

# Does the Right of Renunciation in a Rights Issue of Shares Constitute a Public Offer?: The Never-ending Confusion and Controversy

The observation of the Honorable single judge of the Madras High Court in *Vikramjit Singh Oberoi v Registrar of Companies* [2020] 223 Comp Cas 199 (Mad), that “the allotment of shares to the renounees of rights shares even though they are not existing shareholders of the company, did not amount public offer”, has once again triggered and revived the endless debate as to the question: Does the right of Renunciation in a Rights Issue of Shares constitute a Public Offer? A debate on this issue has been alive for the past several years (before and after the enactment of the Companies Act 2013), but no concrete and foolproof statutory solution has so far been put in place either by the Ministry of Corporate Affairs (MCA) or by the Securities and Exchange Board of India (SEBI).



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## INTRODUCTION

The observation of the Honorable Single Judge of the Madras High Court in *Vikramjit Singh Oberoi v Registrar of Companies* [2020] 223 Comp Cas 199 (Mad), that “the allotment of shares to the renounees of rights shares even though they are not existing shareholders of the company, did not amount to a public offer”, has once again triggered and revived the endless debate as to the question: Does the right of renunciation in a rights issue of shares constitute a Public Offer? A debate on this issue has been alive for the past several years (before and after the enactment of the Companies Act 2013), but no concrete and foolproof statutory solution has so far been put in place either by the Ministry of Corporate Affairs (MCA) or by the Securities and Exchange Board of India (SEBI). While SEBI has been dealing with the issue through circulars, the Companies Act 2013 (‘the Act’) remains vague and unclear.

## RIGHTS ISSUE: THE STATUTORY FRAMEWORK

Section 62 of the Act contains the statutory framework concerning rights issues of shares by companies. Section 23(1)(c) of the Companies Act 2013, inter alia, states:

“A public company may issue securities through a rights issue or a bonus issue in accordance with the provisions of this Act and in the case of a listed company or a company

which intends to get its securities listed, also with the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder.”

Section 23(2)(a) states:

“A private company may issue securities— (a) by way of rights issue or bonus issue in accordance with the provisions of this Act.”

Although Section 23 uses the expression ‘rights issue’, it is not defined in that section or anywhere in the Act. In fact, the phrase ‘rights issue’ is nowhere used in except Section 23. What section 62 says is ‘Further issue of share capital’ or issue of further shares.

A Rights issue is a method by which companies raise capital by offering shares to their shareholders. This is a privilege given to shareholders of a company to subscribe *pro rata* to a new issue of securities (generally at a price below that prevailing in the market). The name ‘rights issue’ arises from the principle of pre-emption rights, according to which any new shares issued by a company must first be offered to the existing shareholders in proportion to their holding of existing shares, that is, *pro rata*. For example, in a 1 for 4 rights issue, shareholders would be given the option to subscribe one new share for every four shares they already hold as on the record date. As rights are usually issued at a discount to the market price/ fair value of existing shares, those not wishing to take up their rights can sell them in the market in case of listed entity or renounce to other persons to subscribe.

Shares offered to the existing shareholders of a company are called ‘rights shares’. In regard to the rights shares, the shareholders of a company have a pre-emptive right to subscribe to these shares. Where a company proposes to increase the subscribed capital by issuing further shares, these shares are offered for subscription to the existing shareholders of the company on a certain basis or in a certain proportion. The shareholders who receive offers for the right shares are also entitled to renounce these to other persons, but the persons who are not shareholders have no right of direct subscription to these shares. It is common to vest in the Board of Directors of a company the power to issue unsubscribed rights shares to any persons selected by the Board.

