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PRIVATE PLACEMENT

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INTRODUCTION

Every company at some point needs to increase its share capital. When it decides to increase its capital, speed and fewer procedural requirements are the two factors which are always of concern. In addition, wire transfers too can sometime take longer than 48 hours. While there are many methods to increase the paid-up capital as discussed below, companies often take recourse to private placement for allotting shares and increasing their capital. Private placements can be made by both private and public companies in accordance with the provisions of the Companies Act, 2013 and SEBI regulations and rules. With the new law under the 2013 Act, the procedure for private placement has become comparatively more structured, time oriented and transparent.

This article discusses the concept and the procedure, timelines, pricing etc. prescribed under the 2013 Act. Apart from the 2013 Act, a listed issuer, has to adhere with the SEBI (Disclosure of Investor Protection) Guidelines, 2003. Since these guidelines refer to the 1956 Act and are yet to be updated, the scope of this article is confined to private placements under Companies Act 2013 and briefly throws light on the loopholes of the private placement provisions under the Companies Act, 1956 ("1956 Act"), which the new law curbs.

A public company may issue securities in the following modes:

- a. 'Public Offer' through issue of prospectus. Public Offer includes:
 - Initial Public Offer (IPO)
 - Further Public Offer (FPO)
 - Offer for sale by existing shareholders to the public.

- b. Private Placement by complying with the provisions of Section 42 of the Companies Act, 2013

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- c. Rights Issue or Bonus Issue in accordance with the provisions of the Act. A Listed Company, in addition, has to comply with the SEBI rules and regulations.

A private company may issue securities in the following modes:

- Private Placement by complying with the provisions of Section 42 of the Companies Act 2013.
- Rights Issue or Bonus Issue in accordance with the provisions of the Act.

In the present article, focus is on the most favored methods used by the companies i.e. PRIVATE PLACEMENT.

BACKGROUND

Over the last two years, in a very well-known controversy of Sahara Group over the money raised by Sahara group companies has played out with the market regulator SEBI. In the case [MANU/SC/0629/2014](#), the companies Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) issued unsecured Optionally Fully-Convertible Debentures (OFCDs) amounting to about Rs. 24,000 crores to more than 2 crore investors. When Securities Exchange Board of India (SEBI), had come to know of the large scale collection of money from the public by Sahara through issuance of OFCDs, it issued a show cause notice to SIRECL and SHICL inter alia stating that the issuance of OFCD's are public issue (since the offer was made to more than 50 persons at a time) and therefore liable to be listed u/s 73 of Companies Act, 1956 and also directed to refund the money solicited and mobilized through the prospectus issued with respect to the OFCDs, since they had violated various other clauses of the SEBI (Disclosure and Investor Protection) Guidelines, 2000 and also various provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

It was urged by the Sahara Group that OFCDs were issued in the nature of "hybrid instruments" as defined u/s 2(19A) of the Companies Act, 1956 and SEBI did not have jurisdiction to administer those securities since Hybrid securities were not included in the definition of 'securities' under the Securities and Exchange Board of India Act, 1992 ("SEBI Act"), or the Securities Contract Regulation Act, 1956 ("SCRA"). The companies also contented that since they were unlisted companies, the issue of these debentures was outside the jurisdiction of SEBI.

The Security and Appellant Tribunal and Supreme Court upheld the SEBI order regarding refund of money to the investors along with interest.

While Sahara is a high profile case, there are several other instances as well, where companies have misused the laws and regulations on private placement and promoters have indulged in malpractices, thereby compromising the interest of innocent stakeholders.

- Provisions in the Companies Act, 1956 were narrow and covered only 'shares' not securities whereas the SEBI provided for 'securities'.
- Companies took the advantage of overlapping powers between MCA and SEBI and resorted to multiple private placements.
- While as per Section 67(3) private placement can be made to maximum 49 persons at one go, there is no restriction on the number of board meetings convened for approving such allotments. As a result companies started calling several meetings and made allotment to 49 persons each time thereby manipulating the law.

