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

- 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 Punishment for personation for acquisition, etc., of securities
- Comprehend the powers of SEBI
- Know about the allotment of securities by company
- Understand the concept of global depository receipt
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—
(a) to public through prospectus (herein referred to as “public offer”) by complying with the provisions of this Part; or
(b) through private placement by complying with the provisions of Part II of this Chapter; or
(c) 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 (15 of 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

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“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 (2g) 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;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;

**Right and bonus issue** - Right and bonus issue of securities by a private company shall be governed by the section 62 under the chapter IV (Share capital and debentures) of this Act, whereas such issue by a public company shall be governed by section 23, and in the case of a listed company it shall also be governed by SEBI Act and its Regulation.

The provisions of Section 23 are tabulated below:

<table>
<thead>
<tr>
<th></th>
<th>Public Company</th>
<th>Private Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Offer (including IPO, FPO or OFS)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Private Placement</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rights issue / Bonus Issue</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Compliance with SEBI rules and regulations</td>
<td>Yes for listed company or company proposed to be listed</td>
<td>No</td>
</tr>
</tbody>
</table>
Example: The Board of Directors of M/s R Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the Registrar of Companies, Mumbai. Here in the given case 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. So, 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.

3. POWER OF SECURITIES AND EXCHANGE BOARD TO REGULATE ISSUE AND TRANSFER OF SECURITIES, ETC.

As per the Explanation to section 24 of this Act, it is hereby declared that all powers relating to all other matters relating to prospectus, return of allotment, redemption of preference shares and any other matter specifically provided in this Act, shall be exercised by the Central Government, the Tribunal or the Registrar, as the case may be. Section 24 lays down power of Securities and Exchange Board (SEBI) to regulate issue and transfer of securities, etc.
(1) As per Section 24(1) The provisions contained in this Chapter, Chapter IV which deals with the share capital and debentures, and in section 127 which deals with the punishment for failure to distribute dividends, shall,
(a) in so far as they relate to —
   (i) issue and transfer of securities; and
   (ii) non-payment of dividend,
   by listed companies or those companies which intend to get their securities listed on any recognised stock exchange in India, except as provided under this Act, be administered by the Securities and Exchange Board by making regulations in this behalf;
(b) in any other case, be administered by the Central Government.
(2) The Securities and Exchange Board shall, in respect of matters specified in subsection (1) and the matters delegated to it under proviso to sub-section (1) of section 458, exercise the powers conferred upon it under sub-sections (1), (2A), (3) and (4) of section 11, sections 11A, 11B and 11D of the Securities and Exchange Board of India Act, 1992.

4. 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.

The matter contained in the prospectus can be classified under three headings

(a) Firstly, under the general information, the prospectus shall contain the following information, namely —

(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed;

(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;

(iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner;

(iv) details about underwriting of the issue;

(v) consent of the directors, auditors, bankers to the issue, expert’s opinion, if any, and of such other persons, as may be prescribed;

(vi) the authority for the issue and the details of the resolution passed therefor;

(vii) procedure and time schedule for allotment and issue of securities;

(viii) capital structure of the company in the prescribed manner;

(ix) main objects of public offer, terms of the present issue and such other particulars as may be prescribed;

(x) main objects and present business of the company and its location, schedule of implementation of the project;

(xi) particulars relating to—

(A) management perception of risk factors specific to the project;

(B) gestation period of the project;

(C) extent of progress made in the project;

(D) deadlines for completion of the project; and

(E) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company;
(xi) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;

(xii) details of directors including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed; and

(xiv) disclosures in such manner as may be prescribed about sources of promoter’s contribution;

(b) Secondly, under the Financial informations, Prospectus set out the following reports for the purposes of the financial information, namely:

(i) reports by the auditors of the company with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed;

(ii) reports relating to profits and losses for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed:

Provided that in case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in such manner as may be prescribed, the reports relating to profits and losses for each of the financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries;

(iii) reports made in the prescribed manner by the auditors upon the profits and losses of the business of the company for each of the five financial years immediately preceding issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date not more than one hundred and eighty days before the issue of the prospectus:

Provided that in case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in the prescribed manner, the reports made by the auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of its business on the last date before the issue of prospectus; and

(iv) reports about the business or transaction to which the proceeds of the securities are to be applied directly or indirectly;
(c) **Thirdly, under the statutory information**, 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 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder; and

(d) state such other matters and set out such other reports, as may be prescribed.

(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.

(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.

