CRITICAL ISSUES IN RIGHTS ISSUE, PRIVATE PLACEMENT AND PREFERENTIAL ALLOTMENT

- CS R. Balasubramanian
RIGHTS ISSUE
RIGHTS ISSUE - IMPORTANT PROVISIONS

- Governed under Section 62 of the Act;
- No provisions in Companies (Share Capital and Debentures) Rules, 2014;
- Further shares to be offered to the existing shareholders in their same proportion of holding;
- No exemption for Private Companies;
- Shareholders meeting is not required;
- The Board also has power to allot shares in any manner not dis-advantageous to the Company (Section 62(1)(a)(iii)).
RIGHTS ISSUE - PROCEDURAL ASPECTS

- The Board of Directors to send an Offer Letter to all the existing shareholders for their subscription to the further issue of shares;
- The Offer Letter to be sent to the shareholders does not have a prescribed format but to contain certain disclosures:
  - Number of shares offered;
  - Offer period (not less than 15 days and not exceeding 30 days)
  - Details about right of renunciation
- Offer Letter to be despatched through RP/SP/Courier/E-mode or any other means having proof of delivery at least three days before opening of issue;
- In case of Private Company, if 90% of members have consented in writing, a period less than the above shall be applicable (5th June 2015 - Exemption).

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RIGHTS ISSUE - PROCEDURAL ASPECTS

- On intimation from the shareholders on the acceptance or rejection of offer, the Board to allot the shares to the shareholders who have accepted the offer;
- If the Shareholder, renounces it in favour of any other person, the Board to allot shares to the person in whose favour the renouncement was made;
- If the Board does not receive any response from the shareholders, they can dispose of the shares in a manner non-dis-advantageous to the Company.
- After allotment of shares, the return of allotment (Form PAS-3) is required to be filed with the Registrar of Companies.
RIGHTS ISSUE - CRITICAL ASPECTS

- Can the Rights Issue Offer Letter be despatched by way of Hand Delivery?
- Should the Company get acceptance / rejection letters from shareholders?
- Can all the shareholders renounce the right in favour of one person who is not a shareholder?
- Should the shareholder bring in the subscription money before the closure of offer period?
- Should the subscription money be brought into a separate bank account?
- Should the Company obtain a valuation certificate from the Registered Valuer for the rights issue of shares?

Penal Provisions - Section 450:
The Company and every officer in default be punishable with a fine which may extend to Rs. 10,000/- and Rs. 1,000/- per day if it is a continuing contravention.
PRIVATE PLACEMENT
PRIVATE PLACEMENT - IMPORTANT PROVISIONS

- Section 42, read with Rule 14 of Companies (Prospectus and Allotment of Securities), Rules, 2014;
- To be made only to a select group of persons as identified by the Board, whose number not to exceed 200;
- Private Placement Offer Letter to be circulated among the investors;
- It does not have any right of renunciation;
- The Company shall not utilize the money, unless the return of allotment has been filed with the Registrar of Companies (proviso to Section 42(4))
- Approval from shareholders by way of Special Resolution is required for Private Placement (excepting non-convertible debentures).
PRIVATE PLACEMENT - PROCEDURAL ASPECTS

- Board and Shareholders (Special Resolution) to be obtained;
- Explanatory statement to contain the following disclosures:
  - particulars of the offer including date of passing of Board resolution;
  - kinds of securities offered and the price at which security is being offered;
  - basis or justification for the price (including premium, if any) at which the offer or invitation is being made;
  - name and address of valuer who performed valuation;
  - amount which the company intends to raise by way of such securities;
  - material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities.
- Form MGT-14 to be filed with the Registrar before issue of Letter of Offer (Rule 14(8) of PAS Rules)
- Private Companies to file MGT-14 for Board or Special Resolution for approval obtained u/s 179(3)(c) (proviso to Rule 14(8)).

