

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 9 | Issue 2

2026

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An Analytical Study of Legal Provisions Governing Private Placement under the Companies Act, 2013

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ABSTRACT

This research paper provides a comprehensive legal analysis of private placement under the Companies Act, 2013. It evaluates statutory provisions, procedural requirements, judicial interpretations, and regulatory developments. The study adopts a doctrinal approach while incorporating critical perspectives to assess the effectiveness of the law in balancing capital formation with investor protection. The report also examines practical challenges faced by companies and suggests reforms for improving efficiency. The analysis reflects a structured academic understanding suitable for LLB-level study and emphasizes clarity, legal reasoning, and interpretative depth.

I. INTRODUCTION

A. Background of the Study

Corporate finance in India has undergone many significant reforms over the last decade with the enactment of the Companies Act, 2013³. Some of the key reforms are in the area of regulation of capital-raising mechanisms, including private placements of securities. Private Placement is generally defined as a mechanism by which a business raises funds from third-party sources (as opposed to going through a public offering) for its own use. Private Placement is primarily used by private companies with a select number of shareholders or companies that are not publicly traded.

There were multiple interpretations of private placement, both as applicable to private placements and those open for posted offerings prior to the Companies Act, 2014 being enacted. However, due to significant uncertainty surrounding the interpretation of the statutes, the probability of private placements being interpreted as public offerings remained significant.

⁴Consequently, many companies abused the private placement route to avoid compliance with

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³Companies Act 2013, ss 23, 42.

⁴Ministry of Corporate Affairs, *Report of the Company Law Committee* (2016).

the extensive disclosure and compliance requirements associated with public offerings.

B. Concept and Meaning of Private Placement

A private placement is when a company sells securities to a special group of people instead of the general public. The Companies Act of 2013, Section 42, defines what it means to sell or offer to sell securities in private placements.

Essential Elements of Private Placement

As we can see from these core elements found in Section 42, there are five essential components of private placement that must be present for a transaction to qualify as private placement:

Selective Offer - Securities must be sold only to a small specific group of people.

Pre-Identification - The group of people to whom the securities are being sold must be identified before the offer letter is issued.

Numerical Limitation - There can be no more than 200 people being offered securities in a year (excluding qualified institutional buyers and employees with stock options).

No Public Offering - The offer cannot be made through any type of advertising, including promotional materials, press releases, etc.

The Offer Must Use the Prescribed Form of Offer Letter (Form PAS-4) – The offer must be presented using the private placement offer letter (Form PAS-4).⁵

In addition, the payment for the securities must be made through a financial institution rather than cash.

The final four elements of private placement listed above set forth the rules and procedures for private placements, which distinguish them from public offerings and provide adequate safeguards to keep private placements as a controlled, regulated means of doing business⁶.

C. Legislative Intent Behind Regulating Private Placement

The laws regarding private placements were intended to protect investors and limit any misuse of private placements.

Prevention of disguised public offerings

Over the years, companies have used private placement laws to obtain money from many investors without following norms for public offerings. Cases like Sahara India Real Estate

⁵Companies (Prospectus and Allotment of Securities) Rules 2014.

⁶Ramaiya, *Guide to the Companies Act* (19th edn, LexisNexis 2015) vol 1.

Corporation Ltd. v. SEBI⁷ showed that companies have received money from thousands of investors by presenting their offerings as private placements.

The 2013 Act created the following:

- A strict limit of 200 people
- Obligation to maintain records through Form PAS-5 and file returns through Form PAS-3
- Increased penalties for non-compliance
- Enhancing transparency and accountability

Maintaining the records required by Form PAS-5 and completing the proper forms for returns of allotment (Form PAS-3) as well as routing money through banks helps to ensure that traceability and accountability exist for private placing.

Balancing ease of doing business and protection for investors.

The new requirements make it more difficult to raise money through a private placement but allow for more efficient capital raising without having to follow the lengthy requirements for a public placement. This balance is especially important for small private companies and start-up companies⁸.

D. Scope and Applicability of Private Placement Provisions

The provisions governing private placements under the Companies Act, 2013⁹ are applicable to all types of companies - including private companies, public companies and listed companies - unless otherwise restricted by statutory or securities market regulations. Consequently, the framework is not limited to one specific group of companies but rather serves as a universal mechanism to facilitate capital raising through selective issuance of securities.

Section 42's application in relation to these provisions must be understood together with other provisions of the Companies Act. For example, Section 23 of the Companies Act distinguishes between public offerings and private placements while Section 62(1)(c) governs preferential allotments which can often overlap with private placements. Furthermore, Section 71 becomes relevant when considering the issuance of debentures. In respect of listed companies, the jurisdictional provisions of SEBI will also apply to the issuance of securities creating a dual

⁷*Sahara India Real Estate Corporation Ltd and Ors v Securities and Exchange Board of India and Anr* (2013) 1 SCC 1 (SC).

⁸Umakanth Varottil, 'Regulation of Private Placements in India' (2015) *IndiaCorpLaw Blog* (archived academic commentary based on statutory interpretation).

⁹Companies Act 2013.

compliance hierarchy for companies¹⁰.

There are a number of offers or securities that are excluded from the definition of private placement¹¹. For example, any offer made to a qualified institutional buyer would not be considered a private placement, nor would the issuance of securities pursuant to an employee stock option plan. The layered applicability of these provisions illustrates the complexity of the Companies Act and therefore requires careful compliance and interpretation.¹²

E. Importance of Private Placement in Corporate Financing

Private placement has become an important tool for corporate finance in an environment where speed, flexibility and strategic control are essential. Private placement enables the company to raise capital without going through a public issue, therefore significantly reducing the time and cost associated with regulatory approvals and disclosures.

The key benefits of private placement include its flexibility; companies can structure their private placements based on their specific financing needs (equities or debt -- common debt instruments are debentures, but they may also be structured in different ways). This flexibility makes private placements appealing not only to new and developing firms seeking customized financing alternatives but also to other companies that are able to leverage the benefits of private placement.¹³

Sophisticated types of investors (such as venture capital firms, private equity funds and institutional investors) often invest in these private placements. In addition to providing capital to the company, these sophisticated investors typically add significant value to the company by contributing managerial experience, providing strategic assistance and accessing markets.

Promoters or owners of companies that utilize private placement may also have more control over their company than if they utilized public offerings. Because securities are issued only to a small number of selected investors through private placements, the dilution of ownership of these companies can be carefully monitored and controlled. This is very different from a public offering, whereby all shares are offered to the general public and the potential for altering control relationships exists.¹⁴

F. Research Problem and Rationale

The Companies Act, 2013 provides a structured and supposedly complete framework; however,

¹⁰Companies (Prospectus and Allotment of Securities) Rules 2014.

¹¹SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018.

¹²Avtar Singh, *Company Law* (Eastern Book Company 2018).

¹³Aswath Damodaran, *Applied Corporate Finance* (4th edn, Wiley 2015).

¹⁴Douglas Cumming and Sofia Johan, *Venture Capital and Private Equity Contracting* (Academic Press 2013).

the continued regulation of private placement is subject to numerous legal and practical difficulties. One significant difficulty has been the procedural complexities which were designed to make organisations more accountable or transparent but will probably act as a mechanism for over-regulation, particularly for smaller organisations.

Another issue with interpretation is the ambiguity of statutory interpretation, such as that caused by the interplay between section 42 and section 62(1)(c) of the Act and how it is interpreted when determining whether certain types of preferential allotments need to comply with the private placement provisions and thus creating uncertainty resulting in the inadvertent breach of obligations.

