

## 6. PROSPECTUS

### QUESTION WISE ANALYSIS OF PAST EXAM PAPERS OF IPCC AND CA INTER

Q.NO.	N-14	M-15	N-15	M-16	N-16	M-17	N-17	M-18 (O)	M-18 (N)	N-18 (O)	N-18 (N)	M-19 (O)	M-19 (N)	N-19 (O)	N-19 (N)	N-20 (O)	N-20 (N)
2	-	-	-	-	-	1	-	-	-	-	-	-	-	-	-	-	-
4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-
8	-	-	4	-	-	-	-	-	-	-	-	-	-	-	-	-	-
10	-	-	-	-	4	-	-	-	-	-	6	-	-	-	-	-	-
12	-	-	-	-	-	-	-	5	-	-	-	-	-	-	-	-	-
16	-	-	-	4	-	-	-	-	-	-	-	-	-	-	-	-	-

### PRACTICAL QUESTIONS ANALYSIS OF PAST EXAM PAPERS OF IPCC AND CA INTER

Q.NO.	N-14	M-15	N-15	M-16	N-16	M-17	N-17	M-18 (O)	M-18 (N)	N-18 (O)	N-18 (N)	M-19 (O)	M-19 (N)	N-19 (O)	N-19 (N)	N-20 (O)	N-20 (N)
CRD 4	-	-	-	-	-	-	-	-	-	-	-	3	-	-	-	-	-
CRD 6	-	-	-	-	-	4	-	-	-	-	-	-	-	-	4	-	-
SP 7	-	-	-	4	-	-	-	-	-	-	-	-	-	-	-	-	-

### CHAPTER OVERVIEW

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### SECTION 1: THEORY FOR CLASSROOM DISCUSSION

One of the advantages of floating a company is raising of capital. Capital could be raised from public at large or from a defined group or inner circle (pre-known select group of persons). The former is called the 'Public offer' and the latter is called 'Private Placement'.

Capital acquisition is inflow of funds for the issuer and needs advertisement which should be in accordance with the relevant legal provisions so that any investor is not defrauded or be-fooled. On successful closure of the application process, securities are allotted to investors which could be then listed on an appropriate segment of a recognized stock exchange.

The provisions related to raising of capital such as issue of prospectus, allotment of shares etc. and other matters incidental thereto are contained in Chapter III of the Companies Act, 2013, which is divided into two parts:

Part I – Public Offer of the chapter comprise sections 23 to 41, and

Part II – Private Placement comprises section 42.

**Q.No.1. What are the different modes in which a company can issue securities? OR Write about issue of securities by public and private companies (Sec.23) (C) (NEW SM, OLD SM)**

Section 23 prescribes different modes of issuing securities by a public and a private Company.

- 1) **PUBLIC COMPANY [Sec 23(1)]:** A Public Company may issue securities -
  - a) To public through prospectus (*herein referred to as "public offer"*) or
  - b) Through private placement; or
  - c) Through Rights issue or Bonus issue.
- 2) **PRIVATE COMPANY [Sec 23(2)]:** A Private Company may issue securities -
  - a) Through private placement; or
  - b) By way of rights issue or bonus issue.
- 3) **DEFINITION OF PUBLIC OFFER:** Public offer includes:
  - a) Initial Public Offer(IPO)
  - b) Further Public Offer (FPO) of securities to the public by a company, (or)
  - c) An Offer for Sale of securities (OFS) to the public by an existing shareholder, through issue of prospectus.
- 4) **RIGHTS ISSUE AND BONUS ISSUE:**

	Public Company	Private Company
Public Offer (Including IPO, FPO or OFS)	Yes	No
Private Placement	Yes	Yes
Rights issue / Bonus Issue	Yes	Yes
Compliance with SEBI rules & regulations	Yes for listed Company or Company proposed to be listed	No

#### SIMILAR QUESTIONS:

1. M/s Kumar Ltd requires Rs.10 lakhs to purchase one plant and machinery. The Company intends to raise funds through issue of securities. Advice the Company as to different modes of issuing securities?
- A. Since M/s Kumar Ltd is a public company, it can raise funds through issue of prospectus or through private placement or through rights issue.
2. Distinguish a Public Company and a Private company with respect to different modes of issuing securities.
- A. Hint: Refer the above answer.

