

3

CHAPTER

Prospectus and Allotment of Securities

S. No.	Table of Contents for the Chapter	PHASE
01.	Introduction – Overview of the Chapter	
02.	Prospectus – Meaning and Definition	I (Basics)
03.	Section 23 – Method of Issue of Prospectus	I (Basics)
04.	Section 24 – Regulation of Issue and Transfer of Securities etc.	I (Basics)
05.	Section 26 – Matters to be Stated in Prospectus – Contents & Requirements as to Prospectus	I (Basics)
06.	Section 27 – Variation in Terms of Contract or Objects Stated in Prospectus	I (Basics)
07.	Section 29 – Public Offer of Securities to be in Demat Form	I (Basics)
08.	Section 30 – Advertisement of Prospectus	I (Basics)
09.	Section 31 – Shelf Prospectus	II (Types)
10.	Section 32 – Red Herring Prospectus	II (Types)
11.	Section 33 – Concept of Abridged Prospectus – Issue of Application Forms for Securities	II (Types)
12.	Section 25 – Deemed Prospectus – The Documents Containing Offer of Securities for Sale	II (Types)
13.	Section 28 – Offer of Sale of Shares by Certain Members of Company	II (Types)
14.	Section 34 & 35 – Criminal & Civil Liability for Mis-Statements in Prospectus	III (Penalty)
15.	Section 36 – Punishment for Fraudulently Inducing Persons to Invest Money	III (Penalty)
16.	Section 37 – Action by Affected Persons	III (Penalty)
17.	Section 38 – Punishment for Personation for Acquisition, etc., of Securities	III (Penalty)
18.	Section 447 – Punishment for Fraud	III (Penalty)
19.	Section 39 – Allotment of Securities by Company	IV (Others)
20.	Section 40 – Securities to be Dealt with in Stock Exchanges	IV (Others)
21.	What is Underwriting Commission?	IV (Others)

22.	Section 41 – Global Depository Receipt [GDR]	IV (Others)
23.	Section 42 – Private Placement	IV (Others)

■ INTRODUCTION

Chapter III	Consists of sections 23 to 42 as well as the Companies (Prospectus and Allotment of Securities) Rules, 2014. <ul style="list-style-type: none"> <input type="checkbox"/> Part I - Public offer (Section 23-41) <input type="checkbox"/> Part II - Private placement (Section 42).
--------------------	---

AGENDA of the Chapter

- One major advantage of a company over other forms of business is its ability to raise capital effectively.
- Capital can be raised in two ways:
 - From the public at large, through a Public Offer, or
 - From a selected group of identified persons, through Private Placement of securities.
- When a company raises capital through a Public Offer, it must issue an advertisement as per applicable legal provisions.
- The purpose of this advertisement is to protect prospective investors from fraud or misleading information.
- Securities are allotted only to those applications which are received in full and are in accordance with the advertisement.
- These securities may be listed on a recognized stock exchange, in the appropriate segment.
- This chapter will explain the legal provisions related to:
 - Issue of prospectus,
 - Allotment of securities, and
 - Other incidental matters related to raising capital.

Before we start understanding the prospectus and why is it needed? We need to answer few questions first like -

1. Why do companies need funds for business?
2. What are the ways to raise money?
3. From whom can we receive funds?

Let's understand some basic terminologies - Public Offer and Private Placements

Points	Public Issue	Private Placement
Type of Offer and Invitee	It is a General Offer to everyone to subscribe for the securities of the company.	It is a Specific Offer to Selected Investors to subscribe for the securities of the company.
Type of Company	Only Listed Public Company can make a Public Issue.	All types of companies can issue their securities on Private Placement basis.

Example	1. Initial Public Offer (IPO) or 2. Further Public Offer (FPO), or 3. Offer For Sale (OFS)	Private Placement (Sec 42) Preferential Issue (Sec 62) Also known as Private Equity.
Offer Letter	Prospectus	Private Placement Offer-cum- Application Letter.

Securities [Section 2(81)]

The term “securities” under the Companies Act, 2013 refers to the definition given in Section 2(h) of the Securities Contracts (Regulation) Act, 1956. It is a broad term and not limited to just shares or debentures.

What All are Included as Securities?

1. Traditional instruments like shares, scrips, stocks, bonds, debentures, debenture stock, and other marketable securities issued by a company or body corporate.
2. Derivatives – These are contracts that derive value from underlying financial assets like stocks or commodities.
3. Units or instruments issued by collective investment schemes to investors.
4. Security receipts – As defined under the SARFAESI Act, 2002, they represent an investor’s interest in financial assets acquired by Asset Reconstruction Companies.
5. Mutual fund units or any other similar instruments issued to investors under mutual fund schemes.

Other Instruments that Qualify as Securities

6. Any certificate or instrument issued by a Special Purpose Vehicle (SPV) that acknowledges the investor’s beneficial interest in debts or receivables, like mortgage debt.
7. Government securities – such as bonds issued by the Central or State Government.
8. Any other instrument declared as a security by the Central Government.
9. Rights or interests in any of the above securities.

What is not Considered a Security?

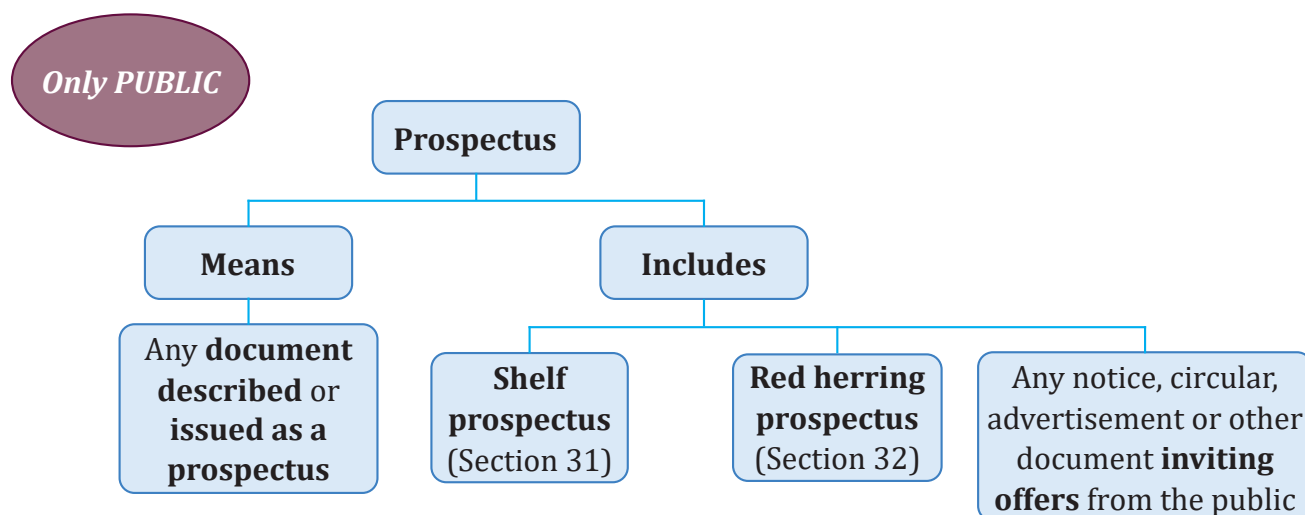
10. Unit Linked Insurance Policies (ULIPs) or similar instruments that offer both life risk cover and investment, issued by insurance companies, are not considered securities.

Example: Which of following shall be considered as securities for purpose of section 23 of the Act;

- (i) Unit linked insurance policy
 - (ii) Actionable claim regarding mortgaged debt
 - (iii) Securities issued by National Asset Reconstruction Ltd.
- (a) (iii) only
(b) Both (i) and (iii) only
(c) Both (ii) and (iii) only
(d) None of the (i), (ii), and (iii)

Answer: (c) (Refer section 2(h) of the Securities Contracts (Regulation) Act, 1956)

■ PROSPECTUS – SECTION 2(70) – MEANING AND DEFINITION



Any document described or issued as prospectus and Includes:

- Shelf prospectus - Section 31
- Red Herring Prospectus (RHP) - Section 32 or
- Any notice, circular, advertisement, or
- other doc inviting Offer from public → means - Deemed Prospectus or prospectus of implication Section 25.
- for subscription or purchase of any security of a body corporate

It must be in writing (No Audio/video/Film etc.)

MULTIPLE CHOICE QUESTIONS (MCQ)

1. A document would be called as a prospectus if it satisfies the following conditions:
 - (a) It is an invitation for subscription of securities of a company.
 - (b) It is an invitation made to the public.
 - (c) **Both (a) and (b)**
 - (d) Either (a) or (b)

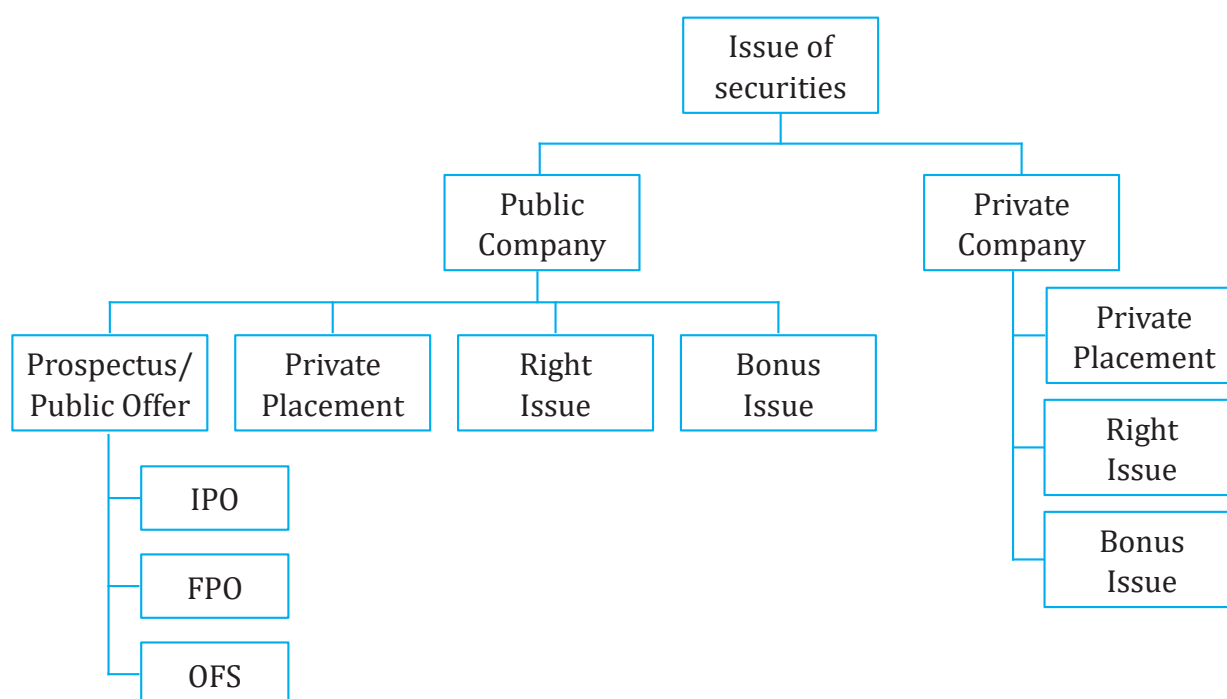
■ SECTION 23 – METHOD OF ISSUE OF PROSPECTUS

Applicability of Sections/Act	Type of Company	Mode of Issuing Securities
Sections 23 to 41	Public Company	1. Public Offer through prospectus (IPO/ FPO/ OFS)
Section 42		2. Private Placement
The Companies Act + SEBI Act, 1992		3. Rights Issue or Bonus Issue

The Companies Act	Private Company	1. Rights Issue or Bonus Issue
Section 42		2. Private Placement

Note: 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.

