

COMPANY LAW

UNIT 3: SHARE CAPITAL

TOPIC-PROSPECTUS

Prospectus (Sec.23 to Sec.38)

As per section 2(70) of Companies Act, 2013 - a prospectus means any document described or issued as a prospectus and includes a *red herring prospectus* or a *shelf prospectus* 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.

- Prospectus must be carefully drafted because it is the basis on which public decides to subscribe. It acts as a window through which potential investor can look into the soundness of the company's venture.
- The companies making public offer are required to comply with the regulations made by SEBI in this regard. Every prospectus must state such information and set out such reports on financial information as maybe specified by SEBI. It must be duly dated and signed by all the directors of the company.
- Prospectus after vetting (critical examination) by SEBI shall be filed with the Registrar. This copy for registration must be accompanied with the written consent of the expert(whose report is to be published in the prospectus) and also the written consent of directors, auditors, bankers, legal advisors , brokers etc. of the company to act in that capacity. Thereafter only can prospectus be issued to public.
- The prospectus must be issued within 90 days of the date on which a copy thereof is delivered for registration.

Offer of securities by Issue House (DEEMED

PROSPECTUS/PROSPECTUS BY IMPLICATION)(Sec.25)

If a company issues its securities to an **Issue House** which then offers the same to public by means of an advertisement/document of its own then such an advertisement or document will be deemed to be prospectus by implication if

- that offer to public is made by Issue House within 6 months after allotment or
- at the date of offer to public, the whole consideration in respect of the securities had not been received by the company

So in such case the responsibility of company, its directors and promoters' remains the same as that in case of direct issue of prospectus by a company.

Offer of sale of shares by certain members (DEEMED PROSPECTUS)(Sec.28)

Where certain members of the company ,in consultation with board of directors, propose to offer some of their holdings to the public then they can do so and any document by which such offer to public is made shall be deemed to be prospectus. Thus the company, and its directors are liable the same way as they would have been in case of prospectus directly issued by the company.

Sec.31- Shelf Prospectus

Many a times, companies and financial institutions like IDBI, ICICI etc. raise money from public frequently in a series. For them, issuing a fresh prospectus everytime they hit the market will be a time consuming and expensive exercise. In order to minimise such a burden, the concept of 'Shelf Prospectus' is introduced. It is a prospectus which is issued when securities are to be offered for subscription in one or more issues over a certain period without the issue of further prospectus. Sec.31 provides that

- A company has to file Shelf prospectus with the registrar at the stage of first offer of securities only.
- Shelf Prospectus shall be valid for one year and so when a company makes subsequent offer of securities during the validity period, it need not file a fresh prospectus with registrar. Rather the company has to just file an **Information Memorandum** containing material facts relating to changes in financials that have occurred between the earlier issue and present issue.
- An Information Memorandum shall be issued to the public along with the Shelf Prospectus.
- An updated Information Memorandum and Shelf Prospectus together shall constitute the prospectus.

Sec.32. Red herring Prospectus

It means a prospectus which does not include complete particulars about the quantum of securities offered and the prices of the securities. The reason is that company doesn't want to offer shares at a predetermined price. Rather it wants to elicit demand for its securities and assess the price offered by potential investors. Sec.32 provides that

- A company proposing to make an offer of securities is required to file with the registrar of companies a Red herring prospectus at least three days before the opening of the subscription list and the offer. The red herring prospectus contains all mandatory details except the issue price and quantum of securities. It states that the issue price will be decided through book building process.
- The issuer specifies the number of securities to be issued and the price band for the bids. It then invites bids from prospective investors. It engages book runners i.e. merchant bankers and, syndicate members, with whom orders/bids are to be placed. On the close of the book running period, the book runners evaluate the bids on the basis of demand at various price levels and as per price-demand analysis, decide the final price. The issue then gets frozen at that price. Allocation is made to successful bidders and rest get refund orders.
- Once the offer of securities is closed, a final prospectus stating therein -the quantum of securities, final price of securities and other details which were not included in Red herring prospectus- is filed with the SEBI and Registrar of Companies.

