Private placement of securities – need for caution

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Companies deploy various mechanism for raising funds to meet its business requirements. Fund raising may be done either by way of debt or equity. For raising funds, in the form of equity, a company may go for private placement or public offerings. The mechanism used for raising funds varies depending on the stage at which the company is operating. A start up may raise funds via private placement whereas a mature company may prefer IPO route.

Public issue means raising funds from the public. When a company makes a public issue for the first time, the public issue is called as Initial Public Offer (IPO), when it makes another public issue to raise capital it is called Further Public Offer (FPO).

Private placement of securities in simplistic term is sale of securities to select people rather than, to be available to public in general. This is the most common and preferred way of raising funds by start-up companies, as they can meet their fund requirements without getting into the eye of public and regulators. By adopting the private placement way, they get time to focus on their business and mature before going for IPO.

Raising of funds through private placement requires a company to pass through a high-level scrutiny by investors, which is a daunting task. Though companies are not required to go for higher level of regulatory compliances for private placement they still need to be vigilant about the methodology being adopted for raising funds.

Recent cases of adjudication and imposition of high level of penalties, thereof, in case of Planify Capital Limited[1] (Planify) and Mayasheel Retail India Limited[2] (Mayasheel) by Registrar of Companies (NCT of Delhi & Haryana) (ROC) has again brought to the forefront the importance of being compliant with law and need for good corporate governance.

What is private placement?

Private placement of securities is regulated through Section 42 of the Companies Act 2013 (Act). Section defines private placement as any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in this section.

Section 42 of the Act is applicable to an offer or invitation for subscribing for any securities. Accordingly, this section is applicable to a private placement offer or invitation of every kind of securities, such as shares, debentures, bonds etc. and also to equity and preference shares as well as convertible and non-convertible preference shares and debentures.

As per dictionaries, private placement is defined as sale of shares to a group of investors rather than to public/ financial investors through stock exchange.

1. Order for Penalty under section 42 of the Companies Act, 2013 in the matter of adjudication of Planify Capital Limited (CIN: U65990HR2021PLC093712) passed by Registrar of Companies, NCT of Delhi & Haryana, dated 3 April 2024
2. Order for Penalty under section 42 of the Companies Act, 2013 in the matter of adjudication of Mayasheel Retail India Limited (CIN: U52599DL2018PLC333450) passed by Registrar of Companies, NCT of Delhi & Haryana, dated 3 April 2024

What is a public offer?

Public offer is defined under Section 23 of the Act to include initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

Essentials of a public offer

The features of an offer that can help us distinguish if it is a private or public, is well established by law and the regulators since long.

To understand what is meant by "Public" we may refer to the decision in Nash v. Lynde, (1929) AC 158 at 159, VISCOUNT SUMMER wherein it was inter alia observed "The 'public in the definition (s 285 of the English Act of 1908) is, of course, a general word. No particular numbers are prescribed… The point is that the offer is such as to be open to anyone who brings his money and applies in due form whether the prospectus was addressed to him on behalf of the company or not."

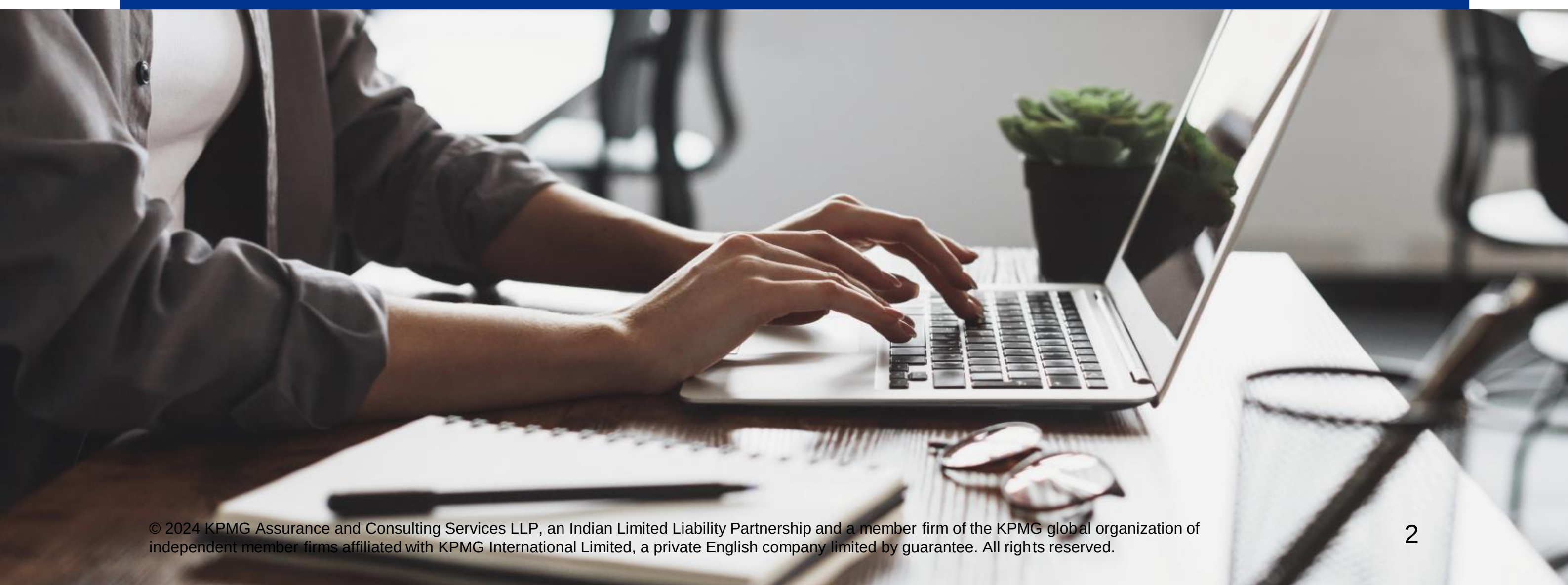
While recommending the insertion of a new section corresponding to section 55 of the English Act (which was subsequently enacted as Section 67 of the 1956 Act), the Company Law Committee (1952) observed as follows:

