

5

RIGHTS ISSUE

5.1 Introduction

One of the ways by which a public company can raise further capital is by issuing securities to its existing shareholders. This is known as a rights issue. S.81(1) of the Companies Act provides for a rights issue by a public limited company. The distinguishing feature of a rights issue is that it is made only to the existing shareholders of the company. It may be by a listed or unlisted public company. However, if the Offer permits, then the shareholders can renounce their right in favour of other shareholders.

5.2 Companies Act

The rights issue is governed by the Articles of Association and must be approved by an Ordinary Resolution of the members in a general meeting. The rights issue is offered to the shareholders in the same proportion as they hold shares in the company. In case the company desires to offer shares to persons other than the existing shareholders, then it needs to pass a special resolution u/s. 81(1A). A private placement or a preferential allotment of shares would fall under this category. S.81(1) of the Companies Act does not apply to a private limited company.

5.3 SEBI Guidelines

The key requirements of the SEBI DIP Guidelines are as follows:

- (a) The DIP Guidelines apply to all rights issues by listed companies except those where the aggregate value of the securities does not exceed Rs. 50 lakhs. However, in such cases the letter of offer must be prepared as per the SEBI disclosure requirements and file the same with the SEBI.
- (b) The eligibility norms specified in the Guidelines for an initial public offer or a public issue do not apply to a rights issue.
- (c) Pricing of a rights issue is free and as per the discretion of the company and the merchant bankers. In case of a public-cum-rights issue, the company can have a differential pricing for the two issues.

- (d) The requirements of promoters contribution and lock-in period are not applicable in the case of a rights issue.
- (e) Rights issues must be kept open for at least 30 days and not more than 60 days.
- (f) The issuer company can utilise the funds collected from rights issue once the stock exchanges are satisfied that a minimum of 90% of the subscription has been received.

5.4 Takeover Regulations

The substantive provisions of the SEBI Takeover Regulations do not apply to an allotment made to a shareholder pursuant to a rights issue to the extent of his entitlement and up to a limit of 55% as specified in Regulation 11. However, this limit can be breached if the acquisition is by any person in control and who has made a disclosure in the letter of offer that he intends to acquire additional shares beyond their entitlement if the issue is undersubscribed. But if the acquisition results in a change of control of management then this exemption would not be available.

5.5 FEMA Provisions

A person resident outside India may purchase equity or preference shares or convertible debentures on a right basis if:

- (i) The offer on right basis does not result in an increase in the percentage of foreign equity already approved, or permissible under the FDI Scheme.
- (ii) The existing shares or debentures, against which rights are offered, are held in accordance with the FEMA Regulations;
- (iii) The existing non-resident shareholders may apply for issue of additional shares, provided the overall issue of shares to non-residents in the total paid-up capital does not exceed the sectoral cap;
- (iv) The offer on right basis to the persons resident outside India is at a price which is not lower than that at which the offer is made to resident shareholders;

The right shares or debentures purchased by the person resident outside India are subject to the same conditions including restrictions in regard to repatriability as are applicable to the original shares against which right shares or debentures are issued.