Sec.33 Abridged Prospectus

Abridged Prospectus means a memorandum which contains such salient features of a prospectus as may be specified by SEBI. It contains similar information as is there in a prospectus but in a concise and precise manner so that cost of public issue of capital may be reduced.

- Every security application form must be accompanied by abridged prospectus and full prospectus is to be furnished only if requested by any person.
- Abridged Prospectus need not accompany the application forms in the following cases:
 - ✓ In the case of bonafide underwriting agreement
 - ✓ Where securities are not offered to public(eg. Private placement cases)
 - ✓ Where offer is made to existing members/debentureholders
 - ✓ Where securities are in all respects similar with those previously issued and dealt in a recognised stock exchange.
- In case of noncompliance of above provisions, a company shall be punishable with a fine of Rs. 50,000 for each default.

MISLEADING PROSPECTUS

A prospectus forms the basis of contract between the company and the investor and therefore it must disclose all material facts very accurately. ***A prospectus containing false information, or ambiguous information or contains misstatement or an omission of material facts is a misleading prospectus.*** In that case, a misled investor (i.e. original allottee of shares who had relied on the prospectus to subscribe the securities and not a buyer in the open market) is entitled to various remedies against those who misled him. (**Case- Peek vs Gurney**)

Here prospectus containing a false statement was issued by Gurney (defendant director) on behalf of the company. "A" relying on the prospectus applied and was allotted shares. Later, he sold 2000 shares to Peek (plaintiff). After some time, the company was wound up and Peek was asked to pay £ 100000 as contributory. Peek asked the directors to indemnify him as prospectus was misleading. It was held that directors were not liable to Peek as he was not original allottee and that they could not be made liable ad-infinitum for all subsequent dealings.

MISLEADING PROSPECTUS

- **False statement -McConnell vs Wright case-** Here the Prospectus stated that the company had acquired certain property, which it had not at that time , acquired. The statement was held false and gave investors the right to proceed against the directors of the company though the property was subsequently acquired by the company a few days after the allotment of shares.
- **Ambiguous statement-Smith vs Chadwick case-** Here the Prospectus stated that the 'present value of turnover ' is £ 10 lakhs per annum. This statement is capable of two interpretations - 'actual produce 'or 'capable of producing'. It was held that statement is ambiguous.
- **Misstatement of material facts- Henderson vs Lacon case-**Here the Prospectus of a company stated that "the directors and their friends have subscribed a large portion of the capital and they now offer to the public the remaining shares". Actually each director had subscribed only ten shares. The statement was held to be misleading.
- **Ommission of material facts-Rex vs Kysant case** - Here the Prospectus stated that dividends varying from 5% to 8% had been regularly paid over by the company over a long period up to the date of prospectus. This statement created an impression that the company was in good financial position. However the truth was that the company had been incurring huge trading losses during these years and dividends were paid only out of accumulated earnings .So the prospectus was deemed to be misleading not because what it stated but because what it failed to disclose.

Circumstances when prospectus is not considered misleading

- **Prospectus containing a general commendation (praise), or any opinion or expectation is not misleading** because opinions can differ and expectations may not be met. eg. the statement that due to honest and efficient management, the company is expected to progress by leaps and bounds, is only a statement of opinion and will give no right of recession. Similarly if the prospectus says that the company is very efficient and progressive and is going to make its place in top 200 companies is a general commendation and its inclusion in prospectus does not make it misleading.
- **Prospectus containing misstatement of some immaterial fact.** eg. if address of the registered office has been given as 256, Asaf Ali Road in place of 265 Asaf Ali Road, or suppose name of director was incorrectly written as Monica Arya instead of Monika Arya, the prospectus will not be treated misleading.
- **Prospectus containing existence of some promise.** If the prospectus of a company asserts the existence of some promise, the prospectus does not become false just because that promise was broken. eg. -Shiromani Sugar Mills Limited vs. Debi Prasad- Here the prospectus stated that "the management agents with their friends, promoters and directors have already promised to subscribe shares worth six lakh rupees." But they actually subscribed much lesser number of shares. It was held that there was no misrepresentation of facts and the prospectus was not misleading.
- **Prospectus containing misrepresentation of law (and not of fact).** The person deceived by it will have no remedy. eg. if a prospectus states that its shares will be issued at a discount of 20%, whereas Sec.53 prohibits issue of shares at discount, it is misrepresentation of law and a person deceived by it will have no remedy.