The Companies act 2013 has done away with these lacunas by the provisions of Section 42.

COMPANIES ACT 2013 PROMISES BETTER TRANSPERANCY TO STAKEHOLDERS BY TIGHTENING THE PROVISIONS FOR PRIVATE PLACEMENT AND CREATING GREATER TRANSPERANCY THEREIN

PRIVATE PLACEMENT UNDER COMPANIES ACT 2013

Before we go further to discuss the provisions, it is important to understand the meaning of the term 'PRIVATE PLACEMENT'. Before the enactment of 2013 act this term was not defined under any law though the ICDR regulations defined the term Preferential Allotment as any allotment to one or more shareholders or persons but not to all the existing shareholders.

Under the new act Chapter III, Part II of the Act, 2013 deals exclusively with private placements. Section 42 of the Act, 2013 defines 'private placement' which can be said in consonance with the interpretation of the Supreme Court as *"any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section including the condition that the offer or invitation is made to not more*

than 200 or such higher number of persons as may be prescribed (excluding QIB's and employees offered securities under ESOP) in a financial year".

Where,

- "Qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 as amended from time to time;
- "security" include— shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.

Under the Companies Act, 1956 the conditions relating to private placement were applicable only to public companies. On the contrary Companies Act, 2013 provides various conditions for private placement of shares and debentures which apply to both private companies and public companies.

CONDITIONS OF PRIVATE OFFER – SECTION 42 and RULE 14 OF THE COMPANIES (PROSPECTUS AND ALLOTMENT OF SECURITIES) RULES, 2014

PRIVATE PLACEMENT LETTER OF OFFER

(A) A company can make an offer or invitation to subscribe to securities through issue of a private placement offer letter in Form PAS-4

(B) Application form to accompany offer letter

A private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within 30 days of recording the names of such persons.

No person other than the person addressed can apply in the application and any application not confirming to this condition shall be treated as invalid.

OTHER CONDITIONS TO BE COMPLIED WITH:

A company shall not make a private placement of its securities unless-

(a) **Private offer to be previously approved by special resolution**

The proposed offer of securities or invitation to subscribe securities should be previously approved by the shareholders of the company, by a special resolution, for each of the offer or invitation.

In the ***Explanatory Statement*** annexed to the notice for the general meeting the basis or jurisdiction for the Price (including premium, if any) at which the offer or invitation is being made shall be disclosed.

In case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

By an amendment made to the Rules by MCA vide GSR 424(E) on 1/07/2014, it is stated that in the case of an offer for non-convertible debentures made within six months from commencement date of the Rules, the special resolution referred to above may be passed within the said six months.

(b) Offer to maximum of 200 persons in a financial year

Such offer or individual shall be made to not more than two hundred persons in the aggregate in a financial year.

Any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option (ESOP) shall not be considered while calculating the limit of two hundred persons.

It may be noted that if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, that is 200, whether the payment for the securities has been received or not whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of Part I of Chapter III of the Companies Act 2013.

Explanation: for the purpose of this sub rule (b), it is hereby clarified that-

(i) The restrictions would be reckoned individually for each kind of security that is equity share, preference share or debenture.

(ii) No offer or invitation of another kind security shall be made unless allotment with respect to offer or invitation made earlier in respect of any other kind of security is completed.

(c) Offer per person of investment of Rs.20,000 /-

The value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities.

(d) Payment from the subscriber's bank account

The payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank Account from where such payments for subscriptions has been received.

- *Monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.*

(e) The number of such offers or invitations shall not exceed four in a financial year and not more than once in a calendar quarter with a minimum gap of 60 days between any two such offers or invitations.

(3) Company to keep record in Form No.PAS-5

The company shall maintain a complete record of private placement offers in Form No.PAS-5. A copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the SEBI within a period of thirty days of circulation of the private placement offer letter.

The date of private placement letter of offer shall be deemed to be the date of circulation of private placement offer letter.

