

PROSPECTUS AND ALLOTMENT OF SECURITIES



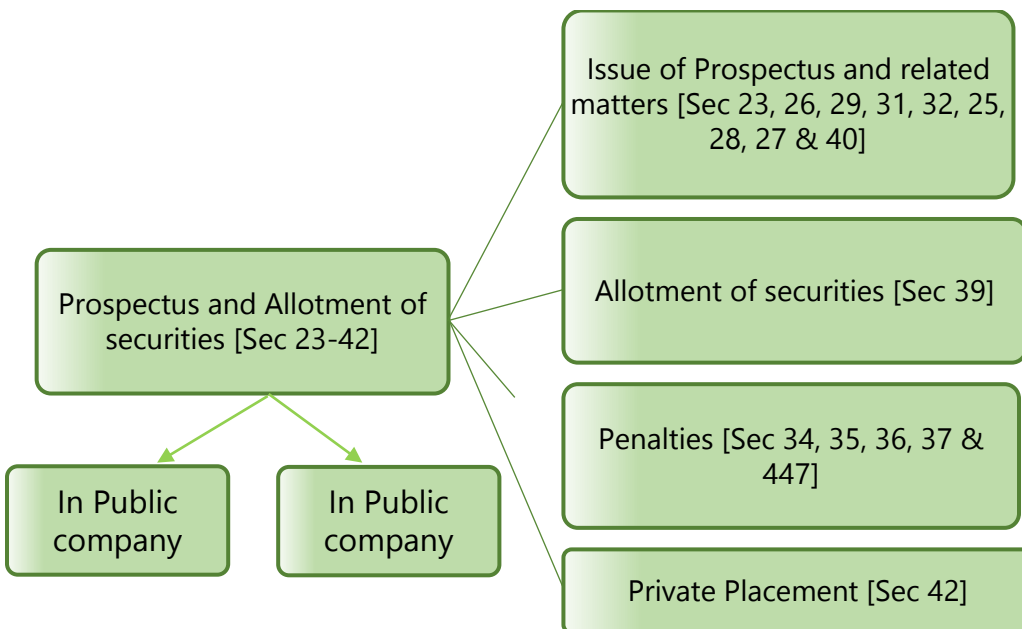
LEARNING OUTCOMES

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

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

CHAPTER OVERVIEW

This Chapter constitutes chapter III of the Act consisting of sections 23 to 42 dealing with the prospectus and allotment of securities. The Act provides the manner in which securities can be issued by both public and private company. This chapter relating to issue of securities is covered under two headings: Part I relates to issue of public offer and Part II relates to issue of securities through private placement.



1. INTRODUCTION

One of the advantages of floating a company is **raising of capital**. Capital could be raised from **public** at large or from a defined group or **inner circle** (pre-known select group of persons). The former is called the '**Public offer**' and the latter is called '**Private Placement**'. Capital acquisition is inflow of funds for the issuer and needs **advertisement** which should be in accordance with the relevant legal provisions so that any **investor is not defrauded** or be-fooled. On successful closure of the application process, securities are allotted to investors which could be then listed on an appropriate segment of a recognised stock exchange.

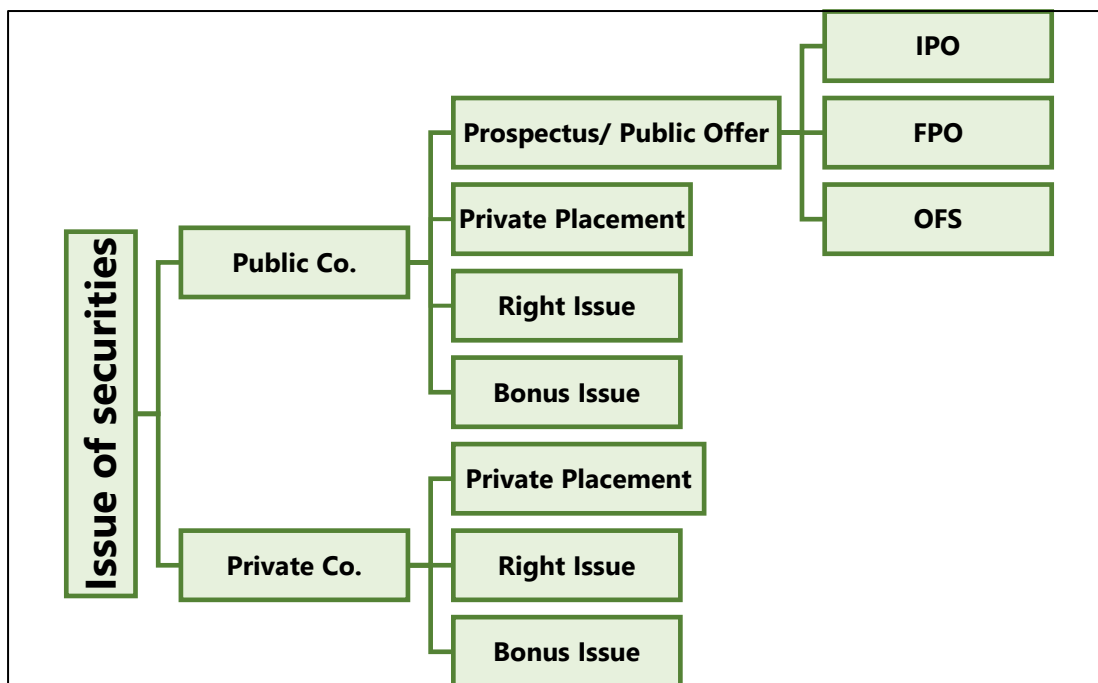
The provisions related to raising of capital such as issue of prospectus, allotment

of shares etc. and other matters incidental thereto are contained in Chapter III of the Companies Act, 2013, which is divided into two parts:

Part I – Public Offer of the chapter comprise sections 23 to 41, and

Part II – Private Placement comprises section 42.