Furthermore, the concurrent oversight from the Ministry of Corporate Affairs and SEBI, particularly in the case of listed companies creates multiple regulatory entities with potential inconsistencies when enforcing adherence to the law. This, combined with the imposition of significant penalties even for minor procedural violations raises issues of proportionality and fairness in regulation.

The above issues collectively demonstrate the need for an in-depth and critical analysis of the legal regime surrounding private placement to identify gaps and reform the existing legislation.

G. Literature Review

The regulation of private placement as a means of capital raising has received noteworthy academic attention in light of its position at the confluence of three important areas: corporate finance; securities regulation; and investor protection. Private placement can be an effective and flexible way to raise capital; however, it also presents a range of potential problems with respect to regulatory arbitrage, transparency and investor exploitation.

This chapter seeks to provide an overview of the existing literature related to private placement under the Companies Act, 2013, which includes academic literature, judicial comments, and policy analysis. The aim of this chapter is to locate the current research within the larger academic discussion of private placement, highlight gaps in the current body of scholarship and establish the need for a critical evaluation of the Indian regulatory framework.

1. Indian Scholarly Perspectives

Indian legal scholars have considered private placements from two different perspectives: (1) as a means of regulatory evolution; and (2) as a mechanism for protecting investors. Many commentators note that before the introduction of the Companies Act, 2013, the lack of any definitive statutory structure created a significant amount of abuse of the private placement

process by companies attempting to avoid onerous disclosure obligations associated with public offerings.

Overall, recent academic commentary analysing Section 42 of the Companies Act, 2013, identifies the section as an important reform to eliminate ambiguities and to preclude improper use of the private placement exemption in order to create disguised public offerings. However, there are significant criticisms surrounding the implementation of overly burdensome and unreasonably rigid procedures as a result of the provisions.

Numerous academics maintain that the extensive compliance criteria required for private placement (i.e., mandatory reporting, numerical limits, specified documentation, etc.) have altered the characteristics of private placements from being an expansive and compliant procedure, to being highly regulated.

Another stream of academic research focuses on the relationship between company law in India and the regulation of securities in India. This has established that there is dual regulation of companies by the Ministry of Corporate Affairs and the SEBI. This dual regulation creates overlapping compliance requirements on companies, causing increased regulatory costs and additional administrative burdens due to two sets of overlapping regulations. This dual regulation has also been cited as a source of uncertainty and inefficiency for companies, especially those that are publicly traded.

2. International Academic Perspectives

Academics internationally have studied private placement from a variety of perspectives and developed a thorough understanding of private placement in countries such as the United States and the United Kingdom. Many academic authors have studied the United States model of private placement and have characterised its "accredited investor" standards as a means of promoting better investor educational opportunities while allowing for greater regulatory flexibility.

The United Kingdom's model of private placement is based on principle rather than strict procedural guidelines. Many academic commentators have noted that this principles-based approach allows for a greater degree of flexibility and innovation within financial markets while simultaneously achieving investor protection in an appropriate manner.

The prevailing perspective in the comparative literature on India has been to find fault with a legal system that emphasizes compliance with laws, which cannot protect investors against the predatory behaviour of others. It is suggested that an alternative dual model of regulation be developed by introducing both rules and principles and utilising hybrid regulatory approaches

to enhance the efficiency of the private placement regulatory regime.

3. Gaps in Existing Literature

When examining available literature regarding private placements, some research gaps remain. The first area is the marginally limited existing critical research on whether or not Section 42 effectively achieves its dual purpose of facilitating the raising of capital and preventing abuse of the private placement provisions. Much of the current literature is descriptive, as opposed to analytical.

The second area of the research gap is limited research dedicated to the practical issues and challenges companies experience with compliance with the regulatory framework. While scholars typically acknowledge that companies face significant challenges as a result of procedural complexity, few empirical or industry-based studies exist that address how these challenges translate into actual transactions.

Finally, little discussion exists regarding proportionality in regulation and the imposition of severe penalties for procedural violations. This point raises key questions about fairness and whether there is equity within the regulatory space.

II. EVOLUTION AND COMPARATIVE ANALYSIS OF PRIVATE PLACEMENT

The history of the current regulatory framework regarding private placement can be told by examining how the law has evolved over time. The initial creation of legislation regarding private placement in India did not have a standardized framework, but was created through a mix of various types of legislation, judicial interpretations, and regulatory rules. As you will see below, the current laws regarding private placements are the result of clarification from earlier ambiguity, misuse of the law, and necessity for a more transparent and accountable system¹⁵.

A. Private Placement under the Companies Act, 1956

The term private placement was created as a concept in the Companies Act, 1956, rather than being defined and codified statutorily. The inadequacy of a statutory definition caused a significant ambiguity in how to determine whether any issuance of securities was either an offer or a sale. As per the legislation's design, it was based upon the legislation's established framework to regulate the public offer through the use of a prospectus. Accordingly, any offer/sale of securities that are not classified as a public offering would be presumed to be private placement based on some inferential basis.

¹⁵ Ministry of Corporate Affairs, *Report of the Company Law Committee* (Government of India 2016).

In this regard, section 67 of the Companies Act, 1956¹⁶ provides for a deeming provision and is the applicable section of the Companies Act 1956 for private placements. Under this provision, if an invitation/offer is made to 50 or more people, it will be deemed to be an offer for public purposes and therefore will be required to comply with the prospectus sections of the Companies Act. However, private placements made to fewer than 50 people would not be able to be treated as an offer for public purposes even though those invitation/offers exceed 50 people in aggregate. This numerical limit on persons who may receive a private placement offer has presented a challenge for both the companies themselves and for the securities industry due to the complexity of capital raising practices that evolve and become more sophisticated with time, thereby resulting in greater numbers of persons to whom private placement offers are made.

In summation, the availability of this regulatory loophole allowed businesses to create products that were in fact publicly available but were actually considered privately placed since in terms of documentation, they were being issued through intermediaries, agents, or via informal networks; thus allowing companies to circumvent the limits of securities issued under section 67 of the Act. The intent of the regulation to allow for the differentiation between public vs private capital raising was defeated by such actions.¹⁷

In addition to these two concerns, the lack of definition relating to the meaning of "offer to the public" in the legislative context left room for interpretation and therefore gave rise to many interpretational disputes, especially in regard to hybrid instruments or large-scale fund mobilization conducted through innovative non-traditional methods (such as via the internet).

Additionally, there was no reference in the regulatory framework that would provide for the protection of potential investors who participated in private placements. Investors did not have access to the same degree of critical financial information regarding the financial strength, risk level, and the company's governance policies as was available to participants in a public offering due to the lack of requirement to disclose this information.

The Companies Act, 1956 regulations were based on conceptual ambiguity, procedural flexibility and a number of regulatory gaps; while these features afforded companies substantial freedom in capital raising, the absence of adequate protections created numerous opportunities for

The lack of any specific safeguards in the form of detailed procedural requirements permitted companies to structure private placements without regard to a company specific standard

¹⁶Companies Act 1956, s 67.

¹⁷Avtar Singh, *Company Law* (Eastern Book Company 2018).

operating procedure. There were no required forms or detailed disclosure expectations associated with a private placement offer and no regulatory oversight to require compliance with those requirements. Consequently, private placements made by companies are likely to have been different and produced inconsistent results¹⁸.

B. Judicial Interpretation and the Role of Courts

In the lack of a proper statutory framework, the courts have played a major role in defining the limits of private placement within India. As a result, in almost all situations, the courts have needed to decide whether an issuance of securities would be a private placement or a public offer and those decisions made an indelible mark on the development of the law.

