

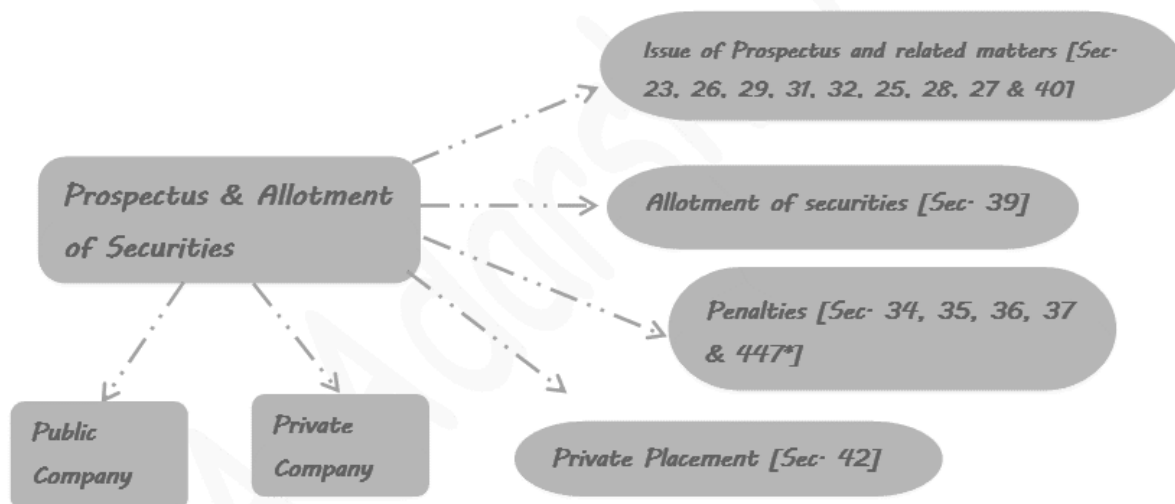
Chapter 3: Prospectus & Allotment Of Securities

This chapter explains the provisions of Chapter III of the Companies Act, 2013 (hereinafter also referred to as "the Act" or "this Act"), consisting of Sections 23 to 42 dealing with the prospectus and allotment of securities. Due to the inherent differences between the nature of public and private companies in addition to restrictions on the later, Chapter III of the Act contained the provisions for issue of securities under two distinct headings (parts):

Part I - Public offer (Section 23-41); Part II - Private placement (Section 42).

The provisions contained in Part I and part II are supplemented by the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Following diagram depicts the arrangement of relevant sections:



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

Introduction

One of the advantages that a company has over other forms of business is its ability to raise capital, either from the public at large or from a set of identified persons. When the capital is raised from the public at large, it is done through a 'Public Offer' and when it is raised from a selected group of identified persons it is carried out through a 'Private Placement' of securities. Where the capital is raised from the public at large through 'Public Offer', an advertisement shall be issued in accordance with applicable provisions to protect the prospective investors from fraud. Securities are allotted against those applications that are received in full and in accordance with the



advertisement issued. Such securities may be listed on an appropriate segment of a recognised stock exchange.

This chapter will explain the provisions relating to raising of capital i.e. issue of prospectus, allotment of securities, and other matters incidental thereto.

Public Offer & Private Placement (Section 23)

Public company issue securities Section 23 (1)

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 specified in Section 23 to Section 41** of the Act; or
- b. Through private placement by complying with the provisions specified in **section 42 of the Act; or**
- C. Through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 19922 and the rules and regulations made thereunder.

Authors Note: Public offer includes initial public offer (IPO) or further public offer (FPO) of securities to the public by a company, or an offer for sale of securities (OFS) to the public by an existing shareholder, through issue of a prospectus.

Students are advised to note; that Further Public Offer also known as Follow-on Public Offer, whereas OFS is sometimes called deemed Public Offer.

Private company issue securities Section 23(2)

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

- a. By way of rights issue or bonus issue in accordance with the provisions of the Act; or
- b. Through private placement by complying with the provisions specified in **section 42** of the Act.

Summary of modes (for issue of securities)

Mode of Issue	Public Company	Private Company
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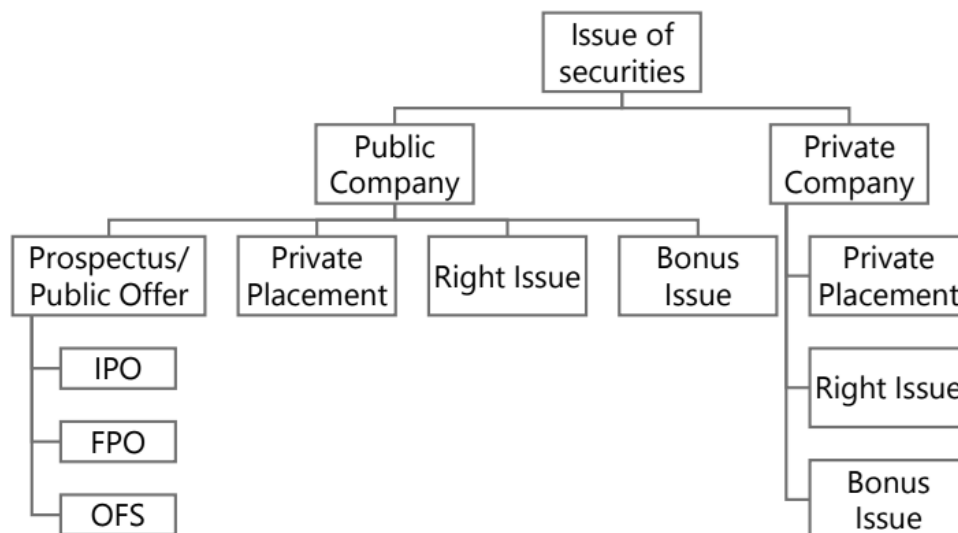


1. Public Offer (including IPO, FPO or OFS)	Yes	No
2. Private Placement	Yes	Yes
3. Rights issue / Bonus Issue	Yes	Yes
4. Compliance with SEBI rules & regulations	Yes*	No

*For a listed company or a company proposed to be listed.

Various modes of issue of securities available to a public company or a private company are depicted in the following diagram for better understanding;

Following diagram for better understanding:



Meaning of Securities section 2 (81)

As per **section 2 (81)**, the term 'securities' means the securities as defined in **clause (h) of section 2** of the Securities Contracts (Regulation) Act, 1956. The definition given thereunder provides, "Securities" include;

(i) **Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature** in or of any incorporated company or other body corporate;

(ia) Derivative;

(ib) Units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) Security receipt as defined in **clause (zg) of section 2** of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.



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

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

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

(ii) **Government securities;**

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

(iii) **Rights or interests in securities.**

To bring ease to doing business for corporates, **Sub-section 3 and 4 to section 23 of the Act inserted vide, the Companies (Amendment) Act, 2020 (enforced w.e.f 28th September 2020)**

Prior to Amendments of 2020, Indian companies can access the overseas equity markets only through depository receipts (e.g. American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) or by listing their debt securities (such as, foreign currency convertible bonds, masala bonds, etc.) on foreign markets.

