Legal Update

VINOD KOTHARI & COMPANY

Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011

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The existing Unlisted Public Companies (Preferential Allotment) Rules, 2003 ("the 2003 Rules") are applicable to unlisted public companies in respect of preferential issue of equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments, which would be convertible into or exchanged with equity shares at a later date., The potential loop holes in the 2003 Rules were noticed in the Sahara case[1] and which has led to the amendments in the 2003 Rules. Previously, the Ministry had placed draft Unlisted Public Companies (Preferential Allotment) Rules, 2011 (Draft Rules) to replace the Unlisted Public Companies (Preferential Allotment) Rules, 2003 on May 24, 2011 for public comments. However, the said draft rules have not yet finalized and issued. However, with some significant additions, Ministry, vide notification dated 14.12.2011 has introduced Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011[2] ("the 2011 Rules") and thereby has tried to cover the earlier loop-holes.

Provisions under 2003 Rules

Previously, under the 2003 Rules, the definition of "Preferential Allotment" in Rule 3(1) included issue of shares on preferential basis and/or through private placement made by a company in pursuance of a resolution passed under sub-section (1A) of section 81 of the Companies Act, 1956 and issue of shares to the promoters and their relatives either in public issue or otherwise.

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[1] http://www.sebi.gov.in/cmorder/SaharaOrder.pdf

[2] http://www.mca.gov.in/Ministry/notification/pdf/Unlisted_Public_Companies14dec.pdf

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Requirements

1. The Company is to pass a special resolution and such resolution is to be acted upon within 12 months from the date of passing of the resolution.

2. The explanatory statement to the notice calling general meeting required certain disclosures on the pricing of the issue, objects of the offer, impact on promoter shareholding and expected timelines are to be provided

3. A certificate from the statutory auditors or the company secretary in practice, certifying that the issue is being made in accordance with the Rules and is laid out in the shareholders meeting

4. Pricing of warrants for conversion to equity shares is to be decided upfront

Key Highlights of 2011 Rules

Definition of Preferential Allotment:

Preferential Allotment shall mean allotment of shares or any other instrument convertible into shares including hybrid instruments convertible into shares on preferential basis made pursuant to the provisions of sub section(1A) of section 81 of the Companies Act, 1956. Details of the allottees to be mentioned in the special resolution and such allotment cannot be to persons more than 49.

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Passing of Special Resolution

Requirement of special resolution is made specifically applicable to issue of convertible instrument including hybrid instruments convertible into shares.

Additions/Requirements under 2011 Rules

1. The offer for preferential allotment cannot be made to more than 49 persons

2. Any offer or invitation not in compliance with provisions of Section 81(1A) read with section 67(3) of the Companies Act, 1956 (the Act) would be treated as public offer and provisions of the SCRA, 1956 and SEBI Act, 1992 will need to be complied with.

3. The money payable on subscription should be paid only by way of cheque or DD or other banking channels but not by cash

4. Allotment of securities should be completed within 60 days from the receipt of application money. If not so allotted, the company should repay application money within 15 days thereafter, failing which it should be repaid along with an interest @ 12percent p.a.

5. The application money should be kept in a separate bank account and should not be utilized prior to allotment.

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6. Company offering securities can not release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about the offer

Our Analysis

The requirements under 2011 Rules will make the preferential issues more transparent. The 2011 Rules have reinforced strict compliance with provision of section 67(3) of the Act and curbed possibilities of public offering under guise of preferential allotment.

2003 Rules definition included issue of shares to promoter and relatives in public issue, which will not be included post amendment and passing of special resolution under 2003 Rules was required for issue of shares only. The 2011 Rules covers and requires special resolution for issue of convertible instrument including hybrid instruments convertible into shares also.

The Draft Rules proposed following significant changes which are not included in the Amendment Rules:

1. Mandatory detailed disclosures in offer document and requirement to get the offer document approved by members and filing of offer document with Registrar of Companies (RoC)

2. Central Government's approval required in case of issue of convertible instruments of more than cumulative amount of INR 50 Million

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3. Securities to be issued by preferential allotment to be in dematerialised form

4. Time period of private placement in terms of offer period and gap between two offers