One important principle developed in the interpretation of the law by the courts has been that the substance of a transaction will prevail over its form. The courts have repeatedly stated that simply calling an offering a private placement is not enough to characterize it as such where, in fact, it is an offering to a large segment of the public.¹⁹

This principle was articulated most clearly in *Sahara India Real Estate Corporation Ltd. v. Securities and Exchange Board of India*²⁰. The companies had issued optionally fully convertible debentures to a extremely large number of investors (millions of investors) and argued that the issuance was a private placement.

The Supreme Court of India rejected the argument of the companies that the issuance had to be treated as a private placement simply because of the way it was structured, because of the size of the fundraising activity that was happening. Section 67 of the Securities and Exchange Board of India (SEBI) Act 1992²¹ – expanded was an offer, or offers, to a number of individuals would be a public issue and thus subject to regulatory oversight under the act.

The court clarified further, that the means of distributing the offer (whether via agents, intermediaries, etc.) is of no relevance for purposes of determining if the offer is for public distribution as long as they offer the security to the public.

The Court's ruling effectively eliminated the ability of companies to segment a large offering into smaller tranches in order to avoid regulatory scrutiny.

The Corporation's impact of the Sahara judgment on the community of professional securities

¹⁸A Ramaiya, *Guide to the Companies Act* (19th edn, LexisNexis 2015) vol 1.

¹⁹Umakanth Varottil, 'The Sahara Case and the Future of Indian Securities Regulation' (2014) 9 *Capital Markets Law Journal* 1.

²⁰*Sahara India Real Estate Corporation Ltd and Ors v Securities and Exchange Board of India and Anr* (2013) 1 SCC 1 (SC).

²¹Securities and Exchange Board of India Act 1992.

practitioners has been substantial. It emphasises that strict adherence to the regulations and standards in the public offering arena is a necessity for all companies, but further exposes the weaknesses and gaps of the current private placement standards and principles.

The Sahara judgment and subsequent cases allowed for the development of the law relating to private placements in general and the interpretation of the phrase “public offering” as well as regulatory oversight issues.

The judicial developments in this area have acted as a stimulus for future statutory reforms, closing the existing gaps created by legislative inaction and creating a framework for the regulation of private placements.

III. STATUTORY FRAMEWORK GOVERNING PRIVATE PLACEMENT UNDER THE COMPANIES ACT, 2013

In this chapter, we will evaluate the evolution and comparative analysis of private placements across jurisdictions; in particular, we will turn to our doctrinal/legislative centerpiece, being an exhaustive examination of the statutory vehicle for private placements, as existed under the Companies Act, 2013²², being primarily contained in Sections 42, 23, and the Companies (Prospectus and Allotment of Securities) Rules 2014²³.

We will determine as we review the statutory scheme of private placement that the legislature has created a heavily regulated method of raising capital and the intent of which is to clearly define and clarify any confusion about the requirements to raise capital under a private placement exemption, and thus mitigate any possibility of misuse of the private placement mechanism.

We will assess and analyze the legal structure of private placements not only from the viewpoint of the statutory words but also regarding how private placements actually operate in the marketplace, the manner in which the statute is interpreted, and whether or not the private placement framework achieves a proper balance between regulatory oversight of the private placement, with a commercial application.

A. Statutory Basis of Private Placement

The private placement of securities has a statutory basis, which is derived from a combination of enabling and regulatory provisions under the Companies Act, 2013. The legal framework for private placement transactions is dictated by the provisions of the Companies Act, 2013, as

²²Companies Act 2013

²³Companies (Prospectus and Allotment of Securities) Rules 2014.

described in Section 23 of that Act, which establishes the types of permissible methods of issuing securities. Section 23 creates the legal framework for private placement transactions by setting out the fundamental basis for differentiating between public offerings and private placements.

The statutory provisions in Section 23 set forth two methods that a public company may use to issue securities. A public company can either make a public offering (which includes an initial public offering, a further public offering or a rights offering) or undertake a private placement. By contrast, a private company may not make a public offering of its securities; rather, it is limited to undertaking a private placement to an eligible person or persons and to making a rights offering. Thus, there is a significant and meaningful distinction between public companies and private companies for the purposes of the Companies Act, 2013, and this distinction reinforces the fundamental corporate law principles regarding private companies operating within a limited ownership structure.²⁴

In this context, Section 42 serves as the substantive source of law governing private placement transactions. Section 42 defines private placements as an offer or invitation to subscribe for securities and describes the factors that may be used to determine whether a particular transaction is a private placement, in order to be compliant with the statutory provisions of the Companies Act, 2013. The important point to note about Section 42 is that it does not simply serve as a definition of what constitutes a private placement; rather, it also provides for complete procedural and compliance mechanisms for private placement transactions, and therefore constitutes a self-contained regulatory provision.

Section 42 encompasses a wide variety of securities, such as common stocks, preferred stock, debt instruments, and hybrid securities. The broad scope of Section 42 means that businesses cannot evade their obligations under this section by changing the kind of instrument they are issuing. Furthermore, the applicability of Section 42 should not be assessed separately from the provisions of other sections, particularly Section 62(1)(c) (the section that establishes the framework for preferential allotments) and Section 71 (the section that establishes the framework for the issuance of debentures).

The relationship between these sections creates a structure of layered regulation whereby many provisions might be applicable to one transaction. As a consequence, the statutory basis of private placement under the 2013 Act demonstrates a deliberate effort to create a single, comprehensive, and enforceable framework of regulation, replacing the fragmented and

²⁴Avtar Singh, *Company Law* (Eastern Book Company 2018).

interpretive system of the previous regime.

B. Essential Conditions for Private Placement under Section 42

Section 42 provides several mandatory elements that determine the legal nature of a private placement. These elements are not simply procedural requirements; they are substantive protections that preserve the private nature of the private placement and prevent its abuse as a disguised public offering²⁵.

1. Offer to Identified Persons

The offer must be extended only to some pre-identified individuals, according to the rules outlined under Section 42. It must be done prior to issuing an offer letter and documenting who has been extended as part of that offer is also required.

From both a legal and a practical standpoint, this requirement plays an important role in the creation of an offer. Legally, it ensures that the offer is not open ended; it cannot be extended indiscriminately. From a practical perspective, the company will have to do due diligence to identify potential investors in advance of a placement being made. This can be a challenge given the change in investor interest over the course of funding events.

The definition of the term "identified persons" can also present challenges with respect to how it should be interpreted. There has been debate over whether the basis for identification of those individuals is based on prior consent, or simply upon a company's selection. Regardless of how "identified persons" is interpreted by a reviewer, one guiding principle is that the offer should be targeted or specific rather than open ended or exploratory.²⁶

2. Limit on Number of Able to be Made an Offer

The limit on the number of offerees for each type of security sold via private placement in the amount of 200 persons in a calendar year is one of the most fundamental aspects of the public and private placement framework. The limit of 200, however, does not apply to offers to qualified institutional buyers and employees receiving such securities as part of their employee stock option plans.

This cap acts as a bright-line test to ascertain whether an offer made thereby is a private placement or a public offer; any offer made to persons in excess of the maximum number of permissible offerees is deemed a public offer, notwithstanding how the offer is structured.

From a compliance standpoint, the requirement to monitor offers made during a financial year

²⁵Ministry of Corporate Affairs, *Report of the Company Law Committee* (Government of India 2016).

²⁶A Ramaiya, *Guide to the Companies Act* (19th edn, LexisNexis 2015).

has created a need for careful documentation of the number of offers made so as to ensure that a company does not inadvertently exceed the limit, as the consequences of breaching the limit can be very serious.