Since more and more businesses are going global & capital raised from across **the border is cost effective, hence section 23 (3)** is inserted to open ways of overseas direct listing for notified class of public companies by allowing them to issue notified securities for the purpose of listing on permitted stock exchanges in permissible foreign jurisdictions or such other jurisdictions as may be prescribed.

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

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



Section 23(4) of the Act empowers the Central Government to exempt any class or classes of public companies from complying with the provisions of Chapter III (Prospectus and Allotment of Securities), Chapter IV (Share Capital and Debentures), **section 89** (Declaration in respect of a beneficial interest in any share), **section 90** (Register of significant beneficial owners in a company) or **section 127** (Punishment for failure to distribute dividends) of the Act, by issuing notification.

Illustration (MCQ)

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

- (i) Unit linked insurance policy
- (ii) Actionable claim regarding mortgaged debt
- (iii) Securities issued by National Asset Reconstruction Ltd

Options

- (a) (iii) only
- (b) Both (i) and (iii) only
- (c) Both (ii) and (iii) only
- (d) None of the (i), (ii), and (iii)

Answer - (c) (Refer section 2(h) of the Securities Contracts (Regulation) Act, 19567)

Regulation of issue and transfer of securities etc. (Section 24)

Securities and Exchange Board of India is empowered to administer those provisions under chapter III and IV of the Act, which pertains to issue & transfer of securities and non-payment of dividend; by listed companies or those companies which intend to get their securities listed on any recognised stock exchange in India, by making regulations in this behalf.

Additional Reading Being capital market regulator, the power is conferred upon Securities and Exchange Board of India under **section 11, 11A, 11B and 11D** of the Securities and Exchange Board of India Act 1992.

All other matters (including matters relating to prospectus, return of allotment, redemption of preference shares) specifically provided in this Act, shall be administered by the Central Government, Tribunal or the Registrar, as the case may be.



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

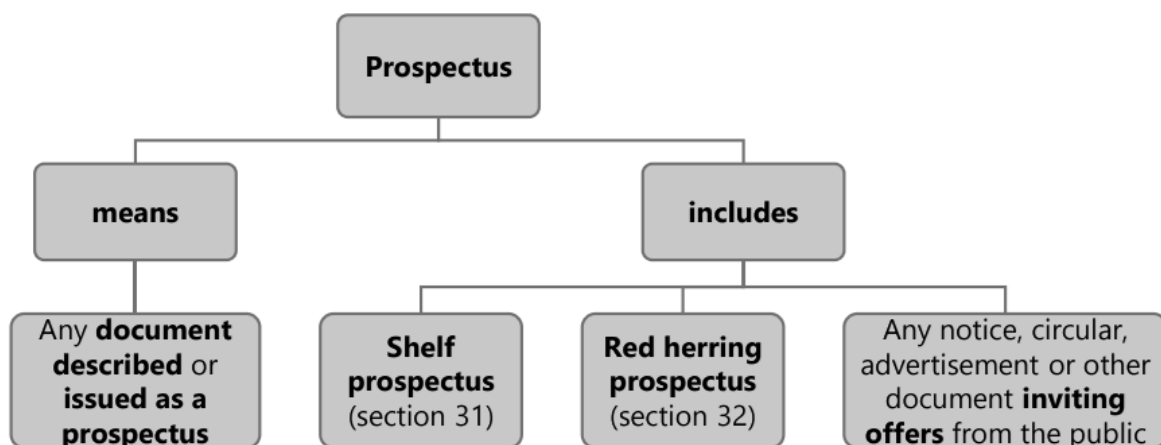
Answer - False (Refer Section 24(1)(a)).

Prospectus

Meaning (Section 2 (70))

Prospectus means any **document described** or **issued** as a prospectus, and **includes** a red herring prospectus referred to in **section 32**, or shelf prospectus referred to in **section 31**, or **any notice, circular, advertisement** or another document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

The definition of prospectus has **two limbs** (means part and includes part) with four elements in totality, these four constituents can be appreciated though diagram presented below:



Out of four constituents of prospectus definition, first three are quite clear; but the fourth one i.e. document inviting offer from the public (considered as deemed prospectus or prospectus by implication) need to be decoded further that too in context to section 25 and landmark judicial pronouncements (elaborated later).

Other elements are also explained/elaborated at relevant place in this chapter.

Deemed prospectus [section 25] - the documents containing offer of securities for sale

Deemed Prospectus (Section 25)

Sub-section 1 provides, where a company allots or agrees to allot any of its securities with a view that those securities (all or any part thereof) being



offered for sale to the public, any document by which the offer is made; shall deemed to be a prospectus (issued by the company) for all purposes.

All the enactments and rules of law containing provisions pertaining to prospectus, matters to be stated, liability for misstatement shall apply to such deemed prospectus; subject to section 25(3) and 25(4). The purpose of deeming provision is to protect gullible investors from various fraudulent practices.

Presumption of view (intent to offer securities for sale to public) under sub-section 1

As per **sub-section 2**, the allotment is presumed to have been made with a view of offering them to the public where either of following conditions fulfilled;

- a. Securities are offered to the public **within six months of allotment**, or
- b. Where the **full consideration has not been received** by the company at the date of offer to the public.

It means, in case if any of above two conditions met; then issuing document shall deemed to be Prospectus under **sub-section 1**.

Authors Note: Sub-section 1 and 2 to section 25 are not exhaustive in nature, there may be certain other situations when issuing document may construe as deemed prospectus. **Case Law: SEBI v Kunnankulam Paper Mills Ltd.**

Where a rights issue is made to existing members with a right to renounce in favour of others, if the number of such others exceeds fifty, it also becomes a deemed prospectus.

Requirements in case of Deemed Prospectus Matters to be stated additionally

As per **Sub-section 3**, following matters need to be stated (in the deemed prospectus i.e., the document through which offer of securities to public is made under sub-section 1) **in addition to those required under section 26**;

- a. A statement of the net amount received or to be received as consideration for the securities to which the offer relates.
- b. The time and place at which the underlying contract for allotment may be inspected.
- c. The persons making the offer were named in the prospectus as directors of the company.



Signing of deemed prospectus (on behalf of company)

Further, as per **Sub-section 4**, it is sufficient, if the document (deemed prospectus i.e., through which offer of securities to public is made under subsection 1) on behalf of the company is signed by its two directors.

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

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

Important:

Additional Reading - For better understanding only

Since the provisions of the Act relating to prospectus and the penal provisions are attracted only when the prospectus (including deemed prospectus) has been issued. "Issued" means issued to the public.

Hence In context of 'Invitation to Public' 'Inviting offer from the Public' or 'Offer of securities for sale to Public' two valid questions arise here:

1. What constitute as 'Public'? Does only 'Public at large' constitute as Public?

The term public is not restricted to the public at large. It includes any section of the public; it is immaterial howsoever such section is selected.

Public connotes persons not personally known to the promoter as distinguished from his own friends, relatives, connections and acquaintances. **Case Law: Re, South of England Natural Gas and Petroleum Co. Ltd**

Facts - 3000 copies of a document which was offered for subscription of shares in a company and which was headed "For Private Circulation only," circulated to the members of certain number of gas companies only.