Further Public Offer also known as Fellow-on Public Offer, whereas OFS is sometimes called deemed Public Offer.



Section 23 (3) and (4)

Background: Why were these provisions inserted through Amendment?

- ❑ Earlier, Indian companies could raise funds overseas only through:
 - Depository Receipts like ADRs (American Depository Receipts) or GDRs (Global Depository Receipts)
 - Or by listing debt instruments abroad (e.g. Masala Bonds, FCCBs)
- ❑ However, raising capital from foreign equity markets is often cheaper and gives access to global investors.

What Section 23(3) Says

- ❑ A specific class of public companies (to be notified) is now allowed to:
 - Issue a specific class of securities for the purpose of direct listing on permitted stock exchanges in:
 - Permissible foreign jurisdictions, or
 - Other prescribed jurisdictions
- ❑ This is called overseas direct listing (without going through the ADR/GDR route).

What Section 23(4) Says

- ❑ The Central Government has the power to exempt such public companies (covered under Section 23(3)) from:
 - Chapter III – Prospectus and Allotment of Securities
 - Chapter IV – Share Capital and Debentures
 - Section 89 – Declaration of beneficial interest in shares
 - Section 90 – Register of significant beneficial owners
 - Section 127 – Punishment for not distributing dividends
- ❑ The exemption is granted through notification, which must be laid before both Houses of Parliament.

Note: How overseas direct listing is different from ADRs/GRDs?

In a direct listing, a domestic company can enlist itself with the stock exchanges of other countries without an intermediary. Unlike American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs), the Indian company can directly offer their shares in foreign markets instead of giving them to a foreign depository bank. Direct listing excludes intermediaries, decreases the overall transaction cost, and increases transparency. (To be covered in detail later)

MULTIPLE CHOICE QUESTIONS (MCQ)

2. A public company may issue securities:
 - (a) By way of public offer
 - (b) By private placement
 - (c) By making a Rights issue or Bonus issue
 - (d) All of the above**
3. A private company may issue securities:
 - (a) By way of public offer
 - (b) By private placement**
 - (c) By offer of sale of securities to public
 - (d) All of the above
4. An issue of prospectus is required for:
 - (a) Initial Public Offer
 - (b) Further Public Offer of securities to the public
 - (c) An offer for sale of securities to the public by an existing shareholder
 - (d) All of the above**
5. A Private Company cannot issue securities:
(1 Mark) (MTP Sep. 22)
 - (a) By way of rights issue
 - (b) By way of bonus issue
 - (c) By way of private placement
 - (d) By issue of Prospectus in Public**

SECTION 24 REGULATION OF ISSUE AND TRANSFER OF SECURITIES ETC.

Who has the authority?

Securities and Exchange Board of India (SEBI) is empowered to administer those provisions under section 11, 11A, 11B and 11D of chapter III and IV of the Securities and Exchange Board of India Act 1992.

For	Authority	Matters
Listed or those who are in the process of listing (Intention)	SEBI	Issue and transfer of securities and non payment of Dividend
	CG, Tribunal or the Registrar as the case may be	All other matters like (including matters relating to prospectus, return of allotment, redemption of preference shares)
Unlisted Public & Pvt	CG (MCA)	CG (MCA)

Example:

Statement: The powers to administer the matters pertaining to redemption of preference share by listed companies vested with the Securities and Exchange Board of India.

Answer: False (Refer Section 24(1)(a))

SECTION 26 MATTERS TO BE STATED IN PROSPECTUS – CONTENTS & REQUIREMENTS AS TO PROSPECTUS

Sub section	Provision	Explanation
(1)	Date, Sign & Contents General Info Statutory Info	<input type="checkbox"/> The prospectus must be properly dated and signed, <input type="checkbox"/> it should include all financial information and reports as required by SEBI in consultation with CG <input type="checkbox"/> along with a declaration that the company is following all relevant laws.
		<input type="checkbox"/> Statement that nothing is contrary to: <ul style="list-style-type: none"> <input type="radio"/> The Companies Act, 2013 <input type="radio"/> Securities Contract (Regulation) Act, 1956 (SCRA) <input type="radio"/> Securities and Exchange Board of India Act, 1992 (SEBI) <input type="radio"/> Rules and Regulations made under above three statutes.
(2)	Exemption No need to follow Sec 26(1) or issue prospectus	<input type="checkbox"/> If the company issues the prospectus to its current shareholders or debenture holders, or <input type="checkbox"/> whether an applicant has a right to renounce the shares or not under section 62 in favour of any other person or <input type="checkbox"/> if it is an offering which is of the same kind of securities already listed on the stock exchange
(3) (Explanation)	Date of Publication	The date written on the prospectus will be treated as its official publication date.
(4)	Filing with Registrar	A company must not issue a prospectus - <ul style="list-style-type: none"> <input type="checkbox"/> unless a signed copy is filed with the Registrar. <input type="checkbox"/> Every director or proposed director must sign it, or <input type="checkbox"/> they can authorize someone else to sign on their behalf.

Note: Such copy shall be signed by every person who is named as either director or proposed director in such prospectus. A duly authorised attorney can sign in representative capacity.

(5)	Experts' Statement Conditions	<p>A prospectus shall include an expert's statement by an expert person who is –</p> <ul style="list-style-type: none"> <input type="checkbox"/> Not or has been not been engaged in – <ul style="list-style-type: none"> <input type="radio"/> Promotion or <input type="radio"/> Formation or <input type="radio"/> Management in company <input type="checkbox"/> Has given written consent of expert <input type="checkbox"/> Has not withdrawn the delivery before delivery to ROC
<div style="border: 1px solid black; padding: 10px; background-color: #f0f0f0;"> <p>Who can be an Expert?</p> <p>CA, CS, ER, Valuer, Cost Accountant and any other person who has authority under any Act</p> </div>		

Note: A statement to that effect (non-existence of conditions, if expert's statement is included) shall also be included in the prospectus.

Purpose of sub-section 5 is to ensure independence of experts to protect the financial interest of prospective investors who may invest in a company after relying upon the statement of such expert. Expert as per section 2(38) of the Act, 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)	Disclosure on Face of Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> The front page of the prospectus must mention <input type="checkbox"/> that a copy has been filed with the Registrar, and <input type="checkbox"/> it should clearly state or refer to the attached required documents. <input type="checkbox"/> Helps with transparency and verification.
(7)	[Omitted]	(No requirement – this clause has been removed.) Omitted from 15-08-2019.
(8)	Validity of Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> A prospectus stays valid <input type="checkbox"/> only for 90 days <input type="checkbox"/> from the date it was filed with the Registrar. <input type="checkbox"/> If 90 days have passed, a fresh copy must be filed again.

Note: Date of filing copy of prospectus with registrar is important in context of concept of validity of prospectus for issue, discussed under section 26(8).

(9)	Penalty for Contravention	If the rules of Section 26 are not followed, the company and anyone involved knowingly will face a fine between ₹50,000 and ₹3,00,000.
------------	----------------------------------	--

Note: The date of issue is important for many reasons, one of them being the value of securities keeps changing.

If 90 days have expired after filling the prospectus, it is better to send a fresh copy of the prospectus to the registrar under section 26(4); to avoid the penalties imposed under section 26(9).

Golden rule of prospectus

Prospectus will be deemed to be untrue if —

- Misleading in the form and context
- Omission of any matters from investor
- Whole picture of the company
- Disclose all facts
- Suppression of a fact - howsoever remote it may be.

Example: The Board of Directors of a Pharmaceutical Limited has allotted shares to the public by issuing a prospectus that is not filed with the Registrar of Companies.

In this regard, it is to be noted that a public company can issue securities to the public only by issuing a prospectus, under section 23(1)(a) of the Act.

Further section 26(4) requires that no prospectus shall be issued unless a duly signed copy of the prospectus forwarded to the Registrar for filing.

In the given case, the company has issued the prospectus in violation of the provisions of section 26. Hence, company as well as the person who is knowingly a party to this, will be punishable with penalty under section 26 (9) of the Act.

Example: Statement – The copy of prospectus submitted with the registrar for filling needs to be duly signed by the majority of directors.

Answer: False

Under section 26(4) of the Act, the copy of the prospectus submitted with the registrar for filing shall be signed by every person who is named as either director or proposed director in such prospectus. A duly authorised attorney can sign in representative capacity.

MULTIPLE CHOICE QUESTIONS (MCQ)

6. An unlisted company makes an offer to allot shares to certain persons in a financial year. It has not yet received any payment in respect of the shares offered. The offer should be made to a maximum number of persons so that it does not constitute a public offer.

- (a) 50 (b) 100
(c) 150 (d) 200

7. A private company cannot issue securities by the way of:

- (a) Initial Public offer
(b) Rights issue
(c) Bonus issue
(d) Private placement

8. An issue of prospectus is not required in the following case(s):

(a) In case of Rights Issue.

(b) In case of further public issue by listed companies of securities which are uniform in all respects with previously issued.

(c) Both (a) and (b)

(d) None of the above

9. Any prospectus issued by a company needs to be:

(a) Dated and signed by all the directors of the company.

(b) Dated and signed by all the present and proposed directors of the company.

(c) Dated and signed by any two directors of the company.

(d) Dated and signed by all the members of the company.

10. Any prospectus shall be valid if it is issued within ___ days of filing a copy thereof with the Registrar.

(a) 60

(b) 90

(c) 180

(d) None of the above

11. Which of the following persons is disqualified from acting as an 'Expert' with reference to the issue of prospectus?

(a) An Engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant.

(b) Any other person who has the power or authority to issue a certificate in pursuance of any law.

(c) A person who is engaged in the formation of the Company.

(d) All of the above

12. The statement of an 'expert' can be included in a prospectus provided:

(a) The Expert has given his written consent to the issue of the prospectus.

(b) The Expert has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for filing.

(c) A statement to that effect is included in the prospectus.

(d) All of the above

SECTION 27 VARIATION IN TERMS OF CONTRACT OR OBJECTS STATED IN PROSPECTUS

Section 27(1)	<input type="checkbox"/> A company can change the terms mentioned in the prospectus or <input type="checkbox"/> The object for which funds were raised, <input type="checkbox"/> Only by a Special Resolution <input type="checkbox"/> Passed in a general meeting.
Proviso 1 to Section 27(1)	<input type="checkbox"/> Details of the notice for the meeting must be published in two newspapers (one in English + one in local language) <input type="checkbox"/> Where the registered office is located, <input type="checkbox"/> Clearly stating the justification for variation.
Proviso 2 to Section 27(1)	<input type="checkbox"/> The company cannot use the raised funds <input type="checkbox"/> To buy, trade or deal in equity shares of any other listed company.
Section 27(2)	<input type="checkbox"/> If shareholders disagree with the proposed change (dissenting shareholders), <input type="checkbox"/> Promoters/controlling shareholders must give them an exit offer <input type="checkbox"/> At a price & manner as per SEBI regulations.

Doctrine of Ultra Vires	<input type="checkbox"/> Once funds are raised, they must be used only as per the objectives stated in the prospectus. <input type="checkbox"/> Any variation needs prior investor approval, and dissenting investors must be given a recall/exit option.
Rule 7(1)	<input type="checkbox"/> The Special Resolution must be passed through postal ballot. <input type="checkbox"/> The notice must include prescribed justifications and details.
Rule 7(2)	<input type="checkbox"/> The notice must be published in Form PAS-1, in newspapers, <input type="checkbox"/> at the same time as postal ballot dispatch.
Rule 7(3)	<input type="checkbox"/> The notice should also be placed on the company's website, if it has one.

