


# 360-degree Analysis of Issue of Securities & Private Equity Funding

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**2(81) Securities** : "securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956

- **Securities includes** “**shares, debentures or other marketable securities of a like nature in or of any incorporated company or other body corporate**”



**2(84) Shares** : means a share in the share capital of a company and includes stock



**2(30) Debentures** : "debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not

# Securities

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graph TD; Securities --> Shares; Securities --> Debentures; Shares --> EquityShares[Equity Shares]; Shares --> PreferenceShares[Preference Shares]; PreferenceShares --> Cumulative[Cumulative, Non Cumulative]; PreferenceShares --> Convertible[Convertible, Non Convertible]; PreferenceShares --> Participating[Participating, Non Participating]; PreferenceShares --> Redeemable[Redeemable, Irredeemable]; Debentures --> ConvertibleDeb[Convertible, Non Convertible, Redeemable (Fully or Partly)]; Debentures --> Secured[Secured, Unsecured];
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## Shares

Equity Shares

Preference Shares

Cumulative, Non Cumulative

Convertible, Non Convertible

Participating, Non Participating

Redeemable, Irredeemable

## Debentures

Convertible, Non Convertible,  
Redeemable (Fully or Partly)

Secured, Unsecured



Difference between :

Issue of Shares

Issue of Securities

## FURTHER ISSUE OF SECURITIES

Section and Rules	Public Offer	Private Placement	Right Issue	Preferential Allotment
<b>Section</b>	24 to 40	42	62 (1)(a)	62 (1)(c)
<b>Rules</b>	<p>The Companies (Prospectus and Allotment of Securities) Rules, 2014</p> <p>Rule 1 to 13</p>	<p>The Companies (Prospectus and Allotment of Securities) Rules, 2014</p> <p>Rule 14</p>	<p>The Companies (Share Capital and Debentures) Rules, 2014 ]</p> <p>Rule 12A</p>	<p>The Companies (Share Capital and Debentures) Rules, 2014 ]</p> <p>Rule 13</p>
	SEBI Regulations, Section 71, Section 55			

## Section 23 Public Offer and Private Placement

A public  
company may  
issue securities

to public through  
prospectus

through private  
placement

through a rights  
issue or a bonus  
issue

A private  
company may  
issue securities

by way of rights  
issue or bonus  
issue

through private  
placement

# RIGHT ISSUE

## Right issue under Section 62 (1)(a)

When company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered—

1. To persons who, at the date of the offer, are holders of equity shares of the company
2. Given in proportion



3. Renunciation rights are available (unless AOA provides otherwise)

4. If a shareholder has neither renounced in favour of another person nor accepted the shares, the Board of directors may dispose of the shares so declined in such manner which is not dis-advantageous to the shareholders and the company.



## OFFER LETTER AND OFFER PERIOD

1. The notice containing offer shall be dispatched through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders **at least 3 days before the opening of the issue**
2. Issue shall be opened for **minimum 7 days and maximum 30 days**
3. In case of Private Limited Company : offer period can be lesser if 90% members give consent


## Procedure for Right issue under Section 62 (1)(a) :

1. Check MOA and AOA
2. BM – Approve offer letter
3. Valuation report – not mandatory
4. Offer Period – 7– 30 days OR Shorter offer period in case of Private Companies
6. Accept/ Decline/ Renounce
5. BM - Allotment of shares / dispose off declined shares
6. Return of Allotment – Form PAS 3
7. Issue of share certificates

# PREFERENTIAL ALLOTMENT

## Preferential Allotment under Section 62 (1)(c)

1. Issue of further shares **to any select person or group of persons** on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities.

