

MOST IMPORTANT QUESTIONS FOR CA INTER CORPORATE & OTHER LAWS			
CHAPTER 3 – PROSPECTUS			
Five Star	Four Star	3 Star	2 Star
✓ Section 34 & 35 - Misstatement	✓ Section 42 - Private Placement	✓ Section 26 31 32 – Prospectus Shelf prospectus Red herring prospectus	✓ Section 39 & 40 – Allotment & listing of securities Underwriter commission ✓ Irregular allotment
<p>Important sections</p> <ul style="list-style-type: none"> ✓ Section 34 & 35 - Misstatement ✓ Section 42 - Private Placement ✓ Section 26 31 32 - Prospectus Shelf prospectus Red herring prospectus ✓ Section 39 & 40 – Allotment & listing of securities Underwriter commission ✓ Irregular allotment 			
Misstatement			
<p>Question 1A</p> <p>MBL Pharmaceutical Limited is committed to provide quality medicines at an affordable cost through relentless pursuit of excellence in its operations, product quality, documentation and services. The company is now focusing on oncology therapeutics & other generics with a vision to be a Global Leader in Oncology. The prospectus issued by the company contained some important extracts of the expert's report on research by oncology department. The report was found untrue. Mr. Diwakar purchased the shares of MBL Pharmaceutical Limited on the basis of the expert's report published in the prospectus. Will Mr. Diwakar have any remedy against the company? State also the circumstances where an expert is not liable under the Companies Act, 2013.</p>			
<p>Answer</p> <p>If - a prospectus includes any statement, which is misleading; or - omission of any matter in the prospectus is misleading; and - any person subscribes for securities acting on any such statement or omission; and - such person sustains any loss as a consequence thereof, Then, - Sec. 35 is attracted.</p> <p>In the present case, Mr. Diwakar purchased the shares of MBL Pharmaceutical Limited on the basis of the expert's report published in the prospectus. Mr. Diwakar can claim compensation for any loss or damage that he might have sustained from the purchase of shares. Further, section 35 also mentions punishment prescribed by section 36 i.e., punishment for fraud under section 447.</p> <p><u>Circumstances when an expert is not liable:</u></p>			
Withdrawal of consent	No person shall be liable u/s 35, if he proves that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent		
Prospectus issued without his consent	No person shall be liable u/s 35 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.		

<p>Defence to any person making a statement on the basis of report of an expert</p>	<p>A person who makes any statement on the basis of report of an expert shall not be liable u/s 35, if it is proved that -</p> <ul style="list-style-type: none">(a) the statement made by such person was a correct and fair representation of the statement made by the expert;(b) the person who made the statement on the basis of the statement made by the expert had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the expert was competent to make it;(c) the expert had given his consent; and(d) the expert had not withdrawn his consent before filing of a copy of the prospectus with the Registrar.
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Question 1B

Aarna Ltd. was dealing in export of cotton fabric to specified foreign countries. The company was willing to purchase cotton fields in Punjab State. The prospectus issued by the company contained some important extracts of the expert report. The report was found untrue. Mr. Nick purchased the shares of Aarna 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. Would Mr. Nick have any remedy against the company? State the circumstances where an expert is not liable under the Companies Act, 2013.

Answer

Provision of Sec 35 same as above

In the present case, Mr. Nick purchased the shares of Aarna Limited on the basis of the expert's report published in the prospectus. Mr. Nick can claim compensation for any loss or damage that he might have sustained from the purchase of shares. **Since, Mr. Nick did not suffer any loss due to purchase of such shares, he cannot claim any compensation for any loss or damage.**

Circumstances when an expert is not liable: Same as above

Question 1C

RD Ltd. issued a prospectus. All the statements contained therein were literally true. It also stated that company had paid dividends for a number of years but did not disclose the fact that the dividends were not paid out of trading profits but out of capital profits. An allottee of shares claims to avoid the contract on the ground that the prospectus was false in material particulars. Decide that the argument of shareholder, as per the provision of the Companies Act, 2013, is correct or not?

Answer

Provision of Sec 35 same as above

In the given question, 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.

Question 1D

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.