Legal Question - Was this a prospectus? Should it contain the particulars required by the Act?

Decision - It was decided that though the offer was only to limited class, it was not less than an offer to the public in any sense, because those persons from limited class were nonetheless the public.

Hence, the distribution of a document entitled, "For Private Circulation only" offering the company shares was an offer to the public and their document was a prospectus. Therefore, it must contain the particulars required by the Act.

2. Whether a single private communication tantamount to issue; can it be construed to a prospectus to attract the provisions of the Act?

The term "issue" is not satisfied by a single private communication. There must be some measure of publicity, however modest. A private communication is not



thus open and does not construe to be a prospectus, hence not attracting the provisions of the Act.

Case Law: Nash Vs Lynde

Facts - Nash applied for certain shares in a company on the basis of a document sent to him by Lynde, the managing director of the company. The document was marked 'strictly private and confidential'. The document did not contain all the material facts required by the Act to be disclosed. Nash filed a suit for compensation for loss suffered by him by reason of the Omissions.

Decision - Suit was dismissed.

Viscount Sumner's landmark dictum in this case is worth to consider here as basis of above answer. "The public in the definition is of course a general word, no particular number are prescribed. Anything from two to infinity may serve, perhaps even one if he is intended to be the first of a series of subscribers but made further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be opened to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication is not thus open and does not construe to be a prospectus."

Illustration (Q&A)

Company's prospectus was given to a solicitor of the company and he forwarded it to one of his clients despite it was marked strictly private, who applied for share based upon same. Later filed suit for damages. Will this communication amount to an issue to the public and whether the provisions of the Act are attracted?

Answer - No, this did not amount to an issue to the public and accordingly the provisions of the Act relating to liability for omissions, etc. not attracted here.

(Refer Nash Vs Lynde)

Matters to be Stated in Prospectus (Section 26)

Requirements as regards to date, sign, and contents to be included [Sub- section 1]

Prospectus 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 of India (SEBI) in consultation with the Central Government.

Proviso to sub-section 1 says the regulations made by SEBI in respect of such financial information or reports on financial information shall apply until the SEBI specifies the information and reports on financial information u/s 26(1).



A declaration shall be made **affirming the compliance** of the provisions of this Act (the Companies Act 2013)

A statement shall also include to the effect that nothing in the prospectus is contrary to the provisions of;

- a. The Companies Act, 2013
- b. Securities Contract (Regulation) Act, 1956
- c. Securities and Exchange Board of India Act, 1992
- d. Rules and Regulations made under above three statutes.

The provisions of **Section 26(1) shall not apply [Sub-section 2]**

The provisions of Section 26(1) shall not apply [Sub-section 2]

- a. If prospectus issued to existing members or debenture-holders of a company
- b. If prospectus issued relating to shares or debentures which are in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

Date of publication of prospectus [Explanation to Sub-section 3]

The date indicated in the prospectus shall be deemed to be the date of its publication.

Filing of signed copy with Registrar [Sub-section 4]

A prospectus shall not be **issued unless a signed copy** of such prospectus has been **delivered to the Registrar for filing**.

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

Example - Ms. Sarika, executive director of leading Fintech Company has to fly to Davos to attend World Economic Forum meet.

While company secretary of the company intended to file a copy of prospectus with registrar upcoming, Ms. Sarika authorised in writing, Mr. Gautam for signing of such copy on her behalf.

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

Conditions in regard to Experts' statement [Sub-section 5]

A prospectus issued under **section 26(1) shall not include a statement** purporting to be made by an expert, if any of following condition met;



- a. If he is engaged or interested in the formation or promotion or management of the company, or
- b. If the expert has not given written consent to the issue of the prospectus, or
- C. If he has withdrawn the consent before the delivery of a copy of the prospectus to the Registrar for filing

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

Purpose of **sub-section 5** is to ensure independence of expert to protect the financial interest of prospective investor who may invest in company after relying upon the statement of such expert.

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

Disclosure on the face of prospectus [Sub-section 6]

Prospectus issued under sub-section (1) shall, on the face of it, state/specify:

- a. That a copy has been delivered for filing to the Registrar under **sub-section (4)**;
- b. 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.

Validity of Prospectus for issue [Sub-section 8]

A prospectus is **considered to be valid for issue, only if 90 days** has not been lapsed from the date on which a copy thereof is delivered to the Registrar under section 25(4).

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

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

Validity of Prospectus for issue [Sub-section 9]

If a prospectus is issued in contravention of the provisions of section 26 the company and every person who is **knowingly a party to the issue of such prospectus shall be punishable with fine of ₹50,000 to ₹3,00,000.**



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

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

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

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

Statement - The copy of prospectus submitted with registrar for filing need to be duly signed by majority of directors.

Answer - False

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

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

Sub-section 1 provides, the terms of a contract referred to in the prospectus or **objects** for which the prospectus has been issued can be varied, but only with the authority of the company given by it in **general meeting by way of special resolution**.

First proviso to sub-section 1 requires that prescribed details of the notice which has to be given to the shareholders are to be published in newspapers (one in English and one in vernacular language) circulating in the city where the registered office of the company is situated indicating clearly the justification for such variation.

The **second proviso to sub-section (1)** also prescribes that such company is not to use any amount raised by it through the prospectus for **buying, trading or otherwise dealing in equity shares of any other listed company**.

Sub-section (2) provides that the dissenting shareholders (i.e., those who did not agree to the variation) are to 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 SEBI by making regulations for this purpose.



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

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

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

Authors Note: Once funds are raised through a given prospectus, the principle of "doctrine of ultra vires" (mutatis mutandis) comes into play i.e., the company has to use the funds strictly in accordance with the prospectus.

But if in any case variation need to made, then such deviations are required to be pre-approved by the investors and 'recall option' needs to be given to the dissenting investors. Deviation regarding use of proceeds of issue for buying, trading or otherwise dealing in equity shares of any other listed company is not permitted in any case.

Rule 7 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

Sub-rule 1, provides for Special Resolution to be passed through Postal Ballot and Contents to be included in Notice.

Sub-rule 2, provides the advertisement of the notice (for getting the resolution passed) shall be in **Form PAS-1** and such advertisement shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders.

Sub-rule 3, the notice shall also be placed on the website of the company, if any.

Illustration (MCQ)

In case of variation in terms of contract or objects in prospectus, which of the followings statement are not true;

- (i) Ordinary resolution shall be passed at general meeting
- (ii) Notice given to shareholder shall also be published in two newspapers
- (iii) Amount so raised can be invested only in equity share of prescribed class of companies.

Options

- (a) (i) only
- (b) Both (i) and (ii) only
- (c) Both (i) and (iii) only



(d) Both (ii) and (iii) only

Answer - (d) (Refer section 27)

Offer of Sale of Shares by Certain Members of Company (Section 28)

Sub-section 1 provides that, member or members of a company, in consultation with board of directors, may offer whole or part of their holding of shares to the public, in accordance with the provisions of the law for the time being in force.

Sub-section 2 provides that the document by which the offer of sale to the public is made shall be treated as prospectus issued by company. Hence, all provisions apply accordingly.