The entire spectrum of the provisions of s. 62(1)(a) must be said to be the law relating to rights issue, comprising the following requirements:

- (1) further shares must be offered to persons who, at the date of the offer (Record date), are holders of existing equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer;
- (2) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days or such lesser number of days as may be prescribed (As prescribed in Rule 12A w.e.f. 01-04-2021 not less than 7 days from the date of offer) and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
- (3) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice offering the shares shall contain a statement of this right; and
- (4) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

## RIGHT OF RENUNCIATION

If the recipient of a rights offer does not wish to take advantage of the offer himself, he can sell the letter and the attendant rights to any other person who becomes entitled to subscribe to the shares offered by the company. To renounce means to give up or put aside voluntarily; to give up by formal declaration. As per the Black's Law Dictionary, to renounce means to give up or abandon formally (a right or interest); to disclaim. The ordinary meaning of the word 'renounce' in the context of the provision in Section 62 is to give up or put aside voluntarily: formally declare one's abandonment of (a claim, right, or possession); to relinquish; abandon; surrender.

As per clause (ii) of Section 62(1)(a), in the case of a rights issue of shares, "unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right."

This provision recognizes the right to renounce by a shareholder the shares offered to him as his 'rights'. This is not, however, an absolute statutory right as the expression "unless the articles of the company otherwise provide" in this clause clearly allow a company to exclude, by articles, this right. Unless the articles of a company

expressly exclude this right, it will be deemed to exist. The effect of these words is to subordinate the provision of the Act to the provision of the articles of the company. In other words, the provision that the offer of further shares shall be deemed to include the right of renunciation by a shareholder in favour of any other person, will not apply if the articles of the company "otherwise provide".

Thus, if the articles of association of the company which makes a rights issue do not bar the right to renounce shares offered, a shareholder receiving the offer for shares, this right will be available as a statutory right and Board while passing a resolution for the rights issue cannot take away this right; the Board can take it away only if the articles of the company contain an express provision debarring the shareholders from this right.

The right of renunciation is often excluded in the case of a private company because whereas, under the Companies Act there is no restriction on the number of members, a private company must limit the number of its members to 200. It is, therefore, incumbent on a private company to ensure that the right to renounce the rights shares offered to its members does not result in the number of its members exceeding 200. Hence, usually, the right of renunciation is not provided in the rights issue of a private company. Clause (ii) of Section 62(1) begins with the words "unless the articles of the company otherwise provide" thereby facilitating any company to prohibit renunciation of rights shares.

In the case of a listed company, the right of renunciation must be given regardless of the provision in the articles of association not giving such right to the members of the company.

An unlisted public company, however, need not give this facility to the member if the articles of association of the company provides so and the Board of Directors decides not to give it in respect of a rights issue. If this right is to be given to the members, a separate form will be supplied to them along with the form for accepting the offer, so that any member wishing to renounce the shares offered to him may do so.

## INTERPRETATION OF THE WORDS "IN FAVOUR OF ANY OTHER PERSON"

The effect of the words "in favour of any other person" in clause (ii) of Section 62(1)(a) was considered by the Delhi High Court in *Raj Kumar Bhatia v AV Light Automotives Ltd* [2016] 197 Comp Cas 144 (Delhi) in the context of the corresponding provision in Section 81 of the Companies Act 1956, and it was held that the right exercised by one of the Directors in renouncing 30,000 shares in favour of "any other person", which, in this case was her mother-in-law was in consonance with Section 81(1)(c). There was no need to bring in Section 81(1A) which envisaged further issue of capital by offering further shares of the company to any person, whether or not that person includes the person referred to in clause (a) of sub-section (1). The court remarked that while interpreting a clause in a statute,

it must be read to conjunct it with the overall intent of the Legislature in enacting the statute. The words used in an enactment must be given a plain meaning within its ambit and context ; and the separate provisions of a statute must normally be read to complement each other; and if it is not possible to do so, each of the provisions must be construed to make it effective and operative (*CIT v. S. Teja Singh* [1959] 35 ITR 408 (SC);AIR 1959 SC 352).

## DEEMED PUBLIC OFFER

Sub-section (2) of Section 42 deals with a private placement of securities by a company , i.e. offering securities only to a select group of persons who have been identified by the Board, whose number shall not exceed fifty or such higher number as may be prescribed excluding the qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option in terms of provisions of clause (b) of sub-section (1) of Section 62, in a financial year subject to such conditions as may be prescribed.”

Explanation III below subsection (4) of Section 42 reads as follows:

Explanation III.—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, whether the payment for the securities has been received or not or 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 this Chapter.