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2. "shares or other securities" means equity shares, fully convertible debentures, partly convertible debentures or any other convertible securities.
  3. Either for cash or for a consideration other than cash Eg. Property and assets acquired, Goodwill, Services, Conversion of Debentures etc.
  4. Also comply with conditions laid down in Section 42 of the Act
  5. For conversion of debentures into equity or loan raised by the company to convert such debentures or conversion of loans into shares in the company – Section 62 is not applicable – Prior Special Resolution approving terms shall be in place

## **Preferential Allotment under Section 62 (1)(c)**

1. Check the provisions of MOA & AOA – authorised by AOA
2. Obtain valuation report from registered valuer
3. BM – Approval of Offer – PAS 4
4. EGM – Special Resolution - MGT 14
5. Offer period
6. Acceptance of offer
7. BM – Allotment - Complete allotment within 12 months from passing of Special Resolution
8. Issue of share Certificates/ Debenture Certificates
9. Return of allotment - in Form PAS-3
10. Maintain records in PAS – 5

# PRIVATE PLACEMENT


## ▶ Section 42

### ▶ Private placement means ;

- ▶ - any offer or invitation to subscribe or issue of securities to **a select group of persons** by a company (other than by way of public offer)
- ▶ - through private placement offer-cum-application, which satisfies the **conditions** specified in this section.

## Private Placement under Section 42

1. A private placement shall be made only to a select group of persons who have been identified by the Board
2. Issue private placement offer and application - shall not carry any right of renunciation.
3. Subscription money paid either by cheque or demand draft or other banking channel and not by cash
4. Allotment within sixty days from the date of receipt of the application money, if not allotted, repay the application money within 15 days from the expiry of 60 days, if fails to repay interest @ 12%.
5. Keep money in separate bank account in a scheduled bank and shall not be utilised for any purpose
6. No public advertisements of issue



7. an offer or invitation to subscribe securities under private placement shall not be made to persons more than 200 in the aggregate in a financial year: (Excludes QIBs and ESOPs)

8. Applicant shall use the same private placement and application issued to him and not any other format

9. Company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar

10. No fresh offer or invitation unless the allotments completed or that offer or invitation has been withdrawn

11. Return of allotment in PAS - 3 within 15 days of allotment

12. Importance w.r.t. Issue of non convertible securities





### **13. For non-convertible debentures :**

a. amount is within the limit of 180(1)(c) – Board Resolution under 179 is sufficient

b. amount exceeds the limit of 180(1)(c) - one Special Resolution for year for all offers or invitations for such Non- Convertible Debentures is sufficient

**\* Applicability for Private Companies**

## Procedure for Issue of Securities through Private Placement

1. Check the provisions of MOA
2. Obtain valuation report from registered valuer
3. BM – Approval of Offer – PAS 4
4. EGM – Special Resolution - MGT 14
5. Issue of Offer letter
6. Offer period
7. Acceptance of offer
8. BM – Allotment
9. Issue of share Certificates/ Debenture Certificates
10. Return of allotment - within fifteen days of allotment in Form PAS-3
10. Maintain records in PAS – 5



## DEEMED PUBLIC OFFER

Any private placement issue not made in compliance of the provisions of sub-section (2) shall be deemed to be a public offer and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable.

## Penalties

1. Default in filing of return : One thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.
2. if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower, and the company shall also refund all monies with 12 % interest to subscribers within a period of thirty days of the order imposing the penalty
3. Consequences of deemed public offers

