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CHAPTER

Prospectus and Allotment of Securities



LDR Questions

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ICAI Module Descriptive Questions

Section 26 Reports which shall be Included in the Prospectus

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

Solution:

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

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

1. Where a company does not issue a prospectus in a public offer as required by section 23; or
2. Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or
3. Where the prospectus has not been filed with the Registrar for filing under section 26 (4); or
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 25% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.

Section 31 Shelf Prospectus

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

Solution:

As per explanation to section 31, the expression “shelf prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

A company is required to issue a prospectus each time it accesses the capital market. It leads to unnecessary repetition for a company which makes more than one offer of securities in a year to mobilise funds from the public. A way out is shelf prospectus which remains valid (on the shelf) a specified time period during which offers for securities may be made by a company to the public without going through the arduous exercise of issuing fresh prospectus every time.

1. Filing of shelf prospectus with the Registrar

Shelf prospectus may be filed with the Registrar at the stage of first offer of securities, by class or classes of companies as the Securities and Exchange Board may provide by regulations in this behalf.

It has to indicate a period not exceeding one year as the period of validity of such shelf prospectus.

The period of validity is to commence from the date of opening of the first offer of securities under such prospectus.

In respect of any second or subsequent offer of such securities issued during the period of validity of such prospectus, no further prospectus is required.

2. Filing of 'Information Memorandum' with the Shelf Prospectus

A company filing a shelf prospectus shall be required to file an information memorandum with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus containing;

- (a) All material facts relating to new charges created,
- (b) Changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities, and
- (c) Such other changes as may be prescribed,

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

3. Safeguard (in case of changes) to applicants who made payment in advance.

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.

4. Information Memorandum together with Shelf Prospectus is deemed Prospectus

Where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Section 26

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

Solution:

As per section 26(1) of the Companies Act, 2013, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government. It is provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

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

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

Section 40 Underwriting Commission

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

Solution:

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

- (a) The payment of such commission shall be authorized in the company's articles of association;
- (b) The commission may be paid out of proceeds of the issue or the profit of the company or both;
- (c) The rate of commission in case of debentures, shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less.

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

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

The company may pay the underwriting commission in the form of flats since there is no prohibition on payment of underwriting commission in kind. Further, in case of *Booth v New Africander Gold Mining Co.*, it was held that underwriting commission may be paid in cash or in kind or in lump sum or by way of a percentage.

Section 42 Private Placement

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

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

Solution:

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

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

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

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

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

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

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

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

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

Section 39 Allotment of Securities

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



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

Solution:

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

Minimum amount stated in a prospectus

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

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

Application money

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

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

Rule 11 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 mentions that if the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Section 40 Underwriting Commission

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

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

Solution:

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to the conditions prescribed under the Companies (Prospectus and Allotment of Securities) Rules, 2014. Rule 13 states that the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less. In the given problem, the Articles of X Ltd. have prescribed 4% underwriting commission, but the directors decided to pay 5% underwriting commission.

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

RTP, MTP and PYQ Descriptive Questions

Section 23 Allotment without Prospectus

8. Examine the validity of these allotments in the light of the provisions of the Companies Act, 2013. The Board of Directors of Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the concerned Registrar of Companies. Explain the remedy available to the investors in this regard. (MTP NOV 2018)

Solution:

Law: According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the registration of the prospectus with the Registrar before its issue.

Conclusion: In the given case, the company has violated the above provisions of the Act and hence the allotment made is void. The company will have to refund the entire money received and will also be punishable under section 26 of the Act.

