

PROSPECTUS AND ALLOTMENT OF SECURITIES



LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Define prospectus
- Understand various types of prospectus
- Explain the procedure for issue of prospectus and other related concepts
- Know about the criminal and civil liability for mis- statements in prospectus and punishment for fraudulently inducing persons to invest money
- Understand the procedure for allotment of securities by companies
- Know the procedure of private placement of securities

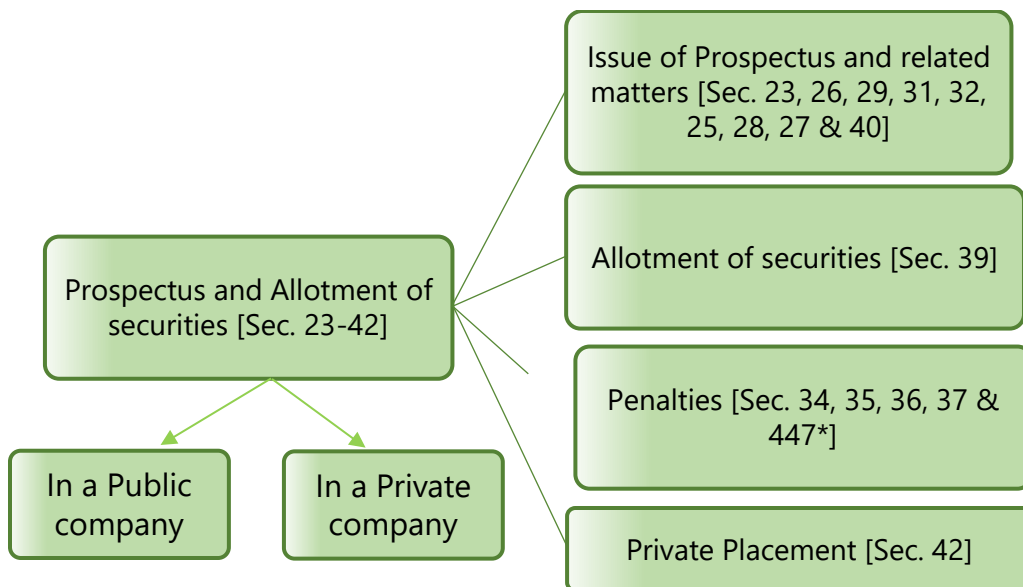
CHAPTER OVERVIEW

This Chapter is based on the Chapter III of the Companies Act, 2013 (in short 'the Act') consisting of sections 23 to 42 dealing with the prospectus and allotment of securities. The Act provides the manner in which securities can be issued by both public and private companies. Chapter III of the Act covers the issue of securities under two headings as under:

Part I - It contains provisions for the issue of securities through public offer;

Part II - It contains provisions for the issue of securities through private placement.

Following diagram depicts the various sections:



* Section 447 contains provisions relating to 'punishment for fraud'.



1. INTRODUCTION

One of the advantages of floating a company is raising of capital from the public at large or from a defined group or inner circle (pre-known select group of persons). When the capital is raised from public at large, it is undertaken through the medium of 'Public Offer' and when it is raised from a defined group of persons it is carried out through 'Private Placement of securities'. Acquisition of capital is inflow of funds for the issuer and needs advertisement which should be in

accordance with the relevant legal provisions so that no investor is defrauded or cheated. On successful closure of the application process, securities are allotted to the investors which could then be listed on an appropriate segment of a recognised stock exchange after fulfilling due formalities.

As already mentioned, the provisions relating to raising of capital such as issue of prospectus, allotment of securities etc., and other matters incidental thereto are contained in Chapter III of the Act. This Chapter is divided into two parts:

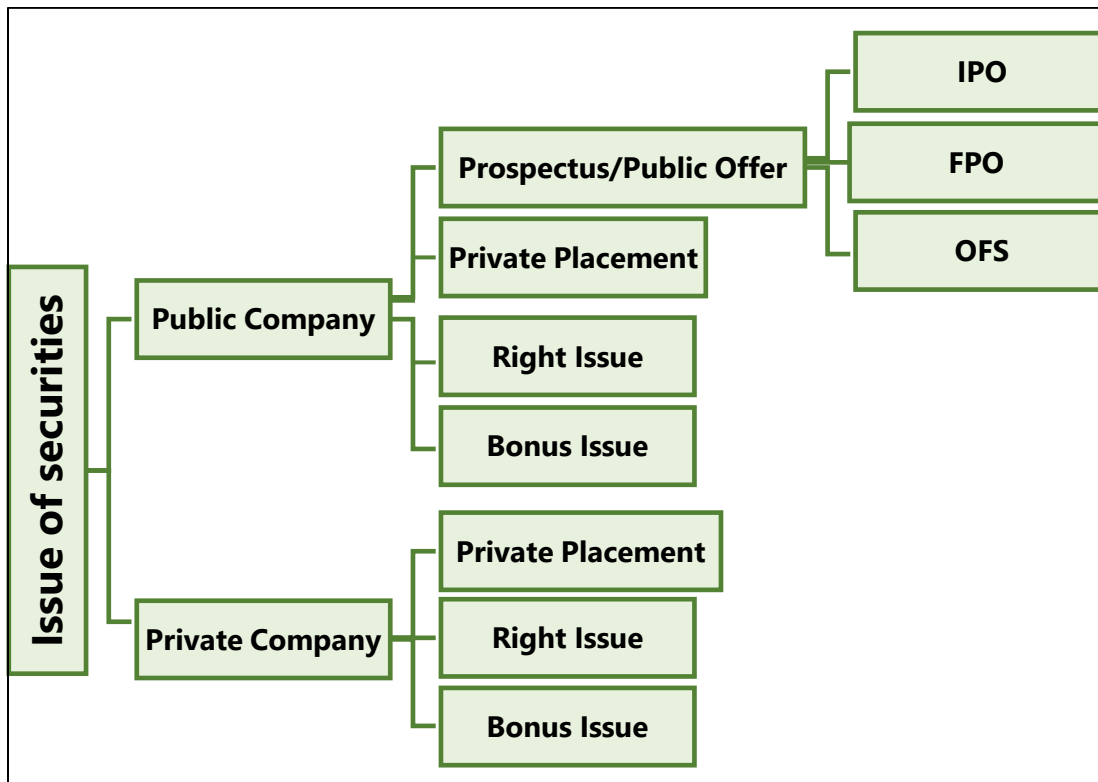
Part I relates to 'Public Offer' (sections 23 to 41); and

Part II relates to 'Private Placement' (section 42).

The provisions contained in Part I and part II are supplemented by the Companies (Prospectus and Allotment of Securities) Rules, 2014. A number of amendments have been made from time to time in the Rules.

2. PUBLIC OFFER AND PRIVATE PLACEMENT

Various modes of issue of securities by a public company or a private company are depicted in the following diagram:



As per Section 23 (1), a public company may issue securities—

- (a) to public through prospectus (herein referred to as “public offer”) by complying with the provisions of Part I; or
- (b) through private placement by complying with the provisions of Part II; or
- (c) through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 (SEBI) and the rules and regulations made thereunder.

As per **Section 23(2), a private company** may issue securities—

- (a) by way of rights issue or bonus issue in accordance with the provisions of the Act; or
- (b) through private placement by complying with the provisions of Part II.

By way of *Explanation* it is provided that, “public offer” includes initial public offer (IPO) or further public offer (FPO) of securities to the public by a company, or an offer for sale of securities (OFS) to the public by an existing shareholder, through issue of a prospectus.

Meaning of Securities

As per **section 2 (81)**, the term ‘securities’ means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 [SCRA].

The definition given by section 2 (h) of SCRA is as under:

“**Securities**” include—

- (i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (ia) derivative;
- (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

- (id) units or any other such instrument issued to the investors under any mutual fund scheme.

Explanation: For the removal of doubts, it is hereby declared that "Securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938.

- (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- (ii) Government securities;
- (ia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interests in securities.