## PROSPECTUS AND ITS REQUIREMENTS

**Q.No.2. Explain the meaning of Prospectus. (C) (NEW SM, OLD SM, OLD PM)**

#### PROSPECTUS [SEC 2(70)]:

- 1) Prospectus means:
  - a) Any document described or issued as prospectus and
- 2) Prospectus includes:
  - a) Shelf prospectus (Sec. 31); or
  - b) A red herring prospectus (Sec. 32); or

- c) Any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

**SIMILAR QUESTIONS:**

1. M/s Prasanth Limited issued an advertisement in a newspaper inviting offers from public for subscription of shares of the company. Is advertisement in newspaper treated as prospectus?
  - A. Yes. Any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate is treated as Prospectus.
2. State whether television advertisements and visual clips giving all required details be treated as prospectus? (M17 -1M)
  - A. No. Because a prospectus must be in writing. Refer Sec. 25 (Prospectus is a document).

**Q.No.3. When the company is not required to issue Prospectus? (or) State the conditions where under the issuing of prospectus is not necessary under the provisions of the Companies Act, 2013 (B) (NEW SM)**

The issue of prospectus is not necessary in the following cases [SEC 26(2)]

- 1) Offer or invitation is made to the existing members or debenture holders of the company.
- 2) Offer or invitation is made to subscribe for shares or debentures which are
  - a) Uniform in all respects with shares or debentures previously issued, and
  - b) Dealt in or quoted on a recognized stock exchange.
- 3) No offer or invitation is made for issue of shares or debentures to public (*i.e. Private Placement*).
- 4) When the shares or debentures are issued by a private company.

**SIMILAR QUESTIONS:**

1. Run Ltd. is planning to issue debentures to its existing debenture holders i.e. rights issue. It issued a prospectus for the same. One of the shareholder objected that the issue of prospectus is not valid. Explain whether the shareholder's objection is tenable or not.
  - A. Prospectus is not required in case of Rights Issue.

**Q.No.4. What are the contents of prospectus? Or What are the matters to be specified in prospectus u/s 26? (B) (N18-4M, N19 (N) - 4M NEW SM)**

Following are the matters to be stated in prospectus:

- 1) Every prospectus issued (*by or on behalf of a public company*) shall be dated and signed.
- 2) The Prospectus shall state such information and reports on financial information as may be specified by SEBI, in consultation with C.G.
- 3) 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.
- 4) **CONTENTS OF DECLARATION:**
  - a) A declaration shall be included in the prospectus. The declaration shall state that the company has complied with all the provisions of the Companies act, 2013.
  - b) The declaration shall further state that nothing in the prospectus is contrary to the provisions of the:
    - i) Companies Act, 2013;
    - ii) Securities Contracts (Regulation) Act, 1956 (42 of 1956) and
    - iii) SEBI Act, 1992 (15 of 1992) and the rules and regulations made thereunder.

**SIMILAR QUESTIONS:**

1. 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. (N19-4M)
  - A. Refer above Answer