Section 26 Reports which shall be Included in the Prospectus


9. The Board of Directors of Ramesh Ltd. proposes to issue the prospectus inviting offers from the public for subscribing the shares of the Company. State the reports which shall be included in the prospectus for the purposes of providing financial information under the provisions of the Companies Act, 2013. (RTP nov 2020) (NOV 2019)

Solution:

Reports which shall be included in the prospectus

- (i) As per section 26(1) of the Companies Act, 2013, every prospectus issued shall be dated and signed
- (ii) It shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.
- (iii) Every prospectus shall make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of:
 - (a) Companies Act, 2013
 - (b) Securities Contracts (Regulation) Act, 1956
 - (c) Securities and Exchange Board of India Act, 1992
 - (d) Rules and regulations made under above Acts.
- (iv) Every prospectus shall contain the following disclosures on the cover page [Section 26(6)]:
 - (a) A statement that a copy of the prospectus has been filed with the Registrar.
 - (b) A list of all such documents as are required to be attached with the prospectus.
- (v) General Information , Financial Information and terms and conditions of the issue as prescribed by ROC
- (vi) Report by Expert

Section 27 Variation in Terms of Contract or Objects Stated in Prospectus

-  **10.** Lotus valley Ltd. issued a prospectus with the object of setting up of a chain of hotels. However, later it decided to set-up a Pharmaceutical Manufacturing unit. Keeping in view of the provisions of the Companies Act, 2013, state whether Lotus valley Ltd. can do so and if it can be done, also state the procedure to be followed for variation in the objects in the prospectus.

(RTP May 2016)

Solution:

Law: Procedure for variation in the objects in the prospectus

As per section 27 the Companies Act, 2013, A company shall vary the terms of contract or object for which the prospectus was issued only if following conditions are satisfied:

- (i) Special resolution is passed in GM; and
- (ii) the prescribed details of the notice of GM (indicating clearly the justification for such variation) are published in 2 newspapers (one in English language and one in vernacular language) circulating in the city in which the registered office of the company is situated. in Form PAS-1.
- (iii) The dissenting shareholders (the shareholders who did not agree to the variation at the time of passing SR) shall be given an exit offer by the promoters or controlling shareholders.

Conclusion: Thus, Lotus valley Ltd. can change the object mentioned in the prospectus from setting up a chain of hotels to setting up of a pharmaceutical manufacturing unit by following the above mentioned procedure of section 27

Section 27

-  **11.** XYZ Limited issued a prospectus to raise funds for a new manufacturing project. After successfully raising the funds, the company identified an investment opportunity in a different industry six months later, requiring a significant portion of the funds. The proposed investment involved trading in equity shares of other listed companies. The board of directors suggested varying the original objectives for which the funds were raised to allow this new investment and recommended passing a special resolution in the company's general meeting. While the promoters and controlling shareholders supported this change, some shareholders expressed concerns, particularly regarding the deviation from the initially stated purpose of the funds.

Based on the provisions of the Companies Act, 2013, advise on the validity of the proposal to redirect the funds toward this new investment.

(RTP Jan 25)

Solution:

Law: According to section 27(1) of the Companies Act, 2013,

- (i) the terms of a contract referred to in the prospectus or objects for which the prospectus has been issued can be varied, but only with the authority of the company given by it in general meeting by way of special resolution.
- (ii) The second proviso to sub-section (1) prescribes that such company is not to use any amount raised by it through the prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

Conclusion: In the given question, XYZ Limited, is planning to use the amount initially raised for investing in a different industry, which also involves trading in equity shares of other listed companies.

Though XYZ Limited has passed a special resolution for the said proposal, it cannot use any amount raised by it through the prospectus for buying, trading or otherwise dealing in equity shares of any other listed company. Hence, the said proposal for new investment is not valid.