The provisions of Section 23 are tabulated below:

| | Public Company | Private Company |
|--|---|-----------------|
| Public Offer (including IPO, FPO or OFS) | Yes | No |
| Private Placement | Yes | Yes |
| Rights issue / Bonus Issue | Yes | Yes |
| Compliance with SEBI rules and regulations | Yes (for a listed company or a company proposed to be listed) | No |

3. PROSPECTUS

(I) Meaning of Prospectus

As per the definition given in section 2 (70), prospectus means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any

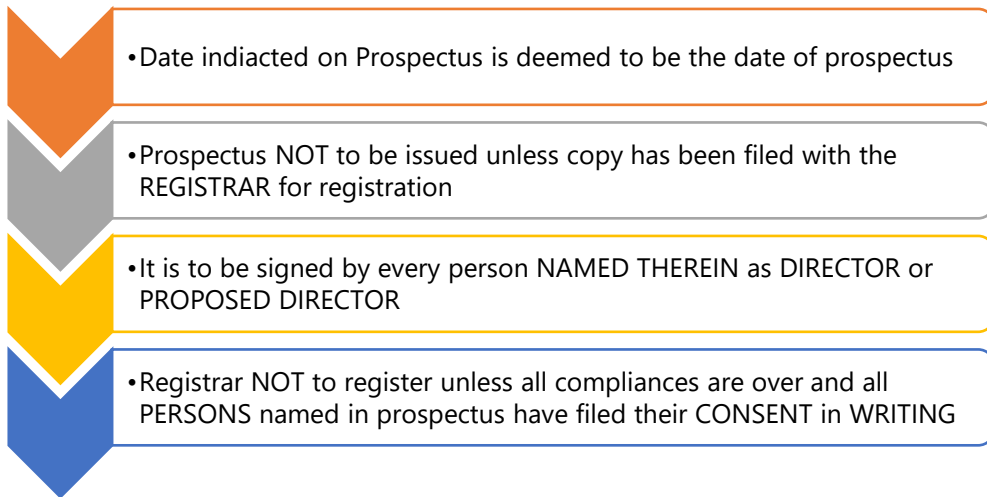
notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

According to the above definition, following points emerge in relation to prospectus:

- (i) Prospectus is any document described or issued as a prospectus. Thus, any document which is described as a prospectus or issued as a prospectus is to called prospectus.
- (ii) A prospectus shall include a red herring prospectus or shelf prospectus.
- (iii) A prospectus shall also include any notice, circular, advertisement or other document which intends to invite offers from the public for the subscription of any securities or purchase of any securities of a body corporate.

Following diagram, in nutshell, describes prospectus:



(II) Matters to be stated in prospectus

Section 26 mentions the various matters which are to be stated in a prospectus. They are as under:

- (1) Prospectus to be dated and signed and to state specified information, etc.:** Every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.

However, until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

¹(c) prospectus shall make a declaration about the compliance of the provisions of the Companies Act, 2013 and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and

¹clauses (a), (b) and (d) to sub-section (1) omitted by the Companies (Amendment) Act, 2017, w.e.f. 07-05-2018.

Exchange Board of India Act, 1992 and the rules and regulations made thereunder. [Sub-section 1 and Proviso]

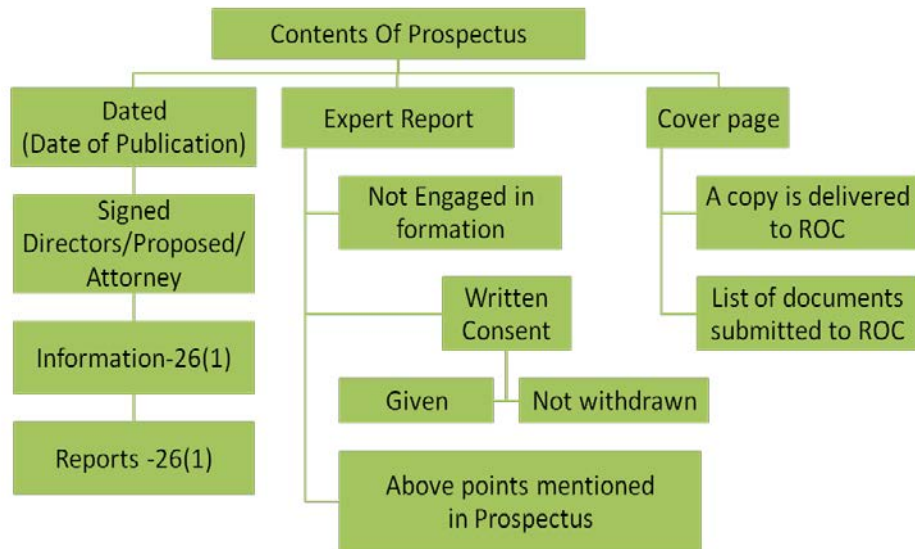
- (2) **Exceptions:** Nothing in sub-section (1) shall apply—
- (a) to the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of section 62 in favour of any other person; or
 - (b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange. [Sub- section (2)]
- (3) **Application of sub-section (1) to prospectus or to a form of application:** Subject to sub-section (2), the provisions of sub-section (1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently.
- As per the *Explanation*, the date indicated in the prospectus shall be deemed to be the date of its publication. [Sub-section (3)]
- (4) **Prospectus to be issued after delivery to Registrar for filing:** No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, there has been delivered to the Registrar for filing, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney. [Sub-section (4)]
- (5) **Prospectus not to include Experts' statement under certain circumstances:** A prospectus issued under sub-section (1) shall not include a statement purporting to be made by an expert unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management, of the company and has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the

prospectus to the Registrar for filing and a statement to that effect shall be included in the prospectus. [Sub- section (5)]

Note: As per Section 2(38) ‘expert’ includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

(6) Prospectus to mention compliances of certain formalities on its face: Every prospectus issued under sub-section (1) shall, on the face of it—

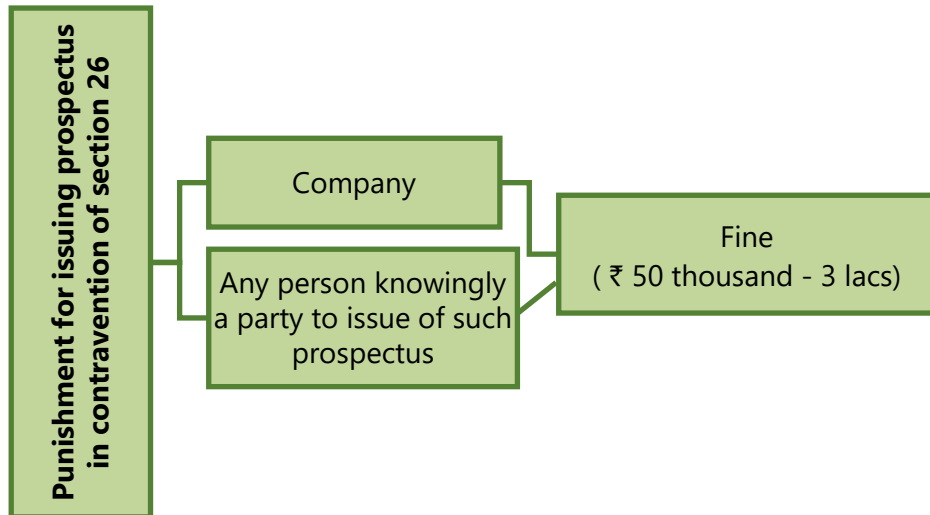
- (a) state that a copy has been delivered for filing to the Registrar as required under sub-section (4); and
- (b) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.



(7) Prospectus to be issued within specified time: No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar under sub-section (4). [Sub-section (8)]

(8) Punishment if ‘issued prospectus’ contravenes applicable provisions: If a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall

not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to **three lakh rupees**. [Sub- section (9)]



Example 1: The Board of Directors of Dr. Sunny Pharmaceutical Limited has allotted shares to the investors at large without issuing a prospectus with the Registrar of Companies, Mumbai. In this regard, it is to be noted that a public company can issue securities to the public only by issuing a prospectus (Section 23).

Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the filing of the prospectus with the Registrar before it is issued.

In the given case, the company has violated the above provisions of the Companies Act, 2013 and hence the allotment made by it is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act.

Note: With the deletion of ²Rules 3, 4, 5 and 6 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, substantial disclosure requirements, being duplicate in nature, have been dispensed with. Henceforth, a company

² Deleted by the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2018, w.e.f. 07-05-2018.

needs to follow applicable SEBI Regulations till SEBI specifies the information and reports on financial information to be stated in a prospectus under sub-section (1).

(III) Public Offer of Securities to be in Dematerialised Form

Section 29 along with *Companies (Prospectus and Allotment of Securities) Rules, 2014* [PAS Rules] contain provisions which require public offer of securities to be in dematerialised form. Further, prescribed class or classes of companies shall issue the securities only in the dematerialised form.

- (1)** Every company making public offer and such other class or classes of companies as may be prescribed shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Dematerialisation of Securities: As per Rule 9 of PAS Rules, the promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialised form.