Sub-section 3 highlights the members' responsibility in the matter of sale under sub-section 1. It provides, the members whether individual or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively to authorise the company to take all actions on their behalf for carrying out the transaction. They also have to reimburse the company for all expenses made by it on this matter.

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

Sub -rule 1, the provisions of **section 23 to 41** of this Act and rules made thereunder shall be applicable to an offer of sale referred to in **section 28** except for the provisions relating to;

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

Sub-rule 2, requires that the prospectus issued under **section 28** shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.

Illustration (Q&A)

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



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

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

Public offer of securities to be in dematerialized form (Section 29)

Sub-section 1 has overriding effect to any other provision of this Act. It provides that every company making a public offer and such other class or classes of companies as may be prescribed, have to issue their securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and regulations made under it.

Sub-section 1A inserted in 2019, provides that in case of prescribed class/classes of unlisted companies, the securities shall be held or transferred only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and regulations made under it.

Sub-section 2 provides, any other company may:

- a. Convert its securities into dematerialised form;
- b. Issue its securities in physical form in accordance with the provisions of this Act;
- c. Issue its securities in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Rule 9 (Dematerialisation of securities) and 9A (Issue of securities in dematerialised form by unlisted public companies; inserted vide Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018) of Companies (Prospectus and Allotment of Securities) Rules, 2014 is relevant for procedural aspects pertaining to Public Offer of Securities to be in Dematerialised Form

Advertisement of Prospectus (Section 30)

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

- (i) the objects,
- (ii) the liability of members and the amount of share capital of the company,



- (iii) the names of the signatories to the memorandum,
- (iv) the number of shares subscribed for by the signatories, and
- (v) the capital structure of the company.

Shelf prospectus (Section 31)

Meaning of 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.

Need of Shelf Prospectus

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

Filing of shelf prospectus with the Registrar [Sub-section 1]

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

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

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

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

Filing of 'Information Memorandum' with the Shelf Prospectus [Sub-section 2]

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

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



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

Rule 10 of the Companies (Prospectus and Allotment of Securities) Rules, 2014

The information memorandum shall be prepared in **Form PAS-2**.

It shall be filed with the **Registrar along with the fee** as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

Information Memorandum together with Shelf Prospectus is deemed Prospectus [Sub-section 3]

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

Illustration (MCQ)

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

Options

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

Answer - c [Refer proviso to section 31(2). It is provided that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such



applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof].

Red Herring Prospectus (RHP) (Section 32)

Meaning of Red Herring Prospectus (explanation to section 32)

The expression "red herring" means a prospectus which does not include complete particulars of the quantum or price of the securities.

Need of Red Herring Prospectus

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

Timing of issue the Red Herring Prospectus [Sub-section 1]

A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.

Filing of Red Herring Prospectus with the registrar [Sub-section 2]

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.

Obligations under Red Herring Prospectus vis-à-vis Prospectus [Sub-section 3]

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.

Filing with Registrar and SEBI upon closing of Offer [Sub-section 4]

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.



Book Building is actually a price discovery method. In this method, the company doesn't fix up a particular price for the shares, but instead gives a price range. An underwriter builds a book by accepting orders from fund managers, indicating the number of shares they desire and the price they are willing to pay.

Concept of abridged prospectus issue of application forms for securities [section 33]

Meaning of Abridged Prospectus [Section 2(1)]

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.

Need of Abridged Prospectus

In fact, '**Abridged Prospectus**' is a summarized form of actual prospectus, containing the salient features of a prospectus to cut the **cost involved in the publication of large number of prospectuses** which has to accompany the application forms for shares or debentures in case of public offer.

Abridged Prospectus accompany the application form [Sub-section 1]

Section 33(1) provides that every application form for shares or debentures has to be accompanied with the abridged prospectus.

Proviso to sub-section 1 provides exceptions, when the requirement of abridged prospectus does not apply:

- a. When application form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures:
- b. In relation to shares or debentures which were not offered to the public; **or**
- C. Where offer is made only to existing members of the company

Right to receive prospectus [Sub-section 2]

Sub-section 2 provides that a prospectus (full prospectus) is to be made available to any person who request for it before the closing of the subscription list and the offer.



Penalty [Sub-section 3]

A company who makes any default in complying with the provisions of section 33, shall be liable to a penalty of fifty thousand rupees for each default.

Mis-statements in prospectus

A contract of shares in a company is a contract of Uberrimae fides (Latin), which means 'utmost good faith'. The legal doctrine of Uberrimae fides provides that all parties to contract must deal in good faith, making a full declaration of all material facts.

Hence, a prospectus must make all statements with scrupulous accuracy and not state facts which are not strictly correct. Neither any information which the law requires to be disclosed to the public be concealed or omitted to be stated from the prospectus nor should the information given be false and misleading.

Mis-statements in prospectus is a serious offence which attracts the provisions of **section 34 (criminal liability) and / or section 35 (civil liability)** of the Act. In this section we will learn about misleading prospectus, remedies for misrepresentation in the prospectus.

What construe as mis-statement and misleading prospectus

A prospectus is said to be misleading, if it includes any mis-statement. In common parlance, mis-statement is the act of stating anything that is false (or not accurate). A statement become false statement, if it produces a wrong impression of actual facts. It could either be due to commission or omission or both.

As per **section 34**, a statement included in a prospectus shall be deemed to be untrue;

- a. if the statement is misleading in the form and context in which it is included:
- or
- b. where any inclusion or omission of any matter is likely to mislead

Some of landmark case law -

Mislead through false Statement (prima-facie of facts) - Henderson v. Lacon

It was stated in the prospectus, 'the directors and their friends have subscribed a large portion of the capital and they now offer to the public the remaining shares.' Whereas, in actually each of director had subscribed only 10 shares. It was held that such a statement is misleading one.

Misled by hiding truth through superficial statement - Rex v. Kysant



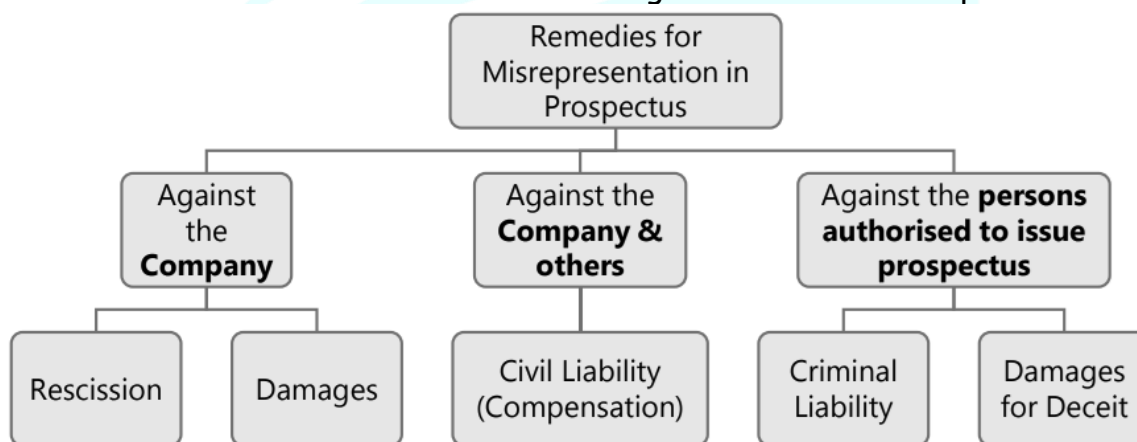
In the prospectus, it is stated that the company had regularly paid dividends, in actual, company has been incurring substantial losses during all those years. Company used to write back some of the past provisions to the credit of the profit and loss account. It was held that the prospectus did not disclose the true picture of the company.

