, it shall comply with following:

- (a) The valuation of the intellectual property or of the know-how provided or other value addition to consideration at which sweat equity capital is issued, shall be carried out by a valuer;
- (b) the valuer shall consult such experts, as he may deem fit, having regard to the nature of the industry and the nature of the property or the value addition;
- (c) the valuer shall submit a valuation report to the company giving justification for the valuation;

- (d) a copy of the valuation report of the valuer shall be sent to the shareholders with the notice of the general meeting;
- (e) the company shall give justification for issue of sweat equity shares for consideration other than cash, which shall form part of the notice sent for the general meeting; and
- (f) the amount of Sweat Equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 198, 309, 310, 311 and 387 of the Companies Act, 1956 if the following conditions are fulfilled:
  - (i) the Sweat Equity shares are issued to any director or manager; and,
  - (ii) they are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards

#### **BRIEF PROCEDURE**

1. To start with valuation of the company has to be done by an independent valuer and a suitable Plan, in line with relevant laws, has to be made and drafted for the company.
2. Set up Compensation Committee in the company, if required, to administer the ESOP, However this is not compulsory for unlisted companies.
3. This Plan has to be approved at the Board Meeting and further approved by way of a Special Resolution at the Shareholders meeting of the company.
4. For the purpose of passing a special resolution, the explanatory statement to be annexed to the notice for the general meeting shall contain following:

- 4.1 the date of the meeting at which the proposal for issue of sweat equity shares was approved by the Board of Directors of the company;
  - 4.2 the reasons/justification for the issue;
  - 4.3 the number of shares, consideration for such shares and the class or classes of persons to whom such equity shares are to be issued;
  - 4.4 the value of the sweat equity shares alongwith valuation report/ basis of valuation and the price at the which the sweat equity shares will be issued;
  - 4.5 the names of persons to whom the equity will be issued and the person's relationship with the company;
  - 4.6 ceiling on managerial remuneration, if any, which will be affected by issuance of such equity;
  - 4.7 a statement to the effect that the company shall conform to the accounting policies specified by the Central Government; and
  - 4.8 diluted earning per share pursuant to the issue of securities to be calculated in accordance with the Accounting Standards specified by the Institute of Chartered Accountants of India.
5. Approval of shareholders by way of separate resolution in the General Meeting shall be obtained by the Company in case of grant of shares to identified employees and promoters, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversion) of the company at the time of grant of the sweat equity shares.
  6. Once Plan is approved by the special resolution, requisite filings with regard to special resolution are to be done with Ministry of Corporate Affairs "MCA". The company would also

be required to maintain necessary registers as per above said Act and Rules. Requisite disclosures are to be made in Director's report by the company with regard to sweat equity shares.

7. Further, as and when options are exercised or get converted into equity shares MCA filings (Form 2) are to be filed accordingly.

### HOW INDIA JURIS CAN ASSIST YOU

1. Initial legal and regulatory advisory on preparing and implementing such Plan / Scheme
2. Drafting suitable Plan / Scheme
3. Assisting on valuation
4. Advise on compensation committee
5. Preparing Board resolutions for getting ESOP approved in Board Meeting
6. If required, advising on setting up of compensation committee for administering ESOP
7. Drafting necessary resolutions for Shareholders meeting for passing the special resolution regarding ESOP
8. Filing Form 23 with MCA
9. Advise on the details to be disclosed in the Director's Report
10. Advise on the ongoing compliances and filings with MCA to be done by the company as and when shares are allotted
11. Any other service required to facilitate smooth execution of aforesaid.