2. PUBLIC OFFER AND PRIVATE PLACEMENT



As per Section 23 (1) A **public company** may issue securities—

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

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

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

Explanation —For the purposes of this Chapter, “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.

As per **Section 2 (81)**—securities means the securities as defined in clause (h) of section 2 of **the Securities Contracts (Regulation) Act, 1956**

“**Securities**” include—

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

Securities however, shall not include any **unit linked insurance** policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938.

- (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a **special purpose** distinct **entity** which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

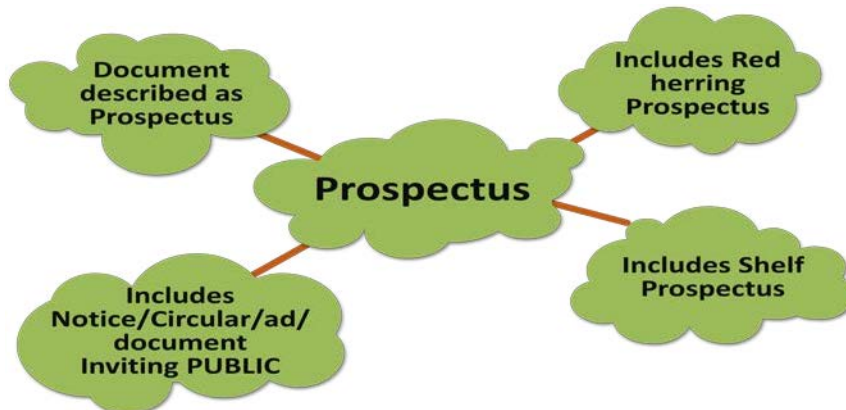
- (ii) **Government** securities;
- (ia) such other instruments as may be **declared by the Central Government** to be securities; and
- (iii) rights or **interests in** securities;

The provisions of Section 23 are tabulated below:

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

3. PROSPECTUS

As per the definition given in Section 2(70) of the Companies Act, 2013, prospectus means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of body corporate.



(I) **Matters to be stated in prospectus**

- (1) According to **Section 26 (1)**, 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**:

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.

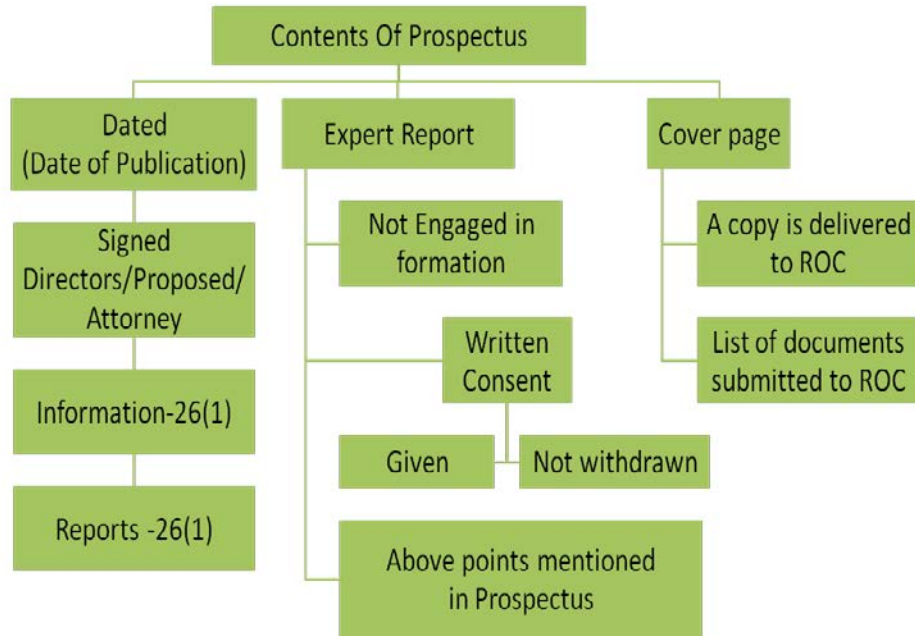
¹(c) prospectus shall make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992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