While the numerical cap is indicative of a preference for certainty against uncertainty, the fact that the number of offerees is used to determine whether an offer is a private placement reflects a significant divergence from other jurisdictions, where the determination is based on the sophistication of the investors.

3. Prohibition on Public Advertisement

Subsection 42 prohibits all forms of public advertising, publicity or use of media by any means (including the use of paper, radio, television, and the Internet) to solicit subscriptions, whether traditional or digital, for any security.

This prohibition is a necessary protection against converting a private placement into a public solicitation, and ensures that the offer is only made to a specific and identified group of persons without any dissemination to the general public.

4. Use of Prescribed Offer Letter (PAS-4)

A private placement offer letter must be filed using the prescribed Form PAS-4²⁷, which has standardised the way companies communicate with investors by providing detailed disclosures regarding the issuer, the type of security being issued, the terms of the offering, and any associated risks. Standardising the offer letter enhances transparency and uniformity between investors, allowing all investors to receive identical information.

This will also assist regulators in reviewing the offer documents for compliance. However, since all private placements must use the prescribed format to provide the required information, it is not clear how this standardisation will constrain the flexibility of issuers when creating complex transactions involving sophisticated finance instruments.

5. Mode of Payment and Banking Channel Requirement

Subscription funds must be paid via banking channel (not in cash), and all payments must originate from the subscriber's bank account. This requirement helps ensure proper tracking and audit in order to maximise the culpable possibility for any post-Transaction regulatory investigation.

From a regulatory perspective, satisfying this requirement will prevent money laundering,

²⁷Form PAS-4, Companies (Prospectus and Allotment of Securities) Rules 2014.

benami transactions and the infusion of unknown and unaccounted funds into the investment process. A proper audit trail will also be available for regulators to review in the event of any post-Transaction investigation.

In practical terms, this requirement necessitates strict compliance with banking norms and documentation, particularly in cross-border transactions or where funds are routed through multiple entities.²⁸

IV. ROLE OF SEBI AND REGULATORY OVERLAPS IN PRIVATE PLACEMENT

Now that we have considered the statutory framework within which private placements are regulated by the Companies Act 2013, let's turn our attention to another vital aspect of the regulatory structure, specifically, how the SEBI (Securities and Exchange Board of India) interacts with the Companies Act and the issue of overlapping regulatory authority. Although section 42 provides a comprehensive framework for private placements, it applies to far more than just company law. SEBI regulations apply in addition to the Companies Act for instances where individuals raise funds from the public through listed entities or through entities whose securities are to be listed.

Through this analysis, it becomes apparent that private placement in India is not governed by one comprehensive jurisdiction but rather is defined by a confluence of company and securities law. Therefore, this chapter will discuss the jurisdictional parameters of SEBI, the regulatory structures governing private placements, and the challenges created as a result of overlapping statutes and jurisdictional boundaries.²⁹

A. Statutory Position and Jurisdiction of SEBI

Authority of SEBI comes from SEBI Act 1992 which allows SEBI to regulate the securities market and protect investors' interest. SEBI's jurisdiction covers all aspects of the securities market such as the issue, transfer and trade of securities with regard to listed companies as well as those companies accessing capital markets through equity or debt issuance.

In relation to the private placement aspect, the SEBI regulatory function is relevant for two types of transactions: 1) the transaction where a listed company offers securities through private placement; 2) the transaction by an unlisted company when issuing proposed securities to be listed. Both transactions fall under the scope of securities market regulation and therefore within SEBI's jurisdiction.

²⁸A Ramaiya, *Guide to the Companies Act* (19th edn, LexisNexis 2015).

²⁹Umakanth Varottil, "The Evolution of Corporate Law in India," *Singapore Journal of Legal Studies*.

SEBI's jurisdiction has been defined by case law, especially in matters regarding large scale capital raising by a company. The principle that has emerged is that any offer made to a sufficiently large number of people regardless of whether it is in an offering or any other form, will fall within the regulatory jurisdiction of SEBI. This principle supports the understanding that the substance and effect of a transaction will determine the application of any regulation, as opposed to the form of the transaction.³⁰

B. SEBI (ICDR) Regulations and Private Placement

The Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations (ICDR Regulations) are one of the key pieces of legislation regulating the issuance of securities via a private placement by publicly traded companies.

The issuance of specified securities by means of a preferential allotment will generally take place via the IPO through various provisions set forth within the ICDR Regulations which specifically govern the issuance of securities.

While the concept of preferential allotments will be similar to a private placement as defined under section 42 of the Companies Act 2013, the use of the preferential allotment mechanism will be subject to additional restrictions set forth under relevant sections of the ICDR and by way of the Terms and Conditions of the Requirement about which allotments will be made.

A key requirement within the ICDR framework is that an issuer will determine the price of the issuance of the securities utilizing a pricing formula determined by the prescribed ICDR pricing provisions, which pricing is often based upon the market price on the effective date of issuance and/or over a prescribed time period preceding the effective date of issuance of the preferred securities.

This pricing method is designed to ensure issuers are fairly priced and existing shareholders are not unjustly disadvantaged in connection with the transaction and/or the pricing of the same.

In addition, an important provision of the ICDR is that securities issued in connection with a preferential allotment must be subject to a lock-in period in which the securities cannot be transferred from one owner to another with the aim of preventing immediate resale, so as to prevent any speculative trading of the securities, thereby promoting stability within the marketplace.

The ICDR Regulations also prescribe detailed disclosure requirements, including the identity of allottees, the purpose of the issue, and the effect on shareholding patterns. These disclosures

³⁰A Ramaiya, *Guide to the Companies Act* (19th edn, LexisNexis 2015).

are intended to ensure transparency and enable informed decision-making by investors and regulators.

As we observe, the SEBI framework complements the Companies Act by introducing market-oriented safeguards, particularly in relation to pricing, disclosures, and investor protection.

C. Overlap between Section 42 and SEBI Regulations

The regulation of private placements presents a challenge due to the overlap that exists between the Companies Act, 2013, Section 42 and the Securities and Exchange Board of India ("SEBI") regulatory framework. Both regulatory systems regulate similar types of transactions; however, they each do so from different perspectives and with different priorities.

More specifically, the emphasis in Section 42 is on procedural compliance and the characteristics of the offer itself (e.g., the number of people receiving offers, the means by which such offers are communicated, and the process for allotting securities). The SEBI regulatory framework generally focuses on market integrity, pricing, and investor protection (particularly in relation to listed companies).

There are many instances where a company has to comply with both the Companies Act, and the SEBI regulatory framework, creating a situation in which the company needs to navigate through two sets of parallel, yet different, requirements. For example, suppose that a listed company is making a preferential allotment of shares. In that case, the company has to comply with the Companies Act's requirements, such as PAS forms and the numerical limits on the number of offerees, and with the requirements of the SEBI regulations, such as pricing and lock-in requirements.³¹

Although the requirements between the two regulatory systems often complement each other, on occasion, they are inconsistent or create duplicative compliance burdens. For example, while the Companies Act limits the number of offerees to whom a company can make an offer (Section 42 imposes a specific limit on the number of offerees), SEBI's regulations do not always impose numerical thresholds (e.g. SEBI regulations focus on disclosures and pricing).

V. JUDICIAL INTERPRETATION OF PRIVATE PLACEMENT IN INDIA

The development of private placement in the context of Indian company law has been influenced by both judicial interpretations and by statutory reforms. Although there is now a statutory defined framework for private placement under Section 42 of the Companies Act 2013, it is apparent that the structure, clarity, and compliance core to this framework are based

³¹S. K. Mohanty, *Capital Markets in India* (PHI Learning).

on earlier judicial responses to instances of abuse of the private placement regime under the Companies Act 1956.

