New Rules for Preferential Allotment/ Private Placement in unlisted public companies\(^1\)

Under Section 81(1A) of the Companies Act, a public company may make a preferential allotment of shares only by passing a special resolution in a general meeting.

On 24 May 2011 the Ministry of Corporate Affairs has issued a new set of draft rules to replace the Unlisted Public Companies ( Preferential Allotment) Rules, 2003. The draft rules which provide for greater compliance and disclosure requirements are open for public comments upto 20 June 2011.

Requirements under Preferential Allotment Rules 2003

Currently an unlisted public company may issue shares or other convertible financial instruments on a preferential basis or through a private placement if it complies with the following rules:

- The Company passes a Special resolution in a General meeting and such resolution is acted upon within 12 months.
- In the Explanatory statement to the notice of the general meeting certain disclosures on the pricing of the issue, objects of the offer, impact on promoter shareholding and expected timelines are to be provided.
- A certificate from the statutory auditors or the company secretary in practice, certifying that the issue is being made in accordance with the Rules, is laid out in the shareholders meeting.
- Pricing of warrants for conversion to equity shares is to be decided upfront.

\(^1\) Unlisted Public Companies ( Preferential Allotment) Rules, 2011
Key changes proposed vide Draft Preferential Allotment Rules 2011

In addition to or in partial modification of the above requirements, the draft rules lay out the following additional compliance requirements:

- **Offer document** – The Company is required to make the mandatory specified disclosures in the offer document. Detailed disclosure requirement with respect to the proposed issue, timelines, project details, financial position etc. have been specified in Annexure I.

  Such document is required to be approved by the members in the General Meeting and copy of the offer document would be filed with the Registrar of Companies (RoC) alongwith the copy of the special resolution approving the issue.

- **Dematerialisation of securities** – All securities issued under preferential allotment or private placement is to be kept in dematerialised form.

- **Time period for private placement** – The issue on a private placement basis is required to close within 30 days of the opening of such issue. Further there should be a minimum gap of 60 days between the closing of one issue and the opening of the subsequent issue.

- **Central Government approval in Private placement** – In case of a private placement of any convertible instruments, the Company would need a prior approval from the Central Government (e-form to be prescribed) where the cumulative amount would exceed INR 50 million. This requirement does not apply to issue of equity shares.

- **Compliance Certificate** – After closing the preferential issue or private placement the Company shall obtain a certificate from a Chartered Accountant or Company secretary or Cost Accountant in practice certifying that the issue was in accordance with the Rules. Such certificate is to be filed with the RoC alongwith the return of allotment.

**Our Comments**

The additional procedural requirements introduced by the draft rules will increase the compliance burden on these companies. With an increasing number of transactions being structured through convertible instruments, the proposal on prior approval from the Central Government for issue of such instruments exceeding INR 50 million can only delay the closure of these transactions.