Article

Revamping private placement mechanism

–building it stringent!!

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Introduction

After the Companies Act, 2013 (the "Act, 2013") came into force, considering the practical problems in implementation, there were scope of further clarifications or modifications as the Act, 2013 left major loopholes in its text. Basis this, the Act, 2013 was referred to the Company Law Committee (CLC) for its review and recommendation. CLC recommended the changes in the Act and accordingly, the Companies (Amendment) Bill, 2016 was placed before the lower house. However, the same was further referred to the Standing Committee on Finance for its comments and recommendation. The Companies (Amendment) Act, 2017 (Act, 2017) received the consent of the President on 3rd January, 2018 which was framed on the recommendations of CLC as well as the Standing Committee. The Act, 2017 awaited the appointed dates for making the provisions effective. Section 42 was one of the provisions which had faced a complete revamp and which has finally been made effective w.e.f. 7th August, 2018.

Further, considering the stringency brought in the Section, the Ministry of Corporate Affairs ("MCA") had put up the draft Companies (Prospectus and Allotment of Securities) Rules, 2014 ("PAS Rules") before the public for their comments on 15th February, 2018. Much after it, MCA has now finally come up with the final PAS Rules and has made it effective from 7th August, 2018.

This write up covers a crisp analysis on the changes made in this section. However, for detailed analysis on the topic, please refer to our website www.vinodkothari.com.

Law prior to amendment

Section 42 of the Act, 2013 read with Rule 14 of the Companies (Prospective and Allotment of Securities) Rules, 2014, prescribes the following requirements:

1. Obtaining approval from the shareholders of the Company by way of special resolution to approve the proposed offer;
2. Identifying prospective investors and sending Private Placement Offer Letter in Form PAS-4;
3. Accompanying offer letter by an application form serially numbered and addressed specifically;
4. Barring any offer under private placement unless past allotments under private placement are completed;
5. Subscribing securities only by way of banking channels such as cheque or demand draft and not by cash;
6. Capping the minimum value of such offer or invitation per person with an investment size of atleast Rs. 20,000/- of face value of the securities;
7. Opening a separate bank account in a scheduled bank for parking the amount received on application;
8. Allotting securities within 60 days of receipt of application money and in case the company fails to do so, then repayment of the application money within 15 days from the completion

of the 60th day otherwise the companies are liable to pay interest at the rate of 12 percent p.a. from the expiry of the 60th day.

9. Barring use of any public advertisements, media marketing or distribution channels for identifying prospective investors and instead maintaining a record of offers in PAS-5 having pre-identified investors to whom the offer is to be made;
10. Filing of e-Form PAS-3 i.e. return of allotment with the Registrar containing the details of the security holders with relevant information within 30 days of circulation of Private Placement Offer Letter.

Law post amendment

While the procedural requirements of making private placement of securities is majorly same to that of the provisions of the Act, 2013, as stated above, there are few significant changes into it as brought in by the Act, 2017. The changes are:'

1. **Authority with the Board to identify investors:** While the Act, 2013, did not provide any clarity on the authority in order to identify the prospective investors, the same was implied that the authority lies with the Board as the Board is empowered to approve a proposal of issuance of securities. The same is now specifically stated and may be said to be only a clarificatory change.

2. **No Renunciation rights:** Where the Act, 2013 was silent on the right of renunciation in the hands of the investor, the Act, 2017, explicitly provides a clarity on the fact that the private placement offer letter and the application shall not carry any renunciation rights. Private placement being an issuance of securities to a specific pre-identified person only, this was implied that the offer would not carry the right of renunciation unlike rights shares which are offered to the existing shareholders.

3. **Discontinuation of filing GNL-2:** Under the Act, 2013, the Company was required to file complete information about the offer with the Registrar and with SEBI (if listed) within 30 days of circulation of the offer letter. However, the requirement of the same has been done away with under the Act, 2017. This will surely reduce the compliance burden of the companies. Consequential change in the rules is also expected w.r.t the same in due course.

4. **Subsequent offers at the same time:** In comparison to the Act, 2013, the Act, 2017, commends for more than 1 private placement offer at a time. The same is very pertinent especially in case on non-convertible debentures where the Company is required to make private placement based on negotiated terms and conditions with each investor. In such a case, such amendment is an enabling amendment.

5. **Reduced timeline for filing PAS-3 and separate penalty:** The Act, 2017 provides for filing the return of allotment within 15 days from the date of allotment compared to 30 days of that in Act, 2013, thereby, making it stringent for companies.

6. **Two-fold penalty**: The Act, 2017 provides for dual situations attracting penal provisions:

    a. In case, the Company defaults in filing return, then its promoters and directors shall be liable to a penalty upto Rs. 25 lac for such delay.

    b. In case, the company makes an offer or accepts monies in contravention of the provisions of the section 42, then its promoters and directors shall be liable for a penalty. The law makers have not prescribed any minimum amount of penalty but have kept it open-ended by extending it to the amount raised through the private placement, however, capping it to 2 crores. The said penalty shall be lower of the two as compared to that of Act, 2013, where higher of the two was to be levied. Further, the company shall also be required to refund the money raised to the subscribers with interest within 30 days of penalty imposed.

    Therefore, where on the one side the law has been made liberal w.r.t the penal provisions by imposing lower of the two penalty, however, on the other side, the provisions to refund money to the investors within 30 days have been kept stringent.

7. **No utilization of money received from private placement unless PAS-3 filed:** A very important or significant change which is rather a strange change brought in the Act, 2017, is that the company making the offer or invitation for subscription of securities through private placement is not allowed to utilise the money raised through private placement unless the return of allotment is filed with ROC. This creates an impractical situation for companies whose fund generation is primarily based on private placement of securities considering filing itself is a post facto event.

In a nutshell

The proposed amendments in Section 42 seems to have answered much of the recommendations/ expectations of the stakeholders. However, stalling the utilization of the funds received through private placement in an era where divestment of funds is a mouse-click away, mandatory holding back the funds merely for the sake of filing the form seems to be a retrograde change. Further, mere technical glitches w.r.t filing of forms by way of MCA server turning down etc. may become a hassle for companies.

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