Section 29 Securities to be in Demat Form

- 12.** Grab Ltd., an unlisted company, intends to make a public offer of securities. However, they are not sure about the compliance requirements for issuing securities in dematerialised form. You being an expert, guide Grab Ltd, on the relevant provisions of the Companies Act, 2013 and whether Grab Ltd. is eligible to issue its securities? **(RTP May 25)**

Solution:

Law: The given issue is based on section 29 of the Companies Act, 2013 read with the relevant 9A (Issue of securities in dematerialised form by unlisted public companies) of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

- (i) As per Section 29 every company making a public offer and unlisted company, have to issue their securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and regulations made under it.
- (ii) Any company, other than a company mentioned above, may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.
- (iii) Every unlisted public company making any offer for issue or buyback or bonus shares or rights offer shall ensure that before making such offer, the entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with provisions of the Depositories Act 1996 and regulations made there under.
- (iv) Following Unlisted Public Co. are exempted from Demat:
 - (a) Nidhi Company.
 - (b) Government Company.
 - (c) 100% Subsidiary

Conclusion: Accordingly, in the given case, Grab Ltd., an unlisted company, falls in the prescribed classes of companies, must ensure that its securities are issued and transferred in dematerialised form in compliance with the Depositories Act, 1996.

Section 30 Contents of its Memorandum to be Specified in Every Advertisement

- 13.** Keya Limited decided to issue 1,00,000 securities of the company. The company decides to publish an advertisement of the prospectus. Enumerate to the company about necessary contents of its memorandum to be specified therein. **(RTP MAY 2021)**

Solution:

Contents of its memorandum to be specified in every advertisement

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

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

Section 31 Shelf Prospectus

- 14.** Prakhar Ltd. intends to raise share capital by issuing Equity Shares in different stages over a certain period of time. However, the company does not wish to issue prospectus each and every time of issue of shares. Considering the provisions of the Companies Act, 2013, discuss what formalities Prakhar Ltd. should follow to avoid repeated issuance of prospectus? **(RTP NOV 2018)**

Solution:

Law: Considering sec 31 of companies act, 2013

- (i) Shelf Prospectus means a prospectus in respect of which the securities are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.
- (ii) Provisions of shelf prospectus is applicable to companies as prescribed by SEBI
- (iii) Any class of company to whom shelf prospectus is applicable, may file a shelf prospectus with the Registrar at the stage of the 1st offer of securities specified in the shelf prospectus.
- (iv) The shelf prospectus shall remain valid for period not exceeding 1 year from the date of opening of the first offer of securities
- (v) Prior to the issue of a subsequent offer of securities under the shelf prospectus, the company shall be required to file an information memorandum with the Registrar. in Form PAS - 2 and filed with ROC along with fee, within 1 month prior to issue of subsequent offer. contain material facts relating to:
 - (a) new changes created;
 - (b) changes in the financial position of the company as have occurred between the previous offer and the succeeding offer of securities; and
 - (c) such other changes as may be prescribed.
- (vi) the information memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Conclusion: In present case, Prakhar Ltd. intends to raise share capital by issuing Equity Shares in different stages over a certain period of time and want to avoid repeated issuance of prospectus we suggest it to file shelf prospectus and follow above procedures as mentioned in sec 31

Section 31

- 15.** Give the meaning of the following as per the Companies Act, 2013: **(MTP SEP 2025)**
- (i) What is a Shelf-prospectus?
 - (ii) What is a Red herring prospectus?

Solution:

- (i) As per explanation to section 31, the expression “shelf prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

A company is required to issue a prospectus each time it accesses the capital market. It leads to unnecessary repetition for a company which makes more than one offer of securities in a year to mobilize funds from the public. A way out is shelf prospectus which remains valid (on the shelf) a specified time period during which offers for securities may be made by a company to the public without going through the arduous exercise of issuing fresh prospectus every time.

- (ii) The expression “red herring” means a prospectus which does not include complete particulars of the quantum or price of the securities.