In this Explanation, the words “makes an offer to allot or invites subscription” contemplate a company offering its securities or inviting offers for subscription for its securities. In the case of allotment of securities to the renounees, there is neither an offer nor an invitation by the company; it is to the shareholders who renounce the offers received by them.

Rule 14(2) of Companies (Prospectus and Allotment of Securities) Rules, 2014 reads as follows:

“(2) For the purpose of sub-section (2) of Section 42, an offer or invitation to subscribe securities under private placement shall not be made to persons more than two hundred in the aggregate in a financial year:

*Provided* that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of Section 62 shall not be considered while calculating the limit of two hundred persons.

*Explanation.*—For the purposes of this sub-rule, it is hereby clarified that the restrictions aforesaid would be reckoned individually for each kind of security that is equity share, preference share or debenture.”

Notably, the right of renunciation forms part of the rights issue provisions and it cannot be separated in the name of interpretation or otherwise. That will amount to rewriting the statute which is not permissible.

## DOES THE RIGHT OF RENUNCIATION IN A RIGHTS OFFER CONSTITUTE A PUBLIC OFFER?

The shareholders, who receive offers for subscribing to the rights shares are also entitled to renounce those shares. Renunciation connotes the surrender to someone else of rights to shares in a rights issue. The person to whom the shares are offered fills in the renunciation form (usually attached to the letter of offer) in favour of the person to whom he wishes to renounce his rights. Persons who are not shareholders of the company are not entitled to subscribe to the rights shares directly otherwise than on renunciation.

When a member to whom any shares are offered by a company in a rights issue renounces them to a person who is not a member of the company, there is not an invitation by the company for subscribing for the shares. If the recipient of a rights offer does not wish to apply for the shares offered to him himself, he can sell the letter and the attendant rights to any other person who becomes entitled to subscribe to the shares offered by the company.

In a Circular issued on 4 November, 57, by the then Department of Company Affairs had clarified that “The issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require the issue or registration of a prospectus.”

Section 56 of the Companies Act, 1956 (‘the 1956 Act’), which corresponds to Section 26 of the 2013 Act, excluded the issue to the existing members or debenture holders of a company of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant for shares or debentures will or will not have the right to renounce in favour of the persons.

## SECTION 67 OF COMPANIES ACT 1956

However, Section 67 of the 1956 Act, entitled “Construction of references to offering shares or debentures to the public, etc.” provided a clue as to what is, and what is not, a ‘public offer’ of shares or debentures, and its subsection (3) provided as follows:

“(3) No offer or invitation shall be treated as made to the public by virtue of sub-section (1) or sub-section (2), as the case may be, if the offer or invitation can properly be regarded, in all the circumstances—

- (a) as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or
- (b) otherwise as being a domestic concern of the persons making and receiving the offer or invitation:

Provided that nothing contained in this sub-section shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more:

Provided further that nothing contained in the first proviso shall apply to the non-banking financial companies or public financial institutions specified in Section 4A of the Companies Act, 1956 (1 of 1956)."

In terms of the first proviso (inserted by the Companies (Amendment) Act, 2000, w.e.f. 13-12-2000), an offer or invitation to subscribe for shares or debentures made to fifty persons or more was to be treated as a public offer/invitation. But it did not unambiguously stated that where the rights shares are offered only to the members of the company with the offer carries the right to renounce the shares by the member receiving the offer to any other person, that would be treated as a public offer/invitation.

In *Palmer's Company Law*, 24<sup>th</sup> edition, p 325, these observations are to be found:

"Where the issue is made to existing holders of shares or debentures, much will depend on whether the letters of allotment which the company issues are renounceable or non-renounceable. In the latter case, it cannot normally be said that the offer is "calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving" the offer, and consequently the offer is not to the public. Where the company issues renounceable letters of allotment, the circle of original allottees can easily be broken by renunciation of those rights and complete strangers may become the allottees; here the offer will normally be held to be made to the public".

