Analytical Speaking

Fallout of Sahara Case?

Companies Bill, 2012 tightens private placement provisions too much

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Companies Bill 2012 tightens Private Placement norms too much

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Companies raise funds for working capital, capital expenditure, and general corporate purposes, by issuing securities. Securities do not necessarily mean shares – it may be bonds, debentures, preference shares, convertibles, and so on. Companies raise such funds by issuing securities either by way of public offers, or by private placements. Public offers are few and far between. This option is available only to listed companies, and given the level of preparation involved, companies cannot afford to go public every now and then. Hence, the most common way of raising capital by companies is private placements, that is, issue of securities other than public or rights offers. All offers of securities by private companies are private placements.

The Sahara case[1] obviously highlighted abuse of this provision to a ridiculous extent – some Rs. 20000 plus crores were raised from a few million investors, calling it a case of private placement. Obviously, the device of private placement was subjected to a massive abuse.

In response, the Companies Bill 2012, passed by the Lok Sabha on 18th December, 2012, and is yet to be passed by the Rajya Sabha, has done massive tightening of the provisions pertaining to private placements. So much so, that the provision may virtually strangulate companies and make it impossible for companies to flexibly raise capital.
What adds to the rigours of the section is that that section is applicable to *all securities* – debt and equity, *and to all companies*, public and private.

'Private Placement' under the Companies Act, 2012

Part II of Chapter III of the Companies Bill 2012 (on notification, Bill to be called Companies Act, 2012) (hereinafter referred to as the "Act") deals exclusively with private placements. The process of private placements has greatly tightened under the Act. Every offer of securities other than pubic, rights or bonus offer amounts to a private placement and shall be governed by the section 42. The Section also requires issue of private placement offer letters for every privately placed offer of securities.

Explanation II (ii) to sub section (2) of section 42 of the Act defines "private placement" as:

> *"Private Placement" means 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.*

In terms of section 42(2) of the Act, a company can make allotment of securities to a maximum of forty-nine persons in a private placement offer *during a financial year*. Whiles counting the maximum limit of allottees, qualified institutional buyers (QIBs) and employees who have been issued securities under ESOP may be excluded.

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[1] The whole text of ruling is available at http://indiankanoon.org/doc/79701153/

Deemed public offers

Section 42(4) of the Act makes it very clear that all offers or invitations which do not comply with the provisions of the Section 42 shall be deemed public offers. The explanation to sub section (2) of the said section also clarifies that any offer to more than forty nine 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, shall be deemed to be a public offer and shall be regulated by the provisions of the Act as prescribed for a public offer. In addition, compliance with applicable provisions SCRA and SEBI will also be required.

It is important to note here that no exception has been provided to any class of companies including the NBFCs. However, the limit of 50 subscribers can be extended as and when so deemed fit by the Central Government. Unless specified, NBFCs and other small private companies will be facing big time as the section covers all companies, whether small or big, private or public.

Bombshell

The provisions on the private placements are applicable to all companies including small and private companies too. The same is evident from the language of Section 23 (2) which specifically burdens the private companies with the compliance of Section 42 in case of private placement offers.

Important to note here that the Act has provided relaxations to 'small companies'[2] from the compliance of strict provisions of the Act at many places, however, no such exemption/relaxation has been provided to even small companies for making allotments through private placements.

Extreme extent of tightening up – obviously thanks to Sahara ruling

The effect of Sahara Ruling is apparent from the extremely stringent provisions of section 42 of the Act prescribed for private placements by ***ALL*** companies. The compliances/ procedure for a privately placed offer is explained below:

- Every private placement is to be made by way of an offer letter *[Section 42 (1)]*

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[2] **Small companies** has been defined in section 2(85) as companies other than public companies having:

a) Paid up share capital of less than Rs 50 lakhs or such amount not exceeding Rs 5 crores; or
b) Turnover as per last profit and loss account does not exceed Rs. 2 crores or such higher amount not exceeding Rs. 20 crores

- The company has to prove that the company had the names of the each of the recipients of the offer and the offer will be addressed by name of such subscribers *[Section 42(7)]*

- Offer can be made only to 49 persons in a financial year *[Section 42(2)]*

    - Unlike the existing Companies Act, 1956 under which the private companies' members are restricted to 50, private companies under the Act can have members up to 200 and under private placement, in a year, a company (including private company) can make allotment to a maximum of 49 people.

- No further offer or invitation of securities can be made by the company unless securities under previous offer have been fully allotted or offer has been withdrawn or abandoned by the company *[Section 42[3)]*

    - This mean if there are unallotted applications out of the past issues, one cannot invite further applications from the subscribers unless the offer has been withdrawn or abandoned by the company.

- One of the rigorous conditions prescribed is that the application money cannot be received in cash. Cheque, DD or banking channels is the only way for issue of securities even under privately placed offers. *[Section 42(5)]*

- All securities under private placement are to be allotted within a period of 60 days from the receipt of application money. If not the securities are not allotted within the specified period, the application money is to be refunded within a period of 15 days from completion of 60 days' time. *[Section 42(6)]*

    - Like public offers, interest penalty has been prescribed if the application money is not refunded within the said period of 15 days. The companies shall be liable to pay an interest @ 12% p.a. from the 16^{th} day along with the application money.

- The entire amount raised by the issue of offer or invitation will need to be parked in a separate bank account and cannot be used until allotted. *[Proviso to section 42(6)]*

- Additional compliances for every private placement offers is that:

    - The particulars of every private offer shall be filed with the Registrar within 30 days of circulation of offer letter. *[Section 42(7)]*

    - The companies offering or inviting subscriptions under private placement cannot advertise or utilize any marketing media. *[Section 42(8)]*

- Return of allotment is required to be filed with the Registrar. *[Section 42(9)]*
    - Important to note that the time for filing such return has not been prescribed. In the existing Companies Act, 1956, time limit for filing return of allotment is 30 days from the date of allotment.

Conclusion

The authority to approve the private placements – whether is to be approved by Board or the members - has not been specified in the section. However, adding to other harsh and rigorous provisions on private placements, section has prescribed severe monetary penalties for promoters and directors of companies making default in compliance with the prescribed provisions. Section 42(10) lays down the penalty as amount involved in the offer or Rs. 2 crores – **whichever is higher** and in addition, the company shall also be liable to refund whole monies to the subscribers so raised under the relevant privately placed offer.

Last year in the month of December, the Ministry issued Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011 (the Rules) and made the preferential allotment rules as applicable *to public companies* more stringent. The private placement provisions as contained in the Act, seems, have been prepared incorporating the provisions of the Rules. The difference between the two is that the Rules are applicable to public companies only and the provisions of the Act on private placement will apply to all companies. The other point of difference is that the Rules require consent of members by way of special resolution for making preferential allotments whereas the Act is silent on such authority approving the private offers. Once the Act comes into force one have to wait and watch that whether the Rules will be repealed or the public companies will be required to comply with both the Act as well as the Rules.

Once the Act comes into effect, it can surely be said that there cannot be another Sahara case and the innocent investors will not be cheated. However, from the point of companies, the provisions are severe and small companies (which are generally family companies) will unnecessarily have to face problems while raising funds through group companies or other family members and relatives.

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