**Q.No.5. State the provisions relating to dating, signing, registration and issue of prospectus?**

**(B) (NEW SM)**

- 1) **BOARD RESOLUTION:** Board has to approve the prospectus by passing a Board Resolution.
- 2) **DATE OF PROSPECTUS 26(3):** The date indicated in the prospectus shall be deemed to be the date of its publication.
- 3) **SIGNING:** The Prospectus must be signed by every director and proposed director named therein.
- 4) **FILING WITH ROC:**
  - a) Every prospectus of the company shall be filed with ROC before its publication i.e., date of prospectus [Sec. 26(4)].
  - b) On the face of each prospectus, it shall be clearly indicated that a copy of prospectus has been filed with the ROC [Sec. 26(6)].
- 5) **TIME LIMIT:** The Prospectus is valid for a period of 90 days after the date on which a copy thereof is delivered to the Registrar.
- 6) **EXPERT'S STATEMENT IN PROSPECTUS [Sec 26(5)]:** A prospectus issued shall not include a statement purporting to be made by an expert unless the expert-
  - a) Is a person who is not engaged or interested in the formation or promotion or management of the company and
  - b) Has given his written consent to the issue of the prospectus and
  - c) Has not withdrawn such consent before the delivery of a copy of the prospectus to the ROC for filing.
  - d) A statement to that effect shall also be included in the prospectus (*Disclosure Requirement*).
- 7) **PUNISHMENT IN CASE OF CONTRAVENTION:**

Person Punishable	Punishment
Company	Minimum: Rs. 50,000; Maximum: Rs. 3,00,000
Every person who is knowingly a party to the issue of such prospectus	<b>Imprisonment</b> for a term which may extend up to 3 years <u>or</u> <b>Fine</b> Minimum: Rs. 50,000; Maximum: Rs. 3,00,000 <u>or</u> <b>Both</b>

**SIMILAR QUESTIONS:**

1. M/s ABC Ltd registered its prospectus with ROC on 05 July 2019. The company plans to issue prospectus to public on 25 November 2019. Advise Company whether it can do so?
  - A. No. Prospectus will have maximum validity period of 90 days. On expiry of 90 days the issue of prospectus is invalid.
2. M/s Honor Ltd issued prospectus to the public without registering the prospectus with ROC. State the consequences that may arise due to contravention of Section 26 of the companies act, 2013.
  - A. Refer point 8 above answer

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 1, 2)**

**Q.No.6. Explain 'Public Offer of securities to be in dematerialized (DEMAT) form'.**

**(B) (NEW SM, OLD SM)**

**PUBLIC ISSUE [SEC. 29(1)]:** Every Company making public offer and such other class or classes of companies, shall issue the securities only in dematerialized form by complying with the provisions of the depositories act, 1996 and the regulations made thereunder [Sec 29(1)].

**OTHER THAN PUBLIC ISSUE [SEC. 29(2)]:** In case of other companies (*other than a companies mentioned u/s 29(1)*) they may convert their securities into dematerialized form or issue its securities in physical form in accordance with the provisions of this act.



**Dematerialisation of securities** [Rule 9 of Companies (Prospectus and Allotment of Securities) Rules, 2014]

- a) The promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialised form.
- b) Provided that the entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only.

**Q.No.7. What is the procedure for varying terms of contract or objects in prospectus and requirements that needs to be complied with? (A) (NEW SM, OLD SM)**

*Once funds are raised through a given prospectus, the principles 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. Deviations are required to be pre-approved by the investors and recall option to be given to dissenting investors. The Procedure for altering terms of prospectus is as below:*

- 1) **VARIATION BY SR:** A company can change the terms of a contract referred to in the prospectus, or objects for which the prospectus was issued, by passing Special Resolution in General Meeting<sup>1</sup>.
- 2) **NOTICE OF RESOLUTION TO SHAREHOLDERS:** Notice in respect of resolution to shareholders is to be published in newspapers (one in English and one in vernacular language) in the city where registered office of the company is situated, clearly indicating the justification for such variation.
- 3) **PROHIBITION ON USE OF MONEY:** A Company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed Company.
- 4) **EXIT OFFER TO DISSENTING SHAREHOLDERS:**
  - a) Promoters or Controlling shareholders shall give an exit offer to dissenting shareholders (shareholders who have not agreed to the proposal).
  - b) The exit price, manner, and conditions of the exit offer may be specified by SEBI by making regulations in this behalf.