- (2) **Exceptions:** Nothing in sub-section (1) shall apply—

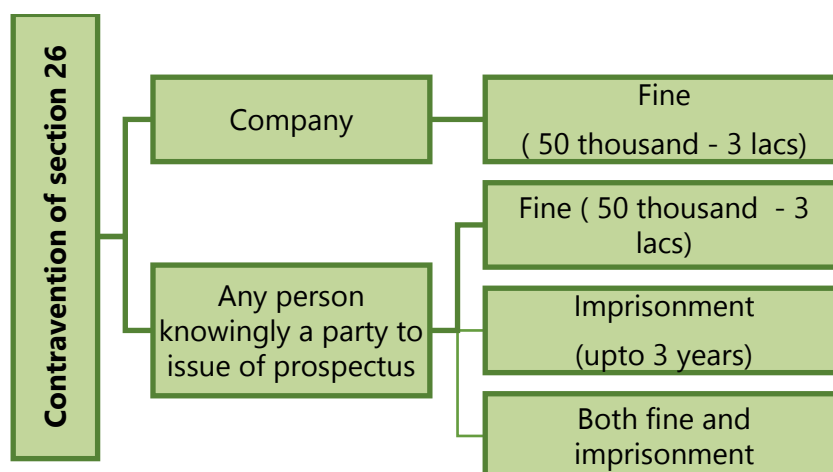
- (a) to the issue to **existing** members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of section 62 in favour of any other person; or
- (b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects **uniform** with shares or debentures previously issued and for the time being dealt in or **quoted** on a recognised stock exchange.
[Sub- section (2)]

¹clauses (a), (b) and (d) have been omitted [Companies (Amendment) Act, 2017, Enforcement Date: 7th May, 2018]

- (3) **Application of sub-section (1) to prospectus or to an application related to formation of a company:** Subject to sub-section (2), the provisions of sub-section (1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently. The **date indicated** in the prospectus shall be **deemed** to be the **date of its publication**.
- (4) **Prospectus to be issued after registration and compliance with other formalities:** No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless **on or before the date of its publication**, there has been **delivered** to the **Registrar for registration**, a copy thereof **signed by every person** who is named therein as a director or proposed director of the company or by his duly authorised attorney. [Sub- section (4)]
- (5) **Experts' excluded from making a statement:** A prospectus issued under sub-section (1) shall **not include** a statement purporting to be made by an expert unless the expert is a person who is **not**, and has not been, **engaged** or interested in the formation or promotion or management, of the company and has given his written **consent** to the issue of the prospectus and has **not withdrawn** such consent before the delivery of a copy of the prospectus to the Registrar for registration and a **statement** to that effect shall be **included** in the prospectus.
- (6) **Mention compliances of the formalities:** Every prospectus issued under sub-section (1) shall, **on the face of it**—
- state** that a copy has been **delivered** for registration to the Registrar as required under sub-section (4); and
 - specify** any **documents** required by this section to be attached to the copy **so delivered** or refer to statements included in the prospectus which specify these documents.



- (7) **Compliance of requirements of this sections before registration:** The Registrar shall **not register** a prospectus unless the requirements of this section with respect to its registration are **complied** with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.
- (8) **Period for the issue of prospectus:** No prospectus shall be **valid** if it is issued more than **ninety days** after the date on which a copy thereof is delivered to the Registrar under sub-section (4).
- (9) **Punishment in case of contravention:** If a prospectus is issued in contravention of the provisions of this section, the **company** shall be punishable with **fine** which shall not be less than **fifty thousand** rupees but which may extend to **three lakh** rupees and **every person** who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to **three years** or with fine which shall not be less than **fifty thousand** rupees but which may extend to **three lakh** rupees, or with both.



The major minimum contents of a prospectus or deemed prospectus are underlined in the sub-section (1) of Section 26 above. In addition to these there are substantial disclosure requirements which are prescribed under *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

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

(II) Public offer of securities to be in dematerialised form

- (1) Section 29(1) states that every company making **public offer**; and Such other class or classes of public companies as may be **prescribed** under the Rule 9 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, shall issue the securities only in **dematerialised** form by complying with the **provisions** of the **Depositories Act, 1996** and the regulations made thereunder.
- (2) Any company, **other than** a company mentioned in sub-section (1), **may convert** its securities into dematerialised form **or issue** its securities in **physical** form in accordance with the provisions of this Act **or** in **dematerialised** form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Securities could be held in physical or dematerialised form. However public offer of securities has to be mandatorily in demat form in accordance with the **Depositories Act, 1996**. Demat ensures fool proof control over issue, sale, purchase, pledge, extinguishment of securities lending transparency and credibility to the entire process and securities markets.

According to Rule 9 of *Companies (Prospectus and Allotment of Securities) Rules, 2014 (Dematerialisation of securities)*

The **promoters** of every public company making a public offer of any convertible securities may hold such securities **only** in **dematerialised** form:

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

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

Section 31 and Section 32 deals with important provision related to Shelf Prospectus and Red-herring Prospectus respectively. These twin provisions play a significant role in facilitating commercial and logistical consideration involved in the funds raising cycle.

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

Likewise, developments in financial markets allow innovative methods of raising funds making 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.

SHELF PROSPECTUS –The expression "shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are **issued for subscription in one or more issues over a certain period** without the issue of a further prospectus

(1) Filing of shelf prospectus with the registrar: According to section 31, any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-

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

no further prospectus is required.

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

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.

- (3) **Memorandum together with the shelf prospectus shall be deemed to be a 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.

RED HERRING PROSPECTUS— The expression “red herring prospectus” means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Section 32 deals with the issue of red herring prospectus by a company. Accordingly law states that-

- (i) **Issue a red herring prospectus prior to the issue of a prospectus:** A company proposing to make an offer of securities

may issue a red herring prospectus **prior** to the issue of a prospectus.

