

Private Placement (Sec 42)

1. Definition of the term ‘private placement’:

Private placement as defined under Explanation II to sub-section (1) of section 42 of the Act, 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.

The offer or invitation to subscribe securities should be given to selected group of persons and not to public at large. ‘Offer of securities’ is to be made to an identified person or persons while ‘invitation to subscribe securities’ is made to a group which shares some common characteristics but the members are unidentified. Hence, to differentiate between the two on the basis of stages of contract, the former is an ‘offer’ as defined in clause (a) of section 2 of the Indian Contract Act, 1872 while the latter is an ‘invitation to offer’. Due to this important distinction, the select person to whom the ‘offer of securities’ is made, has the choice to accept the offer. In case, he decides to accept the offer in part, it amounts to a counter-offer and the company will have the choice to accept the offer. In the latter case of ‘invitation to subscribe securities to a select group of persons’, the persons will make offer to the company and the company will have the choice to accept the offers made therein. Both offer or invitation falls under private placement. The Company has to comply with section 42.

The private placement offer letter shall be in form PAS-4. As provided in sub-section (1) of section 42, this issue of private placement offer letter without prejudice to the provisions of section 26 which provides for matters to be stated in the prospectus.

2. Issue of ‘securities’:

The word ‘securities’ is defined in clause (81) of the Act as to mean ‘securities’ as defined under clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956. For detailed commentary on the same, refer respective definition clause of section 2. The provisions of this section shall be read together with the provisions of sections 55, 62 and 71 and the rules framed thereunder, as the case may be, depending on the type of security to be issued.

In case of issue of debentures, the provisions of section 71 of the Act are also to be complied with. Further, it should be noted that, for the debentures to fall under the provisions of this section, such debentures need to satisfy the definition of ‘securities’ as provided in clause (81) section 2.

3. Maximum number of persons to whom the offer can be made:

As per sub-section (2) read with rule 14 (2) (b), the company can make such offer or invitation to not more than 200 persons in the aggregate in a financial year. This limit is applicable separately to each kind of security. However, any offer or invitation made to

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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 200 persons.

When the number of persons to whom the offer is made exceeds the prescribed number, it will be treated as an offer to public and all provisions of Part I of Chapter III will be applicable to it.

This restriction on the number of persons to whom invitation can be made will not be applicable to registered NBFCs and housing finance companies provided that such companies comply with the regulations specifically applicable to them as stipulated by RBI or National Housing Bank.

4. Approval of shareholders:

Any company which is planning for issue of securities through Private Placement shall obtain the approval of shareholders by way of a special resolution. The explanatory statement annexed to the notice shall narrate the basis or justification for the price including premium. The company has to obtain the approval for each issue of securities. However, in case of non-convertible debentures, it is sufficient to pass a special resolution for all the issues proposed in a period of next one year.

5. Identification of persons by the board:

The board of directors may identify the persons to whom the offer is to be made either before or after the shareholders' approval. After the shareholders' approval, if the Board has not identified the persons, then it shall do the same. After identification of potential investors, the company shall record the names of the proposed offerees in form PAS-5 and within 30 days of such recording circulate the letter of offer in PAS-4 along with an application which is serially numbered. The letter shall bear the name of the offeree to whom it is addressed. No person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid. Renunciation of shares offered is prohibited.

6. Determination of valuation and price of shares and other convertible securities:

In light of clause (c) of sub-section (1) section 62 read with explanation provided sub-rule (2) of rule 13 of Companies (Share Capital and Debentures) Rules 2014 and sub-rule (2) of rule 14 of Companies (Prospectus and allotment of Securities) Rules 2014, the valuation of share or other convertible securities is mandatorily carried by a registered valuer. Till a registered valuer is appointed in accordance with the provisions of the Act, valuation shall be made by an independent merchant banker who is registered with SEBI or an independent Chartered Accountant in practice having a minimum experience of ten years.

Further, the basis or justification for the price at which the private placement offer or invitation made is required to be disclosed at explanatory statement annexed to the notice for the general meeting seeking the approval from the shareholders for private placement.

In case of non-convertible securities, valuation of securities and basis of justification of price are not applicable (ref. section 62).

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7. Minimum subscription and how to receive it:

The minimum investment from each investor shall be of Rs. 20,000/- of the face value of securities not including premium payable on the securities. This provision, however, will not be applicable to registered NBFCs and Housing Finance Companies provided that such companies comply with the regulations specifically applicable to them as stipulated by Reserve Bank of India or National Housing Bank.

The company shall open a separate Bank Account to deposit the funds received in the Private Placement. The company shall accept the subscription money through cheque or demand draft or other banking channels only and not in cash. The payment should be made for subscription of securities from bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received. Monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application. The company shall use the funds to adjust against the allotment or refund in case not allotting the securities. The funds shall not be used for any other purposes.

8. Bar on private placement:

The Act debars the company to go for another issue of securities through private placement unless the securities are allotted under the earlier issue of securities through private placement is completed or withdrawn or abandoned by the company.

9. No advertisement to be placed:

The company shall not issue any kind of advertisement regarding private placement. It cannot use any marketing channels to promote the issue. The reason is that the company has to identify the specific persons to whom the offer is required to be made.

10. Allotment to be made within 60 days:

A company making an offer or invitation under this section shall allot its securities within 60 days from the date of receipt of the application money. If the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within 15 days from the date of completion of 60 days and if the company fails to repay the application money within 60 days, it shall be liable to repay that money with interest at the rate of 12 per cent per annum from the expiry of the 60th day.

11. Difference between Sec 42 & Sec 62:

Class of securities falling under section 62 must be shares or securities convertible into shares resulting into increase in subscribed capital of the company. On the other hand, all securities fall under section 42. Hence, in a way all preferential allotments are private placements. But, all private placements are not preferential allotments. It is to be noted that if company raises loan with an option to convert such loan into shares with prior approval of members of the company by way of special resolution before raising of such loan, neither section 42 nor section 62(i)(c) shall be applicable. However the Company is required to comply with section 62(3) for raising such loans. The issue of securities falling under the section 62(1)(c) shall also comply with the requirements of section 42.

Note: Companies Amendment Bill, 2016 proposes to substantially amend the provisions of Sec 42.