The courts, particularly the Supreme Court of India and SEBI in its quasi-judicial role, have consistently ruled against companies trying to evade regulatory oversight of a public offering by calling such an offering a private placement. The evolution of the jurisprudence regarding private placements can thus be considered as having informing three key areas of consideration: (i) establishing a dividing line between private placements and public offerings, (ii) determining the scope of regulatory jurisdiction, and (iii) enforcing compliance through strict interpretation standards.³²

Accordingly, in the following chapters of this text a doctrinally detailed review of significant cases, regulatory orders, and developments in statutory interpretation are used to define and give meaning to the present regime for private placement under Section 42 of the Companies Act 2013³³.

The interpretation of statutory ambiguities has provided a normative effect to create a key principle for effective private placements. These principles include the principles of substance over form, the prioritization of protecting investors, and recognizing the importance of regulatory compliance as a protection from major financial crimes in the marketplace. The evolution of these key principles demonstrates that courts have more than just interpreted the law; they have been instrumental in crafting the regulatory philosophy surrounding the regulation of private placements in India.³⁴

A. Jurisprudential Foundation: Meaning of “Public Offer” vs Private Placement

1. Statutory Background under the Companies Act, 1956

Under the Companies Act, 1956, a private placement did not have a positive definition; rather, a private placement existed through a negative characterization based on the provisions of Section 67. For example, Section 67(1) defined the terms which would qualify as an offer to the public to include both public and non-public offers (i.e., to limit the number of offerees), and Section 67(2) confirmed that offers made to a sub-set of the public were still considered public offers. Section 67(3) provided for a limited exception from being an offer to the public in that if no more than 50 offerees are offered, then these are not considered public offers (i.e., a carve-out).

³²*Sahara India Real Estate Corp. Ltd. v. SEBI*, (2013) 1 SCC 1.

³³Companies Act, 2013, § 42.

³⁴ Ministry of Corporate Affairs, *Companies Act Framework*.

A lack of statutory clarity within the 1956 Act necessitated reliance upon tests developed through court decisions rather than statutes. As such, courts were required to review each transaction on a case-by-case basis. In these reviews, courts considered factors such as the quantity of the offer, the motivation of the issuer to sell to the general public, and the intended audience for the offering. This unfortunate lack of consistency in statutory language and court interpretation of the statute created many inconsistencies in how the statute was interpreted, creating openings for companies to take advantage of grey areas. As such, increased judicial involvement was warranted in addressing these grey areas.³⁵

However, the Section 67(3) exception did not entail any form of procedural standards (i.e., disclosure, identification of offerees, or filing requirements) and resulted in a regulatory structure that was weak. Therefore, companies used the above to issue securities in several tranches to create a debt or equity security offering, with each offering being under the 50-offeree threshold, but when taken together, the number of investors approached several thousands of offerees.³⁶

The absence of aggregation rules for the purposes of determining the number of offerees on a "single offer" basis, and the lack of statutory requirements, allowed companies to engage in this structuring. Thus, there was a legislative scheme that relied on the numerical limitation without any embedded compliance framework, which ultimately required judicial intervention in order to prevent abuse.

2. Judicial Interpretation of “Offer to the Public”

Judicial interpretation of the term “offer to the public” is based upon a broader definition than that provided in the statutory language; it is determined based on functional and economic characteristics of the offer, such that it was decided that an “offer to the public” did not have to be made to the entire public, nor did it need to be made to a finite number of people, for there to be a "public offer", and that even an offer to a sufficiently large number of undefined individuals could fall under public issue regulations.³⁷

The focus was then shifted away from the actual, known subscribers to whom the offer was made and shifted toward the class of persons to whom the offer could be made, and thus established the “potential reach” test. The courts looked to at whether or not the offer was capable of being freely circulated, whether or not it was open-ended, and whether or not there

³⁵Nishith Desai Associates, *Private Placement and Public Offer Distinction in India*.

³⁶A.K. Majumdar & G.K. Kapoor, *Company Law and Practice*.

³⁷*Sahara India Real Estate Corp Ltd v Securities and Exchange Board of India* (2013) 1 SCC 1, paras 96–103.

were restrictions on transferability or participation. It was held that if application forms were disseminated through agents or brokers or informal networks, that this fact would indicate that the offer was not limited to a closed group.

The word “public” did not refer to a mere numerical vacuum, rather, it was defined in the light of the access to the offer, the circulation of the offer, and the fact that there were no exclusivities to the offer. This interpretative expansion of public offered effective elimination of attempts to rely solely on formality or compliance in seeking to substantively achieve a broad investor base.

3. Rejection of Formalistic Classification

Judicial analysis has firmly rejected the use of internal corporate documentation as well as board or other sorts of declarations as evidence of what constitutes a “private placement;” the courts have determined that private placement is determined based upon objective characteristics of the offer, not a subjective intention of, or label assigned to, such an offer, therefore, the lack of having previously identified the offerees was held to be determinative; if a company is unaware of the identities of possible investors prior to its making the offer in question, the transaction in question will not qualify as a private placement; ex ante selectivity was determined to be a key component of the private placement doctrine, meaning that each investor must be specifically selected and approached on an individual basis.

The courts also established that for an offer to qualify as a private placement, there must be no opportunity for the offer to be transferred, disseminated, or otherwise become available to anyone outside of the identified group of investors; any mechanism that allowed the offering to go beyond the closed-loop group of investors, including the use of intermediaries or the issuance of transferable application forms, was determined to constitute a public offering; thus, this approach has established a substantive test based upon control, exclusivity, and traceability, which serves as the basis for future statutory codification under the 2013 Act³⁸.

B. The Sahara Judgment: Doctrinal Transformation

1. Case Reference and Context

The case of Sahara India Real Estate Corporation Ltd v. SEBI³⁹ was heard by the Supreme Court in 2013 relating to the issuance of "Optionally Fully Convertible Debentures" (OFCDs) by two companies belonging to the Sahara Group of Companies. Sahara India and Sahara Housing issued OFCDs to more than 3 crore investors through a network of agents that provided

³⁸Companies Act 2013, s 42.

³⁹*Sahara India Real Estate Corp Ltd v Securities and Exchange Board of India* (2013) 1 SCC 1.

application forms which looked like prospectuses.⁴⁰

However, they had not filed a prospectus with the Securities and Exchange Board of India (SEBI) or complied with the requirements for a public issue. The companies argued they were exempt from filing a prospectus under section 67(3) of the Companies Act 1956⁴¹ because each issuance was made to fewer than 50 individuals in each tranche. The fund-raising by Sahara companies was done on a significant scale and raised major concerns regarding investor protection, regulatory circumvention and systemic risk.

2. Core Legal Issues

There are several key issues for the court to consider: (a) can a private placement be made via course of action of issuing securities to a large number of people in the segments; (b) can the numerical limit or threshold in section 67(3) be applied to each tranche independently or must they be aggregated; (c) whether the jurisdiction of SEBI applies to unlisted public companies which are making issuances of securities without a listing; (d) would the OFCDs be considered as securities subject to compliance with public offering and prospectus norms; (e) and the interpretation of the proviso to section 67(3) in the context of legislative intent and the securities market and protection of investors.

3. Supreme Court's Interpretation of Section 67

The Court found that Section 67(3)'s definition contains a mandatory creation of evidentiary presumption, which means whenever an offer is made to more than the permitted number of persons, it is deemed to be a public offering regardless of whoever made that offer, how that offer is made, or what term is used for that offer; the Court also rejected the argument that offers should be separated and instead applied the concept of combining the offers into one offering based upon the application of the principle of aggregate offers.