(4) Return of allotment to Registrar

A return of allotment of securities shall be filed with the Registrar within 30 days of allotment in Form No. PAS-3 and with the fee as provided in the

Companies (Registration offices and fees) Rules, 2014 along with a complete list of all security holders containing-

- Full name, address, PAN and email ID of security holder
- Class of security held
- Date of allotment
- No. of securities held, nominal value and amount paid and particulars of consideration received if the securities were issued for consideration other than cash.

(5) Valuation report

The price of the security has to be justified and the inference is that, it Requires a valuation report by a Registered Valuer (can be a Chartered Accountant).

(6) Exemptions from sub rule (2)

The provisions of maximum number of persons of 200 and the maximum value per person shall not be applicable to-

(a) Non banking financial companies which are registered with the Reserve Bank of India under RBI Act, 1934; and

(b) Housing finance companies which are registered with the National Housing Bank under National Housing Bank Act, 1987, if they are complying with regulations made by RBI or National Housing Bank in respect of offer or invitation to be issued on private placement basis. PROVIDED that such Companies shall comply with the above mentioned requirements in case the RBI or the National Housing Bank have not specified similar regulations.

ALLOTMENT OF SECURITIES

(Section 42, sub-section (6), Companies Act, 2013)

A company making an offer or invitation under section 42 shall allot its securities within 60 days from the date of receipt of the application money for such securities.

Application Money

Where a company is not able to allot the securities within the aforementioned period of 60 days, it shall repay the application money to the subscribers within 15 days from the date of completion of 60 days. Further, if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of 12 % p.a from the expiry of the sixtieth day.

The monies received on application under Section 42 shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than:

- For adjustment against allotment of securities; or
- For the repayment of monies where the company is unable to allot securities.

RESTRICTION ON MAKING PUBLIC ADVERTISEMENT

[Section 42, sub-section (8)]

No company offering securities on private placement basis shall release any public advertisement or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

Offence and penalty for non-compliance with the provisions relating to Private Placement:

Offence	Penalty
Making an offer or invitation for subscription of securities on private placement in contravention of Section 42. [section 42(10)]	Penalty on company upto amount involved in offer or invitation or INR 2 crores, whichever is higher.

PROCEDURE TO MAKE ALLOTMENT THROUGH PRIVATE PLACEMENT

- Hold the board meeting and pass board resolution for convening the meeting of members and approving draft notice of meeting of members.
- Hold the general meeting and pass the special resolution.

- Sent letter of offer in Form PAS.4 along with application form to the proposed subscribers.
- File Form MGT.14 along with the fees as provided in the Companies (Registration of Offices and Fees) Rules, 2014, with the Registrar within 30 days of passing the resolution.
- The explanatory statement annexed to the notice for the general meeting required u/s 102 shall disclose the basis or justification for the price (including premium, if any) at which the offer or invitation is being made. .
- If the said offer or invitation is for non-convertible debentures, it shall be sufficient if the company has passed a previous special resolution during year for all the offers or invitation for such debentures.
- The offer or invitation shall not be made to not more than 200 persons in the aggregate in a financial year excluding QIBs and employees offered securities under ESOP.
- The value of such offer or invitation per person shall be with an investment size of not less than 20,000 rupees of face value of the securities.
- All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.
- The payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received and the monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.
- The company shall maintain a complete record of private placement offers in Form PAS-5:
 - File form PAS-5 along with the private placement offer letter in Form PAS-4 with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and

Exchange Board within a period of 30 days of circulation of the private placement offer letter.

- A return of allotment of securities shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing – (i) The full name, address, Permanent Account Number and E-mail ID of such security holder; (ii) The class of security held; (iii) The date of allotment of security; (iv) The number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.
- Issue share certificates and update minute book and registers.
- Company shall intimate the details of allotment of securities to depository immediately on allotment of such shares

PREFERENTIAL ISSUE SHALL ALSO COMPLY WITH CONDITIONS OF SECTION 42 FOR PRIVATE PLACEMENT

Rule 13(1) of the Companies (share capital and debentures) rules, 2014 provides that if authorised by a special resolution passed in a general meeting, shares may be issued by any company in any manner whatsoever including by way of a preferential offer, to any persons whether or not those persons include the persons referred to in section 62(1)(a) or (b). Such issue on preferential basis should also comply with the conditions laid down in section 42 i.e private placement.