It is provided that the entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialised form only.

³(1A) In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder.

Rule 9A of PAS Rules mentions about issue of securities in dematerialised form by unlisted public companies. The provisions are as under:

Issue of securities in dematerialised form by unlisted public companies: According to Rule 9A (1), every unlisted public company (*excluding a Nidhi, a Government company and a wholly owned subsidiary*⁴) shall issue the securities only in dematerialised form and

³ Sub-section (1A) of Section 29 inserted by the Companies (Amendment) Act, 2019, w.e.f. 15-08-2019.

⁴ As per Rule 9A (11).

also facilitate dematerialisation of all its existing securities in accordance with provisions of the Depositories Act, 1996 and regulations made there under.

Conversion of securities in dematerialised form: Rule 9A (2) states that every unlisted public company making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with provisions of the Depositories Act, 1996 and regulations made there under.

Responsibility of every holder of securities of an unlisted public company: According to Rule 9A (3), every holder of securities of an unlisted public company:

- (a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or
- (b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018

shall ensure that all his existing securities are held in dematerialized form before such subscription.

Application to the depository: As per Rule 9A (4), every unlisted public company shall facilitate dematerialisation of all its existing securities by making necessary application to a depository as defined in section 2 (1) (e) of the Depositories Act, 1996 and shall secure International Security Identification Number (ISIN) for each type of security and shall inform all its existing security holders about such facility.

Obligations of every unlisted public company: According to Rule 9A (5), every unlisted public company shall ensure that -

- (a) it makes timely payment of fees (admission as well as annual) to the depository and registrar to an issue and share transfer agent in accordance with the agreement executed between the parties;

- (b) it maintains security deposit, at all times, of not less than two years' fees with the depository and registrar to an issue and share transfer agent, in such form as may be agreed between the parties; and
- (c) it complies with the regulations or directions or guidelines or circulars, if any, issued by the Securities and Exchange Board or Depository from time to time with respect to dematerialisation of shares of unlisted public companies and matters incidental or related thereto.

Prohibition on defaulting unlisted public company: Rule 9A (6) states that no unlisted public company which has defaulted in sub-rule (5) shall make offer of any securities or buyback its securities or issue any bonus or right shares till the payments to depositories or registrar to an issue and share transfer agent are made.

Application of certain provisions: According to Rule 9A (7), except as provided in sub-rule (8), the provisions of the Depositories Act, 1996, the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 and the Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 shall apply mutatis mutandis to dematerialisation of securities of unlisted public companies.

Filing with the Registrar: Rules 9A (8) prescribes that every unlisted public company governed by Rule 9A shall submit Form PAS-6 to the Registrar with such fee as provided in *the Companies (Registration Offices and Fees) Rules, 2014* within 60 days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice.

Reporting of difference: As per Rule 9A (8A), the company shall immediately bring to the notice of the depositories any difference observed in its issued capital and the capital held in dematerialised form.

Grievances redressal mechanism: According to Rule 9A (9), the grievances, if any, of security holders of unlisted public companies under Rule 9A shall be filed before the Investor Education and Protection Fund Authority (IEPF).

Initiation of action by IEPF Authority: Rule 9A (10) states that the Investor Education and Protection Fund Authority shall initiate any

action against a depository or participant or registrar to an issue and share transfer agent after prior consultation with the Securities and Exchange Board of India.

- (2) Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

(IV) Advertisement of Prospectus

According to Section 30, where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the following:

- (i) the objects,
- (ii) the liability of members and the amount of share capital of the company,
- (iii) the names of the signatories to the memorandum,
- (iv) the number of shares subscribed for by the signatories, and
- (v) the capital structure of the company.

(V) Shelf Prospectus, Red Herring Prospectus and Abridged Prospectus

These are described as under:

(A) Shelf Prospectus

Section 31 contains provisions relating to Shelf Prospectus. These provisions play a significant role in facilitating commercial and logistical consideration involved in the funds raising cycle.

We may consider a situation where the issuer company issues debentures frequently and has to file a prospectus every time it issues a new series of debentures. Here, the concept of shelf prospectus comes into play. Literally, it means a prospectus with a given shelf life. Any number of issues could be made during the tenure of the shelf prospectus. The only caveat is to supplement the shelf prospectus by an "information memorandum" containing key updates or changes.

The provisions of Section 31 are stated below:

Meaning of Shelf Prospectus: The expression “shelf prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. [Explanation to Section 31]

(1) Filing of shelf prospectus with the Registrar: Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-

- (i) of the **first offer** of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and
- (ii) in respect of a **second or subsequent offer** of such securities issued during the period of validity of that prospectus,

no further prospectus is required. [Sub-section (1)]

(2) Filing of ‘Information Memorandum’ with the Shelf Prospectus: A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

It is provided that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof. [Sub-section (2) and Proviso]

According to Rule 10 of the *Companies (Prospectus and Allotment of securities) Rules, 2014*, the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the *Companies (Registration Offices and Fees) Rules, 2014*

within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

- (3) Information Memorandum together with Shelf Prospectus is deemed Prospectus:** Where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus. [Sub-section (3)]

(B) Red Herring Prospectus

Section 32 contains provisions relating to Red-herring Prospectus.

Developments taking place in the financial markets from time to time allow innovative methods of raising funds so as to avail the most of favourable market conditions. Timing the issue and book building of issue are facilitated by the concept of red herring prospectus whereby the price per security and number of securities are left open to be decided post closure of the issue.

The provisions of Section 32 are stated as below:

Meaning of Red Herring Prospectus: The expression "red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein. [Explanation to Section 32]

- (1) Red Herring Prospectus is issued prior to issue of Prospectus:** A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
- (2) Filing with the registrar:** A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.
- (3) Obligations under Red Herring Prospectus vis-à-vis Prospectus:** A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
- (4) Filing of Red Herring Prospectus with Registrar and SEBI upon closing of Offer:** Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities

and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

(C) Abridged Prospectus

The term 'Abridged Prospectus' has been defined by Section 2 (1). According to it, 'Abridged Prospectus' means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. In fact, 'Abridged Prospectus' is a summarised form of actual prospectus.

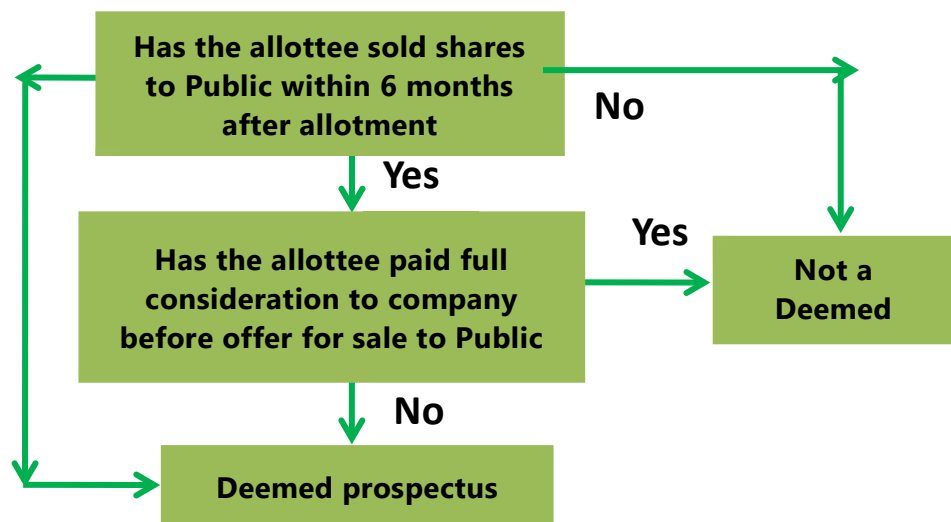
(VI) Document containing Offer of Securities for Sale to be Deemed Prospectus

Section 25 provides that a document by which offer of securities for sale to the public is made, shall be a deemed prospectus. The provisions of Section 25 are mentioned as under:

- (1) Documents which are deemed to be a Prospectus:** Where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company; and all enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply with the modifications specified in sub-sections (3) and (4) and shall have effect accordingly, as if the securities had been offered to the public for subscription and as if persons accepting the offer in respect of any securities were subscribers for those securities, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof. [Sub-section (1)]
- (2) Securities offered for sale to the public:** For the purposes of the Companies Act, 2013, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

 - (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or

- (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it. [Sub-section (2)]
- (3) Effect of section 26:** Section 26 as applied by section 25 shall have effect as if —
- (i) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—
- (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
- (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;
- (ii) the persons making the offer were persons named in a prospectus as directors of a company. [Sub-section (3)]
- (4) Signing of Document in case of a company or a firm:** Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document referred to in sub-section (1) is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be. [Sub-section (4)]



It is to be noted that all applicable provisions relating to prospectus viz., mis-statements, contents, civil and criminal liability etc., are applicable to the deemed prospectus. There is no dilution of liability for the persons making the offer which is in addition to liability of the company whose securities are offered for sale. Additionally, below mentioned information needs to be disclosed as well in the deemed prospectus:

- the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
- the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

The purpose of deeming provision is to protect gullible investors from various fraudulent practices.