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

Section 34, 35 Liability and Protection in case of Mis-Statement in Prospectus

- 16. What is the extent of liability of an expert, in relation to publication of prospectus, for any mis-statement in the report given by him? (MTP MAY 2017)**

Solution:

For any misstatement in report given by prospectus, an expert can be liable for

- (a) Criminal liability (sec 35)
- (b) Civil Liability (sec 34)

A. Criminal liability

- (i) If a prospectus includes any statement by expert; which is misleading; or omission of any matter in the prospectus is misleading and such statement is intentional then, he will be liable u/s 447.
- (ii) However, this section shall not apply to a person:
 - (a) If he proves that such statement or omission was immaterial; or
 - (b) He had reasonable grounds to believe that the statement was true or the inclusion or omission was necessary

B. Civil Liability

- (i) If a prospectus includes any statement by expert; which is misleading; or omission of any matter in the prospectus is misleading and such statement is unintentional then, he will be liable compensate to every person who has sustained any loss or damage
- (ii) However, this section shall not apply to a expert if
 - (a) he withdrew his consent before the issue of the prospectus
 - (b) that the prospectus was issued without his knowledge or consent

Section 34, 35

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



(RTP Nov 2014) (MTP NOV 2019) (6 Marks) (MTP M21)

Solution:

Law: As under Section 34 and 35 of the Companies Act, 2013 A Director shall not be liable if he puts up the following defences:

- (i) Such statement or omission in the prospectus was immaterial, or
- (ii) Director had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true (Section 34, the Companies Act, 2013)
- (iii) Where a person having consented to become a director of the company, withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

where the prospectus was issued without the knowledge or consent of a person, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.(Section 35, the Companies Act, 2013).

(iv) He relied on public document or experts opinion

Conclusion: Yes, the Director shall be held liable. A director can escape liability for mis- statements in a prospectus only on the grounds specified under Section 34 and 35 of the Companies Act, 2013. Relying on statements prepared by promoters is not a ground included there under also a promoter cannot be expert. Accordingly, no defense shall be available to the Director.

Section 34, 35

18. Green Ltd. was dealing in export of rubber to specified foreign countries. The company was willing to purchase rubber trees in A.P. State. The prospectus issued by the company contained some important extracts of the expert report and number of trees in A.P. State. The report was found untrue. Mr. Andrew purchased the shares of Green Ltd. on the basis of the expert's report published in the prospectus. However, he did not suffer any loss due to purchase of such shares. Will Mr. Andrew have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013. (RTP MAY 2020)

Solution:

Law: As per case Derry vs peek, in case of mis-statement in prospectus remedy is available to such allottee to whom personal loss has been caused.

Conclusion: In the present case, Mr. Andrew purchased the shares of Green Ltd. on the basis of the expert report published in the prospectus. Mr. Andrew can claim compensation for any loss or damage that he might have sustained from the purchase of shares. However, he did not suffer any loss due to purchase of such shares. Hence, Mr. Andrew will have no remedy against the company. Circumstances when an expert is not liable: An expert will not be liable for any mis- statements in the prospectus under the following situations:

- (i) Such statement or omission in the prospectus was immaterial, or
- (ii) Director had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true (Section 34, the Companies Act, 2013)
- (iii) Where a person having consented to become a director of the company, withdrew his consent before the issue of the prospectus or was issued without his authority or consent;

Section 34,35

19. 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 contract on the ground that the prospectus was false in material particulars. Decide. (RTP May 2015) (RTP MAY 2018) (MAY 2013)



Solution:

Law: As per case Rex vs Kysant Prospectus must disclose all material facts; no fact must be omitted due to which the nature or quality of privileges disclosed by prospectus is affected; and no facts must be suppressed.

Conclusion: 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 can do so out of capital profits. Hence, a material misrepresentation has been made.

Section 34,35

20. P Ltd. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained a false statement.

Mr. X purchased some partly paid shares of the company in good faith from the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was included in the list of contributories. Decide: (MAY 2016)

- (i) Whether Mr. X is liable to pay the unpaid amount?
- (ii) Can Mr. X sue the directors of the company to recover damages?

Solution:

Law: A person who has applied for shares in the company, and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus.

However as per case Peek vs gurney, the right to claim damage from Company or Directors etc. shall lie only if the person has purchased shares on the strength of a statement in prospectus. If a person buys shares from another shareholder or from the open market, he cannot bring a claim for damages.