#### **ADDITIONAL INFORMATION FOR ACADEMIC INTEREST:**

*Rule-7 of the companies (Prospectus and Allotment of securities) Rules, 2014*

- i) *The advertisement containing the details of the notice of general meeting shall be in Form PAS-1.*
- ii) *It shall be published along with the dispatch of postal ballot notices.*
- iii) *The notice of GM shall also be placed on the website of the Company.*

#### **SIMILAR QUESTION:**

1. Lotus valley Ltd. issued a prospectus with the object of setting up of a chain of hotels. However, later it decided to set-up a Pharmaceutical Manufacturing unit. Keeping in view the provisions of the Companies Act, 2013, state whether Lotus valley Ltd. can do so and if it can be done, also state the procedure to be followed for varying the objects in the prospectus. (RTP M16)
- A. Yes. Lotus valley Ltd. can change the objects mentioned in the prospectus from setting up a chain of hotels to setting up a pharmaceutical manufacturing unit by following the below stated procedure  
For procedure refer the above answer.

## **TYPES OF PROSPECTUS**

**Q.No.8. Document containing offer of securities for sale is deemed to be prospectus. Comment. [Sec.25] (A) (NEW SM, OLD SM, N15 - 4M)**

- 1) **DEEMED PROSPECTUS [Section 25]:** Document by which the offer for sale of shares or debentures is made to the public shall be deemed to be a prospectus issued by the company.

- 
- 1) A company shall vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued by passing a Special Resolution through Postal Ballot. The advertisement containing the details of the notice of general meeting shall be in Form PAS-1. The notice of GM shall also be placed on the website of the Company.

- a) The document of offer for sale is an invitation to general public to purchase shares of the company through an intermediary (*i.e. an issuing house or Merchant house*).
- b) A Company may allot or agree to allot any shares or debentures to an issue house if such company has no intention to make such shares or debentures available directly to the public through issue of prospectus
- c) The Issue house in turn makes offer for sale to the public.

## 2) **EFFECT:**

- a) All enactments and rules of law
  - i) As to the contents of prospectus, and
  - ii) As to liability in respect of mis-statements in prospectus shall apply to deemed prospectus.
- b) It shall be deemed that the persons by whom the offer to the public is made were named in the prospectus as the directors of the company (*Deemed Directors*).

## 3) **PRESUMPTION AS TO DEEMED PROSPECTUS:** In order to constitute 'offer for sale', either of the two conditions must be satisfied (Sec 25 shall apply) -

- a) Offer for sale to the public was made within 6 months after allotment or agreement to allot; or
- b) Whole consideration had not been received by the company when offer to the public was made (*i.e. the shares are not fully paid on the date of offer for sale to public*).

## 4) **CONTENTS OF DEEMED PROSPECTUS:** It must contain following matters -

- a) Contents specified u/s 26
- b) Net amount of the consideration received or to be received by the Company in respect of the securities to which the offer relates; and
- c) Time and place for inspection of contract where the securities have been allotted or to be allotted.

## 5) **SIGNING OF DEEMED PROSPECTUS:** Where a person making an offer is a company or a firm, it shall be sufficient if the document is signed on behalf of

- a) The company – by two directors of the company or
- b) The firm – by not less than one-half of the partners in the firm.

## **SIMILAR QUESTIONS:**

1. M/s Pawan Limited issued shares to Aditya Birla mutual funds on 01 January 2019 with a view to offer the same shares to public. At the time of issue by Company, the shares are fully subscribed by Aditya Birla mutual funds. After 3 months, Aditya Birla mutual funds offered the shares to public. Will it amount to Public Offer? Discuss the applicability of provisions of Chapter III Prospectus and Allotment of Securities Rules.
  - A. Yes, Since issue house has made offer within a period of 6 months, it amounts to public offer.
 