## Section 55 and Rule 9 : Issue and Redemption of Preference Shares

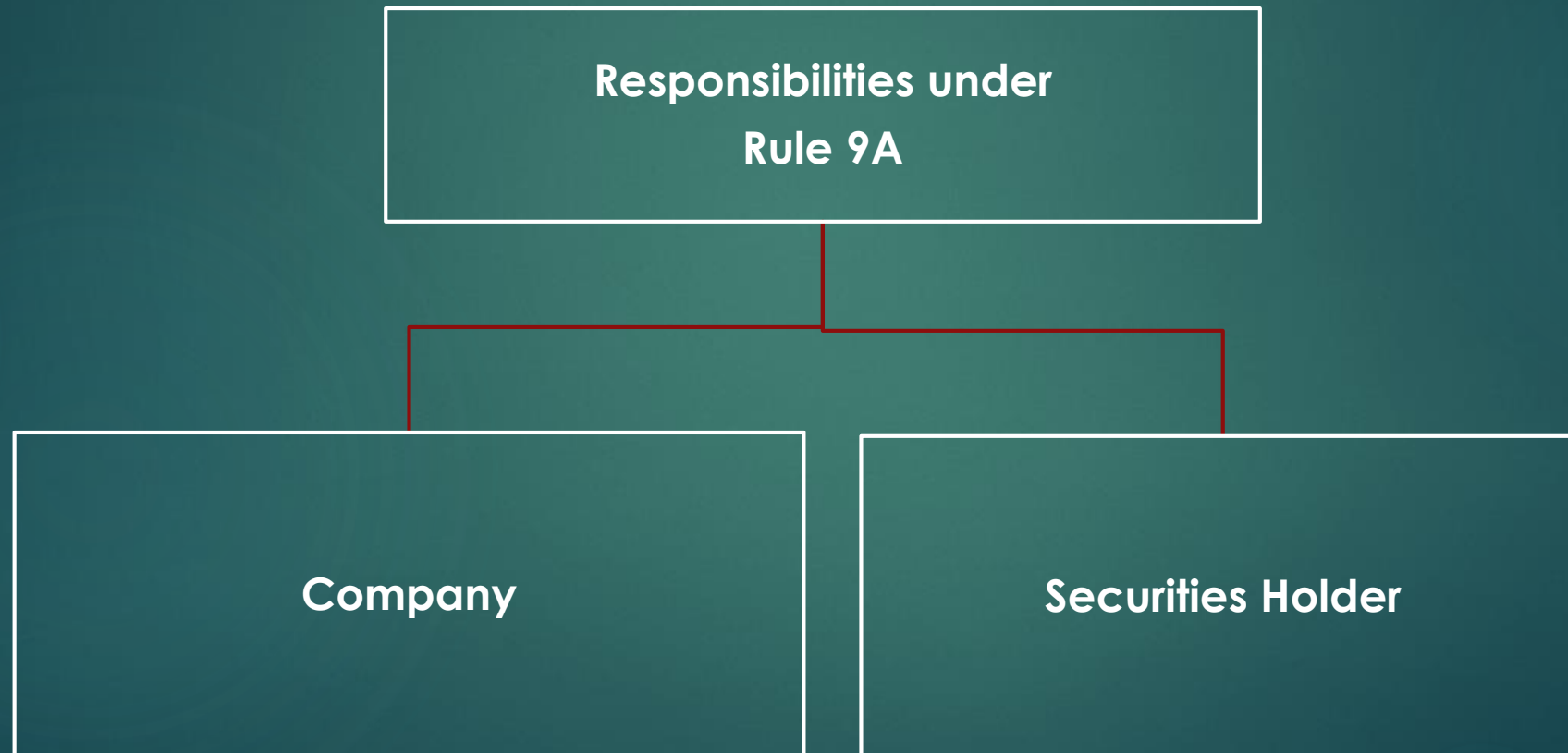
1. Authorised by articles
2. Special resolution
3. No subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.
4. Maximum term – 20 years for other than infrastructure projects
5. Details of issue to be specified in Special resolution viz. participation in surplus funds, payment of dividend (cumulative or non-cumulative) , details of conversion, redemption details etc.

## Section 71 and Rule 18 : Debentures

1. Special resolution
2. No voting rights.
3. Maximum term – 10 years for Secured
4. For secured debentures : Rule 18 shall be followed w.r.t. charge creation, Debenture Trustees, Debenture Trust Deed, Debenture Redemption Reserve etc.
5. No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees.
6. Pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