(VII) Offer of Sale of Shares by Certain Members of Company

Sections 28 contains the provisions which regulate the offer for sale of securities by certain members of company. These provisions are stated as under:

- (1) **Offering of shares to public by certain members permitted:** Where certain members of a company propose, in consultation with the Board of Directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed. [Sub-section (1)]
- (2) **Document offering sale to public is deemed to be a prospectus:** Any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company. [Sub-section (2)]
- (3) **Collective Authorisation and reimbursement of expenses to company:** The members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on

their behalf and they shall reimburse the company all expenses incurred by it on this matter. [Sub-section (3)]

As regards offer of sale of shares by certain members of the company Rule 8 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, contains guiding provisions which are stated as under:

Exceptions to certain Matters: According to Rule 8 (1), the provisions of Part I of Chapter III namely "Prospectus and Allotment of Securities" and rules made thereunder shall be applicable to an **offer of sale** referred to in section 28 except for the following, namely:-

- (a) the provisions relating to minimum subscription;
- (b) the provisions for minimum application value;
- (c) the provisions requiring any statement to be made by the Board of directors in respect of the utilization of money; and
- (d) any other provision or information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply with such provisions.

Disclosure: As per Rules 8 (2), the prospectus issued under section 28 shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.

(VIII) Variation in terms of contract or objects in prospectus

Section 27 contains provisions relating to variation in terms of contract or objects in prospectus. Once funds are raised through a given prospectus, the principle of "doctrine of ultra vires" (*mutatis mutandis*) comes into play *i.e.*, the company has to use the funds strictly in accordance with the prospectus. Deviations are required to be pre-approved by the investors and 'recall option' needs to be given to the dissenting investors. Deviation regarding use of proceeds of issue for buying, trading or otherwise dealing in equity shares of any other listed company is not permitted.

The provisions of Section 27 are stated as under:

- (1) Variation on approval in general meeting by passing of SR:** A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority

given by the company in general meeting by way of special resolution (SR).

It is provided that the details, as may be prescribed, of the notice in respect of such resolution to shareholders, shall also be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation.

It is further provided that such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company. [Sub-section (1) and Provisos]

In respect of variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued, Rule 7 of *the Companies (Prospectus and allotment of Securities) Rules, 2014*, states as under:

Special Resolution to be passed through Postal Ballot and Contents of Notice: According to Sub-rule (1), where the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot and the notice of the proposed special resolution shall contain the following particulars, namely:—

- (a) the original purpose or object of the Issue;
- (b) the total money raised;
- (c) the money utilised for the objects of the company stated in the prospectus;
- (d) the extent of achievement of proposed objects (that is fifty percent, sixty percent, etc.);
- (e) the unutilised amount out of the money so raised through prospectus,
- (f) the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;
- (g) the reason and justification for seeking variation;

- (h) the proposed time limit within which the proposed varied objects would be achieved;
- (i) the clause-wise details as specified in sub-rule (3) of rule 3 as was required with respect to the originally proposed objects of the issue;
- (j) the risk factors pertaining to the new objects; and
- (k) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.

Advertisement to be in Specified Form: According to Sub-rule (2), the advertisement of the notice for getting the resolution passed for varying the terms of any contract referred to in the prospectus or altering the objects for which the prospectus was issued, shall be in Form **PAS-1** and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders.

Placing of Notice on Web-site: According to Sub-rule (3), the notice shall also be placed on the web-site of the company, if any.

- (2) **Exit offer to dissenting shareholders:** The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf. [Sub-section (2)]

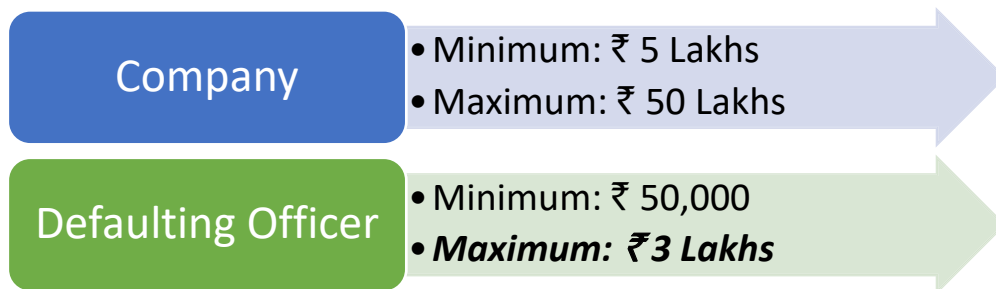


4. SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES

Section 40 contains following provisions in respect of securities which are to be dealt with in the recognised stock exchanges.

- (1) **Filing of an application with recognised stock exchange:** Every company making public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

- (2) **Prospectus to state name of stock exchange:** Where a prospectus states that an application has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.
- (3) **Maintaining of separate bank account:** All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—
- for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or
 - for the repayment of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.
- (4) **Condition purporting to waive compliance shall be void:** Any condition purporting to require or bind any applicant for securities to waive compliance with any of the requirements of this section shall be void.
- (5) **Default in complying with provisions:** If a default is made in complying with the provisions of this section, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to **three lakh rupees**.



- (6) **Payment of commission:** A company may pay commission to any person in connection with the subscription to its securities subject to the prescribed conditions.

Rule 13 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014* prescribes the following conditions for the payment of commission:

- (a) the payment of such commission shall be authorized in the company's articles of association;
- (b) the commission may be paid out of proceeds of the issue or the profit of the company or both;
- (c) **Rate of commission:** Following are the rates of commission-

| <input type="checkbox"/> in case of shares | <input type="checkbox"/> in case of debentures |
|--|--|
| <input type="checkbox"/> shall not exceed 5% of the price at which the shares are issued, or | <input type="checkbox"/> shall not exceed 2.5% of the price at which the debentures are issued, or |
| <input type="checkbox"/> a rate authorised by the articles, | <input type="checkbox"/> as specified in the company's articles, |
| <input type="checkbox"/> whichever is less | <input type="checkbox"/> whichever is less |

- (d) **Disclosure of the particulars in prospectus:** The prospectus of the company shall disclose the following particulars -
- (i) the name of the underwriters;
 - (ii) the rate and amount of the commission payable to the underwriter; and
 - (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- (e) **When no commission is to be paid:** There shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
- (f) **Copy of payment of commission to be delivered to Registrar:** A copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Example 2: A public limited company which wanted to raise funds through public issue of shares had applied for listing of its shares in three recognised Stock Exchanges. However, only two exchanges had given permission for listing. Can the company proceed with the public offer?

Answer: According to Section 40 (1) of the Companies Act, 2013, every company making a public offer of shares shall, before making such offer, make an

application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

As per Section 40 (2), where a prospectus states that an application has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

From the above it is clear that not only the company has to apply for listing of the securities at a recognized stock exchange but also obtain permission thereof before making the public offer.

In view of the above provisions, the company cannot proceed with the public offer of shares before obtaining the necessary approval from the stock exchanges.

Example 3: The Board of Directors of a company decide to pay 5% of the issue price of shares as underwriting commission to the underwriters. However, the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 2013?

Answer: Under Rule 13 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014* the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

The same rule allows the commission to be paid out of proceeds of the issue or the profit of the company or both.

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid since the same cannot exceed the rate which is permitted by the Articles. However, the decision to pay commission out of the proceeds of the share issue is valid provided it is paid at the rate authorised by the Articles.



5. ALLOTMENT OF SECURITIES BY COMPANY

Meaning of Allotment

“**Allotment**” means the appropriation out of previously un-appropriated capital of a company, of a certain number of shares to a person. Till the allotment, as such the shares do not exist. It is on allotment that the shares come into existence. In fact, with the sending of allotment letters, the company starts the process of allotment and it is nothing but acceptance of offer made by the applicants of securities.