In *Gower's Company Law*, 4<sup>th</sup> edition, p 351, it has been observed:

"It is therefore clear that an invitation by or on behalf of a private company to a few of the promoter's friends and relations will not be deemed to be an offer to the public. Nor, generally, will an offer which can only be accepted by the shareholders of a particular company. On the other hand it is equally clear that an offer of securities in a public company even to a handful of people may be an offer to the public if it is calculated (which presumably means 'likely' rather than 'intended') to lean to the securities being subscribed (*i.e.*, applies for on original allotment or purchased *i.e.*, bought after original allotment) by persons other than those receiving the initial offer. In particular, if securities are to be issued under renounceable allotment, letter or letters of right the invitation to take them up must be deemed to be made to the public, since these securities are obviously liable to be subscribed or purchased by others".

The Supreme Court of India, after citing with approval the above two paragraphs of the two great authorities on Company Law, has in the case of *Needle Industries (India) Ltd v Needle Industries Newey (India) Holding Ltd.* (1981) 51 Comp Cas 743, held that the right to renounce the shares by the members of a public company which has

The issue of deemed public issue remains confusing and controversial with regard to renunciation of rights shares issued by a company when the renunciation results in allotment of shares to more than the prescribed number.

become such by virtue of Section 43A would result directly in the infringement of the article relating to the matter specified in Section 3(1)(iii)(b) of the Act, (*i.e.*, the limit on the number of members of a private company), because under clause (c) of section 81(1), the offeree is entitled to split the offer and renounce the shares in favour of as many persons as he chooses, depending partly on the number of shares offered by the company to him. The Supreme Court observed: "The right to renounce the shares in favour of any other person is also bound to result in the infringement of the article relating to the matter specified in Section 3(1)(iii)(c) (*i.e.*, prohibition against an invitation to the public to subscribe for any shares or debentures) because *an offer which gives to the offeree the right to renounce the shares in favour of the non-member is, in truth and substance, an invitation to the public to subscribe for the shares in the company*". (Emphasis supplied).

It is respectfully submitted that the above observations of the Supreme Court seem to be obiter dicta since the court had not made the aforesaid remark after considering all the provisions of the Act regarding public issue versus rights issue inasmuch the question before the Supreme Court was not concerning the distinction between the two but it was concerning applicability of Section 81 to a private company which had become a public under Section 43A of the 1956 Act but which had retained in its articles the conditions constituting a company a private company as contained in Section 3(1)(iii) of the 1956 Act.

The Ministry of Corporate Affairs Letter referred to above had stated as follows:

In a circular issued by the Department of Company Affairs as far back as 1957 (No. 8/81/56-PR) it was stated:

"The issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require the issue or registration of a prospectus".

In one other clarification the Department stated:

"When a special resolution is passed under Section 81(1A), the further shares can be issued either as an offer to public or in any other manner as may be indicated. When the manner of such issue of shares is restricted to a select group (as distinguished from the general public), however

large they may be, it ceases to be an offer to public. The offer containing such an offer cannot be deemed to be a prospectus”.

## THE SAHARA JUDGEMENT

In *Sahara India Real Estate Corporation Ltd. and others v. Securities and Exchange Board of India and another* [2012] 174 Comp Cas 154 (SC), the Supreme Court held that Section 67(3) of the Companies Act, 1956, is an exception to Section 67(1) and (2). If the circumstances mentioned in clauses (a) and (b) of Section 67(3) are satisfied, the offer invitation would not be treated as being made to the public. The first proviso to Section 67(3) indicates, that any offer of securities by a public company to fifty persons or more will be treated as a public issue under the 1956 Act, even if it is of domestic concern or it is proved that the shares or debentures are not available for subscription or purchase by persons other than those receiving the offer or invitation. The facts revealed that the companies had issued securities to the public more than the threshold limit statutorily fixed under the first proviso to Section 67(3) and hence violated the listing provisions which may attract civil and criminal liabilities.