- (ii) **Filing with the registrar:** A company proposing to issue a red herring prospectus shall **file** it with the Registrar **at least three days** prior to the opening of the subscription list and the offer.
- (iii) **Same obligation:** A red herring prospectus shall carry the same obligations as are applicable to a prospectus and **any variation** between the **red herring prospectus** and a prospectus shall be **highlighted as variations** in the prospectus.
- (iv) **Filing of red herring prospectus with registrar and SEBI upon closing of offer:** Upon the closing of the offer of securities under this section, the prospectus stating therein the **total capital raised**, whether by way of debt or share capital, and the **closing price** of the securities and **any other details** as are **not included** in the **red herring prospectus** shall be filed with the Registrar and the Securities and Exchange Board.

ABRIDGED PROSPECTUS means a **memorandum** containing such **salient features** of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. **[Refer the topic 'Issue of application forms for Securities']**

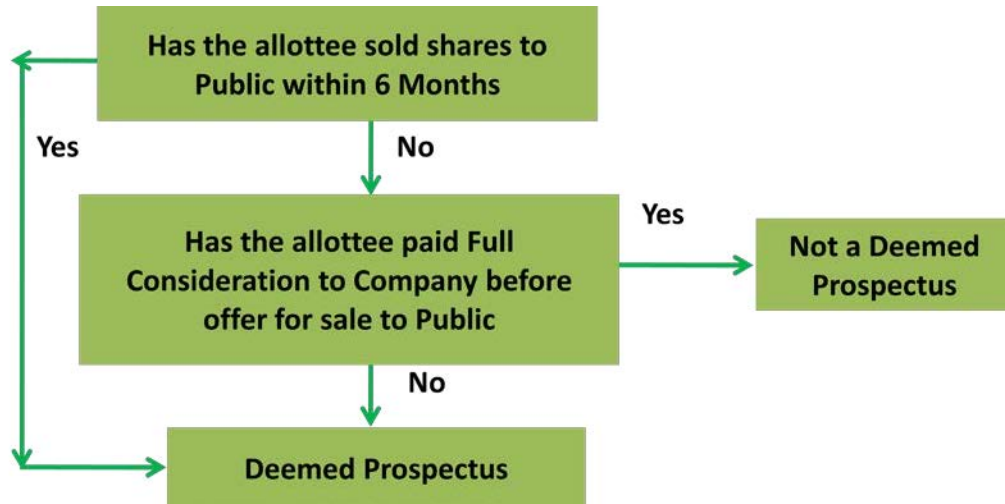
(IV) Document containing offer of securities for sale to be deemed prospectus

Section 25 of the Act states the law related to the **document by which the offer for sale to the public is made** shall, for all purposes, be deemed to be a prospectus issued by the company.

- (1) **Documents which deemed to be a prospectus:** As per Section 25(1), where a **company allots or agrees to allot** any securities of the company with a view to all or any of those securities being offered for sale to the public, **any document by which the offer for sale to the public is made shall, for all purposes, be deemed** to be a prospectus issued by the company; and all enactments and rules of law as to the contents of prospectus and as to **liability in respect of mis-statements, in and omissions** from, prospectus, or otherwise relating to prospectus, shall apply with the modifications specified in subsections (3) and (4) and shall have effect accordingly, as if the securities had been offered to the public for subscription and as if persons accepting

the offer in respect of any securities were subscribers for those securities, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof.

- (2) **Securities offered for sale to the public:** For the purposes of this Act, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—
- (a) that an offer of the securities or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or
 - (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.
- (3) **Effect of section 26:** Section 26 as applied by section 25 shall have effect as if —
- (i) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—
 - (a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
 - (b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;
 - (ii) the persons making the offer were persons named in a prospectus as directors of a company.
- (4) **Person making an offer is a company or a firm:** Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document referred to in sub-section (1) is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be.



Accordingly, all applicable provisions relating to prospectus viz., mis-statement, contents, civil, criminal liability etc. are applicable to the said deemed prospectus. There is no dilution of liability for the persons making the offer which is in addition to liability of the company whose securities are offered for sale. Additionally, below to be disclosed as well in the deemed prospectus:

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

The purpose is to protect gullible investors in all possible manners.

(V) Offer of sale of shares by certain members of company

Sections 28 of the Act deals with the Offer for sale of securities by certain members of company.

- (1) Where certain members of a company propose, in consultation with the Board of directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed.
- (2) Any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of

the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

- (3) The members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively **authorise the company**, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

(VI) Variation in terms of contract or objects in prospectus [Section 27]

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

Accordingly, the section states that-

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

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

Provided further that such company shall **not use** any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any **other listed company**.

- (2) **Exit offer to dissenting shareholders:** The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall

be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.



4. SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES

- (1) **Filing of an application with recognised stock exchange:** In accordance to Section 40(1) every company making public offer shall, before making such offer, make an application to **one or more recognised stock exchange or exchanges** and obtain permission for the securities to be dealt with in such stock exchange or exchanges.
- (2) **Prospectus to state name of stock exchange:** Where a prospectus states that an application has been made, such prospectus shall also **state the name or names** of the stock exchange in which the securities shall be dealt with.
- (3) **To maintain separate bank account:** All monies received on application from the public for subscription to the securities shall be kept in a **separate bank account in a scheduled bank** and shall **not be utilised** for any purpose other than—
 - (a) for adjustment **against allotment** of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or
 - (b) for the **repayment** of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.
- (4) **Condition purporting to waive compliance shall be void:** Any condition purporting to require or bind **any applicant for securities to waive compliance** with any of the requirements of this section shall be **void**.
- (5) **In case of default:** If a default is made in complying with the provisions of this section, both the company and the officer of the company shall be **liable**.

Company

- fine varying from five lakh rupees to fifty lakh rupees

Officer

- punishable with imprisonment upto one year, or
- with fine varying from fifty thousand rupees to three lakh rupees, or
- with both.

- (6) **Payment of commission:** A company may pay **commission** to any person in connection with the **subscription to its securities**, whether absolute or conditional, subject to such conditions as given in Rule 13 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

Conditions for the payment of commission:

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

in case of shares

- shall **not exceed 5%** of the price at which the shares are issued, or
- a rate **authorised** by the articles,
- whichever is **less**

in case of debentures

- shall **not exceed 2.5%** of the price at which the debentures are issued, or
- as **specified** in the company's articles,
- whichever is **less**

- (d) **Disclosure of the particulars:** the prospectus of the company shall disclose the following particulars -
- (i) the **name** of the **underwriters**;

- (ii) the rate and amount of the commission payable to the underwriter; and
 - (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- (e) **No commission to be paid:** there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
- (f) **Copy of payment of commission to be delivered to registrar:** a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Example: A public limited company which went in for Public issue of shares had applied for listing of shares in three recognised Stock Exchanges and out of it only two had given permission for listing. Can the company proceed for allotment of shares?

Answer: Every company making a public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges. [Section 40 (1)]

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

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

Hence, under the Companies Act, 2013 by making the offer of shares before getting the approval from the stock exchanges, it has violated the provisions of section 40.

Example: The Board of Directors of a company decide to pay 5% of issue price of shares as underwriting commission to the underwriters. On the other hand 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 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 rules allow 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 while the decision to pay out of the proceeds of the share issue is valid.



5. ALLOTMENT OF SECURITIES BY COMPANY

“Allotment” means the appropriation out of previously un-appropriated capital of a company, of a certain number of shares to a person. Till such allotment, the shares do not exist as such. It is on allotment that the shares come into existence.

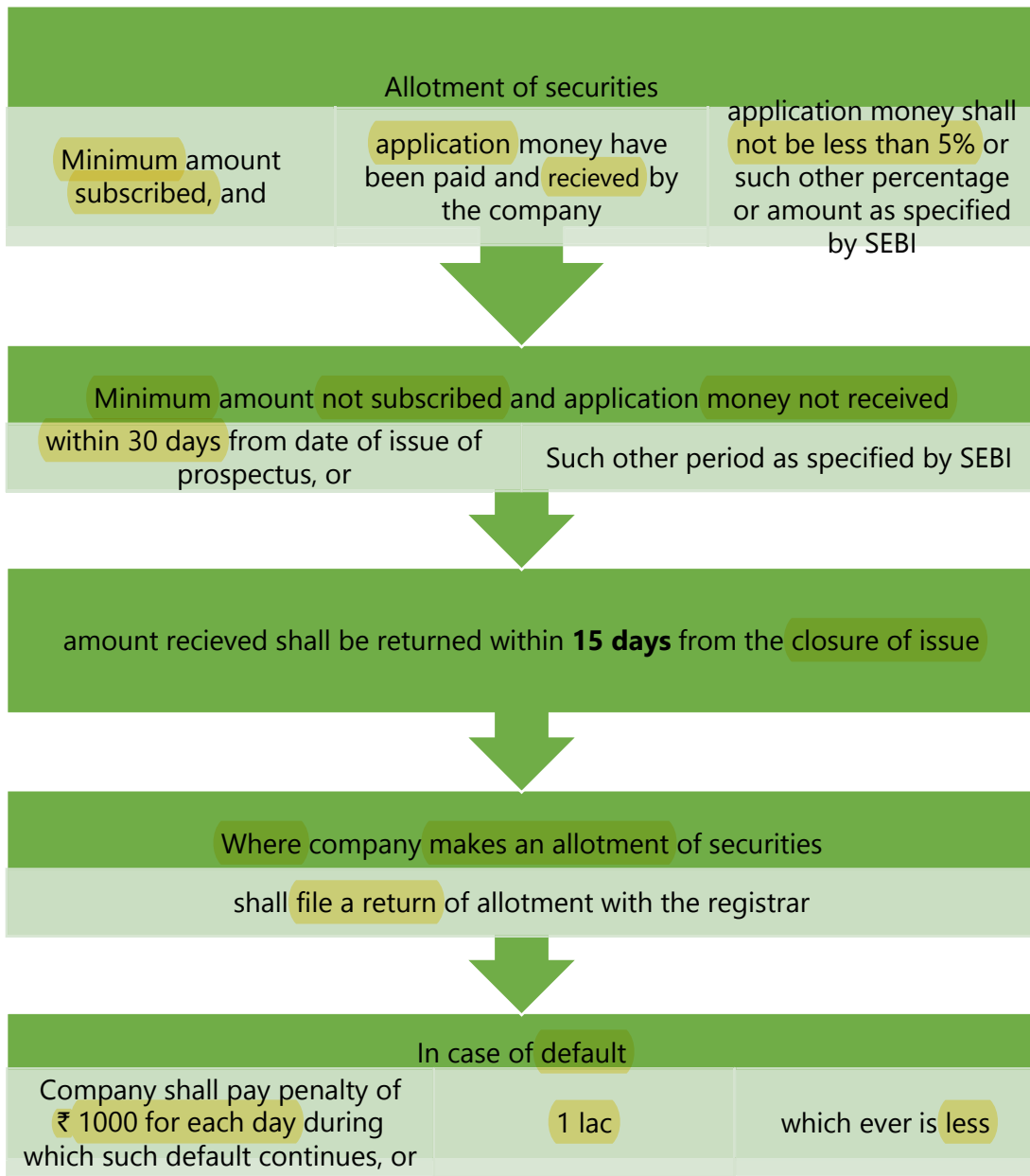
According to **Section 39(1)** no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the **minimum** amount has been subscribed and the sums payable on **application** for the amount so stated have been paid to and received by the company by cheque or other instrument.