Misled through ambiguous statement - *Smith v. Chadwick*

The prospectus of a manufacturing company contains, 'the present value of turnover is £1million sterling per annum,' the statement was true only if production capacity is considered but untrue if it meant the present production level (capacity in utilisation). It was held that, such a statement which director knew may bear multiple meaning out of which any can be false to their knowledge, considered to be furnishing of misleading statement.

Effect of misleading prospectus - remedies of misrepresentation

The fear of heavy liability and criminal sanctions have controlled the directors' tendency of "using extravagant terms and flattering description". But if the prospectus contains a misleading or false statement or omits to disclose a material fact which amounts to misrepresentation, the aggrieved shareholder has the remedies. The law allows the following remedies for misrepresentation:



Remedy of Rescission, Damages and Deceit are not specified under this Act, they are available under the Indian Contract Act 1872 read with relevant provisions of Specific Relief Act 1963. Whereas Criminal and Civil Liability is provided under section 34 and 35 respectively of this Act.

Since remedies specified above are alternative courses, hence all of these remedies are not available simultaneously, whereas appropriate combination of these can be claimed.

To illustrate, claim for compensation under section 35 (civil liability) of this Act (being special statute where jurisdictional power is vested in NCLT) shall not be moved simultaneously with claim for Damages (under general provisions)



Right of rescission

When to seek recession?

A person who has purchased shares from the company on the basis of the prospectus containing untrue and misleading statement of material facts is entitled to apply to the court for the rescission of the contract, under the relevant provisions of the Indian Contract Act 1872.

Effect of rescission

The agreement to take up shares is voidable at the option of the subscriber to the shares; it will remain valid unless he actually rescinds it.

If the court accepts his application for the repudiation of the contract, company will remove his name from the register of members and return his money with interest and other incidental cost.

Entitlement to compensation for any damages which he sustained through the nonfulfillment of the contract arises under **section 75** of the Indian Contract Act 1872.

Exceptions - When right of recession is not available?

- Right to rescind allotment of shares will **not be available** to the subsequent purchasers of shares from the market.
- A subscriber to the Memorandum of Association **cannot also seek any relief**, as the company **cannot be considered to be in existence** at the time when he appended his **signatures to the Memorandum of Association**. He cannot be said to have been influenced by any statement in the prospectus.

Illustration (Q&A)

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

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

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



Right of action for damages

When to evoke?

Where mis-statement amounts to fraud, aggrieved investor also gets a right of action for damages against the company. This right is available even after the company has gone into liquidation.

Pre-requisite to claim for damages

- a. Misrepresentation (fraudulent) was there in the prospectus and it is of material fact
- b. Person is intended to act upon its
- c. Person suffered the damages as consequences of acting upon such fraudulent misrepresentation.

Civil liability for mis-statements in prospectus [section 35]

Offence under **section 35 Loss or damage to subscriber of securities**, as a consequence of acting on basis of inclusion or omission of any matter in the prospectus; which is misleading the subscriber/s.

Who shall be held liable?

- a. Company; and
- b. Every person who is/has;
 - i. A director of the company at the time of the issue of the prospectus;
 - ii. 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;
 - iii. A promoter of the company;
 - iv. Authorised the issue of the prospectus; and
 - v. An expert referred to in **sub-section (5) of section 26**,

Liability for an offence under section 35

A person found guilty under section 35, in addition to any punishment under **section 36**, a company and every other person shall also be liable to pay compensation to every person who has sustained loss or damage.

Exception to liability for guilty/offence under section 35 [Sub-section 2]

Sub-section 2, provides the instances when a person shall not be held guilty under **section 35** of this Act, if he proves;



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

Personal Liability when intend to defraud [Sub-section 3]

Every person referred under **sub-section 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;

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.

Illustration (Q&A)

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

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

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

Criminal liability for mis-statements in prospectus [Section 34]

Offence under section 34?

Where a prospectus is issued, circulated or distributed that includes;



- a. Any statement which is untrue or misleading in form or context in which it is included or
- b. Where any inclusion or omission of any matter is likely to mislead.

Who shall be held liable?

Every person who authorises the issue of such prospectus.

Liability for an offence under section 34

Such persons found guilty under section 34 shall be liable for punishment under section 447 of this Act,

Exception to liability for guilty/offence under section 34 [Proviso to section 34]

Proviso to section 34 provides the instances when a person shall not be held guilty under section 34 of this Act, if he proves that:

- a. Such mis-statement or omission was immaterial, or
- b. 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.

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

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

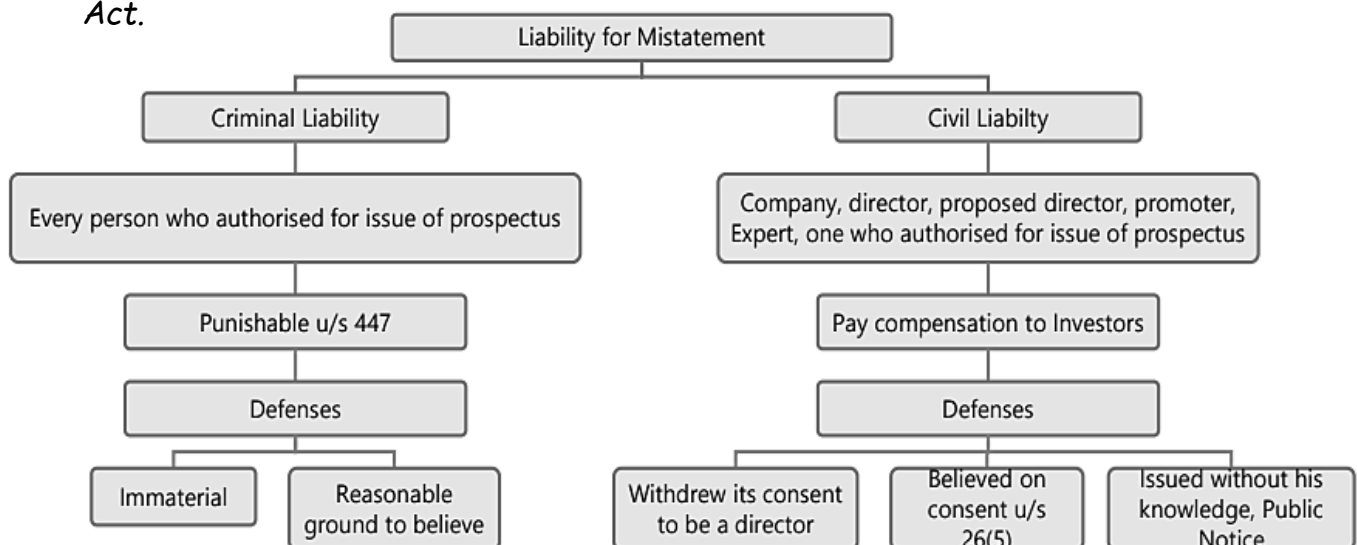


Illustration (Q&A)

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

Answer - Yes, the Director shall be held liable for the false statements made in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis-statements. Certain situations when a director will not incur any liability for mis-statements in a prospectus are covered under exceptions provided by Section 35 (2) but no such exception specifies that relying on the statements prepared by the promoters of the company is a valid ground for a director to escape liability for mis-statement.