Example: Ind-swift pharma limited after issue of prospectus, willing to make variation in object of issue of prospectus (due to change in industry brought by covid-19 among other dynamics of pharma industry). What is your piece of advice to Ind-swift pharma limited?

In a given case, Ind-swift should authorise the changes through special resolution passed at general meeting and a copy of notice that is given to shareholders for such variation shall be published in the newspaper along with justification of variation.

If any shareholder shows dissent then exit option shall be provided in accordance with guideline issued in this regard by SEBI.

Example: In case of variation in terms of contract or objects in prospectus, which of the following statement are not true:

- (i) Ordinary resolution shall be passed at general meeting
- (ii) Notice given to shareholder shall also be published in two newspapers
- (iii) Amount raised can be invested only in equity shares of prescribed class of companies.
 - (a) (i) only
 - (b) Both (i) and (ii) only
 - (c) Both (i) and (iii) only
 - (d) Both (ii) and (iii) only

Answer: (c)

MULTIPLE CHOICE QUESTIONS (MCQ)

- 14.** A company can vary the terms of any contract referred to in the prospectus or objects for which the prospectus was issued, provided:
 - (a) An approval of variation is given by members by way of Special Resolution.
 - (b) The prescribed details of notice are published in newspapers.
 - (c) An exit option is provided to the dissenting shareholders.
 - (d) All of the above**
- 15.** 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 issued in:
 - (a) Form PAS-1**
 - (b) Form PAS-2
 - (c) Form PAS-3
 - (d) Form PAS-4

■ SECTION 29 PUBLIC OFFER OF SECURITIES TO BE IN DEMATERIALIZED FORM

- ❑ 1-Mandatory - Only in Dematerialised form (DEMAT) - Has an overriding effect to any provision of this act.

Every company and such other class(es) of public company issuing securities through Public offer As per Depositories Act 1996

- ❑ 1A - Unlisted Company (such prescribed class)

Securities shall be held or transferred only in DEMAT form by complying Depositories Act 1996

- ❑ 2-Any other company (Private Company) may (Optional) -

- Convert physical to DEMAT
- Issue in physical form
- Issue in DEMAT form.

MULTIPLE CHOICE QUESTIONS (MCQ)

16. Neptune Metal Tools Limited was incorporated on 2nd December, 2018 with twenty-five subscribers and authorised capital of ₹50,00,000 (5,00,000 equity shares of ₹10 each). As the directors of the company are in a dilemma whether to issue physical share certificates to the subscribers or keep the shares in dematerialized form, they need to be advised correctly in this respect.

- (a) Being an unlisted company, Neptune may either issue physical share certificates to the subscribers or alternatively, issue them in dematerialized form.
- (b) Neptune needs to issue shares to the subscribers only in dematerialized form.**
- (c) A company having more than 100 shareholders needs to issue shares in

dematerialized form and therefore, Neptune may issue physical share certificates to the subscribers.

- (d) A company having authorised capital of fifty lakhs and above needs to issue shares in dematerialized form and therefore, Neptune may issue physical share certificates to the subscribers.

17. Which of the following companies or companies shall issue and transfer the securities only in dematerialised form?

- (a) Any company making a public offer and any unlisted public company.**
- (b) Any company making private placement of securities.
- (c) Both (a) and (b)
- (d) None of the above

■ SECTION 30 ADVERTISEMENT OF PROSPECTUS

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:

- A. Objects,
- B. Liability of members and the amount of share capital of the company,
- C. Names of the signatories to the memorandum,
- D. Number of shares subscribed for by the signatories, and
- E. Capital structure of the company.

Content-Relate to clauses of MOA (SSONNCL)

- ❑ Object
- ❑ Liabilities
- ❑ Share Capital and structure
- ❑ Name of signatories
- ❑ Number of shares subscribed

1. A prospectus issued in the form of advertisement must state.

- (a) The objects for which the company has been formed
- (b) The liability of members
- (c) The amount of share capital of company
- (d) All of the above**

Types of Prospectus

- **Section 25** – Deemed Prospectus
- **Section 31** – Shelf Prospectus
- **Section 32** – Red Herring Prospectus or (IM)
- **Section 33** – Abridged Prospectus

SECTION 31 SHELF PROSPECTUS

Provision	Description
Meaning of Shelf Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> A shelf prospectus is a type of prospectus that allows a company to offer its securities to the public <input type="checkbox"/> In multiple issues over a period, <input type="checkbox"/> Without needing to issue a new prospectus each time.
Why is Shelf Prospectus Needed?	<ul style="list-style-type: none"> <input type="checkbox"/> Companies that frequently raise capital during the year would otherwise need to issue a new prospectus for every offer. <input type="checkbox"/> A shelf prospectus saves them from this repetitive and time-consuming process.
Filing of Shelf Prospectus [Sub-section 1]	<ul style="list-style-type: none"> <input type="checkbox"/> The company must file the shelf prospectus with the Registrar of Companies (RoC) at the time of the first offer of securities. <input type="checkbox"/> Only companies from specific classes, as notified by SEBI, can use a shelf prospectus. <input type="checkbox"/> The shelf prospectus must mention a validity period, which cannot exceed one year from the date the first offer opens. <input type="checkbox"/> The period of validity is to commence from the date of opening of the first offer of securities under such prospectus <input type="checkbox"/> During the validity period, for any subsequent issues, no new prospectus is needed.
Filing of Information Memorandum [Sub-section 2]	<p>Before making any second or further offer under the shelf prospectus, the company must file an Information Memorandum (Refer the note) with the RoC, containing:</p> <ul style="list-style-type: none"> <input type="checkbox"/> All material facts about new charges created. <input type="checkbox"/> Any changes in the company's financial position since the previous offer. <input type="checkbox"/> Any other prescribed changes.

Note: Procedural Aspects

- As per Rule 10 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.
- The information memorandum shall be prepared in Form PAS-2.
- It shall be 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.

Protection for Investors (Proviso to Sub-section 2)

- If investors have applied and paid in advance before such changes occurred, the company must inform them about the changes.
- If any investor wants to withdraw after learning of the changes, their money must be refunded within 15 days

Deemed Prospectus [Sub-section 3]

Each time an offer is made using a shelf prospectus and an information memorandum, the two documents together are treated as a prospectus under the law.

Shelf prospectus + IM = Deemed to a prospectus

Example: An applicant who made an application for allotment along with advance payment of subscription, if he expresses a desire to withdraw his application after changes reported in information memorandum came to his knowledge. The company;

- (a) May refund the monies at discretion of Board of Directors
- (b) Shall refund the monies after deducting the administrative charges within fifteen days
- (c) Shall refund all the monies received as subscription within fifteen days
- (d) Shall refund the monies after deducting the administrative charges within 30 days

Answer: (c) [Refer proviso to section 31(2). 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].

MULTIPLE CHOICE QUESTIONS (MCQ)

- 18.** Dwapar Equipment Finance Limited, a Non-Banking Finance Company (NBFC), is desirous of offering secured, redeemable, non-convertible 9% Debentures to the public in three or more tranches over a certain period of time. Which kind of prospectus it is required to issue so that its purpose is served and there arises no need to take out a fresh prospectus for second and subsequent offer of securities. **(MTP NOV 2019)**
- (a) Deemed Prospectus.
 - (b) **Shelf Prospectus.**
 - (c) Red Herring Prospectus.
 - (d) Abridged prospectus.
- 19.** A shelf prospectus filed with the ROC shall remain valid for a period of:
- (a) one year from the date of registration
 - (b) one year from the date of closing of first issue
 - (c) **one year from the date of opening of first issue**
 - (d) Ninety days from the date on which a copy was delivered to ROC

20. After filing of shelf prospectus, a company shall file with the Registrar, an Information Memorandum containing all material changes occurring between first issue and subsequent issue, in:

- (a) Form PAS-1
- (b) Form PAS-2**
- (c) Form PAS-3
- (d) Form PAS-4

■ SECTION 32 RED HERRING PROSPECTUS

Provision	Description
Meaning of Red Herring Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> A red herring prospectus is a type of prospectus that does not mention the final price or number of securities being offered. <input type="checkbox"/> These details are decided later, after the issue closes.
Why is a Red Herring Prospectus Needed?	<ul style="list-style-type: none"> <input type="checkbox"/> It gives companies flexibility to take advantage of market conditions and investor demand. <input type="checkbox"/> By not fixing the price or quantity upfront, <input type="checkbox"/> companies can use book-building to determine them later.
<p>Note: Book Building is actually a price discovery method. In this method, the company doesn't fix up a particular price for the shares, but instead gives a price range.</p> <p>An underwriter builds a book by accepting orders from fund managers, indicating the number of shares they desire and the price they are willing to pay.</p>	
When is a Red Herring Prospectus Issued? [Sub-section 1]	<ul style="list-style-type: none"> <input type="checkbox"/> A company planning to issue securities may release a red herring prospectus <input type="checkbox"/> before the final prospectus is issued.
Filing with Registrar [Sub-section 2]	<ul style="list-style-type: none"> <input type="checkbox"/> The red herring prospectus must be filed with the Registrar of Companies (RoC) <input type="checkbox"/> at least three days before the public offer opens.
Same Legal Obligations as a Prospectus [Sub-section 3]	<ul style="list-style-type: none"> <input type="checkbox"/> A red herring prospectus has the same legal responsibilities and obligations as a regular prospectus. <input type="checkbox"/> Any differences between the red herring prospectus and the final prospectus must be clearly highlighted in the final document.
Filing After Closure of Offer [Sub-section 4]	<ul style="list-style-type: none"> <input type="checkbox"/> After the issue closes, the company must file the final prospectus with the RoC and SEBI, including: <ul style="list-style-type: none"> <input type="checkbox"/> The total capital raised (debt or equity). <input type="checkbox"/> The final price of the securities. <input type="checkbox"/> Any other missing details that weren't in the red herring prospectus.

MULTIPLE CHOICE QUESTIONS (MCQ)

- 21.** A 'Red Herring Prospectus' means a prospectus which does not include complete particulars of:
- The number of shares and price of the shares
 - The total size of the public issue
 - Either (a) or (b)
 - Both (a) and (b)
- 22.** Which of the following statements is/are correct in respect of a red herring prospectus:
- The red herring prospectus shall carry the same obligations as are applicable to a normal prospectus.
 - The company shall file the red herring prospectus with the Registrar at least 3 days prior to the opening of the public issue.
 - The company shall file a complete prospectus with all required details on closing of the offer made under red herring prospectus.
 - All of the above**
- 23.** A prospectus which does not include complete particulars of the quantum or price of the securities included therein is called:
- (1 Mark) (MTP Oct. 23)**
- A deemed Prospectus
 - A Shelf Prospectus
 - An Abridged Prospectus
 - A Red Herring Prospectus**

■ SECTION 33 CONCEPT OF ABRIDGED PROSPECTUS - ISSUE OF APPLICATION FORMS FOR SECURITIES

Provision	Description
Meaning of Abridged Prospectus [Section 2(1)]	<input type="checkbox"/> An abridged prospectus is a brief summary of the full prospectus <input type="checkbox"/> that includes key highlights, <input type="checkbox"/> as specified by SEBI regulations.
Why is Abridged Prospectus Needed?	<input type="checkbox"/> It is used to reduce the cost and effort of printing the full prospectus <input type="checkbox"/> with every share/debenture application form, <input type="checkbox"/> especially during a public offer.
Must Accompany Application Form [Sub-section 1]	<input type="checkbox"/> Every application form for shares or debentures must come along with an abridged prospectus.
Exceptions (Proviso to Sub-section 1)	Abridged prospectus is not required when: <ul style="list-style-type: none"> <input type="checkbox"/> The form is for a genuine invitation to enter into an underwriting agreement. <input type="checkbox"/> The securities are not offered to the public. <input type="checkbox"/> The offer is made only to existing members of the company (rights issue).
Right to Receive Full Prospectus [Sub-section 2]	<input type="checkbox"/> Any person has the right to get the full prospectus <input type="checkbox"/> if they request it before the offer or subscription list closes.