Conclusion:

- (i) Yes, X is liable to pay the unpaid amount on the shares as he cannot avoid contract since he purchased shares from stock exchange As X has purchased partly paid shares, so he is liable for the remaining value of the shares. At the time of winding up he is liable to contribute as a contributory.
- (ii) No, X cannot sue the directors to recover damages for the misstatement in the prospectus. If a person purchases shares in the open market, the prospectus is non operative as far as he is concerned. In the present case, Mr. X purchased shares on the stock exchange even if he did so in good faith he had not relied on the statement in the prospectus. In view of the above, he cannot sue the directors of the company to recover damages.

Section 34, 35

21. With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received a copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 2013 examine whether X's claim for damages is justified. (MTP MAY 2018)

Solution:

Law: A person who has applied for shares in the company, and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus.

However as per case Peek vs gurney, the right to claim damage from Company or Directors etc. shall lie only if the person has purchased shares on the strength of a statement in prospectus. If a person buys shares from another shareholder or from the open market, he cannot bring a claim for damages.

Since, X purchased shares through the stock exchange (open market) which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. Hence, X will not succeed. It was also held in the case of Peek Vs. Gurney that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus.

Section 35

22. Aarna Ltd. was dealing in export of cotton fabric to specified foreign countries. The company was willing to purchase cotton fields in Punjab State. The prospectus issued by the company contained some important extracts of the expert report. The report was found untrue. Mr. Nick purchased the shares of Aarna Ltd. on the basis of the expert's report published in the prospectus. However, he did not suffer any loss due to purchase of such shares. Would Mr. Nick have any remedy against the company? State the circumstances where an expert is not liable under the Companies Act, 2013. **(MTP SEP 2025)**

Solution:

Law: Under section 35(1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person including an expert shall be liable to pay compensation to the person who has sustained such loss or damage. In the present case, Mr. Nick purchased the shares of Aarna Limited on the basis of the expert's report published in the prospectus. Mr. Nick can claim compensation for any loss or damage that he might have sustained from the purchase of shares. Since, Mr. Nick did not suffer any loss due to purchase of such shares, he cannot claim any compensation for any loss or damage.

Section 35(2) of the Companies Act, 2013, provides the instances when a person shall not be held guilty under section 35 of the Act, if he proves:

- (a) He withdrew his consent to be a director of company and prospectus issued without his consent and authority.
- (b) He has given reasonable public notice to effect, that prospectus was issued without his knowledge and consent.
- (c) He made the statement on the authority of an expert whom he believed to be competent and that the expert had given his consent and had not withdrawn it.
- (d) He had reasonable ground for believing the statement to be true and that he did believe it to be true up to the time of allotment.
- (e) The statement was a correct copy of some extract from an official document and that he had in fact believed.

Section 39 Allotment of Securities

23. Alfa Ltd. after receiving 80% of the minimum subscription as stated in the prospectus, has allotted 100 equity shares in favour of Mr. X. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalization of the allotment, for the purchase of certain assets. Mr. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 2013. Discuss in the light of the provisions of the Companies Act, 2013. **(MTP NOV 2017)**

Solution:

Law: According to Section 39 of companies Act, 2013

- (i) no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company
- (ii) Further, according to Section 39(3), if the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the

date of issue of the prospectus, the amount received under sub-section (1) shall be returned within of 15 days from the closure of the issue.

- (iii) If such money is not repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money along with interest at the rate of 15% p.a.

Conclusion: The company has received 80% of the minimum subscription as stated in the prospectus whereas required minimum subscription as per SEBI act is 90%. Hence, the allotment is in contravention of section 39(1) of the Companies Act, 2013 it is required to refund the money received (i.e. 80% of the minimum subscription) to the applicants. It has no other option available. Therefore, in the present case, X is within his rights to refuse to accept the allotment of shares which has been illegally made by the company.