Commenting upon sub-section (3) of s. 67 Jagdish Singh Khehar J. had clearly said:

“Section 67(3) ... provides for an exception to the meaning assigned to the phrase “to the public” (under sub-sections (1) and (2)). In this behalf s. 67(3) delineates two categories of invitations/offers which would not be treated as invitations/offers, “to the public”. *Clause (a) of section 67(3) mandates, that an offer/invitation which forbids a right of renunciation in favour of others would “not” be treated as an invitation or offer “to the public”.*

It is worth noting that the *Sahara* judgment was relating to the provision in Section 67(3)(a) of the 1956 Act. Significantly, there is no identical provision now in the 2013 Act. In fact, the entire Section 67 of the 1956 Act has been done away with and an independent provision dealing with only private placement, i.e. Section 42, enacted. The 2013 Act also failed to make a precise provision declaring that rights issue of shares with the right of renunciation resulting into allotment of the shares to more than fifty (now, two hundred) persons would constitute a public offer/invitation.

## SECTION 26 OF THE COMPANIES ACT 2013

Section 26 contains provisions regarding “Matters to be stated in prospectus” and lays down as to what a prospectus issued by or on behalf of a public company shall state and contain. This obviously emanates from Section 23(1)(a), according to which a public company may *issue securities to public through prospectus* (herein referred to as “public offer”) by complying with the provisions of this Part.

However, Section 26(2)(a) expressly excludes a rights issue and states that “Nothing in sub-section (1) shall apply to the issue to existing members or debenture-holders of a

company, of a prospectus or form of application relating to shares in or debentures of the company, *whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of Section 62 in favour of any other person.*”

## KERALA HIGH COURT DECISIONS

In *Kunnamkulam Paper Mills Ltd v SEBI* [2012] 174 Comp Cas 149 (Ker), SEBI had attacked an unlisted public company’s rights issue on the ground that it was to be treated as a deemed public issue. The company had declared a rights offer of shares to its shareholders with an option to the shareholders to renounce the shares in favour of any other person and allotted equity shares to 163 persons. The Registrar of Companies issued a show-cause notice to the company on the ground that in terms of Section 67 of the 1956 Act, shares could not be privately placed to more than 50 persons without issuing a prospectus for such issue or without complying with the guidelines issued in that respect.

The case was entirely based on the argument that the rights issue with the right of renunciation was amounted to a public issue in terms of Section 67(3)(a) read with the first proviso (noted above) which is evident from the following submissions of SEBI in that case:

“The allegation in that notice was that the offer made by the company is a deemed public issue under the first proviso to Section 67(3) of the Companies Act and since the issue was not made in accordance with Sections 56, 60, 69, 72 and 73 of the Companies Act and the guidelines, and therefore the company is liable to be proceeded with. The petitioner company submitted ... reply to the show-cause notice, mainly contending that they have not made any public issue of shares and the offer is only for right issue to the existing shareholders. After considering the reply, the first respondent issued exhibit P8 order. In exhibit P8 the first respondent found that the offer made by the company for right issue is an offer made by the company to 50 or more persons and therefore the same shall tantamount to a public offer and it is to be regarded as a public issue made by the company in violation of the guidelines. It is further observed that the offer made for right issue of shares need be construed as an offer to the public under Section 67(1) and (2) of the Companies Act, because the action of the company will not fall within the exempted categories of offers specified under Section 67(3) of the Companies Act. It is further stated that by virtue of proviso to Section 67(3) the exemption provisions contained therein will not apply since the offer is made to more than 50 persons.”

A single Judge of the Kerala High Court set aside the SEBI’s order on the ground of jurisdiction in the light of the provisions of Section 55A of the 1956 Act, but did not dwell upon the question whether the first proviso to Section 67(3) was violated by the company.

However, a Division Bench of the High Court reversed the judgment of the single judge [see *Securities and Exchange Board of India v. Kunnamkulam Paper Mills Ltd.* [2013]



178 Comp Cas 371 (Ker)]. The Division Bench's judgment is entirely based on Section 67(3) which is clear from the following observations of the Bench:

"That a public company is entitled to increase the subscribed capital by allotment of further shares unless otherwise provided in the articles of the company is clear from clauses (a) and (b). That the offer so made shall be deemed to include a right exercisable by a person concerned to renounce the shares offered to him or any of them in favour of any other person is clear from clause (c). ... No doubt Section 67(3) clearly indicates that such offer or invitation shall not be applicable under certain circumstances as provided under sub-section (3)(a) and (b). But the first proviso to Section 67(3) of the 1956 Act applies in respect of subscription of shares or debentures made to 50 or more persons even in the case of rights issue when a company exercises its power under Section 81(l)(c) of the Act which gives right to a share-holder to renounce the shares in favour of persons who are not shareholders and when such a right is given to 50 or more persons that also will be deemed to be an offer made to any Section of the public as provided under Section 67(1) and (2). When an offer is made to a section of public necessarily the company will have to comply with the provisions applicable in respect of public issue.