In order to constitute 'offer for sale', either of the two conditions must be satisfied -

    - a) Offer for sale to the public was made within 6 months after allotment or agreement to allot; or
    - b) Whole consideration had not been received by the company when offer to the public was made.
2. When does the issue of a prospectus amounts to an offer to public? In what cases shall a document containing an offer of sale of Shares / debentures be deemed as a prospectus?
  - A. Refer Similar Question 1 for answer
3. Explain the concept of "Deemed Prospectus" under the Companies Act, 2013. Point out the circumstances where under issuing such prospectus is not mandatory. (OLD PM, N15-4M)
  - A. *First write about Deemed Prospectus*

'Offer for sale', is not applicable if the following two conditions are satisfied -

    - a) Offer for sale to the public was made after 6 months of allotment or agreement to allot; and
    - b) Whole consideration had been received by the company when offer to the public was made.

**Q.No.9. Explain the concept of “Offer for sale” of shares by certain members of the Company. [Sec.28]**  
**(A) (NEW SM, OLD SM)**

**OFFER FOR SALE BY CERTAIN NUMBER OF MEMBERS [SEC.28]:**

- 1) **PROCEDURE FOR OFS:** If certain members of a Company propose to offer whole or part of their holding of shares to the public then they may consult the BOD of the Company and shall follow the prescribed procedure.
- 2) **DOCUMENT OF OFFER FOR SALE BE DEEMED AS PROSPECTUS:**
  - a) Any document by which the offer for sale of securities is made to the public (*for all purposes*) shall be deemed to be a prospectus issued by the Company and
  - b) all laws and rules relating to the:
    - i) contents of the prospectus; and
    - ii) liability in respect of mis-statements or omission in the prospectus;
 shall apply, as if such document is a prospectus issued by the Company.
- 3) **MEMBERS COLLECTIVELY AUTHORIZE THE COMPANY TO TAKE ACTION:** The members whose shares are proposed to be offered to the public shall -
  - a) collectively authorize the Company to take all actions in respect of offer of sale and
  - b) reimburse the Company all expenses incurred by the company on this matter.

**Note:**

- a) Offer for sale of securities (OFS) is commonly used by many companies to dilute promoter's holdings or to provide exit route to venture capitalists.
- b) It is different from IPO or FPO in the sense that under OFS securities are offloaded (sold) by earlier allottees through the issuer company.
- c) In OFS there is no change in the balance sheet of the company as no new capital comes into Company.

**SIMILAR QUESTIONS:**

1. Venture capitalists A, B, C have made investment in M/s Lakshmi Infra Ltd. which is a startup company. The Company successfully completed the project with the help of investments made by A, B, C. Now A, B, C has decided to quit the company. Advise venture capitalists as to sale of their investment in company.
- A. Venture capitalists can approach company to sell their investments with the help of company.
2. As per the Companies Act, 2013, any document by which the offer for sale of shares or debentures to the public is made shall for all purpose be treated as prospectus issued by the Company. Comment?
- A. Correct. Any document by which the offer of sale to the public is made shall be deemed to be a prospectus issued by the Company.

**Q.No.10. Explain the concept of “Shelf Prospectus” in the light of Companies Act, 2013. What is the law relating to issuing and filing of such prospectus?**

**(A) (NEW SM, OLD SM, OLD PM, N13 - 4M, N16 - 4M, MTP M18(N))**

**SHELF PROSPECTUS [SEC.31]:**

- 1) **DEFINITION:**
  - a) A shelf prospectus means a prospectus in respect of which
  - b) The securities or class of securities included therein are issued for subscription in one or more issues over a certain period
  - c) Without the issue of a further prospectus.
- 2) **FILING OF SHELF PROSPECTUS WITH THE ROC:**
  - a) Any class or classes of companies as prescribed by the SEBI may file a shelf prospectus with the ROC at the time of first offer of securities.
  - b) Shelf prospectus is valid for period of 1 year. The period of 1 year shall commence from the date of opening of the first offer of securities under the shelf prospectus.