Penalty for Non-Compliance [Sub-section 3]	If a company doesn't follow these rules, it has to pay a penalty of ₹50,000 for each default.
---	---

■ SECTION 25 DEEMED PROSPECTUS - THE DOCUMENTS CONTAINING OFFER OF SECURITIES FOR SALE

Sub Section	Provision	Description
(1)	When a document is treated as a Deemed Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> If a company allots or agrees to allot securities with the intention that they will be sold to the public, then <input type="checkbox"/> The document used for such an offer will be treated as a prospectus issued by the company. <input type="checkbox"/> All rules and liabilities that apply to a real prospectus (such as misstatements or required disclosures) will also apply to this deemed prospectus.
<p>Note: The purpose of deeming provision is to protect gullible investors from various fraudulent practices.</p>		
(2)	Presumption of intention to offer to public	<ul style="list-style-type: none"> <input type="checkbox"/> It will be assumed that the company wanted to offer the securities to the public if – Conditions for a document to be called deemed prospectus- <ul style="list-style-type: none"> <input type="checkbox"/> Issuing house or company allots or offers within 6 months of the agreement with the main company, <li style="text-align: center;">or <input type="checkbox"/> Consideration is not received by the company before offer is made by issuing house or co. to the public. <input type="checkbox"/> If either of the above happens, the offer document is treated as a deemed prospectus.
<p>Note:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Sub-section 1 and 2 to section 25 are not exhaustive in nature, there may be certain other situations when issuing documents may constitute as deemed prospectus. <input type="checkbox"/> SEBI vs Kunnankulam Paper Mills Ltd - Where a rights issue is made to existing members with a right to renounce in favor of others, if the number of such others exceeds fifty, it also becomes a deemed prospectus. 		
(3)	Matters (information) to be included additionally	<ul style="list-style-type: none"> <input type="checkbox"/> The deemed prospectus must also mention:- <input type="checkbox"/> The net amount received or to be received for the securities, <input type="checkbox"/> The time and place where the related allotment contract can be seen, <input type="checkbox"/> The persons making the offer were named as directors in the document. <input type="checkbox"/> These details are required in addition to what is already needed under Section 26, to give full clarity to investors.

Example:

Statement: The matters specified under section 25(3) need to be stated in substitution of matters stated under section 26.

Answer: False [Section 25(3) provides three matters that need to be stated in addition to matters required to be stated in prospectus under section 26.]

(4)

Who should sign the deemed prospectus

- The deemed prospectus must be signed by at least two directors of the company.
- Unlike a regular prospectus where all named/proposed directors must sign (as per Section 26), only two directors' signatures are enough here.

Note: Understanding 'Invitation to Public' and Deemed Prospectus – Additional Insights

When do Provisions of Prospectus Apply?

- The legal provisions and penalties relating to a prospectus (including a deemed prospectus) apply only when the prospectus is “issued”.
- “Issued” means made available to the public, not just prepared or circulated privately.

Who is Considered as 'Public'?

- Not restricted to “public at large.”
- Includes any section of the public, regardless of how they are chosen.
- Even a limited group of people can qualify as “public.”
- Public ≠ personal connections. It excludes friends, relatives, or known associates of the promoter.

Case Law Insights

Case 1: Re South of England Natural Gas and Petroleum Co. Ltd

- Facts: 3000 copies of a share offer were circulated among gas company members. The document said “For Private Circulation Only.”
- Issue: Was it a prospectus, even if meant for a limited audience?
- Decision: Yes, it was still an offer to the public, because the recipients, although limited in number, were still part of the public.
- Key Takeaway: A document marked private can still be a prospectus if it reaches a group that qualifies as public.

Case 2: Nash v. Lynde

- Facts: A document marked “Strictly Private and Confidential” was sent to one person who later sued for lack of full disclosure.
- Issue: Can a single private communication be considered a prospectus?
- Decision: No, private communication is not considered an “issue” to the public. Hence, it doesn't attract prospectus provisions.
- Key Statement (Viscount Sumner):
“The public means anyone who can bring money and apply in due form. A private note, even to one person, doesn't make it a public offer.”

Conclusion:

- ❑ Even if an offer document is meant for a limited audience, it may still be considered a prospectus if it's addressed to persons outside personal circles.
- ❑ A single, truly private communication does not amount to issuing a prospectus and doesn't attract legal consequences under prospectus provisions.
- ❑ The intention to invite public investment, even indirectly, is key in determining whether a document qualifies as a deemed prospectus.

MULTIPLE CHOICE QUESTIONS (MCQ)

24. A issue house (share broker) has issued an advertisement in two leading newspapers for selling a big number of shares allotted to it by a company under a private placement. In which of the following conditions the advertisement will not be deemed as prospectus:
- (a) Advertisement was given within six months from the date of allotment
 - (b) Advertisement was given after six months from the date of allotment and the issue house paid the entire consideration to the company**
 - (c) The issue house did not pay entire consideration to the company till the date of allotment
 - (d) Advertisement was given within three month from the date of allotment
25. ABC Ltd. allotted a big lot of its equity shares to XYZ LLP, a broker house. XYZ LLP issues an advertisement in leading newspapers for selling the shares of ABC Ltd. out of the lot allotted to it by the company. In which of the following case, the advertisement issued by XYZ LLP will not be regarded as a Deemed Prospectus under Section 25 of the Companies Act, 2013.
- (a) The advertisement was issued after 6 months of allotment of shares to XYZ LLP and it has paid the entire consideration for shares to ABC Ltd.**
 - (b) The advertisement was issued within 6 months of allotment of shares to XYZ LLP but it has paid the entire consideration for shares to ABC Ltd.
 - (c) The advertisement was issued after 6 months of allotment of shares to XYZ LLP but has not paid the entire consideration for shares to ABC Ltd.
 - (d) All of the above
26. ABC Ltd. allotted a big lot of its equity shares to XYZ LLP, a broker house. XYZ LLP issues a document for selling the shares of ABC Ltd. to general public and the same is deemed to be prospectus under Section 25 of the Companies Act, 2013. Who shall be the signatories to such a deemed prospectus?
- (a) All the directors of ABC Ltd.
 - (b) Any two directors of ABC Ltd.
 - (c) Not less than on-half of the partners of XYZ LLP**
 - (d) Any two partners of XYZ LLP

■ SECTION 28 OFFER OF SALE OF SHARES BY CERTAIN MEMBERS OF COMPANY

Provision	Description
Sub-section 1	<input type="checkbox"/> A shareholder or group of shareholders can offer <input type="checkbox"/> all or part of their shares to the public, but <input type="checkbox"/> only after consulting with the Board of Directors and <input type="checkbox"/> following the applicable laws.
Sub-section 2	<input type="checkbox"/> The document used to offer these shares to the public will be treated as a prospectus issued by the company, <input type="checkbox"/> so all rules related to a prospectus will apply.
Sub-section 3	<input type="checkbox"/> The shareholders offering the shares <input type="checkbox"/> must authorize the company to act on their behalf to complete the sale and <input type="checkbox"/> must reimburse the company for all related expenses.

Note: Procedural Aspects

Rule 8 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

According to Rule 8 (1) the provisions of section 23 to 41 of this Act and rules made thereunder shall be applicable to an offer of sale referred to in section 28 except for the provisions relating to:

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

Further, Rule 8 (2) requires that 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.

Example: In case of Super-Fix-it Limited, some of members of a company offer part of their holding of shares to the public (in consultation with board of directors), wherein company took all actions on their behalf for carrying out the transaction.

Company incur the expense of 3.2 lakh for carrying out such transactions, can company recover the amount so incurred in full from such members?

Answer: Yes, members who offer whole or part of their holding of shares to the public, in consultation with board of directors, shall authorise the company to take all actions on their behalf for carrying out the transaction, and bound to reimburse the company for all expenses made by it on this matter [Refer section 28(3)].

MULTIPLE CHOICE QUESTIONS (MCQ)

27. The paid up share capital of ABC Ltd. It is 5000000 shares of Rs. 200 each. 20% of its paid up share capital is held by 4 of its promoters, who want to offload their holding

by making an offer of sale to the public by issuing a prospectus. They want to authorise someone to take all actions and complete all formalities related to such an offer of sale.

From the following who can be authorised by them to do so. **(MTP MAY 2019)**

- (a) Any person who has agreed to fulfil all the formalities related to such offer of sale
- (b) Any one or more directors of the company.
- (c) Company itself whose shareholding they want to offload.**
- (d) Any competent officer of the company.

28. In case of 'offer of sale of shares by certain members of the company', which of the following options is applicable:

- (a) The provisions relating to minimum subscription are not applicable**
- (b) Entire minimum subscription amount is required to be received within three days of the opening date
- (c) 25% of the minimum subscription amount is required to be received on the opening date and the remaining 75% within three days thereafter
- (d) 50% of the minimum subscription is required to be received by the second day of the opening date and the remaining 50% within next three days after the second day

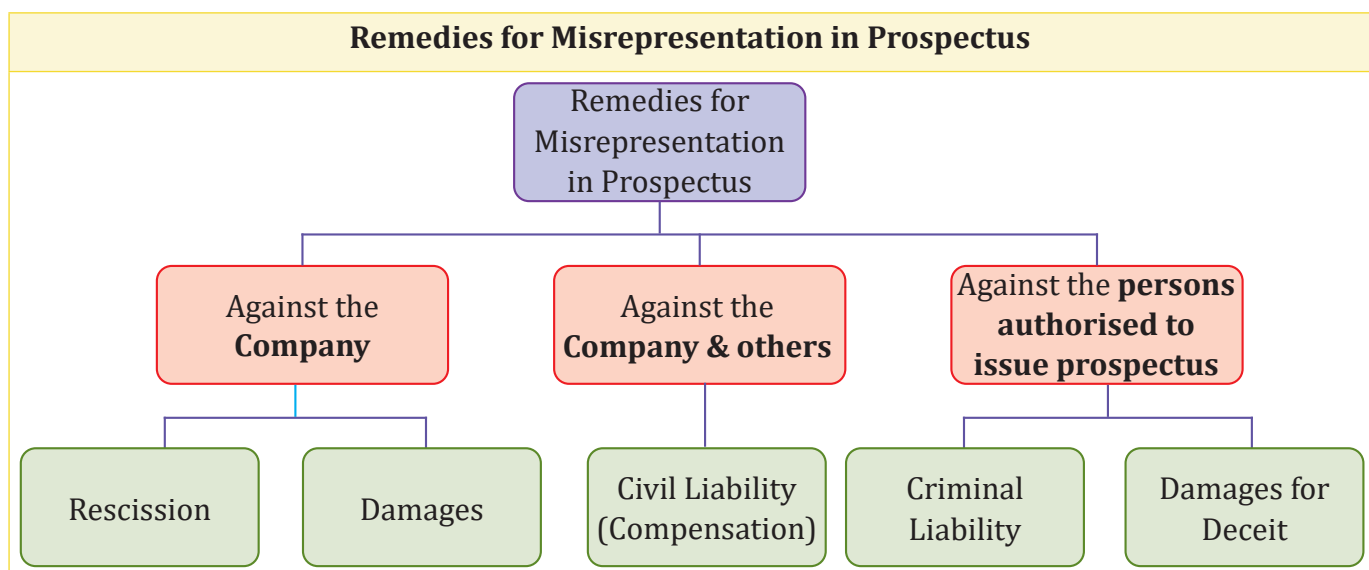
■ MIS-STATEMENTS IN PROSPECTUS

Section/Topics covered in the Phase III (Penalty)	
Rescission as a remedy against the company	
Damages as a remedy against the company	
34	Criminal liability for mis-statements in prospectus
35	Civil liability for mis-statements in prospectus
Damages for Deceit as a remedy against the person	
36	Punishment for fraudulently inducing persons to invest money
37	Action by affected persons
38	Punishment for personation for acquisition, etc., of securities
447	Punishment for Fraud

WHAT CONTRUES AS MIS-STATEMENT AND MISLEADING PROSPECTUS ?	If it contains: A false or inaccurate statement that creates a wrong impression or Omission or inclusion of any matter that could mislead the reader.
Meaning of Uberrimae Fides	<input type="checkbox"/> A contract to buy shares is based on utmost good faith. <input type="checkbox"/> This means both parties must act honestly and disclose all material facts fully and correctly.
Duty of the Company	<input type="checkbox"/> The company must ensure that the prospectus is truthful, accurate, and complete. <input type="checkbox"/> No false or misleading statements should be made, and no required information should be hidden or omitted.