Damages for deceit

When remedy of damages for deceit is available?

Persons responsible for the issue of prospectus can also be held liable in an action for deceit, under general law as provided by section 19 of the Indian Contract Act.

This remedy shall be available even where the remedy by way of rescission as against the company is lost either through laches or negligence or even if the company goes into liquidation.

Prerequisite to claim damages for deceit is available

- a. There was a fraudulent mis-statement related to some existing material facts.
- b. He is original allottee and had seen the prospectus.
- C. He has been actually deceived.

Peek v. Gurney

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



Punishment 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.

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

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:

- a. Any person,
- b. Group of persons or
- C. Any association of persons

If affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Illustration

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

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

It is noteworthy that according to Section 37, a suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any



person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus. Therefore, only M is eligible to file a suit.

Section 37 has paved way for class action

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

Punishment acquisition, for personation of for securities [section 38]

The purpose of the section is to **prevent allotment of shares in fictitious names**. **Sub-section 1 provides**, any person shall be liable for punishment under **section 447**, if:

- a. He makes or abets the making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or
- b. He makes or abets the making of multiple applications in different names or 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 any securities to him or to any other person in a fictitious name.

Sub-section 2, provides that every company which issues a prospectus is required to reproduce prominently the provisions of the sub-section (1) in the prospectus and every form of application for securities.

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

Sub-section 3 provides, where a person has been convicted under the section, the court may order disgorgement of any gain made by such person. The order



may also include seizure and disposal of securities which may be found in his possession.

The amount received through disgorgement or disposal of securities **under sub-section (3), is to be credited to the Investor Education and Protection Fund.**
[Sub section (4)]

Punishment for Fraud (Section 447)

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

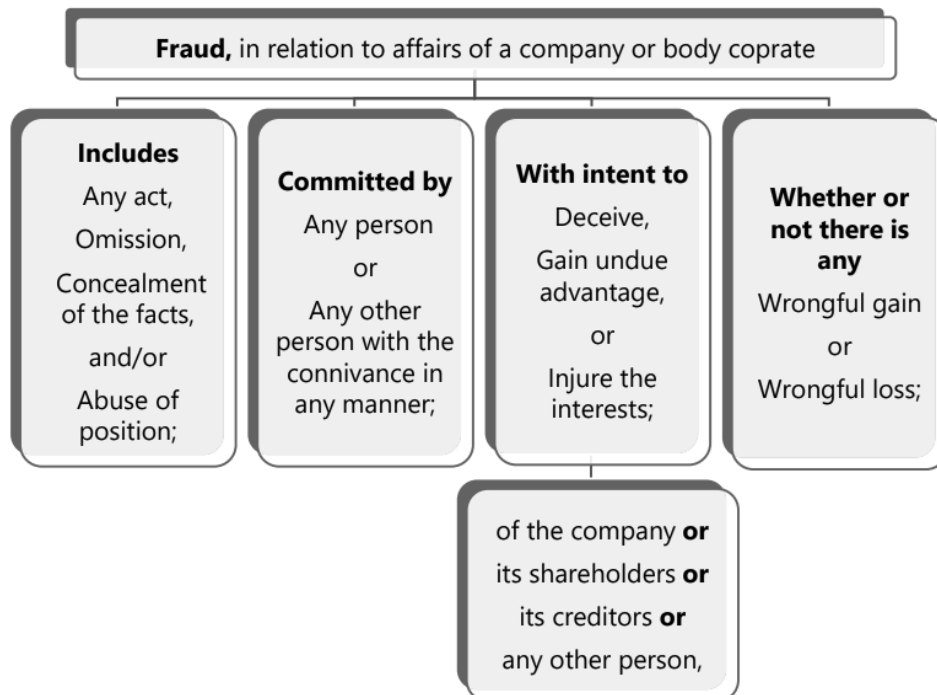
Section 447 provides three explanations, read as:

(i) "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.

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled.

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.





Illustration

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

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

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

Allotment Of Securities by Company [Section 39]

Meaning Of Allotment

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment

Hence, in general sense 'allotment' is neither more nor less than the acceptance by the company of the offer to take shares.



In technical context, it is an appropriation out of the previously unappropriated capital of a company.

Authors Note

Where forfeited shares are re-issued, it is not the same thing as an allotment. A valid allotment has to comply with the requirements of the Act and principles of the law of contract relating to acceptance of offers.

Section 39 of the Act and the Companies (Prospectus and Allotment of Securities) Rules, 2014 contains provisions in respect of allotment of securities when there is a public offer.

Minimum Subscription Is A Must [Sub-Section 1]

The first requisite of a valid allotment is that of minimum subscription.

Hence, when shares are offered to the public, the amount of minimum subscription has to be stated in the prospectus.

No shares can be allotted unless:

- a. At least so much amount (which is stated as minimum subscription) has been subscribed and
- b. The sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument from the subscribers or investors at the time of making application.

Authors Note:

As per the regulation 45(1) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, the minimum subscription is 90% of the entire issue.

Any means by which money can be remitted may be used, but remittances must be cleared and actual cash received by the company before proceeding to allotment. An application for shares, if not accompanied by any such payment, does not constitute a valid offer.

Quantum Of Amount Payable On Application [Sub-Section 2]

The amount payable on application shall not be less than:

- a. 5% of the nominal amount of the security or
- b. Such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

Here, it is important to note that as per the regulation 47(4) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, the minimum sum payable on application per specified security shall be at least twenty five percent of the issue price.



Further, proviso to regulation 47(4) provides that in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Example - If listed company offer the shares with nominal value of 10 then application money shall be at least 2.5 and if nominal value is 100 then shall be at least 25.

Consequences If Minimum Amount Is Not Subscribed [Sub-Section 3]- Return Of Application Money

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of 30 days (or any other period as prescribed by SEBI) from the date of issue of the prospectus, the amount received from applicants shall be returned.

Time period for return of application money

As per **rule 11(1)** of the Companies (Prospectus and Allotment of Securities) Rules, 2014, such refund shall be made **within a period of 15 days from the closure of such issue.**

Default in return of application money

As per **rule 11(1)** of the Companies (Prospectus and Allotment of Securities) Rules, 2014, in case of default in refund within that period, directors and other officers responsible for default shall be **jointly and severally liable to repay that money with interest at the rate of 15% pa.**

Source for return of application money

According to **Rule 11 (2)**, the application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

Section 40(3) and Rule 11(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 are confirming provisions regarding return of application money, in case where allotment is not done.