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

(7) **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.*

These requirements are not applicable:
- to the issue to existing members or debenture-holders of a company
to the issue in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange

**Other significant requirements as prescribed by Section 26:**

- Prospectus to be registered with the ROC within ninety days before issue and this fact should be stated in the prospectus. 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.
- Expert’s opinion could only be included if supported by his consent for such inclusion and that consent is not withdrawn before delivering the prospectus to ROC for registration. 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;

Sub-section (9) of Section 26 (as explained above) contains penal provisions.

**(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.

**(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 Para No. 7 of this chapter]

(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.

Offer for sale of securities (OFS)- Meaning

OFS as it commonly called are commonly used by many companies to dilute promoters’ holdings or to provide exit route to venture capitalist.

It is different from IPO or FPO in the sense that under OFS securities are offloaded by earlier allotees through the issuer company instead of directly by the issuer company. In OFS there is no change in the Balance Sheet of the company as no new capital comes into picture.
(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 this section 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.
Section 25 regards document for offer of sale of securities as a deemed prospectus (unless contrary proved) if:

- 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
- 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.

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 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 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 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
vierea” (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.

5. **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

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(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 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.
6. ADVERTISEMENT OF PROSPECTUS

As per Section 30 where an advertisement of any prospectus of a company is published in any manner, the following shall be specified in the advertisement:

(i) the contents of its memorandum as regards the objects, the liability of members and the amount of share capital of the company, and

(ii) the names of the signatories to the memorandum and the number of shares subscribed for by them, and

(iii) its capital structure.

7. ISSUE OF APPLICATION FORMS FOR SECURITIES

Section 33 deals with “abridged” prospectus means short or edited prospectus in the prescribed manner which accompanies the application form for securities. Most of you must have seen the physical application form for application of securities with fine prints and wondered who care to read those fine prints. You are right to the extent that High Net worth Indiviual (HNI) investors or institutional investor go minutely through the official full prospectus. However, to plug any information gaps for the small investors the provisions for abridged prospectus are made in the Act irrespective of the fact that these are not paid due attention.

Abridged Prospectus - Issue of application forms for securities

(1) According to Section 33(1), no form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus:

Exception: Provided that nothing in sub-section (1) shall apply if it is shown that the form of application was issued—

(a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or

(b) in relation to securities which were not offered to the public.

(2) A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him.

(3) If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default.

8. 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.

**Allotment of securities**

<table>
<thead>
<tr>
<th>Minimum amount subscribed, and application money have been paid and received by the company</th>
<th>application money shall not be less than 5% or such other percentage or amount as specified by SEBI</th>
</tr>
</thead>
</table>

**Minimum amount not subscribed and application money not received**

| within 30 days from date of issue of prospectus, or Such other period as specified by SEBI |

**amount received shall be returned within 15 days from the closure of issue**

**Where company makes an allotment of securities**

| shall file a return of allotment with the registrar |

**In case of default**

| Company shall pay penalty of ₹ 1000 for each day during which such default continues, or 1 lac which ever is less |
Once securities are issued and subscribed for, these need 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

**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 refuses to accept the allotment of shares which has been illegally made by the company.

9. **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:

- **Civil Liability**
  - Loss or damage is an essential condition
  - Civil procedure Code, 1908 applicable
  - Offence against the counterparty

- **Criminal Liability**
  - Mens rea (guilty mind) is an essential condition
  - Criminal Procedure Code, 1973 applicable
  - Offence is regarded committed against the state
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) withdrew his consent to become director before issue of prospectus: 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) Prospectus issued without his knowledge: 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.

(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 dividends 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** : Yes, 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.

**10. 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.
11. 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.
12. PUNISHMENT FOR PERSONATION FOR ACQUISITION, ETC., OF SECURITIES [SECTION 38]

(1) According to section 38 where any person who—

(a) makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

(b) makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

(c) otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name,

shall be liable for action under section 447.

(2) The provisions of sub-section (1) shall be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

(3) Where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person.

(4) The amount received through disgorgement or disposal of securities under sub-section (3) shall be credited to the Investor Education and Protection Fund.

13. 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, 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.

14. GLOBAL DEPOSITORY RECEIPT (GDR)  
[SECTION 41]

GDRs are issued to broad-base the investor pool and to take advantage of the international investment appetite. Securities are offered to a depository which in turn issue Depository Receipts to international investors. These receipts are traded on international stock exchanges.

As per Section 41, a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

The Companies (Issue of Global Depository Receipts) Rules, 2014 and Depository Receipts Scheme, 2014 prescribes the necessary conditions on this regard.

The Companies (Issue of Global Depository Receipts) Rules, 2014, lays the conditions and the manner in which a company may issue depository receipts in a foreign country.