Legal Provision (Section 34)	<input type="checkbox"/> A statement in the prospectus is untrue if: - <input type="checkbox"/> It is misleading in form or context, or <input type="checkbox"/> Any important fact is omitted in a way that misleads.
Impact of Misleading Prospectus	<input type="checkbox"/> If the prospectus contains false or misleading information, or <input type="checkbox"/> fails to disclose a key fact, <input type="checkbox"/> it is treated as misrepresentation. <input type="checkbox"/> In such cases, affected shareholders have legal remedies.
Liability Provisions	Misstatements may lead to: - <input type="checkbox"/> Criminal liability under Section 34, and/or <input type="checkbox"/> Civil liability under Section 35.

Case Name	Key Fact	What was Held
Henderson vs. Lacon	Prospectus falsely stated that “directors and friends have subscribed a large portion of capital”, but in reality, each director had subscribed only 10 shares.	Held as a false and misleading statement – prima facie misrepresentation.
Rex vs. Kysant	Company claimed it was regularly paying dividends. In truth, it was incurring losses and showing fictitious profits by writing back provisions.	Held that true financial picture was hidden – misleading through superficial truth.
Smith vs. Chadwick	Prospectus claimed turnover of £1 million, which was true if based on capacity, but false if interpreted as actual sales.	Held that ambiguous statement known to be misleading can amount to misrepresentation.



Remedies against the Company - RESCISSION & DAMAGES	
When can Rescission be claimed?	<input type="checkbox"/> When a person purchases shares <input type="checkbox"/> based on a prospectus <input type="checkbox"/> containing false or misleading material facts
Effect of Rescission	<input type="checkbox"/> Share agreement becomes voidable at subscriber's option. If rescission is allowed: <input type="checkbox"/> Name removed from Register of Members <input type="checkbox"/> Refund of money + interest + incidental costs
Compensation for Loss (Rescission)	<input type="checkbox"/> Under Section 75, Indian Contract Act, 1872 <input type="checkbox"/> for damages due to non-fulfilment of contract.
Exceptions to Rescission	<input type="checkbox"/> Not available to: <input type="checkbox"/> Subsequent market purchasers (Peek vs Gurney) <input type="checkbox"/> Subscribers to Memorandum of Association as a company were not in existence when he appended his signature, and he cannot be said to be influenced by any statement in the document.
When can Action for Damages be taken?	<input type="checkbox"/> If misstatement amounts to fraud, investors can sue for damages, even if the company is in liquidation.
Prerequisites for Claiming Damages	<input type="checkbox"/> Misrepresentation in prospectus (fraudulent & material) <input type="checkbox"/> Person acted based on the prospectus <input type="checkbox"/> Person suffered damage as a result
<p>Example: 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.</p> <p>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.</p> <p>Accordingly, in the given case the allottee can avoid the contract of allotment of shares.</p>	

■ SECTION 34 & 35 - CRIMINAL & CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS

Basis	Section 34 (Criminal Liability)	Section 35 (Civil Liability)
	Remedies against the Company and others	Remedies against the person authorised to issue the prospectus

When Attracted?	Where a prospectus is issued, circulated or distributed that includes: <input type="checkbox"/> Untrue or misleading statements <input type="checkbox"/> Omission/inclusion likely to mislead	<input type="checkbox"/> Loss or damage to subscriber of securities, as a consequence of acting on basis of inclusion or omission of any matter in the prospectus; which is misleading the subscriber/s
Who is Liable?	Every person who authorises issue of such prospectus	Company and Every person who: <input type="checkbox"/> Is/was a Director <input type="checkbox"/> Is named/consented to be named as Director <input type="checkbox"/> Is a Promoter <input type="checkbox"/> Authorised issue of the prospectus or <input type="checkbox"/> Is an Expert (u/s 26(5))
Punishment/ Liability	Punishable under Section 447 (Fraud): <input type="checkbox"/> Jail up to 10 years <input type="checkbox"/> Fine up to 3 times the fraud amount	<input type="checkbox"/> In addition to the liability under section 36 <input type="checkbox"/> Compensation to persons who suffered loss or damage
Need to Prove Loss?	✗ Not required	✓ Yes, actual loss/damage required
Strict Liability?	✓ Yes, Even if unintentional	✗ No, Intent/reasonableness may be considered

Note: Loss from mis-statement is not essential, to hold a person guilty under section 34.

Liability for offence under section 34, is strict liability, hence it is immaterial where the omission is intentional or unintentional, in both cases a person will be held guilty under section 34 and liable for punishment under section 447 of this Act.

Exceptions/ Defence Available	As per proviso of this section – <input type="checkbox"/> When a person shall not be held guilty under section 34 of this Act, if he proves that - <input type="checkbox"/> Misstatement/omission was immaterial, or <input type="checkbox"/> 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	Person can escape liability if they prove: <input type="checkbox"/> Prospectus issued without consent/knowledge <input type="checkbox"/> Gave public notice of denial <input type="checkbox"/> Statement was based on expert's advice <input type="checkbox"/> Had reasonable grounds to believe it was true <input type="checkbox"/> The statement was a correct copy of some extract from an official document and that he had in fact believed.
--------------------------------------	--	---

Personal Unlimited Liability (u/s 35(3))	✗ Not covered	✓ Yes, <input type="checkbox"/> Every person mentioned in the sub-section (1) shall be personally responsible, without any limitation of liability;
		<input type="checkbox"/> If proved prospectus was issued with intent to defraud or for fraudulent purpose

Example: 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.

Example: 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 by the promoters of the company is a valid ground for a director to escape liability for mis-statement.

Summary of section 34 and 35.



Remedies against the person authorised to issue the prospectus

DAMAGES FOR DECEIT

<p>When remedy of damages for deceit is available?</p>	<ul style="list-style-type: none"> <input type="checkbox"/> Persons responsible for the issue of prospectus can also be held liable in an action for deceit, under general law as provided by section 19 of the Indian Contract Act, 1872. <input type="checkbox"/> This remedy shall be available even where the remedy by way of rescission as against the company is lost either through laches or negligence or even if the company goes into liquidation.
<p>Prerequisite to claim damages for deceit is available</p>	<ul style="list-style-type: none"> <input type="checkbox"/> There was a fraudulent mis-statement related to some existing material facts. <input type="checkbox"/> He is the original allottee and had seen the prospectus. <input type="checkbox"/> He has been actually deceived.

Example: Peek v. Gurney

Gurney issued a fraudulent prospectus on behalf of a company. No shares were purchased by Peek at that time. Several months afterwards, Peek purchased 2,000 shares of the company from the stock exchange. He brought an action against the directors for deceit (on the basis of prospectus). Court held, the directors were not liable as the shares were not purchased on the basis of prospectus.

MULTIPLE CHOICE QUESTIONS (MCQ)

29. Mr. P applies for shares of a company on the basis of a prospectus which contains misstatement. The shares are allotted to him, who afterwards transfers them to Mr. Q, who

suffers heavy loss due to decline in share price. Which of the following statements is/ are-correct?

- (a) Mr. P can file a suit for recession of allotment of shares on the grounds of misstatement in prospectus.
- (b) Mr. Q can file a suit for recession of allotment of shares on the grounds of misstatement in prospectus.
- (c) Both Mr. P and Mr. Q jointly can file a suit for recession of allotment of shares on the grounds of misstatement in prospectus.

(d) None of the above

30. A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the shares allotment on the ground that the prospectus was false in material particulars. Which of the following statements is/are correct?

(a) The nondisclosure of the fact that dividends were paid out of capital profits is a concealment of material fact and therefore there is a misstatement in the prospectus. The allottee can avoid the shares allotment.

- (b) There is no wrong statement made in the prospectus as to payment of dividend by the company and therefore there is no misrepresentation and the allottee cannot avoid the contract.
- (c) Mere silence to facts is not a fraud. Therefore, the allottee cannot avoid the contract.
- (d) None of the above

31. The prospectus issued by a company contained a misstatement. Under Section 35 of the Companies Act, 2013, the Director of the company can defend himself on the following ground(s):

- (a) 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.
- (b) 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) **Either (a) or (b)**
- (d) None of the above

■ SECTION 36 PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY

- 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 any agreement for/to :
 - (a) acquiring, disposing of, subscribing for, or underwriting securities; or
 - (b) 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) obtaining credit facilities from any bank or financial institution, shall be liable for action under section 447.

Example: A huge sum of money was collected under a document described as “project overview” by NRIs but shares not allotted in the proposed joint venture company instead the money was diverted to some off-shore companies controlled by the accused persons. Prima-facie offence under section 36 made-out.

■ SECTION 37 ACTION BY AFFECTED PERSONS

- ❑ A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by:
 - (a) Any person,
 - (b) Group of persons or
 - (c) Any association of persons
- ❑ If affected by any misleading statement or the inclusion or omission of any matter in the prospectus.
- ❑ May file a suit or take any actions.

Example: 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.

Note: Section 37 has paved way for class action

A 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 types 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 the people can file one single case together against the defendant.

■ SECTION 38 PUNISHMENT FOR PERSONATION FOR ACQUISITION, ETC., OF SECURITIES

The purpose of the section is to prevent allotment of shares in fictitious names.

1. Attracted when?

- ❑ A person makes/abets (supports) applications in fictitious names.
- ❑ Multiple applications in different names with different combinations
- ❑ induces, directly or indirectly a company to allot or register any transfer of any securities to him or to any other person in a fictitious name

2. Punishment = u/s 447

- ❑ Disclose such section 38 prohibitions and punishment in every prospectus and every application form

3. Disgorgement (to release everything) –

- ❑ Court may order disgorgement of gain if any made by and
- ❑ seizure and disposal of securities in possession of such person and
- ❑ such amount shall be credited to IEPF.

Note: A person who gets shares allotted in a fictitious name becomes liable as a shareholder. Thus, where a person carried on business under an assumed name and took shares in that name, his trustee in bankruptcy of the said person, could not avoid liability.

