

### Rights Issue (Sec. 62) [Part-2]

*Continued from Geeta Saar 26<sup>th</sup> edition*

**7.3 Further renunciation possible:** The prohibition imposed under clause (b) of sub-section of 2 of 81 of Companies Act 1956 second time renunciation is missing under this Act. Hence one may presume that it is not prohibited in this Act. Second time renunciation of rights issue by any person to any other person on any grounds including that the person in whose favour the renunciation was first made has declined to take shares comprised in the renunciation may be allowed.

**7.4 Case laws:** In re Sangramsinh P. Gaekwad & Ors vs Shantadevi P. Gaekwad on 20 January, 2005 the following aspects were observed

“It is now well-settled that only one pre-emptive offer is to be made which is otherwise to be accepted or not at all. The existing shareholders are not entitled to be given further pre-emptive rights in respect of those unaccepted shares. Even such a right can be waived or modified.

It has further to be borne in mind that a pre-emptive right is granted in favour of a member of a private company so that his right of control is not taken away. Exercise of such pre-emptive rights is particularly needed in relation to those private companies which are essentially incorporated partnerships.” (See Gower and Davies’ Principles of Modern Company Law, Seventh Edition, page 635)

It was further observed that an offer of shares by itself creates any interest in the shares in favour of the person to whom the offer is made. An offer of shares undoubtedly creates “fresh rights” as said by this Court in Mathalone v. Bombay Life Assurance Co. Ltd. (1954 SCR 117 : AIR 1953 SC 385 : (1954) 24 Com Cas 1) but, the right which it creates is either to accept the offer or to renounce it; it does not create any interest in the shares in respect of which the offer is made.”

#### **8. Offer letter:**

Under this section, for rights shares, the company is required to send a notice containing a letter of offer, a securities application and renunciation letter(s) to the equity shareholders of the company whose names are appearing as on the date of offer or record date in case of listed company.

## 8.1 Period of offer

The offer should be kept open for a period of minimum of 15 days and maximum of 30 days. The offer letter should be served a minimum of 3 days in advance before opening the issue. In case of unlisted public company the periods mentioned this section are to be strictly observed. For private companies, the periods mentioned can be lesser if members of private company give consent in writing (either physically or electronically).

However, in case of listed company the offer shall be kept open for a minimum of four weeks (Clause 23(e) of listing agreement or Regulations 39 of Listing Regulations 2015 read with regulation 19 of the Securities (Contracts) Regulations Rules 1957. SEBI ICDR Regulations, the rights issue shall be kept open for, subscription for a minimum period of 15 days and for a maximum period of 30 days.

## 8.2. Terms and conditions of offer

Unlike private placement, the Act does not prescribe any format of offer letter for rights issue. PAS-4 is not applicable for rights issue. However, the section directly or indirectly mandates the company to specify in offer (by way of notice) certain particulars like date of offer, number of shares offered, name of the shareholder, opening date, duration of offer and closing date and a statement about right to renounce and manner of renunciation as per its articles, if any. Apart from the offer letter, the company may need to give securities application form, split request form, renunciation form, form of declination, details about the manner of payment. Unlike filing of PAS-4 in form GNL-2 applicable in case of the preferential, there is no requirement to file offer letter of rights with Registrar of Companies. Offer letter with above attachments and particulars can be sent directly to shareholders.

**8.2.1 Listed Companies:** In case of listed companies, as per regulation 3 of SEBI (ICDR) Regulations, 2009, where the aggregate value of specified securities offered through right issue is fifty lakh rupees or more, the rights issue is required to be made in accordance with the SEBI (ICDR) Regulations, 2009. The merchant banker appointed by the company is required to ensure that offer letter prepared for rights issue also contains the particulars mentioned in section 26 and such other particulars as required under SEBI (ICDR) Regulations, 2009.

As per regulation 2(1)(x) of SEBI (ICDR) Regulations, 2009, “offer document” means a red herring prospectus, prospectus or shelf prospectus and information memorandum in terms of section 60A of the Companies Act, 1956 in case of a public issue and letter of offer in case of a rights issue.

## 9. Disposal of unsubscribed portion rights issue - Disadvantageous to the shareholders and Company

After the expiry of the time specified in the notice of offer or on receipt of earlier communication to whom such notice is given that he declines to accept the shares offered, the board can dispose the same in such manner which is not disadvantageous to shareholders and the Company. The disposal may include abandoning or cancellation based on facts of

case. If board is not able to allot unsubscribed portion, it can abandon or cancel the balance offer. It can pave the way to further offer if any other type of issues. However, in case of listed company before proceeding for disposal of unsubscribed portion of rights issue, the company is required to ensure the listing norms like receipt of minimum subscription.

This section empowers the Board to offer the unsubscribed portion of the rights issue to such persons as it may think fit. However while exercising the power conferred the board has to keep in mind that the proposed allotment should not be disadvantageous to the shareholders and the company. This is a major departure from the old Act to new act. Paradigm shift from using positive sense “most beneficial to the company” to negative sense “not disadvantageous to shareholders and company” seem to be very subjective matter. As class action suits are permitted, even small group of shareholders having requisite numbers shares to knock the tribunal’s/ court’s door may raise objection to disposal of shares by the board by claiming that the proposal shall be disadvantage to the shareholders and Company. While disposing of such unsubscribed portion of shares, the board shall need to exercise due and reasonable care, skill, diligence.