Return Of Allotment [Sub-Section 4]

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in manner as prescribed in the Companies (Prospectus and Allotment of Securities) Rules, 2014.



Time Limit for filing Return of Allotment

According to **Rule 12 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014**, the company shall file a return of allotment with Registrar in **Form PAS-3** within 30 days along with the fee as specified in the **Companies (Registration Offices and Fees) Rules, 2014**.

Attachments to Form PAS-3

According to **Rule 12 (2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014**, lists of following particulars (duly certified by the signatory of the **Form PAS-3** for completeness and correctness) shall accompany:

- a. A list of allottees stating their names, address, occupation, if any, and
- b. Number of securities allotted to each of the allottees.

Additional attachments to Form PAS-3 consideration other than cash. - In case share issued for consideration other than cash.

Rule 12 (3) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, provides, in the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, then following documents shall also be attached;

- a. A copy of the contract, duly stamped, pursuant to which the securities have been allotted
- b. Any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

Further **Rule 12 (4)** states that where a contract referred above is not reduced to writing, the company shall furnish complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and same shall deemed to be an instrument within the meaning of the Indian Stamp Act, 1899.

Rule 12 (5), requires a report of a registered valuer in respect of valuation of the consideration if either of **rule 12(3) or 12(4) applicable**.

Attachments to Form PAS-3 - In case share issued in pursuance of Section 62(1)(c)

Rule 12 (7) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, states that in case the shares have been issued in pursuance of **clause (c) of sub-section (1) of section 62** by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognised stock exchange, there shall be attached to **Form PAS-3**, the valuation report of the registered valuer.



Punishment For Default [Sub-Section 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.**

Illustration

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

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

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

Securities to be dealt with in stock exchanges [Section 40]

Filing of an application with recognised stock exchange [sub-section 1]

Before making public offer, every company shall 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.

Prospectus to state name of stock exchange [sub-section 2]

Name or names of the stock exchange in which the securities shall be dealt with, must be stated in the prospectus.

Maintaining of separate bank account [sub-section 3]

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; or
- b. For the repayment of monies within the time specified by the Securities and Exchange Board.

Authors Note: Section 40(3) and Rule 11(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 are confirming provisions regarding return of application money; in case where allotment is not done.

Condition purporting to waive compliance shall be void [sub-section 4]

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.

Default in complying with provisions [sub-section 5]

If a default is made in complying with the provisions of this section, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees.

Penalty provisions provided under sub-section 5 can be summarized as:

Defaulter	Minimum Fine	Maximum Fine
Company	₹5,00,000	₹50,00,000
Defaulting Officer	₹50,000	₹3,00,000

Payment of commission [sub-section 6]

A company may pay commission to any person in connection with the subscription to its securities subject to **rule 13** of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Authors Note- No commission shall be paid to any underwriter on securities, which are not offered to the public for subscription.

Authorisation and Source

The payment of such commission shall be authorized in the company's Articles of Association. The commission may be paid out of;

- a. proceeds of the issue, or
- b. the profit of the company, or
- c. both

Rate of commission

Security	Rate
Shares	Should not exceed; 5% of the price at which the shares are issued Or



	Any less rate/amount authorised by articles
Debentures	<p style="text-align: center;">Should not exceed;</p> <p style="text-align: center;">2.5% of the price at which the debentures are issued</p> <p style="text-align: center;">Or</p> <p style="text-align: center;">Any less rate/amount authorised by articles</p>

Authors Note: Maximum rate of commission can be 5% and 2.5% in case of shares and debentures respectively subject to rate authorised by article.

Example - Ind-swift Pharma Labs Limited issued the shares to raise capital. Article of Ind-swift authorised payment of commission at rate of 2%. Since rate of commission should not exceed 5% of the price at which the shares are issued or any less rate/amount authorised by articles Hence, cap for payment of commission under section 40(6) of the Act is 2%.

Disclosure of the particulars in prospectus regarding underwriting

The prospectus of the company shall **disclose the following particulars:**

- the **name** of the underwriters;
- the **rate and amount of the commission** payable to the underwriter; and
- the **number of securities** which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

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 filling.

Illustration Q&A

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

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

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

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid since the same cannot exceed the rate which is permitted by the Articles. However, the decision to pay commission out of the



proceeds of the share issue is valid provided it is paid at the rate authorised by the Articles.

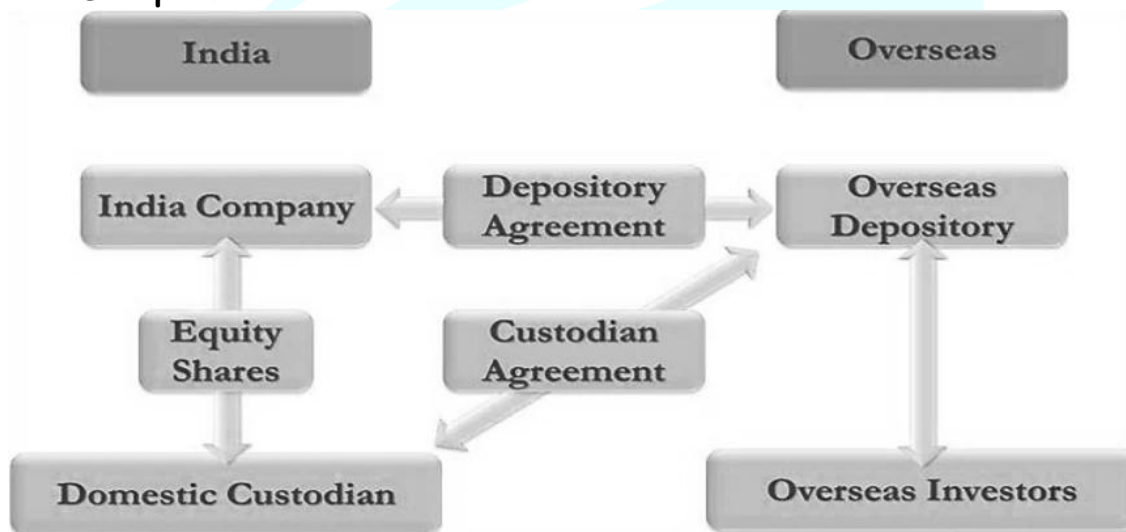
Global depository receipt (GDR) [Section 41]

A global depository receipt is a general name for a depository receipt where a certificate issued by a depository bank, which purchases shares of foreign companies, creates a security on a local exchange backed by those shares.

GDR as per **section 2(44)** of this Act means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India & authorized by a company making an issue of such depository receipts.

Section 41 provides, company may issue depository receipts in any foreign country after passing a special resolution in its general meeting and subject to such conditions as may be prescribed in the Companies (Issue of Global Depository Receipts) Rules, 2014 (as further amended in 2020).

How GDR operates?



Manner and form of depository receipts

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.

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

Voting right

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.

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.

Private placement [section 42]

Provisions relating to the 'private placement' are contained in Part II of Chapter III of the Act, which consist of only one section i.e. section 42 - Issue of shares on private placement basis.