# RULE 9A OF THE COMPANIES (PROSPECTUS AND ALLOTMENT OF SECURITIES) RULES, 2014

## ISSUE OF SECURITIES IN DEMATERIALISED FORM BY UNLISTED PUBLIC COMPANIES





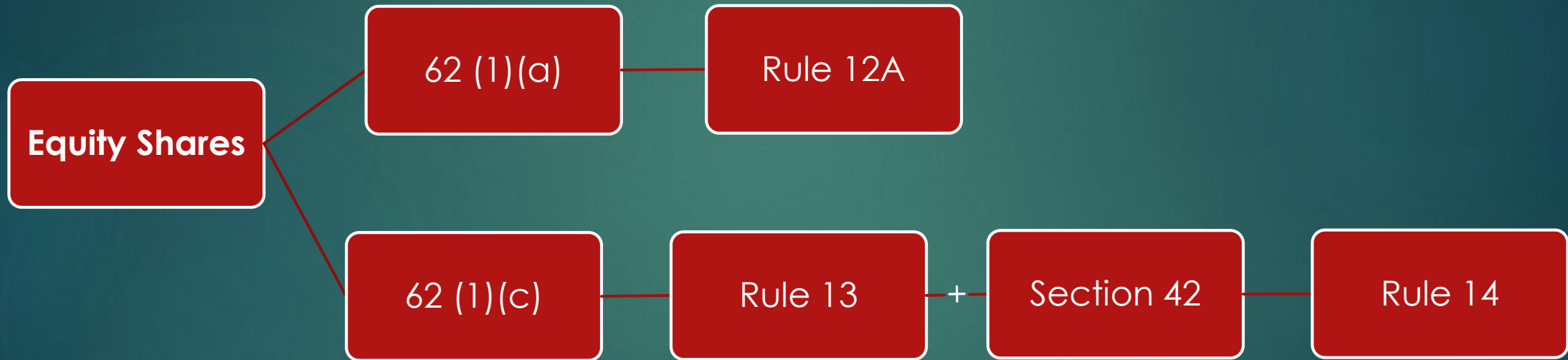
## Company

1. Issue the securities only in Demat form
2. Facilitate dematerialisation of all its existing securities - secure International Security Identification Number (ISIN)
3. Securities of its promoters, directors, key managerial personnel
4. Form PAS-6 - within sixty days from the conclusion of each half year duly certified by PCS or PCA

## Securities Holder

1. Get such securities dematerialised before the transfer
2. Convert all securities in Demat before applying for any new offer





## Preference Shares

Convertible

Section  
55

Rule 9

+

Section  
62(1)(a)/  
(c)

Rule 13

+

Section  
42

Rule 14

Non -  
Convertible

Section 55

Rule 9

+

Section  
23

+

Section  
42

Rule 14

## DEBENTURES

### Convertible

Secured

S 71

R 18

+ S 62(1)(c)

R 13

+ S 42

R 14

Unsecured

S 71

+ S 62(1)(c)

R 13

+ S 42

R 14

### Non - Convertible

Secured

S 71

R 18

+ S 23

S 42

R 14

Unsecured

S 71

+ S 23

S 42

R 14

## Valuation requirement:

1. Section 62(1)(c) - The price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer
2. Rule – 13 : For convertible securities : the price of the resultant shares pursuant to conversion shall be determined by obtaining Valuation report at-
  - a. Upfront (at the time when the offer of convertible securities is made)
  - b. at the time, which shall not be earlier than 30 days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares

(Disclosure shall be made in offer letter)

## Pricing and requirement of Valuation Report for Right Issue, Private Placement and Preferential allotment – Companies Act & FEMA

Type of Issue	Applicant	Valuation requirement	Reference
Right Issue	Resident	Not mandatory	Section 62 (1)(a)
	NR	CA - Registered Valuer/ CMA - Registered Valuer/ SEBI registered Merchant Banker  (RBI User Manual for SMF-FIRMS - Not required)	Foreign Exchange Management (NDI) Rules, 2019  Rule 21 Pricing Guidelines  Rule 7 : Price should not be less than the price at which the offer on right basis is made to the resident shareholders
Preferential Allotment	Resident	Registered Valuer	Section 62 (1)(c)
	NR	CA - Registered Valuer/ CMA - Registered Valuer/ SEBI registered Merchant Banker	Section 62 (1)(c) &  Foreign Exchange Management (NDI) Rules, 2019 Rule 21 Pricing Guidelines
Private Placement	Resident	Registered Valuer	Section 42, Rule 14
	NR	CA - Registered Valuer/ CMA - Registered Value/ SEBI registered Merchant Banker	Section 42, Rule 14 &  Foreign Exchange Management (NDI) Rules, 2019 Rule 21 Pricing Guidelines

