

Questions & Answers

Chapter 3 : Prospectus and Allotment of Securities

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Question 1 : Green Ltd. was dealing in export of rubber to specified foreign countries. The company was willing to purchase rubber trees in A.P. State. The prospectus issued by the company contained some important extracts of the expert report and number of trees in A.P. State. The report was found untrue. Mr. Andrew purchased the shares of Green Ltd. on the basis of the expert's report published in the prospectus. However, he did not suffer any loss due to purchase of such shares. Will Mr. Andrew have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013.

[RTP MAY 2020]

Answer 1 : Under section 35 (1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person including an expert shall, be liable to pay compensation to the person who has sustained such loss or damage.

In the present case, Mr. Andrew purchased the shares of Green Ltd. on the basis of the expert report published in the prospectus. Mr. Andrew can claim compensation for any loss or damage that he might have sustained from the purchase of shares. However, he did not suffer any loss due to purchase of such shares.

Hence, Mr. Andrew will have no remedy against the company

Circumstances when an expert is not liable: An expert will not be liable for any misstatements in the prospectus under the following situations

- i. Under section 26 (5), that having given his consent, but withdrew it in writing before delivery of the copy of prospectus for filing or
- ii. Under section 35 (2), that the prospectus was issued without his knowledge / consent and that on becoming aware of it, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent
- iii. that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had

given the consent required by section 26(5) to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar or, to the defendant's knowledge, before allotment thereunder.

Question 2 : The Board of Directors of Ramesh Ltd. proposes to issue the prospectus inviting offers from the public for subscribing the shares of the Company. State the reports which shall be included in the prospectus for the purposes of providing financial information under the provisions of the Companies Act, 2013. **[RTP NOV 2020]**

Answer 2 : As per section 26(1) of the Companies Act, 2013, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be **dated** and **signed** and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.

Prospectus issued make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act,

the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

Accordingly, the Board of Directors of Ramesh Ltd. who proposes to issue the prospectus shall provide such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government in compliance with the above stated provision and make a declaration about the compliance of the above stated provisions.

Question 3 : Keya Limited decides to issue 1,00,000 securities of the company. The company decides to publish an advertisement of the prospectus. Enumerate to the company about necessary contents of its memorandum to be specified therein.**[RTP MAY 2021]**

Answer 3 : According to Section 30, where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the contents of its memorandum as regards the following :

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

Question 4 : The Board of Directors of Plum Limited proposes to issue a prospectus inviting offers from the public for subscribing to the equity shares of the company. State the reports which shall be included in the prospectus for the purposes of providing financial information under the provisions of the Companies Act, 2013.
[RTP MAY 2022]

Answer 4 : As per section 26(1) of the Companies Act, 2013, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government.

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

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

Question 5 : What is meant by “Abridged Prospectus”?

Answer 5 : **Meaning of Abridged Prospectus:** - According to Section 2(1) of the Companies Act, 2013, an 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.

Question 6 : Examine the validity of the following statement referring to the provisions of the Companies Act, 2013 and/or Rules “The Articles of Association of X Ltd. contained a provision that upto 4% of issue price of’ the shares may be paid as underwriting commission to the underwriters. The Board of Directors of X Ltd. decided to pay 5% underwriting commission. **[MTP MAY 2019]**

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

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

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

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

Question 7 : State in what way does the Companies Act, 2013 regulate and restrict the following in respect of a company going for public issue of shares.

- i. Minimum Subscription and
- ii. Application Money payable on shares being issued?

[MTP MAY 2019]

Answer 7 : The Companies Act, 2013 by virtue of provisions as contained in Section 39 (1) and (2) regulates and restricts the minimum subscription and the application money payable in a public issue of shares as under :

Minimum subscription [Section 39 (1)]

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

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

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

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

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

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

Question 8 : Examine the validity of the following statement referring to the provisions of the Companies Act, 2013 and/or Rules.

