
ROC's Vigilance on Private Placement Provisions: Imposing Penalties on Non-compliant Companies



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I. Introduction:

There are multiple ways of raising funds: One amongst those is Private Placement.

Whenever a company acquires finance from a specified group of persons against issuance of securities of the company, this corporate action is called private placement. The conditions and compliances relating to the private placement are discussed in section 42 of the Companies Act, 2013 read with rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

II. Key provisions relating to Private Placement:

Section 42 and the above-referred Rules prescribe that private placement offers for each kind of security shall not be made to more than 200 persons in the aggregate, in one financial year. Also, the procedures like keeping subscription money in separate bank accounts till allotment and utilisation of subscription money only after filing a return of allotment in form PAS-3 are prescribed in section 42 and its Rules.

Section 42(6) states a timeline of 60 days for making allotment after receipt of money. The subsection further states that if allotment of securities is not done within the prescribed time, the money must be returned to the applicant within 15 days from the end of 60 days and if the money is not so returned, then interest must be paid on such money. Further after completion of these 15 days, the application money received will be considered as deposits accepted by the Company,

Since section 42 deals with a very crucial corporate action, the consequences of non-compliance with this section are also serious. Subsections 9 & 10 of section 42 prescribe penalties for non-compliance with any provisions of section 42 and subsection 11 states that private placement issues not made in contravention of section 42(2), i.e., if made to more than 200 persons in the aggregate, in one financial year, it shall be considered as a public issue of securities and SEBI regulations shall become applicable to such issue.

Subsection 10 of section 42 prescribes that, if the company accepts money in contravention of section 42, then the company and its directors shall be liable to a penalty that may extend a maximum of up to RS. 2 Crores and the company is required to refund all the money received against the allotment of securities.

III. Precedents

Companies doing private placement and not complying with all the applicable provisions of private placement have been facing flak from ROC. ROCs have been adjudicating this matter for a while now. Recently, a company had to face harsh consequences due to non-compliance with section 42 was seen in the latest adjudication order passed by ROC Mumbai on 1st May 2023. In this order, ROC imposed a heavy penalty on the company and ordered a refund of allotment money along with interest.

IV. Facts of the case.

As per the ROC order, the facts of the case were as under.

- ◆ **M/S. NV AUTOSPARES PRIVATE LIMITED** ("the Company") had taken money amounting to Rs. 13 Crores (without making any offer / issue of shares and issuance of private placement offer letter in PAS-4) over the span of 2 financial years – FY 2017-18 and FY 2018-19, from a total of four investors to bailout itself from financial distress. At the time of soliciting the money, the Company had promised that it shall allot shares to the investors under the private placement.
- ◆ Since the Company's account was classified as a non-performing asset and it was not allowed to open a separate bank account, the investors paid part of the share application money directly to the Company's banker as a one-time settlement agreement. Thereafter, the company could open a separate bank account and the remaining money was deposited by the investors in that account.
- ◆ The Company showed the said amount as share application money pending allotment in the balance sheets and made payments out of such amount to the regulators and creditors but did not allot shares to the investors against the money.
- ◆ The investors did not get any copies of financial statements or notices of general meetings etc. for 4 years. Therefore, the investors complained to ROC in this behalf.

Company's contentions.

The Company through its written reply and oral submissions argued that,

- ◆ The Company never intended to make a private placement. Therefore, neither did it identify / shortlist persons to make an offer (offerees) nor did it send any offer letter to anyone.
- ◆ Also, the Company presented before the ROC a letter from investors wherein the investor had referred to the said money infused as financial assistance and not as share application money.
- ◆ The Company also alleged that the investors, in consultation with the Company's auditor and company secretary, showed the money as share application money without the notice and consent of the directors of the Company.

ROC's observations.

After considering the documents submitted by both parties, written replies and oral submissions made before the adjudicating officer, the ROC noted that,

- ◆ The Company failed to identify the persons to whom private placement was to be made, also it did not send offer letters and applications in form PAS-4 to prospective investors. The Company has not placed on record, the approval of shareholders for undertaking the private placement of shares.