- c) No further issue of prospectus is required in respect of a second or subsequent offer of securities included in such prospectus for a period of 1 year.
- d) Any change between current issue and previous issue is given in the form of information memorandum.

### 3) FILING OF INFORMATION MEMORANDUM:

- a) A company filing shelf prospectus shall be required to file an information memorandum containing all material facts relating to:
  - i) New charges created;
  - ii) Changes in the financial position of the Company as have occurred between
    - the first offer of securities or previous offer of securities and
    - the succeeding offer of securities.
  - iii) Other changes as may be prescribed.
- b) Information Memorandum shall be filed with the ROC prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

### 4) WITHDRAWAL OF APPLICATIONS: If a company or any other person has received applications for the allotment of securities along with advance payments of subscription before making of any such change,

- a) It should intimate to the applicant about the changes.
- b) Opportunity must be given to the applicant to withdraw his application, company or other person shall refund all the monies received as subscription within 15 days thereof.

### 5) Where an information memorandum is filed, such information memorandum along with the shelf prospectus shall be deemed to be a Prospectus.

#### SIMILAR QUESTIONS:

1. When a Company is required to issue a 'Shelf Prospectus' under the provisions of the Companies Act, 2013? Explain the provisions of the Act relating to the issue of 'shelf prospectus' and filing it with the ROC? (OLD PM)  
A. Refer the above answer.
2. What is a Shelf-Prospectus? State the important provisions relating to the issuance of Shelf-Prospectus under the provisions of Companies Act, 2013 [Nov 2018 (N) - (2+4=6)]  
A. Refer Point 1 & 2 in above answer.
3. Prakhar Ltd. intends to raise share capital by issuing Equity Shares in different stages over a certain period of time. However, the company does not wish to issue prospectus each and every time of issue of shares. Considering the provisions of the Companies Act, 2013, discuss what formalities Prakhar Ltd. should follow to avoid repeated issuance of prospectus? (RTP N18(N))  
A. Refer the above answer.

**Q.No.11. what is meant by 'Red-herring prospectus'? State the circumstances under which such prospectus is required to be filed with the ROC. What is the requirement relating to filing of final prospectus in such cases?** (A) (NEW SM, OLD SM, OLD PM)

#### RED HERRING PROSPECTUS [SEC 32]:

##### 1) MEANING:

- a) It means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
- b) *Number of shares is disclosed in Red Herring Prospectus with upper and lower price band*

##### 2) PROCEDURE OF ISSUE OF SECURITIES UNDER RED HERRING PROSPECTUS:

- a) A Company proposing to make an offer of securities may issue a RHP prior to the issue of a prospectus.
- b) A Company proposing to issue a RHP shall file it with the ROC at least 3 days prior to the opening of the subscription list and the offer.

- c) A RHP shall carry the same obligations as are applicable to a prospectus.
- d) Any variation between the Red Herring Prospectus and the final Prospectus shall be highlighted as variations in the prospectus.
- e) Once the offer for securities is closed, the details of information which are not included in the RHP are to be filed with the ROC and the SEBI. The final prospectus shall clearly state-
  - i) the total capital raised, whether by way of debt or share capital, and
  - ii) the closing price of the securities and
  - iii) any other details as are not included in the RHP

3) Red Herring Prospectus is also used in Book Building Process.

**SIMILAR QUESTION:**

1. M/s Kinley Ltd intends to issue securities to public through prospectus. While preparing Prospectus, the Company is unable to fix the price of shares that are offered to the public. Advise the company how M/s Kinley Ltd can fix the price with the help of Book Building Process?
- A. Refer the above answer.