Answer

Provision of Sec 35 same as above

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: Same as above

Private Placement

Question 2A

CDS Ltd. is planning to make a private placement of securities. The Managing Director arranged to obtain a brief note from some source explaining the salient features of the issue of private placement that the Board of Directors shall keep in mind while approving the proposal on this subject. The brief note includes, inter alia, the information / suggestions on the following points:

- (i) A private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year.

The aforesaid ceiling of identified persons shall not apply to the offer made to the qualified institutional buyers but is applicable to the employees of the Company who will be covered under the Company's Employees Stock Option Scheme.

- (ii) The offer on private placement basis shall be made only once in a financial year for any number of identified persons not exceeding 200.

The Company solicits your remarks on the points referred above as to whether they are valid or not? Reasoned remarks should be given in accordance with the provisions of the Companies Act, 2013.

Answer

As per the provisions of sub-section (2) of section 42 of the Companies Act, 2013, private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed 50 or such higher number as may be prescribed, in a financial year subject to such conditions as may be prescribed.

Such higher number of persons, as may be prescribed (the prescribed number for this purpose is 200).

While computing the number of persons to whom private placement has been made by a company, following shall be excluded:

- (i) Qualified Institutional Buyers; and
(ii) Employees of the company who have been offered securities under a scheme of employees stock option u/s 62(1)(b).

The restrictions with respect to the maximum number of persons to whom private placement can be made shall be reckoned individually for each kind of security, i.e. equity shares, preference shares and debentures.

Referring to the above-mentioned provisions of sub-section (2) of section 42 of the Companies Act, 2013 and Rule 14 the Companies (Prospectus and Allotment of Securities) Rules, 2014, we can conclude as follows:

- (i) The company is correct in proposing that private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year. This part of the proposal is correct.

The company is also correct in proposing that the aforesaid ceiling of identified persons shall not apply to offer made to the qualified institutional buyers, but the company is not correct in saying that the said ceiling is applicable to employees covered under the Company's Employee Stock Option Scheme. Hence, the second part of the proposal is only partially correct.

- (ii) The Companies (Prospectus and Allotment of Securities) Rules, 2014 provides that an offer or invitation to subscribe securities under private placement shall not be made to persons more than 200 in aggregate in a financial year.

Keeping the ceiling of 200 persons in aggregate during a financial year, offer of private placement can be made more than once in a financial year. Therefore, the second statement is not fully correct.

Question 2B

PQR Bakers 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 PQR Bakers 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?

Answer

Provision of Sec 42 same as above

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.

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

In the given case PQR Bakers 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.

Prospectus

Question 3A
The Board of Directors of Chandra 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.

Answer

Matters to be stated in prospectus [Sec. 26(1)]	<p>(a) The prospectus shall contain such information and reports on financial information as may be specified by SEBI in consultation with CG.</p> <p>(b) Until SEBI specifies the information and reports on financial information, the regulations made by SEBI under SEBI Act, 1992, in respect of such financial information or reports on financial information shall apply.</p> <p>(c) A declaration shall be included in the prospectus. The declaration shall state that - (i) the company has complied with the provisions of the Companies Act, 2013; and (ii) nothing in the prospectus is contrary to the provisions contained in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956 and SEBI Act, 1992 and the Rules and Regulations made thereunder.</p> <p>(d) Every prospectus shall contain the following disclosures: (i) A statement that a copy of the prospectus has been filed with the Registrar. (ii) A list of all such documents as are required to be attached with the prospectus.</p>
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Inclusion of expert's statement in the prospectus	<p>A statement purporting to be made by an expert may be included in the prospectus, only if all the following conditions are satisfied:</p> <p>(a) The expert is a person who is not, and has not been, engaged or interested in the formation or promotion or management of the company.</p> <p>(b) The expert has given his written consent to the issue of the prospectus.</p> <p>(c) The expert has not withdrawn his consent before the date of filing of a copy of the prospectus with the Registrar.</p> <p>(d) A statement is included in the prospectus that the expert has given his written consent and has not withdrawn such consent.</p>
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Question 3B
The Board of Directors of ABC Limited are proposing to raise funds from the public through issue of equity shares. However due to volatile financial markets, the price per share and the number of shares to be issued are left open and to be decided post closure of the issue. As a financial advisor of the company, what would you suggest to the Board in this regard as per the provisions of the Companies Act, 2013?