Apart from the fact that there is no provision in the 2013 Act identical to Section 67, the number 50 (increased to 200 by the Rules) finds a place in the Section dealing with *private placement*, i.e. Section 42 and not in the section dealing with rights issue, i.e. Section 62. There was no definition of 'private placement' in the 1956 Act. The 2013 Act now provides a definition in Section 42 and there is no mention of that number in Section 62. By enacting Section 23, the 2013 now makes a watertight distinction between public issue, rights issue and private placement. So, the number 50 mentioned in Section 42 is relevant

only for the purpose of Section 42 and not for the purpose of Section 62. Moreover, neither Section 62, nor Section 23, nor Section 42, nor any other provision of the 2013 Act makes the number 50 applicable in the case of rights issue when members of the company making a rights issue renounce their rights entitlements to others (non-members) resulting into the number of non-member renounees, exceeding 50. In this scenario, anyone having sound knowledge of law and rules of statutory interpretation cannot read such a restriction into Section 62, because it is against the principle of statutory interpretation to insert any words in a statute.

The Division Bench's order is entirely based on the provision in Section 67(3) and its first proviso as noted above. Be that as it may, now there being no provision similar to Section 67(3) and, on the contrary, a distinct provision on private placement, restricting an offer to 200 persons and otherwise requiring compliance with several requirements, and Section 62(1)(c) requiring a special resolution for any private placement issue, any offer as a private placement issue to more than the prescribed number would amount to a public offer.

The definition of 'prospectus' also does not seem to be of any relevance to argue that a rights issue with the right of renunciation would amount to public issue, even if according to that definition a notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate would amount to a prospectus, because in a rights issue the company does not issue any document inviting offers from the public (or renounees); it invites offers from its members only and the members renounce shares offered to them in favour of other persons; this is neither a public offer as defined in Section 23 nor is it a private placement issue as defined in Section 42 and, moreover, Section 62 or any other provision of the 2013

Act does not cover the renunciation of shares offered in a rights issue in a public offer.

The action initiated by the Registrar of Companies and SEBI against some companies having offered further shares on rights basis with the right of renunciation and decisions in *Sahara* and *Kunnamkulam Paper* were all based on the edifice of Section 67(3) of the 1956 Act including its first proviso. That edifice having collapsed, there would be no justification in alleging violation of a statute in such a case inasmuch as the framework of the provisions of the 2013 Act is quite different from that of the 1956 Act, mainly due to omission of Section 67 and enactment Section 42 being independent provisions dealing with on 'private placement' with an exhaustive definition of that expression. Furthermore, as already noted, the definition of 'prospectus' also is of no avail to argue that a rights issue with the right of renunciation would amount to 'public offer' even if the number of allottees due to renunciation exceeds 50 (or 200). In fact, that number has absolutely no relevance in the case of a rights issue; that is relevant only in the case of a private placement issue which, as noted above, has now been separately and exclusively dealt with by Section 42.