Section 39

- 24.** Kite Limited issued 1,00,000 equity shares of ₹100 each at par to the public by issuing a prospectus. The prospectus discloses the minimum subscription amount of ₹15,00,000 required to be received on application of shares and share application money shall be payable at ₹20 per share. The prospectus further reveals that Kite Limited has applied for listing of shares in 3 recognized stock exchanges of which 1 application has been rejected. The issue was fully subscribed and Kite Limited received an amount of ₹20,00,000 on share application. Kite Limited, then proceeded for allotment of shares. Examine the three disclosures in the above case study which are the deciding factors in an allotment of shares and the consequences for violation, if any under the provisions of the Companies Act, 2013. **(6 Marks) (MTP Sep. 23)**

Solution:

Law: As per section 39,40 of companies act , 2013 there are 3 important criteria for allotment of shares in case of public offer

- (i) Every company shall, before making public offer, make an application to one or more recognised stock exchange and obtain permission for the securities to be dealt with in such stock exchange and The prospectus shall state the name or names of the stock exchange in which the securities shall be dealt with Also none of the stock exchange should reject application
- (ii) The company shall obtain minimum application money on every security which shall not be less than at least:
 - (a) 5% of the nominal amount of the security; or
 - (b) such other percentage or amount, as may be specified by SEBI by making regulations on this behalf.
- (iii) no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company

Conclusion: In above case since Kite Limited has applied for listing of shares in 3 recognized stock exchanges of which 1 application has been rejected, he cannot proceed to issue shares and if allotted, issue will be void

Section 40 Underwriting Commission

- 25.** Modem Jewellery Ltd. decides to pay 5% of the issue price gap of shares as underwriting commission to the underwriters, but the Articles of the company authorize only 4% underwriting

commission on shares. Examine the validity of the above decision under the provision of the Companies Act, 2013. (MAY 2019)

Solution:

Law: Section 40(6) of the Companies Act, 2013 provides that a company may pay commission to any person in connection with the subscription to its securities subject to such conditions as may be prescribed. Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides the conditions. As per Rule 13(c) 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 per cent of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

Conclusion: In the instant case, Modern Jewellery Ltd. decides to pay 5% of the issue price gap of shares as underwriting commission to the underwriters, but the Articles of the company authorize only 4% underwriting commission on shares. Hence the company can only pay a maximum of 4% underwriting commission on shares.

Section 40

26. “The Articles of Association of X Ltd. contained a provision that upto 4% of issue price of’ the shares may be paid as underwriting commission to the underwriters. The Board of Directors of X Ltd. decided to pay 5% underwriting commission. (MTP MAY 2019)

Solution:

Law: Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the number of conditions which are prescribed under Companies (Prospectus and Allotment of Securities) Rules, 2014. Under 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.

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

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid.

Section 42 Private Placement

27. Ram Limited is planning to make a private placement of securities. The Managing Director arranged to obtain a brief note from some source explaining the salient features of the issue of private placement that the Board of Directors shall keep in mind while approving the proposal on this subject. The brief note includes, inter alia, the information/suggestions on the following points: (5 Marks) (MTP Sep. 23)



- (i) A private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year.
- (ii) The aforesaid ceiling of identified persons shall not apply to the offer made to the qualified institutional buyers but is applicable to the employees of the Company who will be covered under the Company’s Employees Stock Option Scheme.
- (iii) The offer on private placement basis shall be made only once in a financial year for any number of identified persons not exceeding 200.

- (iv) The Company solicits your remarks on the points referred above as to whether they are valid or not? Reasoned remarks should be given in accordance with the provisions of the Companies Act, 2013.

Solution:

- (i) The statement is valid as private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year but such limit is per kind of security and for a financial year.
- (ii) The statement is invalid as The aforesaid ceiling of identified persons shall not only apply to the offer made to the qualified institutional buyers but also to the Company's Employees Stock Option Scheme.
- (iii) The statement is valid as private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year but such limit is per kind of security and for a financial year.