Particulars	Income Tax Act, 1961
In case FMV is based on “ <b>Discounted cash flow (DCF)</b> ” method	Only Merchant Banker can do valuation
In case FMV is based on <b>other than “Discounted cash flow (DCF)”</b> method	CA can do valuation

## Section 56(2)(vii) not applicable on the issue of right shares to existing shareholders: ITAT

### ITO v. Rajeev Ratanlal Tulshyan [2022]

#### *Facts of the Case*

Company offered the right issue, and the assessee was allotted shares at face value of a certain amount. The Assessing Officer (AO) alleged that consideration of face value per share was less than fair market value (FMV) of shares and, therefore, the difference between FMV and consideration paid by the assessee would be taxable under section 56(2)(vii)(c)(ii).

#### *ITAT Held :*

CBDT had issued Circular No. 10/2018 on 31-12-2018 clarifying that section 56(2)(vii)(a) shall not be applicable in case of receipt of shares as a result of fresh issuance of shares, including by way of issue of bonus shares, rights shares and preference shares. However, this circular was later withdrawn.

However, the fact that the intent of introducing the provisions was anti-abusive measures remains intact. There is no reason to depart from the understanding that the provisions were counter evasion mechanisms to prevent the laundering of unaccounted income. Therefore, section 56(2)(vii) provisions do not apply to the genuine issue of shares to an existing shareholder.



## Pricing of shares offered by listed company on preferential basis

PNB Housing Finance Ltd. Vs SEBI 09.08.2021

### Facts of the case :

PNB Housing Finance Ltd. ('Appellant Company') is a listed company as on date. Board of Directors decided to issue shares under preferential allotment for Rs. 390 per share. SEBI (on report of stock exchange) informed the company that the resolution passed by Board was ultra-vires since valuation by the Registered Valuer had not been factored while determining the price of the preferential issue and that the **Articles of Association requires the board of directors to consider the valuation report of a Registered Valuer.**

According to section 24 of the Companies Act, all the provisions in Chapter III and Chapter IV so far as they relate to **issue of securities by listed companies would be administered by SEBI.**

Madanlal Fakirchand Dudhediya v. Shree Changdeo Sugar Mills Ltd. [1962] and Section 6 : **Any clause in the Articles of Association which is repugnant to the Companies Act would be void and the Act shall prevail.**

Rule 13(1) of Companies (Share Capital and Debentures) Rules, 2014 : Price of shares to be issued on preferential basis by listed company **shall not be required to be determined by valuation report of Registered Valuer.**

The SAT (Judicial Member) concluded that “AOA is agreement between Company and members. In the present case in order to safeguard the interest of the investors, the questioning order was passed by SEBI on the line of the provisions made in Article 19(2) by the Appellant Company and its shareholders, at the time the Company was to be listed on the Stock Exchanges. Therefore, in my view the same cannot be called as illegal or unjustified.





SAT (Presiding Officer) : Allowed the company's appeal. Allowed company to proceed with preferential issue.

SEBI appealed against the SAT (Presiding Officer's) order in the Supreme Court. However, in the meantime, the Appellant Company decided not to proceed with the preferential issue.

Now after this case, SEBI amended Regulation 164 of SEBI (ICDR) Regulations, 2018 which now provides that **if Articles of Association of the issuer company provide for a method of determination which results in a floor price higher than that determined under ICDR Regulations, then the same shall be considered as the floor price for equity shares** to be allotted pursuant to the preferential issue.

# Let's think...

## From whom Valuation report is required ?

1. Right issue to Resident - DFC
2. Right issue to Non – Resident - NAV
3. Issue under Section 62(1)(c) to Resident - NAV
4. Issue under Section 42 to Non – Resident – DCF
5. Issue of shares by conversion of loan into shares u/s 62(3)

## Relevance of Companies (Acceptance of Deposits) Rules, 2014

### Exempted deposits :

1. Share application money pending for allotment - Allot or return money within 60+15 days
2. Secured bonds or debentures or debentures compulsorily convertible into shares of the company within 10 years
3. Any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognised stock exchange as per applicable regulations made by SEBI.
4. an amount of 25 lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding 10 years from the date of issue) in a single tranche, from a person.