It was stated by the Court that the intent of the established minimum number of persons is to prevent large public fundraising without obtaining the necessary governmental regulatory authorization and allowing for the breaking up of the offering into separate segments would destroy the purpose of having an established minimum number. The interpretation transformed the minimum number limit into a material regulatory trigger instead of just a compliance requirement.

The Court did not accept a literal interpretation of the law based on the way laws were formed. Through rejecting this approach, the Court found that companies creating of artificial holders

⁴⁰Securities and Exchange Board of India Act 1992, s 11B.

⁴¹Companies Act 1956, s 67(3).

for the purpose of raising large sums of capital is contrary to the purpose of regulating securities. By ignoring legal titles of the transaction and thinking about the economic impact of the transaction, the Court was able to deny companies from evading their regulatory requirements by following a technically compliant law.⁴²

The ruling also broadened the definition of "offer to the public" by ruling that even if the offer was made privately to the individual, it was public in its nature because of the aggregate number of transactions will create a public transaction. As such, the Court plugged a significant gap used by companies to create many investors for raising funds, but not following statutes regarding the issuance of the securities and/or providing investors with adequate disclosure.

Additionally, this ruling affirmed regulatory agencies' ability to regulate and investigate these types of transactions via SEBI's extensive powers. As a result, this ruling indicated an increase in the level of regulatory intervention for the purpose of protecting investors over companies' rights to do business as they see fit.

4. Doctrine of Substance over Form in Private Placement

The application of the doctrine of "substance over form" is a critical element of the private placement regulation framework by the courts. The doctrine requires that transactions' substance be determined by their actual characteristics and economic consequences, rather than by their formal structure and name.

The use of this principle in a private placement context has been helpful in preventing issuers from concealing public offerings as private transactions. Courts have consistently ruled that simply naming an issuance as a private placement will not make it so; the issuance must meet the requirements of selectivity and limited participation.⁴³

In applying this doctrine to determine the substance of private placements, we can ensure that the regulatory regimes created to provide investors with protection and promote market integrity cannot be undermined through innovative structuring approaches or technical compliance with the law. Furthermore, application of the doctrine is consistent with the overall regulatory philosophy of interpreting securities regulation in a way that emphasises investor protection and market integrity.⁴⁴

5. Test of "Select Group" Reinterpreted

The opinion of the Court defined the term "select group" to include an additional requirement

⁴²Company Law Committee, *Report of the Company Law Committee* (Ministry of Corporate Affairs 2016).

⁴³*Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613.

⁴⁴*Sahara India Real Estate Corp Ltd v Securities and Exchange Board of India* (2013) 1 SCC 1, paras 100–102.

of having a predetermined set of persons to whom the placement will be offered, to whom there will be an opportunity for some controlled communications prior to the offer. It was the Court's opinion that a private placement must utilise a clearly defined investor group that had previously been identified as having an interest in receiving an offer prior to the placement actually being offered to those persons. In support of that opinion, it ruled that sending out application forms to the public by an agent was contrary to the definition of a select group.

For example, strict compliance with procedural requirements by the courts has resulted in the unintentional consequence of treating even the smallest of procedural errors as violations warranting penal sanctions, thereby contributing to the compliance-heavy character of this framework - the intention of the legislature was to eliminate potential misuse but this has raised questions on whether to apply principles of proportionality to distinguish between substantive and technical violations.⁴⁵

Judicial interpretation of the private placement provisions is therefore characterized by a continuing tension between the enforcement of regulatory discipline and the recognition of practical considerations of business.

6. SEBI Jurisdiction Affirmed

When it ruled in favour of SEBI's jurisdiction over public offerings, the court determined that any sale of shares to the public is subject to regulatory oversight by SEBI (even if the company does not have securities listed on a stock exchange). The terms of the SEBI Act of 1992⁴⁶ were examined in tandem with the Companies Act, and the court concluded that SEBI has regulatory jurisdiction over companies (both listed and unlisted) with respect to investor protection and overall market regulation.

The court rejected the Ministry of Corporate Affairs' exclusive authority over the regulation of unlisted companies and stated that functional overlap among regulatory agencies is permissible where the protection of investors is at stake. Therefore, it holds that the nature of the offer and whether or not the company that has made the offer has listed its securities are not determinative of SEBI's regulatory jurisdiction.⁴⁷

7. Consequences Imposed

Placing Sahara companies' obligation to refund their investors with interest (approximately ₹24,000 crores) squarely on SEBI's shoulder. SEBI had to oversee and manage the entire refund

⁴⁵Company Law Committee, *Report of the Company Law Committee* (Ministry of Corporate Affairs 2019).

⁴⁶Securities and Exchange Board of India Act 1992.

⁴⁷*N Narayanan v Securities and Exchange Board of India* (2013) 12 SCC 152.

process (including identifying and verifying investors) when Sahara failed to adhere to this obligation, additional enforcement action was taken against Sahara companies, including seizure of property and detention of key executives.

The scope and severity of the remedy demonstrate the Court's firm commitment to restoring equity and deterring future violations of securities laws involving public funds being considered public; therefore, all such violations will be enforced with the highest level of consequence and assurance.

8. Doctrinal Impact on 2013 Act

The judgment in Sahara had a direct influence on the drafting of Section 42 of the Companies Act, 2013. Many of the principles developed by the courts were incorporated into statutory law. The original numerical cap for investors has been increased from fifty to two hundred but it is accompanied with very strict rules on how to combine (aggregate) the numbers, and a number of mandatory procedures that include the issuance of PAS-4, maintaining PAS-5, and filing PAS-3 to ensure traceability and accountability.⁴⁸

Prohibiting advertising to the public and requiring that payment from an investor be made through banking channels is consistent with the court's desire to provide a means for controlled communication and transparency to the public. In addition to the shift from an interpretative system of the 1956 Act to a compliance influenced codified system (under 2013 Act), the use of Sahara as precedent is more than that; it is an obligational doctrinal basis for current private placement laws in India.

VI. CRITICAL ANALYSIS OF THE PRIVATE PLACEMENT FRAMEWORK

The implementation of the codified framework for private placement pursuant to Section 42 of the Companies Act, 2013, represented a significant departure from the ambiguity and regulatory voids that permeated the previous system established under the Companies Act, 1956. The intent of the legislature was unambiguous: to prevent the misuse of the process of private placement to avoid public offerings while giving companies an effective means of raising capital through a regulated, transparent process.

Although the framework creates clarity and enhances regulatory oversight, many limitations exist in terms of how it operates. The rigorous focus on procedural adherence, coupled with multiple overlapping regulatory authorities and severe sanctions, raises questions regarding the

⁴⁸Companies (Prospectus and Allotment of Securities) Rules 2014, r 14.

overall effectiveness and proportionality of the regime as a whole.⁴⁹

This chapter provides a critical analysis of the private placement framework through an examination of its fundamental failings, including but not limited to excessive regulation, rigidity in the procedures required for compliance, disproportionate penalties, difficulty in practically complying with the requirements and overlapping regulatory institutions. Additionally, the chapter will evaluate whether the current regime strikes a reasonable balance between investor protection and the ease of conducting business, and assess the need for a more flexible/adaptable regulatory system.

A. Over-Regulation and Procedural Rigidity

One of the main criticisms of the Section 42 private placement framework is that it contains an unusually high degree of procedural requirements. The Indian framework differs from typical private placement notions in that it has a very rigid, formal compliance approach and lacks the traditional flexibility, speed and confidentiality associated with private placements.