## **MISSTATEMENTS IN PROSPECTUS**

*Mis-statement is the act of stating something that is false or not accurate. It could either be by commission or by omission or by both. Mis- statement of prospectus is a serious offence which attracts criminal liability u/s 34 and / or civil liability u/s 35.*

**Q.No.12. Explain the Criminal liabilities for Misstatements in Prospectus?**

**(A) (NEW SM, OLD SM, OLD PM)**

**NATURE OF CRIMINAL LIABILITY [Sec 34]:** Where a prospectus is issued, circulated or distributed, includes any statement which is-

- 1) untrue or misleading in form or context in which it is included, or
- 2) Where any inclusion or omission of any matter is likely to mislead.

**PUNISHMENT:** Every person who authorises the issue of such prospectus shall be liable u/s 447

**EXCEPTIONS (DEFENCE):** The person shall not be criminally liable if he proves that

- 1) that the statement or omission was immaterial
- 2) he had reasonable ground to believe that the statement was true, and he continued to believe up to the time of issue of the prospectus, that the statement was true or the omission was necessary.

**SIMILAR QUESTIONS:**

1. ACE Builders Ltd. issued a prospectus which contained mis-statements about the prospects of the company from a project to be undertaken with intent to defraud the applications for securities. Discuss the provisions of law relating to criminal liability for mis-statement in the prospectus under Section 34 of the Companies Act, 2013 (N18 (O) - 5M)
- A. Refer the above Answer 'Point A'
2. The prospectus of a company stated that the company had the experience of two and half decades in its line of business. In fact, the experience was not of the company itself but that of the partners of a firm which had been over by the company. Investors filed case on company that prospectus contain Misstatements. Comment.
- A. In this case, the management was held not liable for the untrue statement. It was held that there was no mala-fide intention behind the statement. The statement was not so materially false as to make the directors criminally liable.
3. A prospectus of a company contained a table showing that between the years 2011 to 2019 the company has paid dividends every year. This statement created the impression that the company was in sound financial position. In fact, the truth was that during these years the company had sustained substantial losses and the dividend could be paid only out of the funds accumulated in previous years. But this fact was not disclosed in the prospectus.
- A. It was held that the prospectus was false. In this case, there was false representation as the prospectus did not disclose the material fact.
4. When director is not liable to an aggrieved party for a misstatement in a prospectus? In what manner he can defend himself for non-compliance?
- (OLD PM)



A. Refer the above 'exceptions' in Criminal cases.

**Q.No.13. Explain the Civil Liabilities for Misstatements in Prospectus. (A) (NEW SM, OLD SM, OLD PM)**

**CIVIL LIABILITY [SEC 35]:**

- 1) **APPLICABILITY:** Section 35 is attracted if all the following conditions are satisfied
  - a) Prospectus includes any misleading statement; or omission of any matter in the prospectus which is likely to mislead; and
  - b) Applicant has subscribed the securities of the company on belief of such misstatement or omission of material fact; and
  - c) Applicant has suffered some loss as a consequence thereof.
- 2) **PERSON LIABLE FOR MISSTATEMENT:**
  - a) The company;
  - b) Every person who –
    - i) Is a director of the Company at the time of the issue of the prospectus,
    - ii) has agreed to become a director of the company (Proposed Director),
    - iii) Is a promoter of the Company,
    - iv) Has authorised the issue of the prospectus; and
    - v) Is an expert (referred in sec 26 of the Companies Act, 2013).
- 3) **PUNISHMENT:** Every person authorized such issue of prospectus shall be liable for payment of compensation to every person who has sustained any loss or damage.
- 4) **EXCEPTIONS:** A person shall not be liable under subsection (1) if he proves that-
  - a) consent to become a director was withdrawn before the issue of prospectus;
  - b) the prospectus was issued without his knowledge or consent AND on becoming aware of its issue, he gave a reasonable public notice of it;
  - c) 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 of 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.