## Let's think...

1. ABC Private Limited has 2 share holders Mr. A and Mr. B. Company wants to issue equity shares to both. Under which Section of Companies Act shares shall be issued.
2. ABC Private Limited has 2 share holders Mr. A and Mr. B. Company wants to issue equity shares to Mr. A only, who is NRI. Under which Section of Companies Act shares shall be issued.
3. PQR Private Limited wants to issue non convertible Debentures to Mr. D. Under which Section of Companies Act Debentures shall be issued.
4. Can Company make 20 rounds of allotments to a person who is not a existing shareholder through right issue (existing equity shareholders renounce offer in his favour everytime)
5. XYZ Limited wants to issue Non Convertible Preference shares to Mr. A, who is not existing share holder. Whether shares shall be issues under section 42 (Private Placement) or Section 62 (1)(c) (i.e. Preferential allotment)
6. Can company issue debentures through Right Issue?
7. Can shares be renounced to NRI under right issue? Are pricing guidelines applicable? – Amendment in Foreign Exchange Management (Non-debt Instruments) Rules, 2019 dated 27.04.2020



8. Is it possible to convert existing Equity shares in Redeemable Preference shares or issue of fresh Equity shares with option to convert in Redeemable Preference shares

9. Does subscribing to the shares of one company which is related to another company, fall under the purview of section 188(1)(b)? (Ref : Section 44)

## RECENT CASE STUDIES

1. RoC Karnataka imposed total penalty of Rs. 1.5 crores on Valley Monks Private Limited and on its officers in default and directed the Company to refund the monies to subscribers alongwith interest for not complying with the provisions relating to Private Placement Offer. Below mentioned are the non-compliances recorded in the Order:

- a. Company **missed to mention Section 42** in the extracts of Board Resolution and EGM resolution and **Disclosure required under Rule 14** of PAS Rules, 2014;
- b. Failure by Company to pass special resolution and subsequently **file MGT 14, before the issue of private placement offer** cum application letter [Rule 14(8)];
- c. **No separate bank account was opened** for the purpose of receiving application money [Section 42(6)].



2. Registrar of Companies, Gujarat has imposed total penalty of Rs. 2 crore on Tatva Chintan Pharma Chem Limited for noncompliance of Section 42.

The Company **received share application money in general bank account** instead of separate bank account. ROC after hearing the case imposed a penalty of Rs. 1 crore on the Company and Rs. 20 Lakhs each on 5 directors.

3. Mrs. P Malathi Vs. SRP Logistics (P.) Ltd. NCALT : Where respondent directors increased share capital of company and further allotted shares of company to R2-director and to outsider at par by preferential allotment/private placement **without taking Valuation Report** and **Not mentioning name of the allottees in BM and GM resolution** , said increase in share capital and subsequent allotment of shares was **invalid** and thus same was to be set aside