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

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

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

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



Once securities are issued and subscribed for, these needs to be allotted in tune with the conditions as given below:

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

As per *Rule 11 (Refund of Application Money)*

(1) 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.

(2) The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

Example: After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 2013.

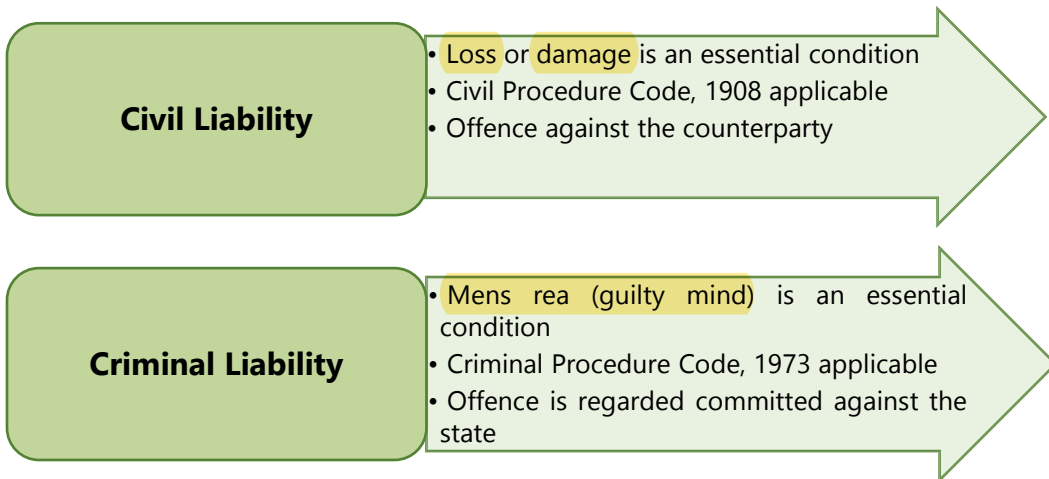
Answer: The company has received 80% of the minimum subscription as stated in the prospectus. Hence, the allotment is in contravention of section 39(1) of the Companies Act, 2013 which prohibits a company from making any allotment of securities until it has received the amount of minimum subscription stated in the prospectus. Under section 39 (3), 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.

6. MIS-STATEMENTS IN PROSPECTUS

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

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



CRIMINAL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 34]

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

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

CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 35]

(1) Liabilities of persons: According to **Section 35(1)**, where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the **company and every person who—**

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

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

-shall, without prejudice to any punishment to which any person may be liable under section 36, be **liable to pay compensation** to every person who has sustained such loss or damage.

(2) Exceptions: No person shall be liable if he proves—

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

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



Example: 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.

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 can do so out of capital profits. Hence, a **material misrepresentation** has been made. Hence, in the given case the allottee can **avoid** the contract of allotment of shares.

Example: 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 and so director is not liable.

Answer: The Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, and section 35 more particularly includes a director of the company in the imposition of liability for such mis statements. Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus.



7. PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY [SECTION 36]

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

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

-shall be liable for action under section 447.



8. ACTION BY AFFECTED PERSONS [SECTION 37]

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

Class Actions – Gift of Companies Act, 2013

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

The **need for these types of suits** was first felt in the context of securities market during the time of **Satyam Scam**, where a large group of people were cheated

regarding their hard earned money invested in Stock Market. During that time, it was felt that it was **not** at all viable regarding **cost effectiveness** for a small stakeholder to file a case independently against the defendant. Millions of cheated investors during that time formed a large group and filed the case against the company, but since there was no available legal remedy or law which can actually support this type of litigation of a group filing charges, it became tough for those investors to take a recourse or gain advantage in the Indian Judicial System by this method. **Class action suits in India were so far filed under the guise of public interest litigations.** Courts were free to dismiss these. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and had their claims rejected.

Example: M applies for share on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Can N 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 to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. 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.