Answer
As a financial consultant the Board of Directors of ABC Limited would be advised to issue a Red Herring Prospectus. The expression "red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein. [Explanation to Section 32]

Thus, ABC Limited may raise funds from public through red herring prospectus whereby the price per security and number of securities are left open to be decided post closure of the issue.

Procedure for issue of securities under red herring prospectus:

- (a) A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.
- (b) A company proposing to issue a red herring prospectus shall file it with the Registrar at least 3 days prior to the opening of the offer.
- (c) Upon the closing of the offer of securities, the prospectus shall be filed with the Registrar and SEBI.
- (d) Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
- (e) The prospectus shall state -
 - (i) the total capital raised, whether by way of debt or share capital;
 - (ii) the closing price of the securities; and
 - (iii) any other details as were not included in the red herring prospectus.

Note: A red herring prospectus shall carry the same obligations as are applicable to a prospectus.

Question 3C

What is a Shelf-Prospectus? State the important provisions relating to the issuance of Shelf-Prospectus under the provisions of Companies Act, 2013.

Answer

Shelf prospectus - As per the Explanation given in Section 31 of the Companies Act, 2013, 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.

Provisions relating to issue of Shelf-prospectus:

Filing of shelf prospectus	Any class or classes of companies, as SEBI may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage of the first offer of securities specified in the shelf prospectus.
Validity period of shelf prospectus	<ul style="list-style-type: none"> ■ The shelf prospectus shall indicate a period not exceeding 1 year as the period of validity of such prospectus. ■ The period of 1 year shall commence from the date of opening of the first offer of securities under the shelf prospectus. ■ With respect to second or any subsequent offer of such securities issued during the period of validity of shelf prospectus, no further prospectus shall be required.
Information memorandum	<ul style="list-style-type: none"> ■ Prior to the issue of a second or subsequent offer of securities under the shelf prospectus, the company shall be required to file an information memorandum with the Registrar. ■ The information memorandum shall be filed with the Registrar within such time as may be prescribed. ■ The information memorandum shall contain all material facts relating to - <ul style="list-style-type: none"> - new charges created;

	<p>- 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</p> <p>- such other changes as may be prescribed.</p>
Intimation of changes and opportunity to withdraw applications	Where a company has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company 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 15 days thereof.

Allotment & listing of securities | Underwriting commission

Question 4A

A Ltd. issued 1,00,000 equity shares of Rs. 100 each at par to the public by issuing a prospectus. The prospectus discloses the minimum subscription amount of Rs. 15,00,000 required to be received on application of shares and share application money shall be payable at Rs. 20 per share. The prospectus further reveals that A Ltd. has applied for listing of shares in 3 recognized stock exchanges of which 1 application has been rejected. The issue was fully subscribed and A Ltd. received an amount of Rs. 20,00,000 on share application. A Ltd., then proceeded for allotment of shares. Examine the three disclosures in the above case study which are the deciding factors in an allotment of shares and the consequences for violation, if any under the provisions of the Companies Act, 2013.

Answer

As per the requirement of the question, disclosures which are the deciding factors in an allotment of shares are laid down in section 39 of the Companies Act, 2013.

According to Section 39(1), no allotment of any securities of a company offered to the public for subscription shall be made unless-

- the amount stated in the prospectus as the minimum amount has been subscribed, and
- the sums payable on application for the amount so stated have been paid to, and received by the company by cheque or other instrument.
- The amount payable on application on every security shall not be less than five per cent of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

In the question, A Ltd. issued shares to public by issuing of prospectus, disclosing minimum subscription, sum payable on application for the amount; and the amount received on share application is more than 5% of the nominal amount of the security.

Further, it revealed that A Ltd. has applied for listing of shares in 3 recognized stock exchanges of which one application was rejected.

In the given instance, there is compliance to section 23, as nothing is talked about matters required to be included in the prospectus under section 26 (1) and about filing with the registrar; assuming that the said requirements have been complied with, requirement of section 39 as regards obtaining of minimum subscription and the minimum amount receivable on application (not less than 5% of the nominal value of the securities offered) are fulfilled.