- ◆ The balance sheet of the Company for the year ended 2018-19 showed the amount of share application money pending allotment as Rs. 10,35,82.407/-, whereas the balance sheet for the year ended 2019-20 showed the amount under the same head as Rs. 13, 92, 19,042/-, which clearly means, the Company has accepted further share application money of Rs. 3,56,36.635/- without completing the earlier offer. No documents have been placed on record by the Company indicating that the earlier offer had been withdrawn or abandoned.
- ◆ From the bank account statement of the Company, it was noticed that the complainants have directly paid the part of money to the bank for clearing the debt of the Company. Thereafter separate bank account was opened, and the remaining money was deposited therein. That means the Company has failed to open separate account in a scheduled bank for keeping the application money.
- ◆ The statutory auditor of the Company had qualified his report for FY 2019-20 saying that company has accepted the share application money but has not made allotment against the same within 60 days from receipt of money also it has not refunded the said money. The directors of the Company had taken note of this qualification in the Board of Directors' report and had replied that the management will decide later about the allotment of shares or refund of money.
- ◆ This shows that Company had accepted share application money in contravention of subsections 2, 3, 5 & 6 of section 42 and had neither made allotment of shares within 60days of receipt of money, nor refunded the money within 15days from the end of 60th day.

Penalty imposed.

Considering the serious violation of section 42 of the Companies Act 2013 on the part of the company, the ROC imposed the following penalty on the company as per section 42(10).

- ◆ Rs. 2 Crores for the financial year 2018-19 and Rs. 2 Crores for the financial year 2019-20 i.e., a total of Rs.4 Crores for two financial years on the Company.
- ◆ Further the Company is also ordered to refund the money to the investors within 30 days from the date of order along with interest of 12%.

Other violations and consequences thereof.

Even though, the said ROC adjudication order talks of violation of section 42 only, there is one more violation on the part of the company in this case. Clause (vii) of the definition of "deposits" provided under rule 2(c) of the Companies (Acceptance of Deposits) Rules, 2014 says that, if allotment of securities is not done within 60 days from receipt of money and the said money is not refunded within 15 days from the end of 60th day, then such money shall become deposit under section 73 and the Company will have to undertake deposit related compliances. Further, these deposits-related sections provide for criminal prosecution in case of non-compliance with these provisions. In the given case, the company has not treated the money as deposits and therefore has not done deposit-related compliances.

Other Similar Adjudication Orders by ROC under Section 42

Name of the Company	Name of ROC	Details of Violation	Penalty on Company	Penalty on Director
Valleymonks Private Limited	Bangalore	<ul style="list-style-type: none"> ◆ Company did not open a separate bank account for receiving allotment money. ◆ Filed MGT-14 after sending the offer letter. ◆ No mention of section 42 in the board and shareholder resolution 	5000000 refund of allotment money	+ 50,00,000each on 2 directors

Burger King India Limited	Mumbai	◆ Company did not keep the allotment money in a separate bank account	2,00,000	1,00,000 each on 3 officers in default
Biocon Biologics Limited	Bangalore	◆ Company filed form PAS-3 with a delay of 100 days	1,00,000	total 6,13,000 on 7 officers in default
Krazybee Services Private Limited	Bangalore	◆ Company utilised allotment money before filing return of allotment in form PAS-3 13,000 total 65000 on 5 officers in default		
Anand Rathi Wealth Limited	Mumbai	◆ Separate bank account was not opened	5,00,000	
Gozing Technology Private Limited	Delhi	◆ Delay in filing of EForm PAS 3 (pursuant to issuance of CCPS)	Rs 1,11,000/-	Rs 1,11,000/- each on 3 directors

Conclusion.

This order highlights the importance of compliance with section 42 and brings to notice the profound consequences of non-compliance. The companies should take into consideration all these factors before undertaking private placement and make sure that all the provisions are complied with.

Considering such exorbitant penalties, it is highly significant that companies be absolutely cautious about these compliances. Companies should ensure the below mandatory (but frequently missed) compliance for undertaking private placement: -

- ◆ Separate bank account be opened for receipt of share application money
- ◆ Keeping a record of persons to whom private placement is made in Form PAS-5 format
- ◆ E-Form MGT-14 for special resolution or board resolution, as the case may be, is filed with ROC before circulating a private placement offer letter (PAS-4) to offerees
- ◆ PAS-3 is filed before utilizing the application money,
- ◆ Contents of explanatory statements to notice convening shareholders meeting (especially details of registered valuer) should be verified and correctly inserted

These are some basic and frequently missed compliances which should be ensured for smooth process of fund raising via private placement and no penalty from Regulators in future.