9. PUNISHMENT FOR FRAUD

Meaning of fraud: "Fraud" in relation to affairs of a company or any body corporate, includes-

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

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

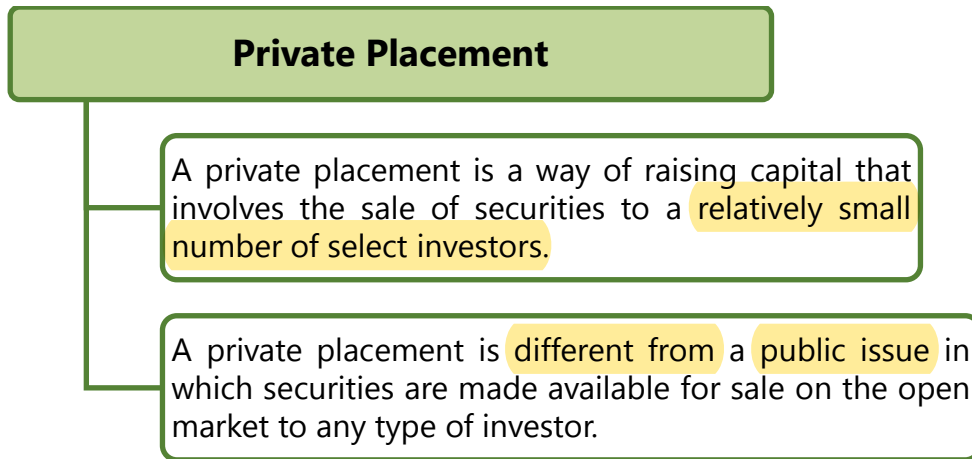
According to section 447 of the Act, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may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

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

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

	Fine		Imprisonment
Fraud of less than 10 lakh rupees or 1% of turnover whichever is less	Upto ₹ 50 Lakhs	or	Upto 5 years
Fraud of equal to or more than 10 lakh rupees or 1% of turnover whichever is less	Min: amount of fraud Max: (amount of fraud) x 3	and	Min: 6 months Max: 10 Years
Involving Public Interest	Min: amount of fraud Max: (amount of fraud) x 3	and	Min: 3 years Max: 10 Years

10. PRIVATE PLACEMENT OFFER OR INVITATION FOR SUBSCRIPTION OF SECURITIES ON PRIVATE PLACEMENT [SECTION 42]



Offer or Invitation for Subscription of Securities on Private Placement: [Section 42]

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

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

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

Provided that the private placement offer and application shall **not carry any right of renunciation.**

Explanation I.—"private placement" means any offer or invitation to subscribe or

issue of securities **to a select group of persons by a company (other than by way of public offer)** through private placement offer-cum-application, which satisfies the conditions specified in this section.

Explanation II.—"qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time, made under the Securities and Exchange Board of India Act, 1992.

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

(4) Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person alongwith subscription money paid either by **cheque or demand draft or other banking channel** and not by cash:

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

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

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

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

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

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

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

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

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

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

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

As per **Rule 14** of *Companies (Prospectus and Allotment of Securities) Rules, 2014*,

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

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

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

Provided further that this sub-rule shall not apply in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of sub-section (1) of section 180 and in such cases relevant Board resolution under clause (c) of subsection (3) of section 179 would be adequate:

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

(2) For the purpose of sub-section (2) of section 42, an offer or invitation to subscribe securities under private placement shall not be made to persons more than **two hundred** in the aggregate in a financial year:

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

Explanation.- For the purposes of this sub-rule it is hereby clarified that the restrictions aforesaid would be reckoned individually for each kind of security that is equity share, preference share or debenture.

(3)² A return of allotment of securities under section 42 shall be filed with the Registrar within fifteen days of allotment.

(4)³ The provisions of sub-rule (2) shall not be applicable to -

- (a) non-banking financial companies which are registered with the Reserve Bank of India under the Reserve Bank of India Act, 1934 and
- (b) housing finance companies which are registered with the National Housing Bank under the National Housing Bank Act, 1987,

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

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

(5)⁴ A company shall issue private placement offer cum application letter only after the relevant special resolution or Board resolution has been filed in the Registry:

Provided that private companies shall file with the Registry copy of the Board resolution or special resolution with respect to approval under clause (c) of subsection (3) of section 179.

SUMMARY

- ◆ Securities could be offered to public at large (public offer) or through private placement subject to the type of issuer company
- ◆ Prospectus, deemed prospectus, abridged prospectus, red-herring prospectus, shelf prospectus, information memorandum need to comply with the minimum information requirements as prescribed in the Act and the Rules
- ◆ Fraudulent Omission or commission in the issue documents attract civil as well as criminal liability.