REMEDIES AVAILABLE TO A MISLED INVESTOR

- **Remedies against the company (Under Indian Contract Act,1872)**
 - ✓ Recission of Contract
 - ✓ Claiming damages for fraud
- **Remedies against individual directors/experts etc(Under Companies Act,2013)**
 - ✓ Criminal Liability (Sec.34)
 - ✓ Civil Liability (Sec.35)

Remedies against the company

Rescission of Contract - Under Indian Contract Act, a contract induced by a misstatement of material fact, whether innocent or fraudulent, is voidable at the option of the aggrieved party. Hence, the misled allottee is entitled to rescind his contract, return the shares and receive back his money. But to succeed in a suit for rescission, he has to prove that prospectus was **issued by company**; it contained **misrepresentation of facts**; misrepresentation was **material** and he had actually **relied upon** the statement in question while applying for shares. **However this right of rescission gets lost in the following cases-**

- Lapse of time- if subscriber fails to take action within reasonable time
- Affirmation- eg. attempts to sell shares, accepts dividend, pays calls, attends meetings etc.
- Liquidation- if company goes into liquidation before the subscriber commenced legal proceeding for rescission (this is because any payment to him on rescission would injure the interest of creditors)

Suit for damages - If the subscriber proves that the misstatements were made fraudently (and not innocently) and that he had actually been deceived, he can additionally claim damages by way of interest. Thus, this right can be exercised only after rescission of contract and the allottee cannot both retain the shares and claim damages from company. Further, the right to claim damages also gets lost in the same circumstances as stated above in which right to rescission gets lost. *Ordinary damages shall be the difference between the price at which shares were allotted and the present market value.*

Remedies against the individuals viz. directors, promoters, experts etc.

These remedies are available to the subscriber whether he rescinds his contract or not. These remedies are generally resorted to when the misled investor does not want to rescind the contract or is unable to rescind the contract because of loss of right of rescission. Thus the misled subscriber can retain the shares and at the same time hold liable the persons guilty of issuing misleading prospectus.

Sec.34.Criminal liability in case of misleading prospectus -Where a prospectus contains an untrue or misleading statement, every person authorising its issue shall be punishable for fraud u/s 447 and so will be punished with prescribed fine\imprisonment. But the alleged person can escape liability if he proves

- that the statement was immaterial or
- that he believed on reasonable grounds that it was true.

Sec.35.Civil liability in case of misleading prospectus -If any person subscribes the securities by relying on any statement in prospectus which is misleading/untrue and as a result incurs a loss, then he shall be compensated by the company and the following persons (viz. directors\promoters**experts in respect of only their own untrue statement**). But the alleged person(s) can escape liability if he proves that-

- he withdrew his consent to act as director before the prospectus was issued and it was issued without his consent or
- that the prospectus was issued without his consent and on becoming aware of its issue, he gave public notice that it was issued without his consent or knowledge or
- that the statement was in fact made on the authority of a competent expert and the expert had given his consent and not withdrawn it.

OTHER OFFENCES RELATING TO PUBLIC ISSUE

Sec.36 Punishment for fraudulently inducing persons to invest money

Any person who, knowingly or recklessly, makes any statement\promise\forecast which is false\deceptive\misleading in order to induce another person to enter into any agreement for acquiring\disposing\subscribing\underwriting securities\making profit from fluctuations in share prices\obtaining credit facilities from any bank or financial institution etc. shall be guilty of fraud and liable for action under section 447. Thus sec.36 is a generic provision that would cover all misstatements or fraud or reckless conduct outside the prospectus but made in connection with a public offer of securities.