Under the requirements of Section 42, issuers must obtain several levels of approval (board of directors and shareholders by special resolution) prior to issuing a prescribed form of offer letter (Form PAS-4), keeping detailed records (Form PAS-5) and filing returns of allotment (Form PAS-3) within specific time frames. Each one of these steps has been assigned statutory requirements and there is no room for variation or change (deviation).

Although the intent behind the procedural requirements is to promote transparency and accountability through regulation, they have, in effect, turned private placements into a process that bears a strong resemblance to a publicly registered (regulated) offering as a result of the compliance burden imposed on them. The fact that private placement has been designed conceptually as an alternative to the public raising of funds makes the comparison particularly troubling.⁵⁰

On a practical basis, these procedural requirements impose serious operational difficulties on companies attempting to comply with these rules, as they must adhere to the stringent timelines and document requirements, otherwise they will incur significant penalties.

In addition, the requirement for uniform compliance across all companies has disadvantages because there are many different kinds of businesses. The impact of complying falls most heavily on small and medium businesses and startups that use private placements to fund their

⁴⁹Avtar Singh, *Company Law* (17th edn, Eastern Book Company 2018).

⁵⁰Eilis Ferran, *Principles of Corporate Finance Law* (2nd edn, OUP 2018).

operations. Consequently, the emphasis is on compliance rather than efficiency.⁵¹

B. Disproportionate Penalties and Absence of Distinction between Violations

Another concern is that the current penalty structure is unnecessarily harsh and lacks the ability to impose a penalty based on the nature of the offence. Section 42, which treats all violations as strict liability and does not differentiate based on the nature of the violation or the severity of the impact of the violation.

One crucial element of this strict liability approach is that there is no clear distinction between a substantive violation (e.g., offering to the public by way of private placement) and a procedural/technical violation (e.g., failure to file an application in a timely manner or typographical errors).

A substantive violation has the potential to compromise the goal of the regulations and should be subject to severe penalties. A procedural violation will not necessarily cause harm to an investor or result in the circumvention of the rules.

The legal system, despite having separate categories for different violations, treats each category much the same. For example, if a company delays paying its Form PAS-3, it can face penalties just like other companies that do not file their forms on time (even if the company has completed the underlying transaction) and, in some extreme cases, the company may find itself facing additional regulatory obligations because the non-compliance may have caused the private placement to be reclassified as a public offering.

This failure of proportionality leads to questions about the fairness of the law and its ability to achieve its regulatory objectives. A system that imposes significantly higher penalties for minor procedural violations can deter companies from using the private placement system at all. Moreover, it causes regulators to focus on technical compliance rather than substantive misconduct.

From a policy standpoint, more nuance is needed in assessing violations, they should not just be classified into two categories: intentional and inadvertent. There must be specific penalties given to each violation to ensure that the overarching purpose of the regulatory system is met, which is to protect.⁵²

C. Change & Incompatibility with Real-World Business Practices

The success of any legal system, whether based on sound theory or not, depends upon how it

⁵¹Gower and Davies, *Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016).

⁵²Douglas Cumming, *Venture Capital and Private Equity Contracting* (Academic Press 2012).

operates in practice. Several sections of Section 42 do not seem to be appropriate or consistent with the current state of the business world.

Pre-identifying the investors is one example. The law requires potential investors to be identified prior to issuing the offer letter. In today's fundraising environment – and particularly in the start-up ecosystem where the investment decision-making process tends to be continuously negotiated, due diligence will change, and investor interest will evolve – the rigidity of the pre-identifying requirement fails to accommodate these dynamic and iterative processes.

The 200-person limit also imposes practical difficulties as a result of having a defined numerical limit with respect to the total number of offerees; however, these types of obstacles arise most frequently within complex funding situations. Companies with multiple rounds of financing, multiple classes of securities and operating through various group structures may encounter challenges in accurately tracking and calculating their total number of offerees. Accordingly, the failure to calculate the number of offerees correctly could result in a company being subject to unintended regulatory violations.

Another area of concern is the prohibition against public solicitation. In an era where business communications are commonly conducted over online platforms and professional networks, it becomes increasingly difficult to determine whether the means of communication are private in nature as opposed to being publicly solicited. The lack of clarity associated with these issues introduces uncertainty into the regulatory compliance process.

While the law intends to provide discipline and control, it often does so at the expense of flexibility and commercial viability.

D. Regulatory Overlap and the Burden of Dual Compliance

Due to the existence of several regulatory authorities regulating private placement in India (for example both the Ministry of Corporate Affairs and the Securities and Exchange Board of India) there are overlapping jurisdictions between the two regulators, including where companies have listed their securities/deal on securities exchanges (that is listed companies), or where companies are proposing to offer their securities for listing on a recognised stock exchange. As a result there is effectively a dual compliance framework because companies must comply with both companies' act and SEBI regulations.

The Companies Act encompasses the procedural aspect of the offering (for example by way of the documentation, approvals and numerical limits); whereas SEBI regulations represent the market related aspects of the offering (for example price, disclosure and investor protection).

While there is a certain degree of inherent compatibility between these two regulatory regimes, their concurrent application creates practical difficulties for companies that are required to comply with more than one set of requirements - often at least in relation to a particular disclosure in relation to an offering, in such companies must typically make similar disclosures but in different formats (for example same price, same investor protection) - imposing an additional compliance burden; increasing costs of compliance; and increasing the potential for inconsistent compliance with each of the regimes.

A further issue relating to dual compliance arises from the lack of sufficiently defined boundaries between the Companies Act and SEBI regulation resulting in legal uncertainty. Companies may have difficulty determining their obligations with respect to each existing statutory regime, particularly the situation where there is significant overlap and/or conflict between the provisions of the Companies Act and those of SEBI; companies may have difficulty determining the extent to which they must comply with each existing statutory regime when either or both of the statutory regimes appear to conflict or overlap.

Courts have resolved this issue with the principle of harmonious construction requiring companies to comply cumulatively with the respective statutory framework in respect of offerings.⁵³

E. Need for Reform: Towards a Balanced and Adaptive Framework

The analysis of the existing framework reveals a fundamental tension between regulatory control and commercial flexibility. The current system is effective in preventing abuse and ensuring transparency, but it does so at a cost to efficiency and ease of doing business.

The reformed system must try to strike a more reasonable balance between the prevention of abuse and ensuring transparency, while also allowing for efficient and easy business.

There are a number of ways in which this can be accomplished:

First, the regulation must be proportional in terms of how penalties are applied. For example, differentiating between substantive violations and procedural violations will make enforcement mechanisms fairer and more targeted.

Second, it is important to simplify procedures. For example, reducing the number of mandatory filings, rationalising timeframes and creating a uniform format for disclosure will greatly reduce the burden associated with compliance, while still achieving the overall objectives of the regulations.

⁵³Josh Lerner and Antoinette Schoar, 'The Illiquidity Puzzle' (2004) *Journal of Finance*.

Third, it could be useful to incorporate components of investor-based regulatory models, similar to the concept of accredited investors in other countries. For example, regulation based on the sophistication and capacity of investors to take on risks would provide more differentiated regulation to the different levels of sophistication.

Fourth, there needs to be greater coordination among various regulatory authorities to avoid duplication and ensure consistency. For example, working toward a development of a system for integrated compliance and developing collaboration regarding the creation of joint regulatory guidelines will improve both efficiency and clarity.