² Rule 14 (6)

³ Rule 14(7)

⁴ Rule 14(8)

- ◆ SEBI has power to deal with matters related to listed or proposed to be listed securities. Central Government (MCA, Regional Director, ROC) has power to deal with matters related to unlisted securities
- ◆ Issue of securities (shares, debentures or hybrid securities) through public offer to be made only in demat form
- ◆ Existing holders of securities could offload their stake through required compliances for an OFS
- ◆ Provision related to timelines, pre-requisites for allotment and listing wherever applicable needs to strictly adhered to avoid any penal provision
- ◆ Private placements have somewhat diluted disclosure requirements as public exposure is not there

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Offer of securities or invitation to subscribe securities under private placement shall be made to -----maximum number of person in the aggregate in a financial year.
 - (a) 50
 - (b) 100
 - (c) 150
 - (d) 200
2. A private company may issue securities through the way of , except-
 - (a) Public offer
 - (b) Rights issue
 - (c) Bonus issue
 - (d) Private placement
3. Registrar of companies shall refuse to register a prospectus:
 - (a) If it is not dated
 - (b) Contains statement of an expert who has not signed it
 - (c) Contains information which is six month old

- (d) In all the above cases
4. 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
5. Shelf prospectus remains valid upto-
- (a) 6 months
 - (b) 1 year
 - (c) 2 years
 - (d) 5 years
6. An issue house (share broker) has made an advertisement in newspaper for selling a big lot of share allotted to it by the 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 but it has paid the entire consideration to the company
 - (b) advertisement was given after six months from the date of allotment & it has paid the entire consideration to the company
 - (c) It has not paid entire consideration to the company till the date of allotment
 - (d) None of the above
7. In which of the following situations a company will have to issue prospectus or abridged prospectus along with the application form:
- (a) In relation to shares or debentures which are not offered to the public
 - (b) In relation to issue of shares or debentures to the existing members or debenture holders
 - (c) In relation of issue of shares which are uniform with shares previously issued and quoted on a recognized stock exchange
 - (d) in relation to shares or debentures which are to be offered to the public

8. Criminal liability under section 34 for misstatement in prospectus may be avoided if : 1) the consent to become director was withdrawn 2) prospectus was issued without his knowledge 3) misstatement was immaterial 4) had reasonable ground to believe in truthfulness 5) it was based on statement of expert
- (a) 3 & 4
 - (b) 1; 2; 3; 4 & 5
 - (c) 1; 2 & 5
 - (d) 3; 4 & 5
9. If a person makes multiple applications in different names; then which of the following statements are not true:
- (a) he shall be liable for action under section 447
 - (b) above provision shall be prominently reproduced in prospectus
 - (c) Court may also order disgorgement of gain
 - (d) Disgorged gain will be transferred to Insolvency and Bankruptcy fund
10. Which of the following 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
11. A holder of depository receipts shall have right to vote:
- (a) at par with other equity shareholders
 - (b) through overseas depository and in the proportion as already specified by company
 - (c) no right to vote
 - (d) only on resolutions directly affecting them

12. A public company sent private placement offer letter to 200 persons of its choice in March 20XX and allotted shares to them in April 20XX. Can it send private placement offer letter to 200 new people in May 20XX?
- (a) Yes
(b) No
(c) Yes with the permission of ROC
(d) Yes with the permission of NCLT
13. Which of the following statement is contrary with the provisions of the Companies Act; 2013?
- (a) a private company can make a private placement of its securities
(b) 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
14. A company can change terms of contracts mentioned in prospectus by way of:
- (a) Ordinary resolution though postal ballot
(b) Ordinary resolution in meeting
(c) Special resolution in meeting
(d) Special resolution through postal ballot
15. 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

Answer to MCQs

1. (d) 2. (a) 3. (d) 4. (d) 5. (b) 6. (b)
7. (d) 8. (a) 9. (d) 10. (c) 11. (b) 12. (a)
13. (c) 14. (d) 15. (c)

Question and Answer

Question 1

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

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to a number of conditions which are prescribed under *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 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, and 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 is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates.

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

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

Question 2

PQR limited wants to raise funds for its upcoming project. It has issued private placement offer letters to 55 persons in their individual name to issue its equity shares. Out of these four are qualified institutional buyers. Before allotment under this offer letter company issued another private placement offer letter to another 155 persons in their individual name for issue of its debentures. Being a public company can it issue securities in a private placement? Is it in compliance with provisions related to private placement or should these offers be treated as public offers? What if the offer for debentures is given after allotment of equity shares but within the same financial year?

Answer

According to section 42 of the companies act, 2013 any private or public company may make private placement through issued of a private placement offer letter.

But the offer shall be made to persons not exceeding fifty or such higher number as may be prescribed, in a financial year. For counting number of persons qualified institutional buyers and employees under employees stock option scheme will not be considered.

Here rules prescribed limit as 200 persons in a financial year. But this limit should be counted separately for each type of security.

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 shall be governed by the provisions related to prospectus.

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

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

In the given case PQR limited is a public company and looking at above provisions we can say that even a public company can make private placement. Company has given offer to 55 persons out of which 4 are qualified institutional buyers hence the offer is given to effectively 51 persons which is well within the limit of 200 persons. From this angle company is in compliance with private

placement rules.

But company has given another private placement offer which is non compliance of provisions of section 42 hence the offers given by company will be treated as public offer and will be governed accordingly.

But if the company gives offer for debentures in the same financial year after allotment of equity shares is complete then both the offers can well be treated as private placement offers. Here we should not add 51 and 155 persons for checking the limit of 200 because this limit should be checked

Question 3

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

- (i) *Minimum Subscription, and*
- (ii) *Application Money payable on shares being issued?*

Answer

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

Minimum subscription [Section 39 (1)]

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

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

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

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

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

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

Question 4

The Board of Directors of Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the Registrar of Companies, Mumbai. Explain the remedy available to the investors in this regard.

Answer

According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. 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.

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

Question 5

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.

Answer

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

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

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

Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis-statements in the prospectus.