Securities Class Action (Sec.37). This section provides that a suit may be filed by any person(individual private suit) or groups of persons(class action suit) who have been affected under section34\35\36 by any misleading statement or inclusion or omission of any matter in the prospectus. Funding of class action suits could be out of Investor Education and Protection Fund. A class action allows a number of claimants with a common grievance against a company to file a lawsuit against it. Claimants can pool their resources, share attorney's services and save time and costs of litigation. The scale of economies associated with class actions seem especially critical to those individuals who have limited resources or small claims that render individual lawsuits expensive and unfeasible.

Sec.38 Punishment for personation

If, for acquiring shares, any person applies to a company in a fictitious name or makes multiple applications in different names or combinations of names\surnames, then he shall be guilty of fraud under section 447*. Thus he maybe liable to imprisonment and fine. **To warn public against indulging in such practices, it is provided that this provision should be prominently reproduced in every prospectus and every securities application form.** If a person is convicted under this section, the court may order **disgorgement (recovery)of gains** made by this person and **seizure and disposal of securities** in possession of the person. The amount received through disgorgement or disposal of securities shall be credited to Investor Education and Protection Fund u\s 125.

Sec.42 Private Placement

It means any offer of securities or invitation to subscribe securities to a select group of persons identified by the Board of the company

- Proposed offer must be approved by a special resolution of shareholders
- Company can issue securities through Private Placement Offer cum Application
- Offer be made to such identified persons ≤ 200 (excluding QIBs and employees under ESOPs)
- If offer is made to > 200 persons it, be deemed as public offer & provisions as applicable to prospectus will apply
- Money payable on subscription shall only be through cheque/demand draft / banking channels but not by cash
- Securities to be allotted ≤ 60 days from receipt of application money else money + interest be refunded to them
- Application money be kept in a separate bank a/c in a scheduled bank & be utilised only for allotment/repayment
- Co. making private placement not to release any advertisement/utilise any media to inform public about the offer
- Co. to file with ROC a Return of Allotment giving details about names ,addresses of allottees ,shares allotted etc.
- Contravention of any of the provisions of this section, would subject the company, its promoters and directors to a penalty which may extend to amount raised through private placement or 2 crore rupees, whichever is lower and the company shall refund all monies with interest @12% per annum to subscribers within 30 days of order imposing penalty.

BOOK BUILDING

Bookbuilding is a method of offering shares to investors in which the price at which shares are to be offered is discovered through a bidding process. Instead of announcing the offerprice of securities in advance , bids (within the specified price range) are invited from the potential investors itself and then the final price is worked out. Bookbuilding is seen as an alternative to fixed price issue mechanism. Book building process-

- The issuer company going for a public issue nominates lead merchant bankers as ‘Book runners’.
- The company files a copy of red herring prospectus with SEBI atleast 3 days before the opening of the offer.
- The issuer company specifies the number of securities to be issued and the priceband for the bids
- The issuer company also appoints syndicate members with whom orders are to be placed by the investors. The syndicate members input the orders into an ‘electronic book’ and this process is called bidding.
- The book normally remains open for a period of 5 days. Bids should be within the range specified. Bids can be revised by the bidders before the book closes.
- After the closure of book building period, book runners evaluate the bids on the basis of demand at various price levels and decide the final price keeping in mind the number of securities which are to be allotted.
- The issue gets frozen on that price .Securities are allotted to successful bidders and the rest get refund orders.