Eligibility to issue depository receipts. - A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

“Scheme” means the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or any modification or re-enactment thereof.

Conditions for issue of depository receipts.–

1. **Passing of resolution**: The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

2. **Approval of shareholders**: The Company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting:

3. **Depository receipts shall be issued by an overseas depository bank**: The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

4. **Compliance with all the provisions, schemes, regulations etc.**: The Company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

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(5) **Compliance report to be placed at the meeting**: The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

**Manner for issue of depository receipts** –

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas as depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

**Proceeds of issue** - The proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

**Right to vote to the holder of depository receipts** -

(1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

**Non applicability of certain provisions of the Act** –

(1) The provisions of the Act and any rules related to public issue of shares or debentures shall not apply to issue of depository receipts abroad.
(2) The offer document, if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 (Register of members etc.) of the Act, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.

For example: Many Indian companies have their GDRs and ADRs (American Depository Receipts) listed on international stock exchanges like Infosys, HDFC Bank, RIL, ICICI Bank, L&T, etc.

15. **PRIVATE PLACEMENT - OFFER OR INVITATION FOR SUBSCRIPTION OF SECURITIES ON PRIVATE PLACEMENT [SECTION 42]**

“Private placement” means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies below conditions. Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) shall be required to be complied with 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 involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

**Requirements of offer or invitation for subscription of securities on private placement: [Section 42]**

(1) **Issue of private placement offer letter**: According to Section 42(1), a company may, make private placement through issue of a private placement offer letter.

(2) **Offer/invitation to number of persons**: The offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

As per the Rule 14 sub-rule (2) of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, limit on membership i.e., the higher number, have been

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1. In case of Nidhis, section 42 except sub-section (1), explanation (II) to sub-section (2), (4), (6), (8), (9) and (10) shall not apply. *Vide Notification dated 5th June, 2015*
prescribed. According to it, offer of securities or invitation to subscribe securities shall be made to not more than two hundred persons in the aggregate in a financial year.

However Qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of section 62 (1)(b), are excluded from the limits.

“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.

Offer/ invitation made to more than the prescribed number of persons: 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.

(3) No issue of fresh offer/ invitation: No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier-
   (i) have been completed, or
   (ii) that offer or invitation has been withdrawn, or
   (iii) abandoned by the company. 

(4) Offer / invitation treated as public offer: Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

(5) Payment of amount: All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

(6) Time for allotment of securities: A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities.

Default in allotment of securities: Where the company is not able to allot the securities within that period, it shall repay the application money to the subscribers

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within fifteen days from the date of completion 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:

** Separate Bank Account:** 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) **Offers made to the persons whose name is recorded:** All offers covered under this section shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.\(^4\)

(8) **No publication required:** No company offering 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 offer.

(9) **Filing with the registrar:** Whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(10) **In contravention of the section:** If a company makes an offer or accepts monies in contravention of this section—

<table>
<thead>
<tr>
<th>Persons liable</th>
<th>Penalty</th>
</tr>
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<tbody>
<tr>
<td>Company, Promoters and Directors</td>
<td>• May extend to the amount involved in the offer or invitation, or&lt;br&gt;• Two crore rupees- whichever is higher</td>
</tr>
<tr>
<td>Company</td>
<td>• Shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.</td>
</tr>
</tbody>
</table>

\(^4\) This provision shall not apply to specified IFSC public and IFSC private company.
**Procedure of allotment of securities through Private placement**

1. Issue of private placement letter
2. Payment of money towards subscription
3. Allotment of securities within 60 days from receipt of application money
4. Transfer amount in separate bank account
5. Return of allotment filed with registrar with complete list of security holders

In case of contravention, Company, promoters and directors shall be liable for penalty.

**Procedure in case of failure of allotment of securities through Private placement**

1. Company fails in allotment of securities within 60 days from receipt of application money
2. Shall repay application money within 15 days from the date of expiry of 60 days
3. Company then also fails to repay the application money within the aforesaid period
4. Company shall be liable to repay application money + Interest @12% p.a from expiry of 60th day

**Section 42** except sub section (1), Explanation. (II) to sub section (2), sub-sections (4), (6),(8),(9) and (10) shall not apply to a Nidhi company as per the notification dated 5th June 2015.

As per Rule 14(2) of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, certain restrictions has been put on the companies to make a private placement of its securities.

A company shall not make a private placement of its securities, unless-

(a) **Previous approval of shareholder** : The proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations.

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Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed.