RELAXATION: however, by amendment rules, 2015, dated 18/03/2015, first proviso to Rule 13(1) was inserted which provided that where a company makes a preferential issue to one or more of its members only, the provisions of private placement shall not apply.

Industry Impact

The Companies Act, 2013 is likely to curb malpractices in private placement and also ensure greater coordination between SEBI and MCA by regulating such matters.

Provisions of the Act that will curb malpractices:

Use of term 'Securities' instead of 'shares'

Use of the term shares in the Companies Act, 1956 restricted regulations of issuances of various other instruments by company to raise funds, companies manipulated this loophole by using other terminology or nomenclature for instruments used to raise funds, thereby easily escaping the regulatory oversight. Having understood the practices the Government decided to cover issue of all type of securities in the Companies Act and thus minimise the chances of manipulation.

Restriction on number of persons to whom a private placement offer can be made in a financial year-

The number of persons to whom invitation or offer of private placement can be made in a financial year has been **restricted to 200 in aggregate** and not more than four such offers can be made in one financial year. The limit on

number of persons to whom the securities allotted under private placement can be transferred will also act as a deterrent in indirectly allotting shares to more than prescribed number of persons.

Use of banking channels for private placement-

Since the subscription money will have to be paid through a cheque or a demand draft or other normal banking channels, opportunities to launder money will go down.

Requirements to complete allotment in 60 days-

It has been specified that allotment under private placement should be made within 60 days of receiving the application money. The proposal will curb the common practice under which the companies accepted funds as application money without adequately complying with regulations for accepting deposits. These companies would accept application money from any person, use the money for various purposes and then refund them, as there was no time table for allotment of shares or refund of funds raised.

CONCLUSION

Since the requirements for raising the funds by way of private placement have been made more stringent, it will significantly increase the compliance burden on companies looking to raise funds through private placement. It is also to be noted that as no specific exemption has been provided for private companies or small companies, it will lead to reduce flexibility available to private companies and the companies operated by closely held people for the raising funds. However, the better governance of all companies is expected which will lead to the transparency in the affairs of the Company and accountability of the directors.

FOR REFERENCE

Draft resolution of the board according approval to make a private issue of equity shares of the company pursuant to section 42 and 62(1)(c) of the Companies Act, 2013

“RESOLVED THAT pursuant to the provisions of Section 42 and Section 62(1)(c) of the Companies Act,2013 and subject to the approval of the company in general meeting by special resolution, the approval of the Board be and is hereby accorded to make a private issue of 5,00,000 equity shares of Rs.10 each at a price of Rs. 150 per share recommended by M/S....., valuer.”

“RESOLVED FURTHER that the said shares be offered privately in accordance with the said Section 42 to twenty suppliers who meet 80% of the requirements of raw materials to the company and fifteen large consumers of the company’s products on the basis of the statement placed at the meeting duly initialled by the Chairman for thhe purpose of identification giving their names, address, the number of shares offered to each, price per share and total amount payable to the company by crossed Account payee cheque or crossed demand draft, which is hereby approved.”

“RESOLVED FURTHER that the private placement offer letter draft whereof placed at the meeting duly initialled by the Chairman for the purpose of identification be and is hereby approved and the said letter be issued to the said persons by registered post or by electronic mode under the signature of Mr....., Managing Director.”

“RESOLVED FURTHER THAT a committee consisting of Mr.....and Mr....., Directors, be constituted and authorised to allot the shares applied for within sixty days of the receipt of the applications in accordance with the provisions of said Section 42.”

“RESOLVED FURTHER THAT the secretary shall file the return of allotment with all details as prescribed to the Registrar of Companies as soon as the allotment is made.