Legal Provisions governing Allotment

Section 39 contains provisions in respect of allotment of securities when there is a public offer. Further, *the Companies (Prospectus and Allotment of Securities) Rules, 2014* [PAS Rules] have also been issued.

(1) Receipt of Minimum Amount is a must: No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

The prospectus must state the minimum amount to be subscribed. Such minimum amount must be received from the subscribers or investors at the time of making application.

(2) Quantum of Amount Payable on Application: The amount payable on application on every security shall not be less than five per cent of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

(3) Consequences if minimum amount is not subscribed: If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

Refund of Application Money: Rule 11 (1) of the PAS Rules mentions that if the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

Which Account to be used for Refund: According to Rule 11 (2), the application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

(4) Return of Allotment: Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed.

Time Limit for filing Return of Allotment: According to Rule 12 (1) of PAS Rules, whenever a company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form PAS-3, along with the fee as specified in *the Companies (Registration Offices and Fees) Rules, 2014*.

Details to be attached with PAS-3: Rule 12 (2) states that there shall be attached to the Form PAS-3 a list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the Form PAS-3 as being complete and correct as per the records of the company.

Attachments with PAS-3 when Securities are issued for consideration other than cash: According to Rule 12 (3), in the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form PAS-3 a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

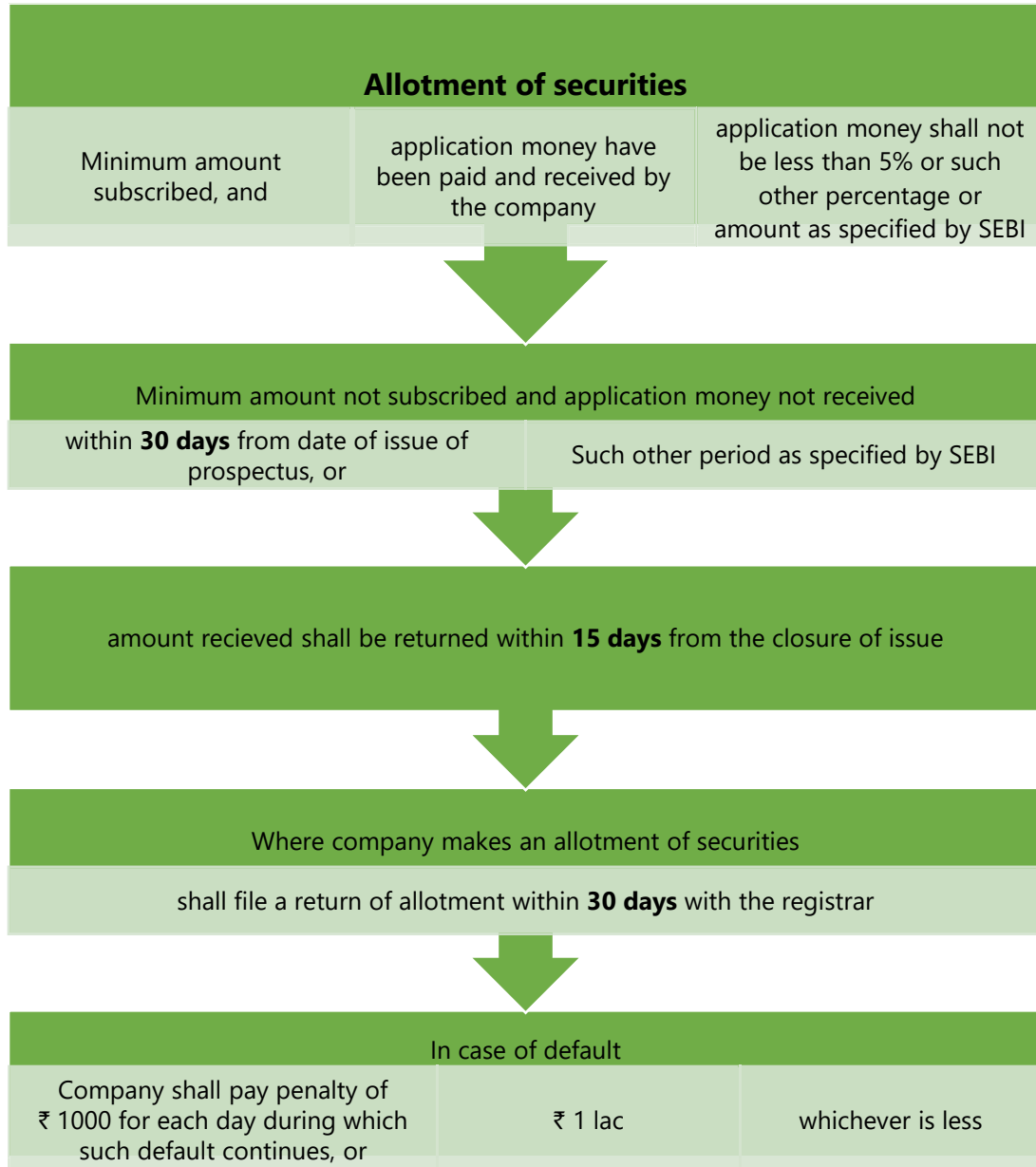
Attachments with PAS-3 when Contract is not Reduced to Writing: Rule 12 (4) states that where a contract referred to in sub-rule (3) is not reduced to writing, the company shall furnish along with the Form PAS-3 complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899, and the Registrar may, as a condition of filing the particulars, require that the stamp duty payable thereon be adjudicated under section 31 of the Indian Stamp Act, 1899.

Attachment of Report of a Registered Valuer: According to Rule 12 (5), a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract as mentioned in sub-rule (3) and sub-rule (4).

Attachment of Resolution in case of Bonus Shares: Rule 12 (6) states that in the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form PAS-3.

Attachment of Valuation Report of the Registered Valuer when shares have been issued in pursuance of Section 62 (1) (c): Rule 12 (7) states that in case the shares have been issued in pursuance of clause (c) of sub-section (1) of section 62 by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to Form PAS-3, the valuation report of the registered valuer.

(5) Punishment for Default: In case of any default under sub-section (3) or sub-section (4), the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.



Once securities are issued and subscribed for, these needs to be allotted according to the conditions given below:

- ◆ Minimum subscription to be received within 30 days of issue of prospectus. In case minimum subscription is not received, the issue is considered as failed. To take care of such an eventuality, the merchant bankers in case of public offer resort to underwriting, suitable pricing, bringing in anchor investors etc., among other things. In case of a failed issue, the entire issue proceeds need to be refunded along with applicable interest.
- ◆ Application money need to be minimum 5% of the nominal amount and such amount must be sufficient to cover the minimum amount stated in the prospectus.
- ◆ Return of allotment needs to be filed with the ROC within the specified time after the allotment of securities.

Example 4: After having received 80% of the minimum subscription as stated in the prospectus, Raksha Detective Instruments Limited, before finalisation of the allotment, withdrew 50% of the said amount from the bank for the purchase of certain assets. Thereafter, it started allotting the shares to the subscribers. Rashmi, one of the subscribers, was allotted 1000 equity shares. She, however, refused to accept the allotment on the ground that such allotment was violative of the provisions of the Companies Act, 2013.

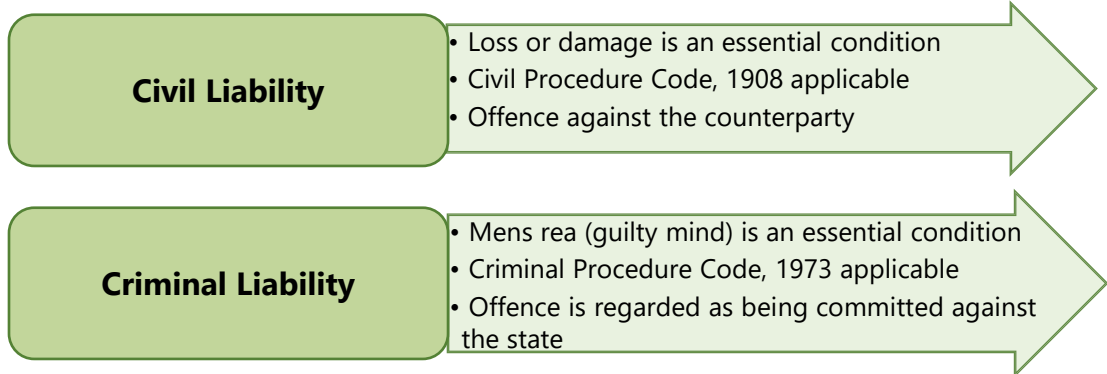
Answer: According to the above example, Raksha Detective Instruments Limited has received only 80% of the minimum subscription as stated in the prospectus. Since minimum amount has not been received in full, the allotment is in contravention of section 39 (1) of the Companies Act, 2013 which prohibits a company from making any allotment of securities until it has received the amount of minimum subscription stated in the prospectus. Further, under section 39 (3), such company is required to refund the application money received (*i.e.* 80% of the minimum subscription) to the applicants.