A company may make private placement of securities subject to provisions of section 42 of this Act in supplement with those stated under rule 14 of the Companies (Prospectus and Allotment of securities) Rules, 2014.

Meaning of private placement [explanation I to section 42(3)]

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

Offer to be made only to a select group of persons [sub-section 2]

A private placement shall be made **only to a select group of not more than two hundred (200) persons** in a financial year, who have been **identified by the Board**, after passing as **special resolution** in this regard.

Authors Note:

1. These select group of persons is referred to as **"identified persons"**
2. While computing threshold limit of 200, following shall be **excluded**;
 - a. qualified institutional buyers **and**,



- b. employees of the company being offered securities under a scheme of employees' stock option under section 62(1)(b)
3. As per **Explanation II to sub-section 3**, the term "qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
4. **Section 42(2)** originally contains 'fifty (50) or such higher number as may be prescribed'. Since **Rule 14 (2)** of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (as amended through Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018) prescribed 'an offer or invitation to subscribe securities under private placement shall not be made to persons **more than two hundred (200)** in the aggregate in a financial year', hence limit of identified persons under section 42(2) shall be read as two hundred (200).
5. The aforesaid restrictions would be reckoned individually for each kind of security that is equity share, preference share or debenture.
6. **non-banking financial companies (NBFCs) which are registered with the Reserve Bank of India; and housing finance companies (HFCs) which are registered with the National Housing Bank; if they are complying with any 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, then need not to comply with rule 14(2) stated above.**

Private placement shall be deemed to be an offer to the public [explanation III to section 42(3) read with sub-section 11 to section 42]

As per **explanation III to section 42(3)**, 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 200 identified 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 provisions contained in section 23 to 41 shall apply.**

Further **section 42(11)** provides, in such case 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.



Though **penalty under sub-section 9 and 10 to section 42** of this Act, still can be imposed.

Manner of issuing private placement offer and application [subsection 3]

A company making private placement **shall issue private placement offer and application to identified persons** (whose names and addresses are recorded by the company) stated in **Rule 14**.

Authors Note: *Private placement offer and application shall not carry any right of renunciation*

Resolution for the Private Placement Offers

Rule 14 (1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires **prior approval of the shareholders** of the company, by a **special resolution** for each of the private placement offers or invitations. The **explanatory statement annexed** to the notice for shareholders' approval, **must disclose the following**:

- 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; principal terms of assets charged as securities.

Exceptions above rule:

Board resolution under **section 179(3)(c)** shall be adequate in case of offer or invitation for **non-convertible debentures**, where the proposed amount to be raised **does not exceed the limit** as specified in **section 180(1)(c)**. But if amount is above the said limit, it shall be sufficient if the company passes a previous **special resolution only once in a year** for all the offers or invitations for such debentures during the year.



Even for issue of securities to **QIBs**, it shall be sufficient to pass a previous **special resolution only once in a year** for all the offers or invitations for all the allotments to such buyers during the year.

Filing of Resolution with Registrar

Copy of resolutions passed above shall be moved to registrar **prior** to issue of **private placement offer cum application letter**.

Authors Note: Vide Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022 the principal rules of 2014 further amended to insert a proviso to Rule 14(1) which deals with Private Placement.

The proviso states that when a company makes an offer or invitation to subscribe to securities, no offer or invitation of any securities shall be made to a body corporate incorporated in, or a national of, a country which shares a land border with India, unless such body corporate or the national, as the case may be, have obtained Government approval under the FEMA Rules, 2019 and attached the same with the private placement offer cum application letter.

This means that companies will now have to obtain government approval under the FEMA Rules before inviting subscription to securities or offering securities to any entity from a country that shares a land border with India i.e. China, Bhutan, Nepal, Pakistan, Bangladesh, and Myanmar.

Applicable Application Form

Rule 14 (4) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, provides a **private placement offer cum application letter** shall be:

- a. Issued in **form PAS-4**
- b. **Serially numbered**
- c. Addressed **specifically** to the person to whom the offer is made
- d. Sent either in **writing or in electronic mode**
- e. Sent **within thirty days** of recording the name of such person pursuant to **section 42 (3)**.

Authors Note: 1. No person other than the person so addressed in offer-cum-application letter, allowed to apply through such application form. 2. Any application not conforming to this condition shall be treated as invalid.



Maintaining Complete Records

Rule 14 (4) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires the company to **maintain a complete record of private placement offers in Form PAS-5.**

Manner of subscribing to the private placement issue [sub-section 4]

Person who is identified and provided with private placement application cum letter, if willing to subscribe securities in the private placement, then may apply in through same letter along with subscription money.

Authors note:

1. Subscription money shall be paid either by cheque or demand draft or other banking channel, but not by cash.
2. **Rule 14(5)** of the Companies (Prospectus and Allotment of Securities) Rules, 2014, Payment shall be made from the bank account of the person subscribing to such securities **and** the company shall keep the record of the bank account from where such payment for subscription has been received.
3. **First proviso to rule 14(5)** states above, provides that; in case of **joint holders**, monies payable on subscription to securities shall be paid from the bank account of **the person whose name appears first in the application**.
4. Company shall **not utilise monies raised through private placement** unless allotment is made and the return of allotment is filed with the Registrar in accordance with **sub-section (8) of Section 42**.

Illustration Q&A

Ruhi and her brother Sohiti were offered jointly 1000 equity shares of ` 100 each by Soumya Software Private Limited under the issue of shares on private placement basis. Offer-cum-application letter addressed to both containing their names as "Ms. Ruhi, Mr. Sohiti". From whose account the company is required to take subscription money for 1000 equity shares?

Answer - According to the first Proviso of Rule 14 (5) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application. Since Ruhi's name appears first in the application, therefore the subscription of ` 1,00,000 shall be payable by her from her account. It is obligatory for the



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

Limit on fresh offer [sub-section 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.

Proviso to sub-section 5 read as, subject to the maximum number of identified persons (i.e., 200), a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

Time limit for allotment of securities [sub-section 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.

1. If company fails to make allotment within 60 days, then repayment of the application money to the subscribers shall be made within fifteen days from the expiry of sixty days
2. If the company further fails to repay the application money within the 60 days, then it shall be liable to repay that money with interest at the rate of twelve percent per annum from the expiry of the sixtieth day.

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

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

Prohibition on public advertisement [sub-section 7]

No company shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about issue under **section 42**.

Filing of return of allotment [sub-section 8]

Section 42(8) read with Rule 14 (6) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides, **a return of allotment in form PAS-3** (along-with the fee as provided in the Companies (Registration Offices



and Fees) Rules, 2014) shall be **filed with the Registrar within fifteen days from the date of the allotment under section 42**, with a **complete list** of all the allottees containing;

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

Default in filing the return of allotment [sub-section 9]

For **defaults in filing the return of allotment**, 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**.

Example - An allotment of security under private placement (section 42) was completed on 9th November 2022. Return of allotment in Form PAS-3 filed on 28th November 2022. Therefore, a penalty of ` 4000 shall be imposed on company, its promoter and directors.

Punishment for contravening the private placement provisions [sub-section 10]

For making offer or accepting money in contravention to section 42, liability will be:

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