### MADRAS HIGH COURT DECISION

Contrary to the Kerala High Court (Division Bench) decision in the *Kunnamkulam case (supra)*, a single judge of the Madras High Court held in *Vikramjit Singh Oberoi v Registrar of Companies* [2020] 223 Comp Cas 199 (Mad), held that the allotment of shares to the renounees of rights shares even though they are not existing shareholders of the company, did not amount public offer. In this case, the company had allotted shares on right basis to its existing shareholders and many of the existing shareholders had renounced their entitlement in favour of others who were not shareholders. On that basis, the Registrar of Companies alleged that Section 67 of the Companies Act, 1956 was attracted because the renunciation was in favour of more than 50 persons. In other words, the case of the Registrar of Companies was that the renunciation converts the rights issue into a public issue and that, therefore, Section 56 of the Companies Act, 1956 should have been adhered to. It was submitted by the company that Section 81 of the Companies Act, 1956 mandates that the company should grant the right of renunciation to all its existing shareholders while issuing the letter of offer to such shareholders; thereafter, such existing shareholders are statutorily entitled to renounce their rights in favour of any person. It was further submitted that the company does not have any control over the aforesaid process and, consequently, cannot insist that such renunciation should be in favour of existing shareholders of the company.

Rejecting the Registrar's allegation, the learned single judge held:

"The alleged offence is in respect of non-compliance of *public issue related requirements*. It is the settled legal position that any public company should make a further issue of shares only to existing shareholders, in the

same proportion, unless a special resolution is passed authorizing the company concerned to issue shares to others. Such issue is referred to as a rights issue. It is also the settled position that when a rights issue is made, the letter of offer is issued to all existing shareholders and it is mandatory that each shareholder is given the right to renounce such shares to any person. The relevant provision, in this regard, is Section 81(1)(a), (b) and (c) of the Companies Act, 1956. Therefore, the company does not have any control in respect of such renunciation, which may be in favour of any person, including third parties. Learned senior counsel also referred to the letter No. 8/81/56-PR dated November 4, 1957 of the Ministry of Company Affairs, in this regard, to the effect that such renunciation does not require the issuance of a prospectus. Consequently, it cannot be said that the rights issue was converted into or metamorphosed into a public issue merely because renunciations were made in favour of more than 50 third parties. Therefore, I have no hesitation in concluding that the company and the petitioners did not commit the alleged offence of violating Sections 56 and 67 of the CA, 1956. Nevertheless, the issuance of multiple show cause notices, in spite of the reply of the company, establishes a reasonable apprehension of prosecution. Consequently, the petitioners are entitled to relief under Section 463(2) of the Companies Act, 2013."

### DOES ALLOTMENT OF UNSUBSCRIBED SHARES IN RIGHTS OFFER CONSTITUTE 'PRIVATE PLACEMENT OFFER'?

As noted earlier, Section 62 permits offering of further shares to persons other than existing members of the company. This is, however, permissible subject to compliance with the conditions laid down in 62(1)(c) and the Rules made under that section. However, Section 62(1)(c) does not deprive a rights issue from its status as such despite the right given to the Board of Directors to dispose of unsubscribed shares in such manner which is not disadvantageous to the shareholders and the company; it also cannot constitute either a public issue or private placement issue, even if the allottees of such shares happen to be outsiders or strangers and are more than two hundred in number.

As in the case of a rights offer with the right of renunciation, so in the case of a rights offer with the right given to the Board in accordance with the provision in Section 62(1)(a)(iii) (to dispose of unsubscribed shares in such manner which is not disadvantageous to the shareholders and the company) also cannot constitute either a public offer or a private placement offer, even if the allottees of such shares happen to be 'outsiders' or 'strangers', not being existing shareholders of the company.

### DIFFERENCE BETWEEN 'OFFER' AND 'ALLOTMENT'

The Regulatory authorities seem to have been making no difference between 'issue', 'offer' and 'allotment' of shares which is one of the reasons for the present

confusion and controversies, whereas the judiciary in India and UK have different view going by the conceptual and statutory framework (which is expected to prevail but is, unfortunately, adhered to).

The authorised capital comes into existence or is said to come into existence or is said to be created on being provided for in the memorandum of association of the company. When the shares are so created, they may remain unissued for a long time. The shares thus created are said to be issued when a resolution authorising the issue, is passed by the Board of Directors or the shareholders of a company, in its Board meeting or general meeting. The issued shares come into existence on being allotted vide a resolution of the Board of Directors or Company. 'Allotment' is the appropriation of a certain number of shares to a person, out of the previously unappropriated shares. Thus, it is on 'allotment' of shares that the shares come into existence. [Farwell L.J. in *Mosely v Koffyfontein Mines Ltd.* (1911) 1 Ch. 73]

"It is plain that the words 'creation', 'issue' and 'allotment' are used with the three different meanings familiar to business people as well as to lawyers. There are three steps with regard to new capital; first it is created; till it is created the capital does not exist at all. When it is created it may remain unissued for years, as indeed it was here; the market did not allow of a favourable opportunity of placing it. When it is issued it may be issued on such terms as appear for the moment expedient. Next comes allotment." [Re *Florence Land and Public Works Co.* (1885) LR 29 Ch. D 421].