Therefore, in the present case, Rashmi is within her rights to refuse the allotment of shares which has been illegally made by the company.

6. MIS-STATEMENTS IN PROSPECTUS

In common parlance, mis-statement is the act of stating something that is false or not accurate. It could either be due to commission or omission or both.

Mis-statement of prospectus is a serious offence which attracts the provisions of section 34 and / or section 35. Liabilities can be classified under two headings:



CRIMINAL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS

The provision of Section 34 which mentions criminal liability for mis-statements in a prospectus are stated as under:

Where a prospectus, issued, circulated or distributed under Chapter III, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

Exception: It is provided that nothing in this section shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

Note: The provisions of section 447 are given later in the chapter.

CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS

Section 35 contains the provisions relating to civil liability for mis-statements in a prospectus. They are stated as under:

(1) Liabilities of Persons involved: Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

(a) is a **director** of the company at the time of the issue of the prospectus;

- (b) has **authorised himself** to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- (c) is a **promoter** of the company;
- (d) has **authorised the issue of the prospectus**; and
- (e) is an **expert** referred to in sub-section (5) of section 26,

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage. [Sub-section (1)]

(2) Exceptions: No person shall be liable under Sub-section (1) if he proves—

- (a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- (b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
- (c) that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar or, to the defendant's knowledge, before allotment thereunder. [Sub-section (2)]

(3) Unlimited Liability when prospectus issued with intent to defraud:

Where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus. [Sub-section (3)]

Example 5: An allottee of shares in a company brought action against a director in respect of false statements made in the prospectus. The director contended that the statements were prepared by the promoters and he simply relied on them. Is the director liable under the circumstances?

Answer: Yes, the Director shall be held liable for the false statements made in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis-statements.

Certain situations when a director will not incur any liability for mis-statements in a prospectus are covered under exceptions provided by Section 35 (2) but no such exception specifies that relying on the statements prepared the promoters of the company is a valid ground for a director to escape liability for mis-statement.



Example 6: All the statements contained in a prospectus issued by a company were literally true. It was also stated in the prospectus that the company had paid dividends for a number of years but there was no disclosure regarding the fact that the dividends were paid out of realised capital profits and not out of trading profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars.

Answer: The non-disclosure of the fact that dividends were paid out of capital profits is a concealment of material fact as a company is normally required to distribute dividend only from trading or revenue profits and under exceptional circumstances it can pay dividend out of capital profits. Hence, a material misrepresentation has been made.

Accordingly, in the given case the allottee can avoid the contract of allotment of shares.

Example 7: A prospectus issued by a company contained certain mis-statements. On becoming aware of the fact regarding mis-statements in the prospectus, one of the experts Anilesh who had earlier given his consent, forthwith gave a reasonable public notice stating that the prospectus was issued without his knowledge and consent. Is it possible for Anilesh to escape liability for mis-statement in the prospectus?

Answer: Section 35 (2) of the Companies Act, 2013 states that no person shall be liable under Sub-section (1) if he proves that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

The case of Anilesh is covered under the above exception provided by Sub-section (2) and therefore, he will escape liability for mis-statement in the prospectus.



7. PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY

Section 36 prescribes punishment for fraudulently inducing persons to invest money. The provision is stated as under:

Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into, -

- (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or
- (b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
- (c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution,

shall be liable for action under section 447.

Note: The provisions of section 447 are given later in the chapter.



8. ACTION BY AFFECTED PERSONS

According to Section 37, a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Section 37 has paved way for class action.

Class Actions – Gift of the Companies Act, 2013

Class action suit is for a group of people filing a suit against a defendant who has caused common harm to the entire group or class. This is not like a common litigation method where one defendant files a case against another defendant while both the parties are available in court. In the case of class action suit, the class or the group of people filing the case need not be present in the court and can be represented by one petitioner. The benefit of these type of suits is that if several people have been injured by one defendant, each of the injured person need not file a case separately but all of the people can file one single case together against the defendant.

The need for these types of suits was first felt in the context of securities market during the time of Satyam Scam, where a large group of persons was cheated and all such persons had to lose their hard-earned money invested in the stock market. During that time, it was felt that it was not at all viable and cost effective for a small stakeholder to file a case independently against the defendants. Millions of cheated investors during that time formed a large group and filed the case against the company, but since there was no available legal remedy or law which could actually support this type of litigation initiated by a group, it became tough for those investors to take a recourse or gain advantage from the Indian Judicial System. Class action suits in India were so far filed under the guise of public interest litigations. Courts were free to dismiss them. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and ultimately had their claims rejected.

Example 8: M applies for equity shares of a company on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Whether N can bring an action for a rescission on the ground of mis-statement under section 37 of the Companies Act, 2013?

Answer: No. N cannot bring an action for rescission of the contract for buying shares from M on the ground of mis-statement made in the prospectus. Section 37 of the Companies Act, 2013 does not become applicable in such a situation.

It is noteworthy that according to Section 37, a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus. Therefore, only M is eligible to file a suit.

9. PUNISHMENT FOR FRAUD [SECTION 447]

Section 447 describes punishment for fraud. According to it, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It is provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

It is provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

Meaning of Certain Terms⁵

Fraud: The term 'fraud' in relation to affairs of a company or any body corporate, includes-

- ◆ any act,
- ◆ omission,
- ◆ concealment of any fact, or
- ◆ abuse of position

committed by any person, or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of,

⁵ As per *Explanation* to Section 447.

the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

Wrongful Gain: The term 'wrongful gain' means the gain by unlawful means of property to which the person gaining is not legally entitled;

Wrongful Loss: The term 'wrongful loss' means the loss by unlawful means of property to which the person losing is legally entitled.

| | Fine | | Imprisonment |
|--|---|--------|---|
| (i) Fraud involving less than 10 lakh rupees or 1% of turnover, whichever is lower (<i>public interest not involved</i>) | Up to ₹ 50 lakhs ⁶ | or/and | Up to 5 years |
| (ii) Fraud involving at least 10 lakh rupees or 1% of turnover, whichever is lower (<i>public interest not involved</i>) | Minimum fine equal to amount of fraud; and Maximum fine three times of amount of fraud | and | Minimum 6 months; and Maximum 10 Years |
| (iii) Fraud at (ii) involves public interest | Minimum fine equal to amount of fraud; and Maximum fine three times of amount of fraud | and | Minimum 3 years; and Maximum 10 Years |

10. PRIVATE PLACEMENT

Provisions relating to the 'private placement' are contained in Part II of Chapter III of the Act.

Private Placement

A private placement is a way of raising capital that involves the issue of securities to a relatively small number of select investors.

A private placement is different from a public issue in which securities are made available for issue or sale on the open market to any type of investor.

⁶ Substituted for 'twenty lakh rupees' by the Companies (Amendment) Act, 2019, w.r.e.f. 02-11-2018.

Issue of Shares on Private Placement Basis

According to Section 42⁷, following provisions are applicable when shares are issued on private placement basis. They are also supplemented by Rule 14⁸ *the Companies (Prospectus and Allotment of Securities) Rules, 2014* [PAS Rules].

(1) **Applicability:** A company may, subject to the provisions of section 42, make a private placement of securities.

(2) **Offer to be made only to a Select Group of Persons:** A private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed fifty or such higher number as may be prescribed [excluding the qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option in terms of provisions of clause (b) of sub-section (1) of section 62], in a financial year subject to such conditions as may be prescribed.

According to Rule 14 (2) of the PAS Rules, an offer or invitation to subscribe securities under private placement shall not be made to persons more than two hundred in the aggregate in a financial year.

It is provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees' stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons.

As per **Explanation** given in this Rule, it is clarified that the restrictions aforesaid would be reckoned individually for each kind of security that is equity share, preference share or debenture.

Non-applicability of Sub-rule (2): The provisions of sub-rule (2) shall not be applicable to -

- (a) non-banking financial companies (NBFCs) which are registered with the Reserve Bank of India; and
- (b) housing finance companies (HFCs) which are registered with the National Housing Bank;

if they are complying with regulations made by the Reserve Bank of India or the National Housing Bank in respect of offer or invitation to be issued on private placement basis.