The provisions of section 40 of the Companies Act, 2013 states that every company making public offer shall, before making such offer, make an application to one or more recognized stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

The above provision is very clear that not only the company has to apply for listing of the securities at a recognized stock exchange, but also obtain permission thereof from all the stock exchanges where it has applied, before making the public offer. Since one of the three recognized stock exchanges, where the company has applied for enlisting, has rejected the application and the company has proceeded with making the offer of shares, it has violated the provisions of section 40. Therefore, this shall be deemed to be irregular allotment of shares.

Question 4B

Johnson Limited goes for Public issue of its shares. The issue was over subscribed. A default was committed with respect to allotment of shares by the officers of the company. There were no Managing Director, Whole time Director or any other officer/person designated by the Board with the responsibility of Complying with the provisions of the Act.

State, who are the persons considered as officers in default under the Companies Act, 2013.

Examine who will be considered in default in the instant case?

Answer

As per section 39 of the Companies Act, 2013, which deals with the allotment of securities, states that in case of any default related to minimum subscription and of return of allotment money under sub-section (3) and (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.

As per section 2(60) of the Act, Officer who is in default, has been described as:

For the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely: —

- (i) whole-time director (WTD);
- (ii) key managerial personnel (KMP);
- (iii) where there is **no key managerial personnel**, such director or **directors as specified by the Board**, or **all the directors**, if no director is so specified;
- (iv) any **person who**, under the **immediate authority** of the **Board** or any **key managerial personnel**, is **charged** with any responsibility.
- (v) any **person in accordance with whose advice**, directions or instructions the Board of **Directors** of the company is **accustomed to act**,
- (vi) **every director**, in respect of a contravention of any of the provisions of this Act,
- (vii) in respect of the **issue or transfer of any shares** of a company, the share transfer agents, **registrars and merchant bankers** to the issue or transfer;

In the given case, as stated Johnson Limited, committed a default with respect to the allotment of shares by the officers. As in company there were no managing director, whole time director, or any other officer/person designated by the Board with the responsibility of complying with the provisions of the Act. Therefore, in such situation, all the directors of the company may be treated as officers in default.

Question 4C

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

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription to its securities, subject to a number of conditions which are prescribed under the Companies (Prospectus and Allotment of Securities) Rules, 2014. In relation to the case given, the conditions applicable under the above Rules are as under:

- (a) The payment of such commission shall be **authorized in the company's articles** of association;
- (b) The commission may be paid **out of proceeds of the issue or the profit of the company or both**;
- (c) The rate of commission in case of debentures, **shall not exceed two and a half per cent (2.5%) of the price at which the debentures are issued**, or as specified in the company's articles, whichever is less.

Thus, the underwriting commission in case of debentures is limited to 2.5%.

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

The company may pay the underwriting commission in the form of flats as both the Companies Act and the Rules do not impose any restriction on the mode of payment though the source has been restricted to either the proceeds of the issue or profits of the company. [**Booth v New Africander Gold Mining Co**]

Irregular allotment

Question 5

Explain various instances which make the allotment of securities as irregular allotment under the Companies Act, 2013.

Answer

Irregular allotment: The Companies Act, 2013 does not specifically provide for the term "Irregular Allotment" of securities. Hence, we have to examine the requirements of a proper issue of securities and consider the consequences of non- fulfillment of those requirements.

In broad terms an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 or 40. Irregular allotment therefore arises in the following instances:

1. Where a **company does not issue a prospectus** in a public issue as required by **section 23**; or
2. Where the prospectus issued by the company **does not include any of the matters required to be included therein under section 26 (1)**, or the information given is misleading, faulty and incorrect; or
3. Where the **prospectus has not been filed with the Registrar** for registration under section 26 (4); or
4. The **minimum subscription** as specified in the prospectus has **not been received** in terms of section 39; or
5. The **minimum amount** receivable on application is **less than 5% of the nominal value** of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a **public issue**, **approval for listing has not been obtained** from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.
7. **Return of allotment is not filed** with the Registrar after making allotment of securities (Contravention of Sec. 39).
8. Moneys received on application are not kept in a separate bank account in a scheduled bank (Contravention of Sec. 40).