The Supreme Court extensively dealt with this subject in the landmark case of *Sree Gopal Jalan v Calcutta Stock Exchange Association Limited* [1963] 33 Comp Cas 862: AIR 1964 SC 250. It was held: 'The term issue of shares is not defined anywhere in the Act. There is a difference between 'creation', 'issue' and 'allotment' of shares. A share in a company comes into existence on the evolution of a process which begins with the creation of a share and ends with its allotment. The intermediary step is that of 'issue' of the shares. The Supreme Court has held that 'creation', 'issue' and 'allotment' are the three stages towards the formation or coming into existence of new share capital. After review of UK case law on the subject, the Supreme Court observed as follows:

"It is beyond doubt from the authorities to which we have earlier referred, and there are many more which could be cited to show the same position, that in Company Law 'allotment' means the appropriation out of the previously unappropriated capital of a company, of a certain number of shares to a person. Till such allotment the shares do not exist as such. It is on allotment in this sense that the shares come into existence. Learned counsel for the appellant has not been able to cite any case where the word 'allotment' has been used to describe a transaction with regard to an existing share, that is, a share previously brought into existence by appropriation to a person out of the authorised capital. In every case the words 'allotment of shares' have been used to indicate the creation of shares

by appropriation out of the unappropriated share capital to a particular person. We find no reason why the word 'allotment' in section 75 [of the Companies Act 1956] should have a different sense."

In *Morgan Stanley v Kartick Das* [1994] 81 Comp Cas 318 (SC); 1994 AIR SCW 2801, the Supreme Court once again reiterated the view taken by it in *Sree Gopal Jalan* case (Supra), that the shares come into existence only on the allotment thereof. Till such time as the allotment takes place, the shares do not come into existence. Creation of share capital without allotment does not bring the shares into existence.

The expression 'issue of shares' has been interpreted by the UK's Supreme Court in *National Westminster Bank plc and another v Inland Revenue Commissioners* [1994] 3 All ER 1 (HL) (by majority decision) as meaning not only the passing of a resolution or making of an offer or receiving applications for subscribing to the shares, but it is something more than that, and it contemplates the process of an application followed by allotment and notification and completed by entry on the register; the term 'issue' in relation to shares means something distinct from allotment and imported that some subsequent act had been done whereby the title of the allottee had become complete. But that was a case in the context of a provision in tax law which sought to grant a relief from tax and provided that an individual who qualified for the relief must subscribe for eligible shares in a qualifying company, and those shares were issued to him after 5 April 1983 and before the end of 1993. In fact, in the above case, in the minority judgment, two judges held that the word 'issue' has been recognised as a mercantile rather than as a technical legal term and it derives its meaning from its context and that 'issue of shares' does not require allotment and registration of the shares in the name of the allottee.

## CONCLUSION

Despite the enactment of Sections 23 and 42 and re-enactment of Section 62, the issue of deemed public issue remains confusing and controversial with regard to renunciation of rights shares issued by a company when the renunciation results in allotment of shares to more than the prescribed number. The regulatory authorities' contention that it does result in a public issue is not backed by a clear and unambiguous statutory provision and there have been conflicting court rulings. This state of affairs put unlisted public companies into a dilemma and quandary. There is no reason why this unhappy state of affairs should be allowed to exist. Probably, a solution lies in making a clear and unambiguous provision in Section 26 stating that "Notwithstanding anything contained in any other provision of this Act, allotment of any securities of a company to more than the prescribed number of persons, whether in a rights issue or otherwise (including renouncement of shares offered in a rights issue) shall be considered an offer or invitation to the public."