⁷ As substituted by the Companies (Amendment) Act, 2017, w.e.f. 07-08-2018.

⁸ As substituted by the Companies (Prospectus and Allotment of Securities) Rules, 2018, w.e.f. 07-08-2018.

It is provided that such companies shall comply with sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.

(3) **Manner of Issuing Private Placement Offer and Application:** A company making private placement shall issue private placement offer and application in such form and manner as may be prescribed to identified persons, whose names and addresses are recorded by the company in such manner as may be prescribed.

It is provided that the private placement offer and application shall not carry any right of renunciation.

Meaning of 'Private Placement': As per *Explanation I*, the term "private placement" means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in section 42.

Meaning of 'Qualified Institutional Buyer': As per *Explanation II*, the term "qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time, made under the Securities and Exchange Board of India Act, 1992.

When a Private Placement shall be deemed to be an Offer to the Public: As per *Explanation III*, if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of Part I of Chapter III.

Requirement of Special resolution: According to Rule 14 (1) of the PAS Rules, for the purposes of sub-section (2) and sub-section (3) of section 42, a company shall not make an offer or invitation to subscribe to securities through private placement unless the proposal has been previously approved by the shareholders of the company, by a special resolution for each of the offers or invitations.

In the explanatory statement annexed to the notice for shareholders' approval, the following disclosure shall be made:-

- (a) particulars of the offer including date of passing of Board resolution;

- (b) kinds of securities offered and the price at which security is being offered;
- (c) basis or justification for the price (including premium, if any) at which the offer or invitation is being made;
- (d) name and address of valuer who performed valuation;
- (e) amount which the company intends to raise by way of such securities;
- (f) material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities.

As per the second *Proviso to Rule 14 (1)*, sub-rule (1) shall not apply in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of sub section (1) of section 180 and in such cases relevant Board resolution under clause (c) of sub-section (3) of section 179 would be adequate.

As per the third *Proviso to Rule 14 (1)*, in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation exceeds the limit as specified in clause (c) of sub-section (1) of section 180, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitations for such debentures during the year.

As per the fourth proviso to Rule 14(1), in case of offer or invitation of any securities to qualified institutional buyers, it shall be sufficient if the company passes a previous special resolution only in a year for all the allotments to such buyers during the year.

Applicable Application Form: According to Rule 14 (3) of the PAS Rules, a private placement offer cum application letter shall be in the form of an application in Form PAS-4 serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the name of such person pursuant to section 42 (3).

It is provided that no person other than the person so addressed in the private placement offer cum application letter shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

Maintaining of Complete Record: According to Rule 14 (4) of the PAS Rules, the company shall maintain a complete record of private placement offers in Form PAS-5.

Timing of issue of private placement offer cum application letter: According to Rule 14 (8) of the PAS Rules, a company shall issue private placement offer cum application letter only after the relevant special resolution or Board resolution has been filed in the Registry.

It is provided that private companies shall file with the Registry copy of the Board resolution or special resolution with respect to approval under clause (c) of sub-section (3) of section 179.

(4) **Manner of Subscribing to the Private Placement Issue:** Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash.

It is provided that a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (8) of Section 42.

Utilisation of Bank account: Supplementing the above sub-section (4), Rule 14 (5) of the PAS Rules provides that the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the bank account from where such payment for subscription has been received.

In case of joint holders, it is provided⁹ that monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

It is further provided¹⁰ that the provisions of sub-rule (5) shall not apply in case of issue of shares for consideration other than cash.

Example 9: Ruhi and her younger brother Sohit were offered jointly 1000 equity shares of ₹ 100 each by Soumya Software Private Limited under the issue of shares on private placement basis. From whose account the company is required to take subscription money for 1000 equity shares?

Answer: According to the first Proviso of Rule 14 (5) of the PAS Rules, monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application. It is presumed that Ruhi's name appears first in the application and therefore, the subscription of ₹ 1,00,000 shall be payable by her from her account. It is obligatory

⁹ First Proviso to Rule 14 (5).

¹⁰ Second Proviso to Rule 14 (5).

for the company to ensure that the money is paid from her bank account and not from the bank account of her younger brother Sohiti.

(5) **Limit on Fresh Offer:** No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

It is provided that subject to the maximum number of identified persons under sub-section (2) of section 42, a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

(6) **Time Limit for Allotment of Securities:** A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day.

It is provided that the monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to allot securities.

(7) **Prohibition on Public Advertisement:** No company issuing securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

(8) **Filing of Return of Allotment:** A company making any allotment of securities under this section, shall file with the Registrar a return of allotment within fifteen days from the date of the allotment in such manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

As regards **Return of Allotment**, Rule 14 (6) of the PAS Rules states that a return of allotment of securities under section 42 shall be filed with the Registrar within fifteen days of allotment in Form PAS-3 and with the fee as provided in *the Companies (Registration Offices and Fees) Rules, 2014* along with a complete list of

all the allottees containing-

- (i) the full name, address, Permanent Account Number and E-mail ID of such security holder;
- (ii) the class of security held;
- (iii) the date of allotment of security;
- (iv) the number of securities held, nominal value and amount paid on such securities, and particulars of consideration received if the securities were issued for consideration other than cash.

(9) **Default in Filing the Return of Allotment:** If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.

(10) **Punishment for Contravening the Private Placement Provisions:** Subject to sub-section (11), if a company makes an offer or accepts monies in contravention of section 42, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

(11) **Deemed Public Offer:** Notwithstanding anything contained in sub-section (9) and sub-section (10), any private placement issue not made in compliance of the provisions of sub-section (2) shall be deemed to be a public offer and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable.

SUMMARY

- ◆ Securities can be offered to public at large (public offer) or through private placement. However, a private company is prohibited from resorting to public offer.
- ◆ Prospectus, deemed prospectus, abridged prospectus, red-herring prospectus, shelf prospectus, information memorandum need to comply with the minimum information requirements as prescribed in the Companies Act, 2013 and the applicable Rules.

- ◆ Fraudulent omission or commission in the prospectus attracts civil as well as criminal liability.
- ◆ SEBI has power to deal with matters relating to listed or proposed to be listed securities. Central Government (through MCA represented by Regional Directors and ROCs) has power to deal with matters relating to unlisted securities.
- ◆ Issue of securities (shares, debentures or hybrid securities) through public offer is to be made only in demat form by the companies which are not exempted.
- ◆ Existing holders of securities could offload their stake through required compliances for an offer for sale of securities to the public (OFS route).
- ◆ Provision related to timelines, pre-requisites for allotment and listing wherever applicable needs to strictly adhered to avoid any penal provision.
- ◆ Private placements have somewhat diluted disclosure requirements as public exposure is not there.

TEST YOUR KNOWLEDGE

Question 1

Explain various instances which make the allotment of securities as irregular allotment under the Companies Act, 2013.

Answer

Irregular allotment: The Companies Act, 2013 does not specifically provide for the term "Irregular Allotment" of securities. Hence, we have to examine the requirements of a proper issue of securities and consider the consequences of non- fulfillment of those requirements.

In broad terms an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 or 40. Irregular allotment therefore arises in the following instances:

1. Where a company does not issue a prospectus in a public offer as required by section 23; or
2. Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or

3. Where the prospectus has not been filed with the Registrar for filing under section 26 (4); or
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.

Question 2

What is a Shelf-Prospectus? State the important provisions relating to the issuance of Shelf-Prospectus under the provisions of the Companies Act, 2013 and the Companies (Prospectus and Allotment of securities) Rules, 2014.

Answer

Shelf prospectus – As per the Explanation given in Section 31 of the Companies Act, 2013, the expression “shelf prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

Provisions relating to the issue of Shelf-prospectus are as under:

- (1) **Filing of shelf prospectus with the Registrar:** According to section 31 (1), any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-
 - (i) of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and
 - (ii) in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.
- (2) **Filing of Information Memorandum with the Shelf Prospectus:** According to Section 31 (2), a company filing a shelf prospectus shall be

required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

- (3) **Intimation of Changes:** According to Proviso to Section 31 (2), where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

According to Rule 10 of the *Companies (Prospectus and Allotment of securities) Rules, 2014*, the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the *Companies (Registration Offices and Fees) Rules, 2014* within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

- (4) **Information Memorandum together with the Shelf Prospectus is deemed Prospectus:** According to Section 31 (3), where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Question 3

The Board of Directors of Chandra Mechanical Toys Limited proposes to issue a prospectus inviting offers from the public for subscribing to the equity shares of the Company. State the reports which shall be included in the prospectus for the purposes of providing financial information under the provisions of the Companies Act, 2013.