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PRIVATE PLACEMENT - PROCEDURAL ASPECTS

- Letter of offer to be circulated to the proposed investors in Form PAS-4;
- Letter of offer, serially numbered, to be given either in writing or electronic mode within 30 days of recording of the investor’s name by the Company.
- Investor to remit the funds from his bank account;
- The amount so received to be kept by the Company in a separate Bank account maintained in a Scheduled Bank;
- The allotment to be made within 60 days of receipt of money by the Company. If not allotted, the refund to be made to the investor within 15 days from the expiry of 60 days;
- Failure to refund will attract a penal interest of 12% p.a. from the expiry of 60 days.

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PRIVATE PLACEMENT - PROCEDURAL ASPECTS

- The Company to file return of allotment (Form PAS-3) within 15 days of allotment and can use the money only if the Form PAS-3 has been filed.
- The Company also to maintain a complete record of private placement offers in Form PAS-5;
- Equity, Preference Shares as well as Debentures can be issued in this manner;
- In case of different securities issued, the maximum limit of 200 persons in a FY will be applicable for each of such securities, so issued.

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PRIVATE PLACEMENT - CRITICAL ISSUES

- Is there any offer period for the Private Placement offer?
- Can a Company make one single Private Placement Offer and have multiple times of allotment of securities to various investors?
- Can we maintain a separate bank account in a Private Bank?
- Can a Company allot shares for consideration other than cash under Private Placement?
- Is there any process of identification of persons by the Board of Directors for issue of shares through Private Placement?
PRIVATE PLACEMENT- CRITICAL ASPECTS

Belated filings with the Registrar:

- Form MGT-14 to be filed with the Registrar before issue of Letter of Offer (Rule 14(8) of PAS Rules);
- The Company to file return of allotment (Form PAS-3) within 15 days of allotment (Section 42(8));
- The Company shall not utilize the money, unless the return of allotment has been filed with the Registrar of Companies (proviso to Section 42(4)).

Penal Provisions:

- Failure to file return of allotment within prescribed time - Company, Promoters and Directors liable for penalty of Rs. 1,000/- per day during the default but not exceeding Rs. 25 Lakhs;
- Any other contravention of Section 42 - Company, Promoters and Directors liable for penalty which may extend to amount raised through Private Placement or Rs. 2 Crores, whichever is lower and Company also to refund the monies.

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PREFERENTIAL ALLOTMENT
PREFERENTIAL ALLOTMENT - IMPORTANT PROVISIONS

- Governed u/s 62(1)(c) of the Act read with Rule 13 of Companies (Share Capital and Debentures) Rules, 2014;
- Can be issued to existing members, employees, or outsiders too;
- Conditions of Private Placement are also required to be followed for Preferential allotment (Rule 13(1));
- Exception to be above is given only if the shares are allotted to one or existing members alone;
- Can be issued only for securities which either are equity or convertible into equity.
- Can be issued for consideration other than cash too.
PREFERENTIAL ALLOTMENT - PROCEDURAL ASPECTS

- Issue to be authorized by Articles of Association;
- Board and Shareholders’ Approval (Special Resolution) to be obtained;
- Explanatory statement to contain detailed disclosures as per Rule 13 of Companies (Share Capital and Debenture) Rules, 2014;
- Price of the shares to be determined based upon valuation report from registered valuer; Not applicable for listed Companies;
- Price offered shall not be less than the price determined by the valuer;
- Offer letter to be sent to the proposed allottees in Form PAS-4 (this is not applicable if the proposed allottees are existing members alone).
PREFERENTIAL ALLOTMENT - PROCEDURAL ASPECTS

- The proposed investors to accept the offer in the prescribed format and to bring in the subscription money in a separate bank account (not applicable if shares are issued only to the existing member or members)

- Other conditions of Section 42 (Private Placement) to be complied with (not applicable if shares are issued only to the existing member or members)

- Allotment to be made within 12 months from the date of passing Special Resolution authorizing Preferential Allotment.