■ SECTION 447 PUNISHMENT FOR FRAUD

FRAUD Meaning	Fraud in relation to affairs of a company or any body corporate, includes- <ul style="list-style-type: none">❑ 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, 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” means the gain by unlawful means of property to which the person gaining is not legally entitled.❑ “Wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.
----------------------	--

Fraud, in relation to affairs of a company or body coprate

```
graph TD; Root["Fraud, in relation to affairs of a company or body coprate"]; Root --- Includes["Includes  
Any act,  
Omission,  
Concealment  
of the facts,  
and/or  
Abuse of  
position;"]; Root --- Committed["Committed by  
Any person or  
Any other  
person with  
the connivance  
in any manner;"]; Root --- Intent["With intent to  
Deceive,  
Gain undue  
advantage,  
or  
Injure the  
interests;"]; Root --- Whether["Whether or  
not there is  
any  
Wrongful  
gain  
or  
Wrongful loss"]; Intent --- IntentDetail["of the company or  
its shareholders or  
its creditors or  
any other person,"]; style Includes stroke:#0056b3; style Committed stroke:#e91e63; style Intent stroke:#ff9800; style Whether stroke:#d32f2f; style IntentDetail stroke:#0056b3;
```

Amount and nature of fraud	Fine			Imprisonment	
	Minimum	Maximum		Minimum	Maximum
Fraud involving less than 10 lakh rupees or 1% of turnover, whichever is lower (public interest not involved)		Up to 50 lakh	or/and	—	Up to 5 years
Fraud involving at least 10 lakh rupees or 1% of turnover, whichever is lower (public interest not involved)	Equal to amount of fraud	3 times of amount of fraud	and	6 Months	10 Years
Fraud in question involves public interest	Equal to amount of fraud	3 times of amount of fraud	and	3 Years	10 Years

Example: Mr. Raju, one of prospective investors under section 37 of this Act, sued the persons who authorized the issue of prospectus for the fraudulent misstatements they made in the prospectus. Mr. Raju also filed a complaint under section 420 of the IPC, 1860 and section 447 of this Act.

Mr. Angad one of the authorised persons, plead that Mr. Raju did not take any share, hence he has not borne any sort of loss, therefore he cannot seek the remedies, for what he is asking for and they are not punishable under section 447, because fraud is not committed against Mr. Raju. Whether the persons who authorised the issue of prospectus are punishable under section 447?

Answer: In this case, the persons who authorised the issue of prospectus shall be punishable under section 447 for the fraudulent misstatement, despite the fact that Mr. Raju had not borne any loss. Because wrongful gain or loss is not an essential constituent of fraud under section 447.

■ SECTION 39 ALLOTMENT OF SECURITIES BY COMPANY

Section/Rule	Heading	Explanation
—	Meaning of Allotment	<ul style="list-style-type: none"> <input type="checkbox"/> When someone applies for shares using the company's form and the company accepts it, that is called allotment. <input type="checkbox"/> Hence, in general sense 'allotment' is neither more nor less than the acceptance by the company of the offer to take shares. <input type="checkbox"/> In technical context, it is an appropriation out of the previously unappropriated capital of a company. <input type="checkbox"/> Reissue of forfeited shares is not considered as an allotment. <input type="checkbox"/> Allotment must follow Companies Act and basic contract law rules (like offer and acceptance).

Sec 39(1)	Minimum Subscription is a Must.	<input type="checkbox"/> When shares are offered to the public, the amount of minimum subscription has to be stated in the prospectus. No shares can be allotted without receiving: <input type="checkbox"/> Minimum subscription amount (as mentioned in the prospectus) is fully subscribed, and <input type="checkbox"/> The application money has been paid and received by the company via cheque or other banking instruments.
SEBI Reg. 45(1)	What is Minimum Subscription?	<input type="checkbox"/> SEBI requires minimum subscription to be at least 90% of the total issue. <input type="checkbox"/> ✓ Money must be actually received by the company. <input type="checkbox"/> Within 30 days from the date of issue of prospectus via cheque or any other instrument <input type="checkbox"/> ✗ If no payment is made with the application then the allotment is not valid.
<p>Note: As per the regulation 45(1) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 201828, the minimum subscription is 90% of the entire issue.</p> <p>Any means by which money can be remitted may be used, but remittances must be cleared and actual cash received by the company before proceeding to allotment. An application for shares, if not accompanied by any such payment, does not constitute a valid offer.</p>		
Sec 39(2)	Amount Payable on Application	Application money must be at least: <input type="checkbox"/> 5% of the nominal value, or <input type="checkbox"/> Any other amount specified by SEBI. <input type="checkbox"/> As per SEBI Reg. 47(4): Minimum 25% of the issue price must be paid on application. <input type="checkbox"/> In case of Offer for Sale, full issue price for each specified security shall be payable at the time of application.
—	Example	<input type="checkbox"/> If share face value is ₹10 → at least ₹2.5 must be paid (25%). If face value is ₹100 → at least ₹25 must be paid.
Sec 39(3)	Refund if Minimum Subscription Not Received	<input type="checkbox"/> If the minimum subscription is not received within 30 days (or such period as SEBI may prescribe) from the issue of prospectus, <input type="checkbox"/> The company must refund the money received from applicants.
Rule 11(1)	Time Limit for Refund	<input type="checkbox"/> Refunds must be made within 15 days from closure of the issue.
	Penalty for Late Refund	<input type="checkbox"/> If refund is delayed, the directors and responsible officers must jointly and severally repay with 15% interest per annum.

Rule 11(2)	Bank Account for Refund	<input type="checkbox"/> The refund must be credited to the same bank account from which the application money was received.
Sec 39(4)	Return of Allotment	<input type="checkbox"/> If a company with share capital allots any securities, it must file a return of allotment with the ROC in the prescribed manner.
Rule 12(1)	Time Limit for Filing PAS-3	<input type="checkbox"/> Return of allotment must be filed with ROC in Form PAS-3 within 30 days of allotment.
Rule 12(2)	Attachments to PAS-3	<input type="checkbox"/> List of allottees with name, address, occupation (if any), and <input type="checkbox"/> Number of shares allotted. <input type="checkbox"/> Certificate from form's signatory confirming correctness and completeness.
Rule 12(3)	Extra Attachments (Non-Cash Consideration)	If shares are allotted for non-cash consideration, attach: <ul style="list-style-type: none"> <input type="checkbox"/> Stamped copy of contract <input type="checkbox"/> Contract for services or sale of property, if applicable
Rule 12(4)	If No Written Contract Exists	<input type="checkbox"/> Where there's no written contract, <input type="checkbox"/> company must submit full stamped details of the oral agreement. <input type="checkbox"/> It will be treated like a contract under Indian Stamp Act, 1899.
Rule 12(5)	Valuation Report	<input type="checkbox"/> If Rule 12(3) or 12(4) applies, company must attach a valuation report by a registered valuer.
Rule 12(7)	Valuation in Sec 62(1) (c) Cases	<input type="checkbox"/> If shares are issued under Sec 62(1)(c) (e.g., preferential allotment by unlisted companies), a valuer's report must be attached to PAS-3.
Sec 39(5)	Penalty for Default	For any default under Sec 39(3) or Sec 39(4), the company and defaulting officer will be liable to a penalty of: <ul style="list-style-type: none"> <input type="checkbox"/> ₹1,000 per day of default or <input type="checkbox"/> ₹1,00,000 — whichever is less.

Example: 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 a 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 have been illegally made by the company.

MULTIPLE CHOICE QUESTIONS (MCQ)

32. Delight Sports Garments Limited is contemplating to raise funds through issue of prospectus in which, according to the directors, a sum of ₹50 crores should be stated as the minimum amount that needs to be subscribed by the prospective subscribers. The funds shall be raised in four instalments consisting of application, allotment, first call and second & final call. Advise the company by which instalment it should receive the minimum subscription stated in the prospectus. **(RTP NOV 2019)**

- (a) Along with the amount subscribed as application money.
- (b) Along with the amount subscribed as final call money.
- (c) Along with the amount subscribed as first call money.
- (d) Along with the amount subscribed as second and final call money.

SECTION 40 SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES

Sub Section	Provision	Key Points/Explanation
(1)	Application to Stock Exchange	<ul style="list-style-type: none"> <input type="checkbox"/> Companies must apply to one or more recognised stock exchanges before public offer. <input type="checkbox"/> Must obtain permission.
(2)	Mention in Prospectus	<ul style="list-style-type: none"> <input type="checkbox"/> Name(s) of the stock exchange(s) must be clearly mentioned in the prospectus. <input type="checkbox"/> Minimum subscription <input type="checkbox"/> Amount of application money
(3)	Separate Bank A/c	Application money to be kept in separate bank account in a scheduled bank. Used only for: <ul style="list-style-type: none"> <input type="checkbox"/> Adjustment on allotment on pro rata basis (if approved by stock exchange) <input type="checkbox"/> Refund to applicants (if no allotment).
	Confirmed by Section 40(3) + Rule 11(2) of Companies (Prospectus & Allotment of Securities) Rules, 2014.	
(4)	Waiver = Void	Any condition that waives compliance of Section 40 is void.
(5)	Penalty on Default	
	Defaulter	Minimum Fine
	Maximum Fine	
	Company	5,00,000
	Defaulting Officer	50,000
		3,00,000

■ UNDERWRITING COMMISSION – SECTION 40(6)

UNDERWRITING COMMISSION							
An underwriter is a person, firm, or institution who undertakes the responsibility to subscribe to the unsubscribed portion of securities of a company in case the public does not take up all the securities offered in a public issue.							
(6) To be followed with conditions laid down in Rule 13	Commission Payment (Underwriting) <ul style="list-style-type: none"> <input type="checkbox"/> Companies can pay commission to person helping with subscriptions (per Rule 13). 						
	Not allowed <ul style="list-style-type: none"> <input type="checkbox"/> No commission to underwriter if securities are not offered to the public. 						
	Source of Commission <ul style="list-style-type: none"> <input type="checkbox"/> Articles must authorise payment. <input type="checkbox"/> Can be paid out of: <ul style="list-style-type: none"> <input type="checkbox"/> Issue proceeds <input type="checkbox"/> Company profits <input type="checkbox"/> Both 						
Maximum Commission Rate							
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%; text-align: center;">Security</th> <th style="width: 50%; text-align: center;">Rate</th> </tr> </thead> <tbody> <tr> <td style="text-align: center; vertical-align: middle;">Shares</td> <td style="text-align: center;"> Should not exceed; 5% of the price at which the shares are issued Or Any less rate/amount authorised by articles </td> </tr> <tr> <td style="text-align: center; vertical-align: middle;">Debentures</td> <td style="text-align: center;"> Should not exceed; 2.5% of the price at which the debentures are issued Or Any less rate/amount authorised by articles </td> </tr> </tbody> </table>		Security	Rate	Shares	Should not exceed; 5% of the price at which the shares are issued Or Any less rate/amount authorised by articles	Debentures	Should not exceed; 2.5% of the price at which the debentures are issued Or Any less rate/amount authorised by articles
Security	Rate						
Shares	Should not exceed; 5% of the price at which the shares are issued Or Any less rate/amount authorised by articles						
Debentures	Should not exceed; 2.5% of the price at which the debentures are issued Or Any less rate/amount authorised by articles						
Note: Maximum rate of commission can be 5% and 2.5% in case of shares and debentures respectively subject to rate authorised by article.							
Example: Ind-swift Pharma Labs Limited issued the shares to raise capital. Article of Ind-swift authorised payment of commission at a rate of 2%. Since rate of commission should not exceed 5% of the price at which the shares are issued or any less rate/amount authorised by articles Hence, cap for payment of commission under section 40(6) of the Act is 2%.							

	Disclosure in Prospectus	Must mention: Underwriter's name Rate & amount of commission Number of securities underwritten
	Filing with ROC	Copy of contract for payment of commission to be filed with Registrar (ROC)

Example: 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.

IRREGULAR ALLOTMENT – CASES WHERE ALLOTMENT WOULD BE IRREGULAR

Reasons-Irregular Allot	Consequences
23-Without prospectus	Co. and officer = 10,000 and 1000 for every day. Max-50,000 for officers and 2 Lacs for the company
26-Misleading	Co-50,000 to 3 lacs Officer (knowingly party) -50,000 to 3 lacs
26-Not delivered to ROC	
39-Min subscription	Co and officer = 1000 for each day or 1 lakh whichever is less
39-Application money	
39-Return of Allotment	
40-Permission from SE	Co-5 lacs to 50 lacs Officer-50,000 to 3 lacs
40-Separate Bank Acc.	