“The Articles of Association of X Ltd. contained a provision that up to 4% of issue price of the shares may be paid as underwriting commission to the underwriters. The Board of Directors of X Ltd. decided to pay 5% underwriting commission

[MTP MAY 2019]

Answer 8 : Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the number of conditions which are prescribed under *Companies (Prospectus and Allotment of Securities) Rules, 2014*. Under the *Companies (Prospectus and Allotment of Securities) Rules, 2014* the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less

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

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

Question 9 : An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them. Is the Director liable under the circumstances? Decide referring to the provisions of the Companies Act, 2013. **[MTP NOV 2019]**

Answer 9 : Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorizes the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such misstatements.

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

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

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

Question 10 : Sudarshan Exports Ltd. was dealing in export of rubber to specified foreign countries. The company was willing to purchase rubber trees in Andhra Pradesh. The prospectus issued by the company contained some important extracts of the expert report and number of trees in Andhra Pradesh. The report was found untrue. Mr. Alok purchased the shares of Sudarshan Exports Ltd. on the basis of the expert report published in the prospectus. Will Mr. Alok have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013. **[MTP MAY 2020]**

Answer 10 : Under section 35 (1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person including an expert shall, be liable to pay compensation to the person who has sustained such loss or damage.

In the present case, Mr. Alok purchased the shares of Sudarshan Exports Ltd. on the basis of the expert report published in the prospectus. Mr. Alok can claim compensation for any loss or damage that he might sustained from the purchase of shares, which has not been mentioned in the given case.

Hence, Mr. Alok will have no remedy against the company.

Circumstances when an expert is not liable: An expert will not be liable for any misstatements in the prospectus under the following situations :

- i. Under section 26 (5), that having given his consent, but withdrew it in writing before delivery of the copy of prospectus for registration, or
- ii. Under section 35 (2), that the prospectus was issued without his knowledge / consent and that on becoming aware of it, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
- iii. that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by section 26(5) to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.

Question 11 : 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 these circumstances? Decide referring to the provisions of the Companies Act, 2013. **[MTP MAY 2021]**

Answer 11 : 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.

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

1. No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.
2. No civil liability for any mis-statement under section 35 shall apply to a person if he proves that :
 - i. having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
 - ii. 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.
 - iii. that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before filing of a copy of the prospectus with the Registrar or, to the defendant's knowledge, before allotment thereunder.

Therefore, in the present case the director cannot escape the liability by stating that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis-statements in the prospectus.

Question 12 : What is meant by “Abridged Prospectus”? [MTP MAY 2021]

Answer 12 :

1. **Meaning of Abridged Prospectus:** - According to Section 2(1) of the Companies Act, 2018, an 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.

Question 13 : Swati Limited is intending to issue its securities on private placement basis. Explain to the directors of the company, the provisions of the Companies Act, 2013, on the following matters:

- i. Meaning of Private Placement
- ii. 'Time Limit for Allotment of Securities' and 'repayment of application money in case of default in allotment. [MTP MAY 2022]

Answer 13 :

1. **Meaning of 'Private Placement':** As per Explanation I to section 42(3), the term "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.
2. **'Time Limit for Allotment of Securities' and 'repayment of application money in case of default in allotment':** A company making an offer or invitation under section 42 shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day.

Question 14 : ABC Limited proposes to issue series of debentures frequently within a period of one year to raise the funds without undergoing the complicated exercise of issuing the prospectus every time of issuing a new series of debentures. Examine the feasibility of the proposal of ABC Limited having taken into account the concept of deemed prospectus dealt with under the provisions of the Companies Act, 2013. **[MTP MAY 2022]**

Answer 14 : **Information Memorandum together with Shelf Prospectus is deemed Prospectus** . The expression “shelf prospectus” means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. [Explanation to Section 31]

Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-

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

No further prospectus is required for issue of securities. [Sub-section (1)]

Hence, the proposal of ABC Limited to take into account the concept of deemed prospectus is correct.

Question 15 : Prakash Limited wants to raise funds for its upcoming project. Accordingly, it has issued private placement offer letters for issuing equity shares to 55 persons, of which four are qualified institutional buyers and remaining are individuals. Before the completion of allotment of equity shares under this offer letter, company issued another private placement offer letter to another 155 persons in their individual names for issue of its debentures.

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

[MTP MAY 2021]

Answer 15 : According to section 42 of the Companies Act, 2013 any private or public company may make private placement through issue of a private placement offer letter.

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

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

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

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

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

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

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

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