**9.1 Disposal is mandatory:** Sub-Section 3 of section 42 of the Act, mandates the companies to close all other offers before proceeding with fresh offer under that section. In other words, if any portion of any issue including right issue is not completed or disposed of, the company can’t proceed with a private placement offer. The disposal either by way of allotment or abandoning or cancellation can be down by way of resolution passed by the board.

**9.2 Department Circulars:** Disposal of unsubscribed portion is not a fresh issue: The department of company affairs in its letter no. 2(27) /56-PR dated 04 October, 1976 clarified that any allotment made whenever someone applies for unsubscribed portion of rights issue, does not amount to increase in the subscribed capital of the company as it is already a portion of issued capital. Accordingly, provisions of section 81(1) of Companies Act 1956 do not attract to such allotment.

**Renunciation to third party does not amount a public issue:** In another letter No.8/81/56-PR dated 04-11-1957 department clarified in case of rights issue, the right to renounce in favour of third parties does not require the issue or registration of prospectus. Though the clarification was given under old Act it seems to be relevant in terms of sub-section 2 of section 26 of Act, wherein it is said that subsection (1) (Content, signing etc., of prospectus) is not applicable to right issue. It seems renunciation to third party does not amount offer of shares to public.

## **10. Time lines for exemption to private company:**

As per exemption notification dated 06-05-2015, the timelines mentioned at sub-section (1) (a)(i) of 62 (15 days to 30 days) sub-section (2)(b) (3 days) can be less than if 90% of members of private company give consent in writing.

**11. The manner of Serving of notice of offer:** As per sub-section 2 of this section, the notice of offer should be sent either registered post or speed post or through electronic mode to

all the existing equity shareholders at least three days in advance before opening of issue. No physical hand-delivery is permitted under this section. The manner of serving is applicable to all companies. There is no exception from the manner of notice to any class of companies. The manner is found place in the state in alignment of circular issued by the department of corporate affairs on 17/8/89-CL-v dated 03-09-1992. The circular was issued to mandate all the listed company to send all letter of offers for rights issue by registered post.

**12. No rights issue allowed during or after buy back:** As per section 68 and rule made thereunder rights issue is not permitted during the currency of buy back offer or within 6 months from date of closure of buy back offer.

**13. Allotment- Rights issue:** Once decided by the board in their meeting about the amount to be raised, proportion, record date or other practical date to draw the list of eligible equity shareholders, the rights issue offer letters along with such attachments as discussed earlier are to be sent to all equity shares of the company. Upon receipt of signed securities application along with payment or declinations, the board needs to allot the shares including unsubscribed portion if any in such manner and file form PAS-3 along with list of allottees and board resolution with the ROC and issue the shares certificates/credit the same into demat account of respective shareholders after payment of stamp duty applicable. In case of listed company comply with SEBI ICDR Regulations, 2009.

#### **14. Rights issue to non-resident shareholders**

As per provisions clause (b) of sub-section (3) of Section 6 read with Section 47 of Foreign Exchange Management Act 1999 together with Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 and master circulars on Foreign Direct Investment (FDI) issued by Reserve Bank of India (RBI) and consolidated master circulars on FDI issued by Department Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India from time to time, the company while making the rights issue to existing non-resident shareholders, should also adhere to, apart from sectoral cap, reporting requirements, the following special conditions:

Regulations 6 of Foreign Exchange Management (Transfer or issue of Security by/to a Person Resident outside India) Regulations, 2000.

#### **Acquisition of right shares :**

- (1) A person resident outside India may purchase equity or preference shares or convertible debentures offered on right basis by an Indian company which satisfies the conditions specified in sub-regulation(2).
- (2) An Indian company which satisfies the following conditions, may offer to a person resident outside India, equity or preference shares or convertible debentures on right basis, namely:

- i) The offer on right basis does not result in increase in the percentage of foreign equity already approved, or permissible under the Foreign Direct Investment Scheme in terms of these Regulations;
  - ii) The existing shares or debentures against which shares or debentures are issued by the company on right basis were acquired and are held by the person resident outside India in accordance with these Regulations;
  - iii) The offer on right basis to the persons resident outside India is at a price which is not lower than that at which the offer is made to resident shareholders.
- (3) The right shares or debentures purchased by the person resident outside India shall be subject to same conditions including restrictions in regard to repatriability as are applicable to the original shares against which right shares or debentures are issued:

Provided that the amount of consideration for purchase of right shares or debentures is paid by way of inward remittance in foreign exchange through normal banking channels or by debit to NRE/FCNR account, when the shares or debentures are issued on repatriation basis:

Provided further that in respect of the shares or debentures issued on non-repatriation basis, the amount of consideration may also be paid by debit to NRO/NRSR/NRNR account.

**14.2 Issue of Right shares to OCBs:** OCBs have been de-recognised as a class of investor with effect from September 16, 2003. Therefore, companies desiring to issue rights share to such erstwhile OCBs will have to take specific prior permission from the Reserve Bank. As such, entitlement of rights share is not automatically available to OCBs. However, bonus shares can be issued to erstwhile OCBs without prior approval of the Reserve Bank, provided that the OCB is not in the adverse list of RBI.

**14.3 Additional allocation of rights share by residents to non-residents:** Existing non-resident shareholders are allowed to apply for issue of additional shares / convertible debentures / preference shares over and above their rights share entitlements. The company can allot the additional rights shares out of unsubscribed portion, subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

*Concluded*

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