Whereas in case of offer or invitation for non-convertible debentures it shall be sufficient if the company passes previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

As per the *Companies (Prospectus and Allotment of Securities) Amendment Rules, 2014*, dated 30th June 2014 further a new proviso has been added. According to which also that in case of an offer or invitation for non-convertible debentures referred to in the second proviso, made within a period of six months from the date of commencement of these rules, the special resolution referred to in the second proviso may be passed within the said period of six months from the date of commencement of these rules.”

(b) **Offer/invitation to the number of persons**: Such offer or invitation shall be made to not more than two hundred persons 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.

(c) **Dependence on the value of offer/invitation**: The value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities.

(d) **Company to maintain record of bank account**: The payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the bank account from where such payments for subscription have been received.

**Example**: ABC Company is offering 1000 shares of ₹ 10 each to a shareholder on private placement basis. Whether the offer made by the ABC is in order?

**Answer**: As per the section 42 read with the Rule 14(2) of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, the value of private placement offer or invitation person shall be with an investment size of not less than ₹ 20,000 of face value of securities, irrespective of the fact that the actual allotment amount (including share premium) may be much higher than the said limit. Here in the given case the face value of securities offered is less than ₹ 20,000. Here the offer made by ABC is not acceptable as a private placement under section 42.
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. Similarly, fraudulent inducement for subscription or impersonation for securities application is also punishable offence.
- 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

Answer to MCQs
1. (d)  2. (a)  3. (d)  4. (d)  5. (b)

Question and Answer

Question 1

What are the requirements as to the issue of the Prospectus?

Answer

Comprehensive rules and regulations have been incorporated into the Companies Act, 2013 in respect of this basic document which is the only source of vital information for the investors to ascertain the soundness or otherwise of the company. Since the prospectus is intended to save the investing public from victimisation, the Legislature has aimed at securing the fullest disclosure of all material and essential particulars and laying the same before all the prospective buyers of shares and imposing stringent liabilities for violations.

Briefly the rules and regulations are as follows:

(i) **Matters to be stated in a Prospectus** – In order to provide a thorough and comprehensive information on all aspects of the company and the proposed issue, section 26 (1) of the Companies Act, 2013 lists down a large list of items that must be stated in the Prospectus.

(ii) **Registration of prospectus** – Section 26 (4) provides that 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 or his duly authorized representative, who is named therein as a director or proposed director of the company.

Under sub section (7) it is provided that the Registrar shall not register the prospectus unless the requirements for registration under section 26 are complied with and the prospectus is accompanied by the consent of all the persons named in the prospectus.

(iii) Approval of prospectus by various agencies: The draft prospectus has to be approved by various agencies before it is filed with the ROC of the concerned State.

(iv) The lead financial institution underwriting the issue, if applicable: The draft prospectus is vetted by SEBI to ensure adequacy of disclosures. However, vetting by SEBI does not amount to approval of prospectus. SEBI does not take any responsibility for the correctness of the statements made or opinions expressed in the prospectus.

Question 2

With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received 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.

Answer

Under 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 a body corporate.

A prospectus is a document inviting offers from the public. The prospectus and any statement therein has no legal binding either on the company or its directors, promoters or experts to a person who has not purchased securities in response to it.

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. X will not succeed. It was 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.

**Question 3**

* 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 the 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 4**

Examine the validity of the following statement referring to the provisions of the Companies Act, 2013 and/or Rules:

“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.

**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.

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.

**Question 5**

*When is an allotment of shares treated as an irregular allotment? Briefly state the effects of an irregular allotment.*

**Answer**

**Irregular allotment:** The Companies Act, 2013 does not separately provide for the term “Irregular Allotment” of securities. Hence, one will have to examine the requirements of a proper issue of securities and consider the consequences of non-fulfilment 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 and 40. Irregular allotment therefore arises in the following instances:

1. Where a company does not issue a prospectus in a public issue 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 registration under section 26 (4);
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.
Effects of irregular allotment: The consequences of an irregular allotment depend on the nature of irregularity. However, the Companies Act, 2013 does not mention (unlike the previous Companies Act) that in case of an irregular allotment the contract is voidable at the option of the allottee.

Under section 26 (9) of the Companies Act, 2013 if a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with 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.

Similarly, in case the company has not received the minimum subscription amount within 30 days of the date of issue of the prospectus, it must refund the application money received by it within the stipulated time. Any allotment made in violation of this will be void and the defaulting company and officers will be liable to further punishment as provided in section 39 (5).

Under section 40 (5) any default made in respect of getting the approval to listing of securities in one or more recognized stock exchange in case of a public issue, will render the company punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Hence, under various provisions of the Companies Act, 2013 stringent punishment has been provided for against irregular allotment of securities but the option of going ahead with such allotment even if desired by the allottee is not specifically permitted.