MULTIPLE CHOICE QUESTIONS (MCQ)

33. When a copy of the contract for the payment of underwriting commission is required to be delivered to the Registrar:

(MTP NOV 2020)

(a) Three days before the delivery of the prospectus for registration

(b) At the time of delivery of the prospectus for registration

(c) Three days after the delivery of the prospectus for registration

(d) Five days after the delivery of the prospectus for registration

- 34. Which of the following statements is not true?**
- (a) in case of shares, the rate of underwriting commission to be paid shall not exceed five percent of the issue price of the share.
 - (b) underwriting commission should not be more than the rate specified by the Article of Association.
 - (c) in case of debentures, the rate of underwriting commission shall not exceed five percent of the issue price of the debentures.**
 - (d) amount of commission may be paid out of profits of the company.
- 35. On which offer of securities, commission is permitted to be paid to any underwriter by the company:**
- (a) When securities are offered on rights basis
 - (b) When securities are offered in the form of bonus issue
 - (c) When securities are offered on private placement basis
 - (d) When securities are offered to the public for subscription**
- 36. No allotment of any securities of a company offered to the public for subscription shall be made unless:**
- (a) The amount stated in the prospectus as the minimum amount has been subscribed.
 - (b) The application money in respect of minimum subscription has been received by the company.
 - (c) Both (a) or (b)**
 - (d) Either (a) or (b)
- 37. The minimum amount payable on application on every security in a public issue shall not be less than of the nominal amount of the security.**
- (a) 2%
 - (b) 5%**
 - (c) 7%
 - (d) 10%
- 38. If the minimum subscription amount is not received within from the date of issue of the prospectus, the application amount received by the company under Section 39(1) shall have to be refunded.**
- (a) 7 days
 - (b) 30 days**
 - (c) 45 days
 - (d) 90 days
- 39. If the minimum subscription amount is not received within the prescribed period, the application amount received under Section 39(1) shall be returned within the closure of the issue.**
- (a) 7 Days
 - (b) 15 Days**
 - (c) 30 Days
 - (d) 60 Days
- 40. In case of non-receipt of Minimum subscription, and the delay in making refund of application money received, the interest applicable under Section 39(3) is:**
- (a) 15% per annum from the date of closure of the issue.
 - (b) 15% per annum from the date of receipt of application money.
 - (c) 15% per annum from the expiry of 15 days from closure of the issue.**
 - (d) 15% per annum from the expiry of 15 days from date of prospectus.
- 41. Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in, within after the date of allotment.**
- (a) Form PAS-1, 15 Days
 - (b) Form PAS-3, 30 Days**
 - (c) Form PAS-3, 15 Days
 - (d) Form PAS-1, 30 Days
- 42. The application monies received from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and before making allotment, cannot be utilised for:**
- (a) Adjustment against allotment of securities
 - (b) Refund of application money
 - (c) Application for the objects listed in the prospectus**
 - (d) All of the above

43. With regard to the provisions of Companies Act, 2013 which of the following statements is/are not correct?

- (a) The payment of underwriting commission shall be authorised in the Company's Articles of Association.
- (b) The commission may be paid only out of proceeds of the issue or the profit of the company or both.
- (c) The rate of commission paid or agreed to be paid shall not exceed, in case of shares, 5% of the issue price or rate authorised in Company's Articles.
- (d) The rate of commission paid or agreed to be paid shall not exceed, in

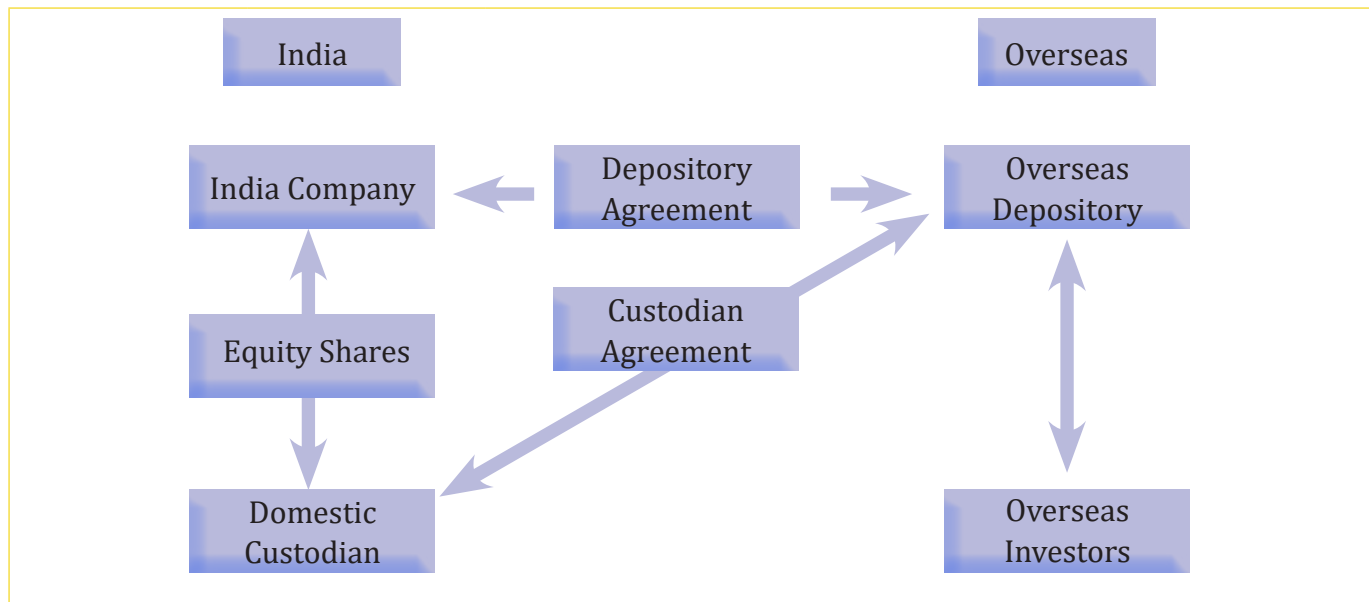
case of shares, 2.5% of the issue price or rate authorised in Company's Articles.

44. A Limited made a public issue of Debentures. The articles of the company authorises the payment of underwriting commission at 2 percent of the issue price. The company has negotiated with the proposed underwriters, Gama Brokers and has finalised the rate at 2.25 per cent. The amount that the company is eligible to pay as underwriting commission is: **(2 Marks) (MTP Sep. 23)**

- (a) 5% (b) 2%
- (c) 2.5% (d) 2.25%

■ SECTION 41 GLOBAL DEPOSITORY RECEIPT

Section/Rule	Provision	Explanation
<p>A global depository receipt is a general name for a depository receipt where a certificate issued by a depository bank, which purchases shares of foreign companies, creates a security on a local exchange backed by those shares.</p>		
<p>Purpose of Depository Receipts</p> <p>SEBI do not allow to Indian company to raise fund from o/s India via issuing shares in the foreign country so when an Indian company wants to get their shares listed on foreign Stock Exchange they use this route.</p>		
Sec 2(44)	Definition of GDR	<ul style="list-style-type: none"> <input type="checkbox"/> A Global Depository Receipt (GDR) is any instrument in the form of a depository receipt, <input type="checkbox"/> Created outside India by a foreign depository, and <input type="checkbox"/> Authorized by the company issuing such receipts. <input type="checkbox"/> It can be called by any name (ADR, GDR, etc.) but must represent shares of an Indian company.
<p>Parties involved</p>		
<p>Indian listed company</p>		<p>Overseas Depository Bank (ODB)</p>
<p>Domestic Custodian Banka</p>		<p>Foreign investors</p>



Sec 41	Power to Issue GDRs	<p>A company can issue depository receipts in a foreign country if:</p> <ul style="list-style-type: none"> <input type="checkbox"/> It passes a special resolution in the general meeting <input type="checkbox"/> It complies with the conditions prescribed under the Companies (Issue of GDRs) Rules, 2014
Rule 4	Manner & Form of Issue	<p>GDRs can be issued:</p> <ul style="list-style-type: none"> <input type="checkbox"/> By public offer, private placement, or any method allowed in that country. <input type="checkbox"/> GDRs may be listed or traded on any recognized foreign platform.
Rule 5(1)	Source of Shares for GDRs	<p>GDRs may be backed by:</p> <ul style="list-style-type: none"> <input type="checkbox"/> New shares issued for this purpose, or <input type="checkbox"/> Existing shares held by shareholders (called sponsored issue) Conditions as specified by RBI or Central Government must be followed.
Rule 5(2)	Name in which Shares are Allotted	<ul style="list-style-type: none"> <input type="checkbox"/> The underlying shares are allotted in the name of the overseas depository bank. <input type="checkbox"/> The depository bank then issues GDRs against those shares.
Rule 6	Voting Rights	<ul style="list-style-type: none"> <input type="checkbox"/> Before Conversion: The overseas depository bank votes on behalf of the GDR holders, as per the agreement between all parties. <input type="checkbox"/> After Conversion: GDR holder becomes a member of the company and can vote directly, like a normal shareholder.

■ SECTION 42 PRIVATE PLACEMENT

Section	Provision	Explanation
Section 42 and Explanation I to Section 42(3)	Meaning of Private Placement	<ul style="list-style-type: none"> <input type="checkbox"/> Every private company and listed Public company can make a <input type="checkbox"/> Private placement which means offering securities <input type="checkbox"/> to a selected group (not public) <input type="checkbox"/> through a private placement offer-cum-application (PAS-4) <input type="checkbox"/> by following Section 42 and Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014.
Section 42(2)	Offer only to select group of persons	<ul style="list-style-type: none"> <input type="checkbox"/> The offer can be made only to a maximum of 200 identified persons <input type="checkbox"/> in a financial year (per security) <input type="checkbox"/> approved by the Board and <input type="checkbox"/> shareholders via special resolution
<p>Note: Private placement can be made to a maximum of 200 persons in a financial year.</p> <ul style="list-style-type: none"> <input type="checkbox"/> While calculating this limit of 200 persons, exclude: <ul style="list-style-type: none"> <input type="radio"/> Qualified Institutional Buyers (QIBs), and <input type="radio"/> Employees offered securities under Employees Stock Option Scheme [Section 62(1)(b)] <input type="checkbox"/> Originally, Section 42(2) mentioned 50 or such higher numbers as may be prescribed. <input type="checkbox"/> But as per Rule 14(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (amended in 2018): <ul style="list-style-type: none"> <input type="radio"/> The prescribed limit is 200 persons per financial year, so Section 42(2) is now read as 200. <input type="checkbox"/> The limit of 200 applies separately for each kind of security: Equity shares, Preference shares and Debentures. <input type="checkbox"/> Exception: The limit of 200 does not apply to: <ul style="list-style-type: none"> <input type="radio"/> NBFCs registered with RBI, and <input type="radio"/> HFCs registered with NHB, <input type="radio"/> If they follow the RBI/NHB regulations for private placement. 		
Section 42(11) & Explanation III to Section 42(3)	Deemed public offer of 200+ persons	<ul style="list-style-type: none"> <input type="checkbox"/> If more than 200 identified persons are offered securities, <input type="checkbox"/> it's treated as a public offer, and <input type="checkbox"/> Sections 23–41 and SEBI laws apply even if money is not received or listing not intended.