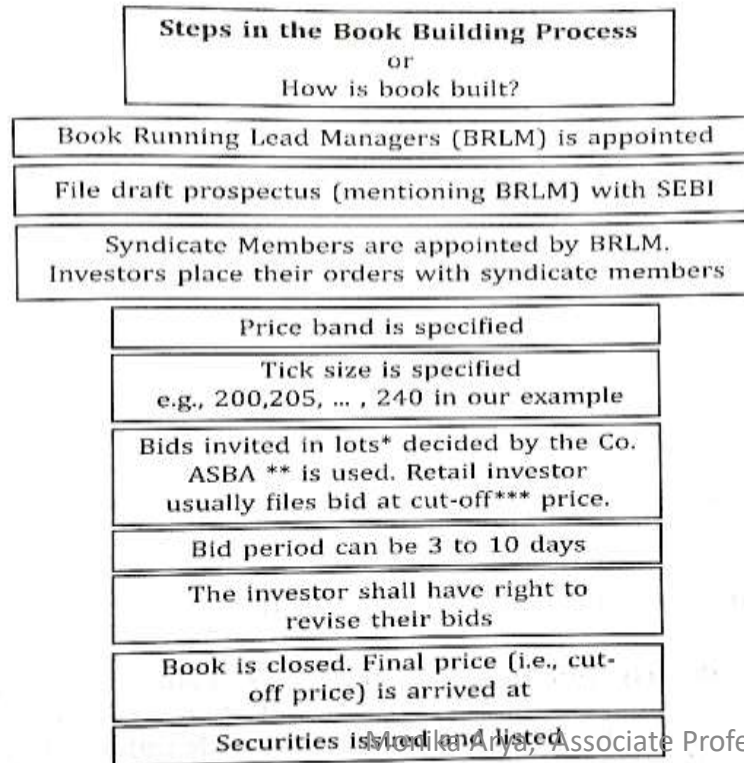
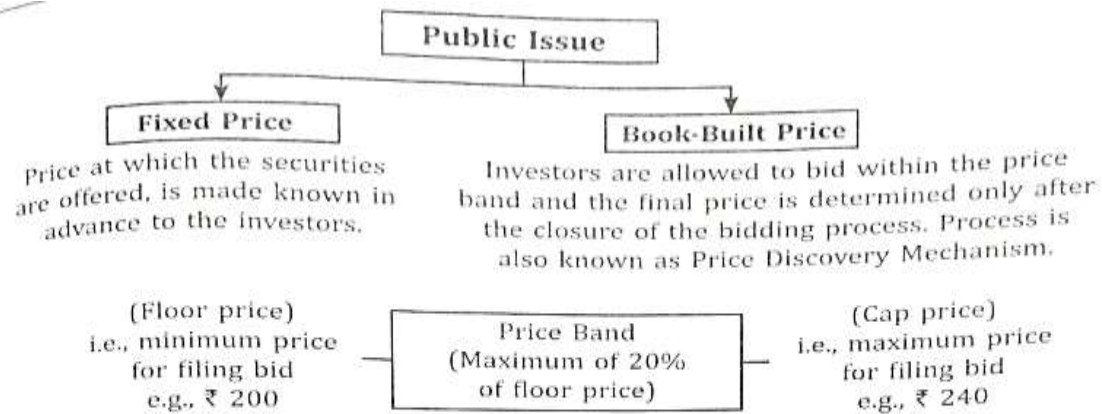
Advantages

- ✓ It helps the company to realize the true value for its equity or what investors perceive the intrinsic value of the company to be
- ✓ It co. gets an insight into its credibility factor among the investors which can be gauged by the demand generated for its shares

Limitations

- ✓ Suitable only for the issuer companies which are fundamentally strong and well known to the investors
- ✓ This system works efficiently in mature market conditions where the investors are well informed of various factors affecting the market price of the securities.

Book Building Process (Taken From Company Law By Rajni Jagota)



*Company specifies minimum lot size which can be applied for. Application can be made for minimum lot size or multiples of it.

** ASBA (Allotment Based on Bid Amount) is a mode of payment whereby the application money

BOOK BUILDING EXAMPLE

- PRICE RANGE FOR BIDDING-(Rs.200- Rs.240)
- Shares to be offered by the company- 100,000

Price	Shares Demanded	Cumulative Demanded
200	30000	179000
205	27000	149000
210	22000	122000
215	21000	100000
220	18000	79000
225	17000	61000
230	16000	44000
235	15000	28000
240	13000	13000
245	REJECTED (beyond price range)	

Since the company will be able to sell 100000 shares easily at a price of Rs. 215 each, this price will be frozen . Those who were willing to buy shares at a price more than 215 will be rather happy if shares are allotted to them at Rs. 215. those bidding less than 215 will get their refunds.