"One of the methods by which savings are attracted from the public is through "placings" by a broker's or issuing office or investing syndicates. While it will be hard to provide statutorily that every placing must be deemed to be an offer for sale, such placings as are to all intents and purposes "offers to the public" should be brought indisputably within the provisions of the Act… The object of this section is to cover such placings." (Pages 298, 299 of the Company Law Committee's Report)

Further, Ministry of Company affairs issued Department Press Note (Press Note No. 17/6/92-CL-V, dated 06-07-1992) which stated inter alia that "It has come to the notice of Government that some companies utilize the services of brokers and other intermediaries for private placement of equity shares, out of promoters quota or otherwise, insert advertisements in the print media and also mass mail literature / material / brochures subscribed by the caption "Confidential / For private circulation only". It is also noticed that the rights of renunciation are floated in the market by the companies themselves, charging unofficial premia from the investing public. Under Section 67(3) of the 1956 Act, no offer or invitation shall be treated as made to the public, only if the same can be regarded in all circumstances:

a. as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or

b. otherwise as being a domestic concern of the persons making and receiving the offer or invitation.



Adjudication matter of Planify Capital Limited[3]

ROC noticed that Planify has been acting as a fund-raising platform for start-ups and is engaged in selling of shares of unlisted companies to investors through its website. It had also campaigned and raised funds for itself through its platform. Planify sold its shares to Planify Enterprises Private Limited (group company) and then sold the shares using the Planify platform to 76 persons. Planify argued that the transactions, involving buying and selling of securities were actually secondary market transactions. Therefore, it was argued that section 42 cannot be invoked with regard to these transactions as it was not directly issuing the shares to the people at large using the Planify portal.

Section 42(7) of the Act, 2013 prohibits use of a 'distribution channel'. The facts of the case clearly indicated that Planify Platform used by Planify Enterprises Private Limited was a "distribution channel" of Planify.

ROC held that it cannot be denied that the purpose of the selling the shares to Planify Enterprises Private Limited was to only find the potential investors for the Planify. The real intention was to issue the shares to the public at large. Thus, the provisions of section 42(7) of the Companies Act, 2013 stood violated.

ROC levied penalty amounting to INR 7 crore on Planify and its directors under section 42(10) of the Act.

Adjudication matter of Mayasheel Retail India Limited[4]

ROC noticed that Mayasheel has used Planify platform for raising funds by selling its shares. Mayasheel had first issued the shares to Planify, which in turn used its platform for selling the shares to people at large.

Mayasheel argued that Planify had bought these shares through a private placement, and it was Planify which was now selling the shares on its platform. Thus, the transactions, involving buying and selling of securities of Mayasheel on the Planify Portal were actually secondary market transactions. Therefore, Section 42 of the Act cannot be invoked with regard to these transactions.

ROC held that the arguments advanced were at odds with the information available on the public domain. As per news articles Bazar India [the brand under which the Mayasheel operates] had raised INR 25 crore in Series A funding on Planify Capital Platform, which would be used by the subject company for expanding its team, marketing and branding, funding expansion plans and platform advancement, which indicated that the funds were actually being raised by the subject company.

ROC held that in the present case, the private placement of shares of Mayasheel to Planify was solely done to find potential buyers for its securities through the Planify platform, thereby it results into creation of a distribution channel, which is prohibited under section 42(7).

Thus, the selling of shares of the subject company on the Planify platform would not get the protection of section 58(2) as this selling was not a transaction simpliciter between the buyer and the seller of securities as envisaged under section 58(2), rather it emanated out of a private placement which created a distribution channel [a prohibited act] for selling of securities to the public at large on the platform and thus it is violative of section 42(7). On the other hand, the transaction through which Planify directly bought shares from the promoters/directors of Mayasheel for selling the same on its platform, would get the protection of section 58(2).

ROC levied penalty under section 42(10) of the Act of INR 2.89 crore on company and directors of Mayasheel.

3. Order for Penalty under section 42 of the Companies Act, 2013 in the matter of adjudication of Planify Capital Limited (CIN: U65990HR2021PLC093712) passed by Registrar of Companies, NCT of Delhi & Haryana, dated 3 April 2024

4. Order for Penalty under section 42 of the Companies Act, 2013 in the matter of adjudication of Mayasheel Retail India Limited (CIN: U52599DL2018PLC333450) passed by Registrar of Companies, NCT of Delhi & Haryana, dated 3 April 2024

Need to follow good governance

Growing need for good governance and ensuring compliances are core to the existence of an entity. Noncompliance leads to imposition of penalty resulting in loss of market worthiness.

As a start-up or an entity looking to raise funds from private investors compliance with the provisions of Companies Act 2013 is must in letter and spirit, so as to avoid the penalties and ensure worthiness in eyes of investors.

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