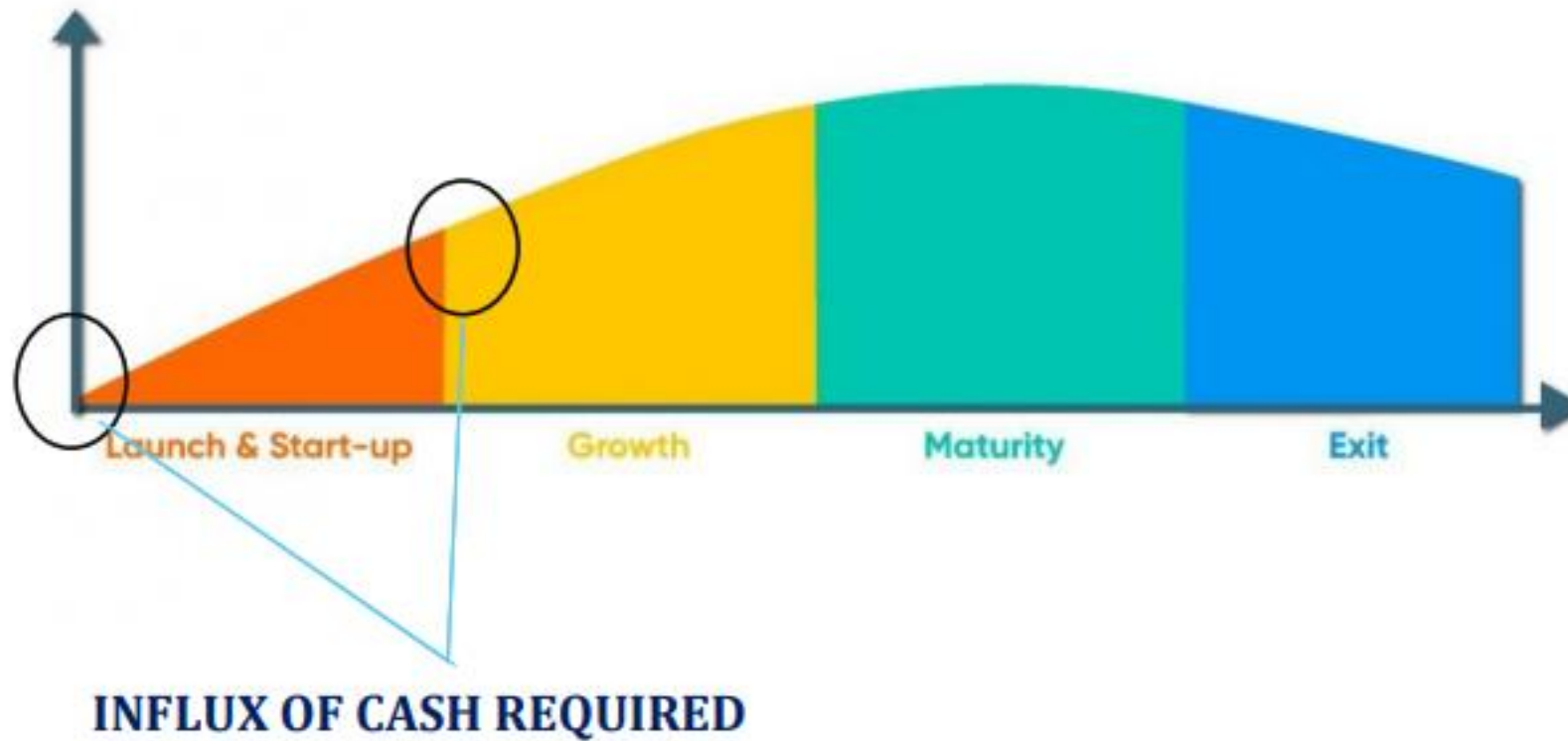
# PRIVATE EQUITY FUNDING

- Funding is the lifeblood of a start-up as they rarely grow organically.
- Initially, the funds are contributed by the founders themselves, but as the operations of the business grow; it requires outside funding.
- According to Research, 90% of the new start-ups fail. Therefore, an investor, especially in an early stage start-up, demands security for his investment, which comes in the form of the investment rights.
- Therefore, deal structuring and drafting of deal agreement in apt manner is the key to balances the needs of the founder as well as the investor, and reduces the chances of disputes.



# OPPOURTUNITIES FOR INVESTMENTS

## BUSINESS LIFECYCLE



# Role of CS under Companies Act and beyond the compliance

1. Structuring should start at incorporation
2. Involve in transaction at initial stage – Negotiations
3. DD tracker
4. Follow deadlines of compliance and filing under Section 42,62,55,56,71.
5. Term sheet drafting is more crucial than SPA or SHA
6. SHA clauses like Tag along, Drag along, ROFO, ROFR
7. Take Key Transactional Details (KTDs) from client
8. Money in one go or in tranches
9. NDA
10. Team work is must
11. Holistic approach is required
12. Prepare timeline and follow the same
13. Knowledge of all applicable laws is necessary - Contract Act, Companies Act (expert level), FEMA, Income Tax, Stamp Act
14. Proposal should be in place covering scope of work and fees schedule



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*THANK you!!*