Answer

As per section 26(1) of the Companies Act, 2013, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state such

information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.

It is provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

According to clause (c) of Section 26 (1), the prospectus shall make a declaration about the compliance of the provisions of the Companies Act, 2013 and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Accordingly, the Board of Directors of Chandra Mechanical Toys Limited which proposes to issue the prospectus shall provide such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government to comply with the above stated provisions and make a declaration about such compliance.

Question 4

Unique Builders Limited decides to pay 2.5 percent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act, 2013.

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to a number of conditions which are prescribed under the *Companies (Prospectus and Allotment of Securities) Rules, 2014*. In relation to the case given, the conditions applicable under the above Rules are as under:

- (a) The payment of such commission shall be authorized in the company's articles of association;
- (b) The commission may be paid out of proceeds of the issue or the profit of the company or both;

- (c) The rate of commission in case of debentures, shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less.

Thus, the underwriting commission in case of debentures is limited to 2.5%.

In view of the above, the decision of Unique Builders Limited to pay underwriting commission exceeding 2% as prescribed in the Articles is invalid.

The company may pay the underwriting commission in the form of flats as both the Companies Act and the Rules do not impose any restriction on the mode of payment though the source has been restricted to either the proceeds of the issue or profits of the company.

Question 5

PQR Bakers Limited wants to raise funds for its upcoming project. Accordingly, it has issued private placement offer letters for issuing equity shares to 55 persons, of which four are qualified institutional buyers and remaining are individuals. Before the completion of allotment of equity shares under this offer letter, company issued another private placement offer letter to another 155 persons in their individual names for issue of its debentures.

Being a public company is it possible for PQR Bakers Limited to issue securities under a private placement offer? By doing so, whether the company is in compliance with provisions relating to private placement or should these offers be treated as public offers? What if the offer for debentures is given after allotment of equity shares but within the same financial year?

Answer

According to section 42 of the Companies Act, 2013 any private or public company may make private placement through issue of a private placement offer letter.

However, the offer shall be made to the persons not exceeding fifty or such higher number as may be prescribed, in a financial year. For counting number of persons, Qualified Institutional Buyers (QIBs) and employees of the company being offered securities under a scheme of employees' stock option will not be considered.

Further, Rule 14 (2) of *the Companies (Prospectus and Allotment of Securities) Rules, 2014* prescribes maximum of 200 persons who can be offered securities under the private placement in a financial year, though this limit should be counted separately for each type of security.

It is to be noted that if a company makes an offer or invitation to more than the prescribed number of persons, it shall be deemed to be an offer to the public and accordingly, it shall be governed by the provisions relating to prospectus.

Also, a company is not permitted to make fresh offer under this section if the allotment with respect to any offer made earlier has not been completed or otherwise, that offer has been withdrawn or abandoned by the company. This provision is applicable even if the issue is of different kind of security.

Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions will apply accordingly.

In the given case PQR Bakers Limited, though a public company but the private placement provisions allow even a public company to raise funds through this route. The company has given offer to 55 persons out of which 4 are qualified institutional buyers and hence, the offer is given effectively to only 51 persons which is well within the limit of 200 persons. From this point of view, the company complies the private placement provisions.

However, as per the question, the company has given another private placement offer of debentures before completing the allotment in respect of first offer and therefore, the second offer does not comply with the provisions of section 42. Hence, the offers given by the company will be treated as public offer.

In case the company gives offer for debentures in the same financial year after allotment of equity shares is complete then both the offers can well be treated as private placement offers.

Question 6

How does the Companies Act, 2013 regulate and restrict the following matters in respect of a company going for public issue of shares:

- (i) *Minimum Amount stated in the Prospectus; and*
- (ii) *Application Money payable on shares.*

Answer

The Companies Act, 2013 by virtue of the provisions as contained in Section 39 (1) and (2) regulates and restricts the minimum amount stated in the prospectus and the application money payable in a public issue of shares as under:

Minimum amount stated in a prospectus [Section 39 (1)]

No Allotment shall be made of any securities of a company offered to the public for subscription; unless; -

- (i) the amount stated in the prospectus as the minimum amount has been subscribed; and
- (ii) the sums payable on application for such amount has been paid to and received by the company.

Application money: Section 39 (2) provides that the amount payable on application on each security shall not be less than 5% of the nominal amount of such security or such amount as SEBI may prescribe by making any regulations in this behalf.

Further section 39 (3) provides that if the stated minimum amount is not received by the company within 30 days of the date of issue of the prospectus or such time as prescribed by SEBI, the company will be required to refund the application money received within such time and manner as may be prescribed.

Rule 11 (1) of *the Companies (Prospectus and Allotment of Securities) Rules, 2014* mentions that if the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum. In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Section 40 (3) provides that all moneys received on application from the public for subscription to the securities shall be kept in a separate bank account maintained with a scheduled bank.

Question 7

The Board of Directors of Reckless Investments Limited, having registered office at Mumbai, has allotted equity shares to the 550 investors of the company without issuing a prospectus. As no prospectus was issued, nothing was delivered to the Registrar of Companies, Mumbai for filing. Explain the remedy available to the investors in this regard.

Answer

According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Further, where the limit crosses 200 investors the issue shall be deemed to be a public offer, as provided by Section 42. Section 26 (1) lays down the matters required to be disclosed and

included in a prospectus and requires the delivery of the prospectus to the Registrar for filing before its issue.

In the given case, the company has violated the above provisions and therefore, the allotment made by it is void. The company will be required to refund the entire moneys received and will also be punishable under section 26 (9).

Question 8

An allottee of shares in a company brought action against a director in respect of false statements made in the prospectus. The director contended that the statements were prepared by the promoters and he simply relied on them. Is the director liable under these circumstances? Decide referring to the provisions of the Companies Act, 2013.

Answer

Yes, the Director shall be held liable for the false statements made in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis-statements.

The only situations when a director will not incur any liability for mis-statements in a prospectus are as under:

- (a) No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.
- (b) No civil liability for any mis-statement under section 35 shall apply to a person if he proves that:
 - (1) having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
 - (2) the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

Therefore, in the present case the director cannot escape the liability by stating that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis-statements in the prospectus.

Question 9

Sudarshan Exports Limited was dealing in export of rubber to specified foreign countries. The company was willing to purchase rubber trees in A.P. State. The prospectus issued by the company contained some important extracts of the expert's report and number of trees in A.P. State. The report was found untrue. Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's report published in the prospectus. Will Mr. Alok have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013.

Answer

Under section 35 (1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person including an expert shall be liable to pay compensation to the person who has sustained such loss or damage.

In the present case, Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's report published in the prospectus. Mr. Alok can claim compensation for any loss or damage that he might have sustained from the purchase of shares, which has not been mentioned in the given case. Further, Section 35 also mentions punishment prescribed by section 36 i.e. punishment for fraud under section 447.

Circumstances when an expert is not liable: An expert will not be liable for any mis-statement in a prospectus under the following situations:

- (i) Under Section 26 (5): It states that having given his consent, the expert withdrew it in writing before delivery of the copy of prospectus for filing, or
- (ii) Under section 35 (2) (b): It states that the prospectus was issued without his knowledge/consent and that on becoming aware of it, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent;
- (iii) An expert will not be liable in respect of any statement not made by him in the capacity of an expert and included in the prospectus as such;
- (iv) Under Section 35 (2) (c): It states that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that

the person making the statement was competent to make it and that the said person had given the consent required by section 26(5) to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar or, to the defendant's knowledge, before allotment thereunder.

Question 10

Examine the validity of the following statement with reference to the provisions of the Companies Act, 2013.

"The Articles of Association of X Limited contain a provision that the underwriting commission may be paid up to 4% of the issue price of the shares. However, the Board of Directors have decided to pay the underwriting commission of 5% to Deal & Co., the underwriters."

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to the conditions prescribed under the *Companies (Prospectus and Allotment of Securities) Rules, 2014*. Rule 13 states that the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

In the given problem, the articles of X Ltd. have prescribed 4% underwriting commission but the directors decided to pay 5% underwriting commission.

Therefore, the decision of the Board of Directors to pay 5% underwriting commission to the underwriters (*i.e.* Deal & Co.) is invalid.