- If allotment not completed within 12 months, another Special Resolution is required to be passed.
PREFERENTIAL ALLOTMENT - DISCLOSURES IN EXPLANATORY STATEMENT

- the objects of the issue;
- the total number of shares or other securities to be issued;
- the price or price band at/within which the allotment is proposed;
- basis on which the price has been arrived at along with report of the registered valuer;
- relevant date with reference to which the price has been arrived at;
- the class or classes of persons to whom the allotment is proposed to be made;
- intention of promoters, directors or key managerial personnel to subscribe to the offer;
- the proposed time within which the allotment shall be completed;
- the names of the proposed allottees and the percentage of post preferential offer capital that may be held by them;
- the change in control, if any, in the company that would occur consequent to the preferential offer;
- the number of persons to whom allotment on preferential basis have already been made during the year, in terms of number of securities as well as price;
- the justification for the allotment proposed to be made for consideration other than cash together with valuation report of the registered valuer.
- The pre issue and post issue shareholding pattern of the company in prescribed format.
PRIVATE PLACEMENT - CRITICAL ISSUES

- If a Company issues equity shares to an outsider u/s 62(1)(c), will it be termed as Preferential Allotment or Private Placement?
- Is there any difference between Preferential Allotment and Private Placement?
- Will the naming of the issue as Preferential Allotment or Private Placement make any difference?
KEY DIFFERENCES BETWEEN PRIVATE PLACEMENT AND PREFERENTIAL ALLOTMENT
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Private Placement</th>
<th>Preferential Allotment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governing Section</td>
<td>42</td>
<td>62(1)(c)</td>
</tr>
<tr>
<td>Meaning</td>
<td>Offer or invitation made to a select group of persons</td>
<td>Issue of shares to any persons whether or not they include members and employees</td>
</tr>
<tr>
<td>Securities to be issued</td>
<td>Any security including Equity, Preference and Debentures</td>
<td>Only Equity and other securities convertible into Equity can be issued</td>
</tr>
<tr>
<td>Shareholders’ Approval</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Allottees</td>
<td>Any person as identified by the Board</td>
<td>To members, employees or any other persons</td>
</tr>
<tr>
<td>Disclosures in Explanatory Statement</td>
<td>Only a few as per Rule 14 of PAS Rules</td>
<td>Detailed disclosures as per Rule 13 of SH Rules</td>
</tr>
<tr>
<td>Offer Letter</td>
<td>In prescribed format (PAS-4)</td>
<td>No format prescribed</td>
</tr>
<tr>
<td>Particulars</td>
<td>Private Placement</td>
<td>Preferential Allotment</td>
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<td>--------------------------</td>
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<tr>
<td>Mode of payment</td>
<td>Through any banking channel but not cash</td>
<td>Either for cash or consideration other than cash</td>
</tr>
<tr>
<td>Time limit for allotment</td>
<td>Within 60 days of receipt of subscription money</td>
<td>Within 12 months from the date of passing Special Resolution</td>
</tr>
<tr>
<td>Authorisation in Articles</td>
<td>Not Required</td>
<td>Required</td>
</tr>
<tr>
<td>Bank Account</td>
<td>Separate Bank account is required</td>
<td>No such requirement.</td>
</tr>
</tbody>
</table>
OTHER IMPORTANT PROVISIONS

Pricing of shares - Tax implications:

Section 56(2)(viib) of the Income Tax Act, 1961 - Income from Other Sources;

Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the Fair Market Value (FMV) of the shares will be treated as Income from Other Sources.

FMV can be determined either by the formula prescribed in Rule 11UA(2)(a) or only by a Merchant Banker as per Rule 11UA(2)(b) in Income Tax Rules, 1962.
OTHER IMPORTANT PROVISIONS

Pricing Guidelines- FEMA Requirements:

Foreign Exchange Management (Transfer or Issue of Security by a Person resident outside India) Regulations, 2017:

Price not to be less than:

- Worked out under SEBI Guidelines for Listed Companies;
- Valuation done as per any internationally accepted pricing methodology for valuation on arm’s length basis by a CA / Merchant Banker / Practising CMA.
Thank you!

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