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Issuance of shares by unlisted public companies – a more complex process?

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When a public company wants to raise capital but does not want to go through a cumbersome public issue route, preferential or private allotment to investors is a quick and economical option. In the case of listed companies, it is imperative to ensure that the interests of public shareholders are protected. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (the Regulations) read with the provisions of the Companies Act, 1956 (the Act) ensure that preferential issuances are made in a fair and proper manner.

An unlisted public company generally does not have public shareholders. In the above circumstances, preferential issues by unlisted companies do not require very strict regulation.

Preferential issuances by unlisted public companies are regulated by the provisions of the Act read with the provisions of the Unlisted Public Companies (Preferential Allotment) Rules, 2003 (the Rules). On December 14th 2011, the Government introduced certain amendments to the Rules in the form of the Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011 (the Amendment Rules).

The move appears to have been triggered in pursuance of private placements by two Sahara Group companies, Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited which through private placements of optionally fully convertible debentures reportedly raised approximately 40,000 crores from approximately 30 million investors.

The Amendment Rules – overview

At the outset, the Amendment Rules merely reiterate certain provisions of the Act which prohibit public offerings under the guise of a preferential allotment. The provisions of the Act make it clear that any issuance of shares by a company, arising from an invitation made to the public to subscribe to shares, would be regarded as an offer made to the public. Where an offer to subscribe is made to more than 49 persons, it is deemed to be one made to the public. Therefore, private and unlisted companies are prohibited from making such offers.

The Amendment Rules appear to borrow the above concept and now expressly prohibit issuances of shares to more than 49 persons. This however has created some issues, which we have discussed hereunder.

Under the present regime of the Act all issuances of shares (whether to the public or otherwise) are governed by the provisions of Section 81(1A) of the Act implying that the Rules would apply to all such non-public issuances. The Rules do not specifically exclude their applicability to issuances like stock options thereby leading to a situation where an unlisted public company can not issue stock options to more then 49 of its employees.

In fact, issuances of stock options, sweat equity, foreign securities and the like are excluded by the Regulations (which apply to listed companies). This has led to a position where certain private issuances by listed companies are simpler than those by unlisted companies.

While the aforesaid could never have been the intent of the Amendment Rules, the Amendment Rules admittedly do not provide for any exceptions.

Other amendments made by the Amendment Rules include providing details of proposed allottees to the shareholders, allotment of securities within 60 days and a separate bank account for deposit of share application money, thereby making private issuances by unlisted companies very cumbersome.

In light of the aforesaid, we can only hope that in the course of dealing with truant unlisted companies, the Government restrains itself from casting unreasonable and cumbersome obligations on those which are otherwise compliant.

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