Section 42(3)	Issue of private placement offer & application	<input type="checkbox"/> Offer/application must be sent only to identified persons recorded by the company.
Note: Private placement offer and application shall not carry any right of renunciation.		
Rule 14(1)	Special resolution requirement	<input type="checkbox"/> Companies must pass a special resolution for each private placement. <input type="checkbox"/> with the explanatory statement.
	List of the required disclosures in the Explanatory Statement	The following must be disclosed in the notice for shareholders' approval: <ol style="list-style-type: none"> 1. Particulars of the Offer – Including date of Board resolution approving the offer. 2. Kinds of Securities Offered – And the price at which they are being offered. 3. Basis/Justification of Price – Including premium, if any. 4. Name & Address of Valuer – Who has performed the valuation. 5. Amount to be Raised – Total funds the company intends to raise through the offer
		6. Material Terms of Raising Securities – Such as: <ul style="list-style-type: none"> ➤ Proposed time schedule ➤ Purpose/Object of the offer ➤ Promoters'/Directors' contribution, if any (as part of the offer or separately) ➤ Principal terms of assets charged as security
<p>Note: Board resolution under section 179(3)(c)30 shall be adequate in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised does not exceed the limit as specified in section 180(1)(c). But if the amount is above the said limit, 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.</p> <p>Even for issue of securities to QIBs, it shall be sufficient to pass a previous special resolution only once in a year for all the offers or invitations for all the allotments to such buyers during the year.</p>		
Rule 14(1) - Proviso (2022 Amendment)	Border-sharing country approval	<input type="checkbox"/> No offer or invitation to subscribe securities via private placement shall be made to: <input type="checkbox"/> Any body corporate incorporated in, or Any national of, a country sharing a land border with India, unless:

		<ul style="list-style-type: none"> <input type="checkbox"/> Such body corporate or national has obtained Government approval under: <input type="checkbox"/> FEMA (Non-Debt Instruments) Rules, 2019 <input type="checkbox"/> The approval must be attached with the Private Placement Offer cum Application Letter (with PAS-4) <input type="checkbox"/> Countries sharing land border with India: China, Bhutan, Nepal, Pakistan Bangladesh, Myanmar.
Rule 14(4)	Application form (PAS-4) requirements	<ul style="list-style-type: none"> <input type="checkbox"/> Offer-cum-application letter (PAS-4) must be <input type="checkbox"/> serially numbered, <input type="checkbox"/> personally addressed, <input type="checkbox"/> sent in writing/e-mode <input type="checkbox"/> within 30 days of recording the name.
Note:		
<ul style="list-style-type: none"> <input type="checkbox"/> No person other than the person so addressed in offer-cum-application letter, allowed to apply through such application form. <input type="checkbox"/> Any application not conforming to this condition shall be treated as invalid. 		
Rule 14(4)	Record Maintenance	Companies must maintain complete records of offers in Form PAS-5.
Section 42(4) & Rule 14(5)	Manner of Subscription & Payment	<ul style="list-style-type: none"> <input type="checkbox"/> Identified persons can apply using the offer letter and <input type="checkbox"/> pay through cheque/DD/banking channels—not cash. <input type="checkbox"/> Payment must be from the subscriber's bank account. <input type="checkbox"/> The company shall keep the record of the bank account from where such payment for subscription has been received.
	Joint holders – payment Example	<ul style="list-style-type: none"> <input type="checkbox"/> In case of joint names, payment from first name. <input type="checkbox"/> If shares are offered to Ruhi and Sohit, and Ruhi's name is first, payment must be from Ruhi's account, not Sohit's.
Section 42(5)	Limit on fresh offers	<ul style="list-style-type: none"> <input type="checkbox"/> A new offer can't be made unless an earlier allotment is done or the offer withdrawn. <input type="checkbox"/> But multiple issues to separate groups (max 200 each) allowed.

Note: 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.

Section 42(6)	Time limit for allotment	<input type="checkbox"/> Allotment must be completed within 60 days of receiving money.
Proviso to Section 42(6)	Refund if no allotment	<input type="checkbox"/> If not allotted in 60 days, refund within 15 days is mandatory. If delayed further, interest @12% p.a. is payable.
Section 42(6) - Proviso	Use of money received	<input type="checkbox"/> Money received must be kept in a separate scheduled bank account and used only for - <input type="checkbox"/> For adjustment against allotment of securities; or <input type="checkbox"/> For the repayment of monies where the company is unable to allot securities.
Section 42(7)	No public advertisement	Companies cannot advertise or use media/public platforms to promote a private placement issue.
Section 42(8) & Rule 14(6)	Filing Return of Allotment	<input type="checkbox"/> File PAS-3 within 15 days of allotment with a complete list of all the allottees containing; <input type="checkbox"/> the full name, address, Permanent Account Number and E-mail ID of such security holder; <input type="checkbox"/> the class of security held;
		<input type="checkbox"/> the date of allotment of security; <input type="checkbox"/> 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.
Section 42(9)	Penalty for delay in filing PAS-3	<input type="checkbox"/> Company, promoter, directors will pay ₹1,000 per day (max ₹25 lakh) if return is not filed on time.

Example: An allotment of security under private placement (section 42) was completed on 9th November 2023. Return of allotment in Form PAS-3 filed on 28th November 2023. Therefore, a penalty of 4000 shall be imposed on the company, its promoter and directors.

■ SECTION 42(10) - PUNISHMENT FOR CONTRAVENTION

- If offer is made or money accepted in violation of Section 42,
- The company and officers in default are liable for penalty -

Liabe	Nature of penalty	Description
Promoters and Directors	Fine	Amount raised through the private placement Or two crore rupees, whichever is lower
Company	Refund	All monies along-with interest (as specified in sub-section 6) to subscribers within a period of thirty days of the order

MULTIPLE CHOICE QUESTIONS (MCQ)

45. A private placement shall be made only to a select group of persons identified by the Board, whose number shall not exceed

(Nov 23)

- (a) 30 or such higher number, subject to conditions, as may be prescribed, in a financial year.
- (b) 40 or such higher number, subject to conditions, as may be prescribed, in a financial year.
- (c) **50 or such higher number, subject to conditions, as may be prescribed, in a financial year.**
- (d) 60 or such higher number, subject to conditions, as may be prescribed, in a financial year.

46. Being in need of further capital, Rimsi Cotton-Silk Products Limited opted to offer 50.00 lacs equity shares of Rs. 1 each to 50 identified persons on 'private placement' basis and accordingly a letter of offer accompanied by serially numbered application form was sent to them after fulfillment of due formalities including passing of special resolution. One of the applicants, Rajan made a written complaint to the company highlighting the fact that the letter of offer was incomplete as well as illegal, for the same did not contain 'renunciation clause' though he wanted to exercise his 'right of renunciation' in favour of one of his son Uday. By choosing the correct option, advise the company in this matter. (2 Marks) (MTP NOV 2019)

(a) As the 'Right of Renunciation' cannot be denied, the company needs to rectify its mistake by including the same in the letter of offer and the application form.

(b) **The company is prohibited from providing 'Right of Renunciation' and therefore, the letter of offer and the application form need not include any such clause.**

(c) Instead of absolute prohibition, the company needs to provide 'Right of Renunciation' limited to twenty five percent of offering.

(d) Instead of absolute prohibition, the company needs to provide 'Right of Renunciation' limited to fifty percent of offering.

47. Which of the following statements is contrary to the provisions of the Companies Act, 2013?

(a) A private company can make a private placement of its securities.

(b) The company has to pass a special resolution for private placement.

(c) **Minimum offer per person should have Market Value of ₹20,000.**

(d) A public company can make a private placement of its securities.

48. Shripad Religious Publishers Limited has received application money of ₹20,00,000 (2,00,000 equity shares of ₹10 each) on 10th October, 2019 from the applicants who

applied for allotment of shares in response to a private placement offer of securities made by the company to them. Select the latest date by which the company must allot the shares against the application money so received.

- (a) 9th November, 2019
- (b) 24th November, 2019
- (c) 9th December, 2019**
- (d) 8th January, 2020

49. Innovative Tech Sol Limited intends to invite subscription to ₹1.10 crores equity shares of ₹10 each on private placement basis. The persons identified as potential subscribers are within the statutory limit and also include the two other categories to which such statutory limit is not applicable. One such category is employees of the company who are offered equity shares under Employees' Stock Option Scheme. By choosing the correct option, name the other excluded category.

- (a) Quality Institutional Buyers
- (b) Qualified Institutional Buyers.**
- (c) Qualification Institutional Buyers.
- (d) Qualified Investing Institutional Buyers.

50. ABC Ltd. issued an offer to 145 identified members for subscribing shares of the company by private placement including 10 qualified institutional buyers. In the same financial year, it wants to make another private placement offer for subscribing the debentures of the company. The maximum number of persons it can make the second offer is:

- (a) 55
- (b) 65
- (c) 200**
- (d) 210

51. PQR Ltd. issued private placement offer letters to 200 Identified Persons in March 2020 for subscription to shares of the company, and the allotment is pending for the same. The company wants to make another private placement offer to another set of 200 persons in April, 2020 for allotment of

debentures of the company. Decide which of the following answers is correct in the given situation?

(a) The company can make fresh offers since the limit of 200 applies with respect to each financial year and applied separately for different types of securities.

(b) The company can make fresh offers since the limit of 200 applies with respect to each financial year.

(c) The company can make fresh offers since the limit of 200 is applied separately for different types of securities.

(d) None of the above

52. A company making private placement shall issue private placement offer and application in:

- (a) Form PAS-3
- (b) Form PAS-4**
- (c) Form PAS-5
- (d) Form PAS-6

53. The company shall maintain a complete record of all private placement offers made by it in:

- (a) Form PAS-3
- (b) Form PAS-4
- (c) Form PAS-5**
- (d) Form PAS-6

54. A company making offer for private placement of securities shall make the allotment within

- (a) 15 days of date of private placement offer
- (b) 30 days from receipt of application money
- (c) 45 days from date of private placement offer

(d) 60 days from receipt of application money

55. If the company fails to make the allotment of securities offered through private placement, the application amount received shall be returned within

(a) 10 Days from expiry of 60 days of receipt of application money

(b) 15 Days from expiry of 60 days of receipt of application money

(c) 30 Days from date of receipt of application money

(d) 60 Days from date of private placement offer

56. If the company fails to repay the application money received in private placement offer, it shall be liable to repay that money with interest @

- (a) 12% per annum from the date of private placement offer.
- (b) 15% per annum from the date of receipt of application money.
- (c) 12% per annum from the 60th Day of receipt of application money.**
- (d) 15% per annum from the 60th Day of receipt of application money.

57. Which of the following statements is/are correct with regard to private placement of securities?

- (a) The private placement offer shall

not be made unless the proposal has been previously approved by the shareholders of the company, by a special resolution for each of the offers or invitations.

- (b) The private placement offer can be made without the approval of shareholders by special resolution, in case of an offer for NCDs if the amount to be raised does not exceed the limits specified in Section 180(1)(c) and such issue is approved by the Board of Directors of the company.
- (c) The private placement offer shall be made only after the relevant Resolution has been filed with the Registrar.
- (d) All of the above.**

■ PAS FORMS COVERED

Form No.	Purpose
PAS-1	ADVERTISEMENT for varying any contract referred to in the prospectus or altering the object for which prospectus was issued
PAS-2	Information Memorandum circulated before filing the prospectus (Shelf type situations)
PAS-3	Return of Allotment to be filed after allotment of shares/securities
PAS-4	Private Placement Offer Letter / Application Form
PAS-5	Record of Private Placement Offers maintained by the company
INC-35	(AGILE/AGILE-PRO / AGILE-PRO-S) - GST, EPFO, ESIC, bank account, and other linked registrations with SPICe+.