Finally, moving gradually from a rules-based system to a principles-based system—focusing on transparency, fairness and other outcomes, rather than on rigid procedural requirements—will give regulatory authorities the flexibility to adapt the regulations to meet the changing practices in the marketplace.⁵⁴

In closing, the private placement regime under the Companies Act, 2013 has improved corporate fundraising regulation in India by eliminating deficiencies in both the previous legal system and the lack of adequate investor protection though it has created new concerns related to enforcement.

The main problem for most issuers is that they may find themselves facing additional regulatory burdens, including time delays, expenses, and confusion, due to the increased regulatory scrutiny engendered by the new law coupled with more severe penalties for those who fail to comply with the new rules, requiring them to operate within an overly rigid framework that does not reflect market realities as they relate to the nature and availability of financing options.

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To be able to provide the continued support that is needed for private placements as a viable method of raising capital, a more balanced and flexible regulatory framework should be developed to meet the principal goals of transparency and investor protection while providing companies with efficient operation opportunities in an increasingly rapidly changing financial marketplace.

⁵⁴John Armour, Henry Hansmann and Reinier Kraakman, 'What is Corporate Law?' (2009) *Harvard Law School Discussion Paper*.

⁵⁵Reinier Kraakman et al, *The Anatomy of Corporate Law* (OUP 2017).

VII. CONCLUSION

The goal of this research project was to explore the regulatory framework that governs private placement transactions under the Companies Act 2013. Specifically, this study focused on the operation of section 42 of the Act and how it relates to other sections and the regulatory framework under the Indian Companies Law.

However, the focus of our study was not only to describe an overview of the law, but to critically analyse the development of case law and interpretive case law surrounding this area of law and its operation in practice, as well as its interaction with other areas of corporate and securities law.

Since this study began, we have seen a shift away from less regulated private placements as an exception under previous company law, to a highly regulated and compliance-driven private placement mechanism under the Act.⁵⁶ This shift is indicative of an active and concerted effort on the part of regulators and lawmakers to both address the past abuse of private placements and enhance protection for consumers and improve market integrity.

A. Summary of Findings

An underlying finding from this research was that all private placements must be conducted from a legal framework that requires accountability and transparency. Section 42 embodies this principle as it provides for detailed procedural requirements to safeguard against private placements being used as smoke screens to carry out illegal transactions.

Simultaneously, the study establishes that the efficiency of the framework is not solely a function of statutory law but is influenced as well by the judiciary's interpretation of the law and regulatory enforcement. Court decisions, especially those that have clarified the line between a public offering and a private placement, have helped delineate that line; as a result, the courts have provided necessary context for the creation of related statutes. Further, the enforcement of the statutes by a regulatory body (i.e., SEBI) has reinforced the principle of substance over form, ensuring that transactions' validities would not be jeopardised through creatively-structured transactions.⁵⁷

Another critical finding relates to a strict culture of compliance; therefore, compliance with procedures must be completed prior to the transaction's validity. This further adds to regulatory discipline but at the same time introduces a lack of flexibility and rigidity that historically has

⁵⁶OECD, *Corporate Governance of Listed Companies in India* (OECD Publishing 2019)

⁵⁷Umakanth Varottil, 'Regulating Private Placements in India' (2016) 28 *National Law School of India Review* 45

been and continues to be associated with private placements.⁵⁸

The observation is that there is increased regulatory convergence, as both the Company's Act and Securities Regulation apply to private placements. Therefore, this demonstrates the evolving nature of the capital markets and presents challenges in terms of compliance and coherence.

B. Doctrinal Position: Nature and Purpose of Private Placement

As a result of the above analysis, private placements can no longer be considered merely an exception to the public issue rules, but have become an alternate and independently regulated method of raising capital and as such, should be governed in accordance with their own principles of compliance.

The three fundamental components of private placements have been reinforced through statutory and judicial interpretations: selective nature of investors, controlled nature of communications and procedural traceability. Each component helps ensure that private placements are distinguished from public offerings while also ensuring a basic level of investor protection. However, there exists a conflict between the freedom to contract and the restrictions placed upon them by regulation.⁵⁹

The private placement process is based upon negotiated transactions between parties, but the mandatory requirements of the regulatory system have a limiting effect on this freedom. This conflict is central to the current regulatory system and is a significant factor in both its strengths and weaknesses.

C. Critical Reflections on the Existing Framework

The analysis performed throughout this dissertation has illustrated that while the current regulatory framework provides adequate protection against historical abuses, it has a number of major deficiencies. The most prominent issue is the excessive concentration on procedural compliance in a manner that does not take into consideration factors such as investor sophistication or transaction-specific risks associated with the transaction.

Further, the rigidity of the numerical thresholds and timelines established by law provide certainty; however they do not always reflect the realities of the current capital market. Finally, the lack of proportionality in the enforcement of non-compliance creates an element of significant risk of disproportionate effects especially in the case of minor technical non-

⁵⁸*Securities and Exchange Board of India v Shriram Mutual Fund* (2006) 5 SCC 361

⁵⁹Luca Enriques and Sergio Gilotta, 'Disclosure and Financial Market Regulation' (2015) ECGI Working Paper

compliance.

While numerical limits and strict deadlines improve clarity, they do not necessarily correlate with the reality of today's world of capital markets. There is also a risk of unintentional harm caused by enforcement of rules without proportionality, particularly as it relates to technically non-compliant behaviour.⁶⁰

A related issue is the level of regulatory overlap leading to the compliance complexity for corporations and to the lack of clarity that results. The deficiencies in the harmony of the regulatory regimes lead to a decreased efficiency of the overall system; therefore, there is a need for more collaboration among the various regulatory bodies. While those limitations indicate that the framework is solid in concept, there is a need for refocusing and adjusting it so it continues to be effective in a dynamic economic climate.⁶¹

D. The Way Forward: Towards a Balanced Regulatory Model

The future of private placement regulation depends on creating a more equitable combination of investor protection and regulatory flexibility. Achieving such an arrangement will require a movement away from a completely rules-based system to an arrangement that has both risk-based and principle-based regulations.⁶²

This type of arrangement would differentiate between the various transactions and investors, and thereby permit the law to provide appropriate levels of regulation in their respective contexts. This includes providing a mechanism by which the evolving methods of financing can be integrated into the law, allowing for the law to be relevant and responsive to those changes.⁶³

E. Final conclusion

The private placement mechanism established by Companies Act of 2013 functions as legislative balancing regulation between providing capital formation opportunities and protecting investor interests. The legislative course of development and judicial findings by way of precedent in this area of law have led to a regulatory framework that is expected to be much stronger than prior regulations.⁶⁴

For a private placement framework to serve its intended purpose, it must adapt to the changing nature of market conditions within the constraints of core principles. Going forward, the challenge will not be in trying to destroy the current framework; rather, the focus should be on

⁶⁰Julia Black, 'Forms and Paradoxes of Principles-Based Regulation' (2008) LSE Law Working Paper

⁶¹Christine Parker, *The Open Corporation* (Cambridge University Press 2002)

⁶²Steven Schwarcz, 'Rethinking the Disclosure Paradigm' (2008) 85 Texas Law Review 1

⁶³John Coffee Jr, 'Market Failure and the Economic Case for Disclosure' (1984) 70 Virginia Law Review 717

⁶⁴OECD, *Corporate Governance in India* (2019)

developing the current structure to further improve and strengthen both the functionality and equity of the private placement regulatory framework.⁶⁵

It is believed that well-designed private placement regulatory regimes can support the growth of corporate finance in India by providing companies access to capital while providing appropriate protection to investors. As the private placement regulatory framework continues to develop, it will ultimately serve as a significant factor in shaping India's corporate and financial environment.

⁶⁵Paul Davies, *Principles of Modern Company Law* (Sweet & Maxwell 2016)