**SIMILAR QUESTIONS:**

1. Who is an Expert? When is he liable for any Mis - Statement in the prospectus? When is an expert not liable for untrue statements in the prospectus issued by a company? (NEW SM, OLD PM, MTP M17 - 8M)
- A. Expert includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force; AND Write above answer
2. When director is not liable to an aggrieved party for a misstatement in a prospectus? In what manner he can defend himself for non-compliance? (OLD PM)
- A. Refer point 4 above
3. State the liability of an 'expert' in case of misrepresentation in the prospectus. When an expert will not be liable for untrue statement made in the prospectus?
- A. Refer above answer
4. Who is an expert for untrue statements in the prospectus issued by a Company? State the liability of an 'expert' in case of misrepresentation in the prospectus. When will an expert not liable for his untrue statements made in the prospectus?
- A. Refer above answer

(IMMEDIATELY REFER PRACTICAL QUESTION CRD 3, 4, 5, 6)



**Q.No.14. What are the penalties for fraudulently inducing a person to invest money?**

**(B) (NEW SM, OLD SM, OLD PM)**

**PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY [SEC 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—

- 1) Any agreement for acquiring, disposing of, subscribing for, or underwriting securities; or
- 2) Any agreement, the 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
- 3) Any agreement for obtaining credit facilities from any bank or financial institution,

Then such person shall be punishable for fraud u/s 447.

**Q.No.15. Write a short note on Punishment for Fraud (Sec. 447 of Companies Act)**

**WHEN FRAUD IS OF GREATER MAGNITUDE**

- 1) **NO PUBLIC INTEREST:** Any person who is found to be guilty of fraud (involving an amount of at least ten lakh rupees ( $\geq 10,00,000$ ) or 1 % of the turnover of the company, whichever is lower) shall be punishable with:
  - a) **Imprisonment:** Imprisonment for a term which shall not be less than 6 months but which may extend to 10 years **AND**
  - b) **Fine:** Shall also be liable to fine which shall not be less than the “amount involved in the fraud”, but which may extend to “3 times the amount involved” in the fraud.
- 2) **PUBLIC INTEREST:**
  - a) **Imprisonment:** Imprisonment for a term which shall not be less than 3 Years but which may extend to 10 years **AND**
  - b) **Fine:** Shall also be liable to fine which shall not be less than the “amount involved in the fraud”, but which may extend to “3 times the amount involved” in the fraud.

**WHEN FRAUD IS OF LEESER MAGNITUDE**

- 1) **FRAUD LESS THAN 10 LAKHS AND NO PUBLIC INTEREST:**
  - a) With imprisonment for a term which may extend to 5 YEARS or
  - b) With fine which may extend to 50 LAKHS or
  - c) With both.
- 2) **FRAUD LESS THAN 10 LAKHS AND PUBLIC INTEREST:**
  - a) **Imprisonment:** Imprisonment for a term which shall not be less than 3 Years but which may extend to 10 years **AND**
  - b) **Fine:** Shall also be liable to fine which shall not be less than the “amount involved in the fraud”, but which may extend to “3 times the amount involved” in the fraud.
- 3) The person liable u/s 447 shall continue to be liable for any other debt under this act or any other law for the time being in force (including repayment of any debt).

**NOTE:** “fraud” includes any act, omission, concealment of any fact or abuse of position 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.

- a) “Wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled.
- b) “Wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

**Q.No.16. State the remedies available against a Company to a subscriber for allotment of shares on the faith of a misleading prospectus. What conditions must be satisfied by such a subscriber before opting for the remedies?**  
**(A) (NEW SM, OLD SM, OLD PM)**

- 1) If a contract is induced by fraud then the contract becomes voidable at the option of the aggrieved party.
- 2) Investor can rescind the contract if all the following conditions are satisfied:
  - a) The Prospectus was issued by or on behalf of the company;
  - b) The Prospectus contained misrepresentation of facts;
  - c) The misrepresentation was material;
  - d) Investor must have subscribed the shares on the faith of the prospectus;
  - e) Investor must cancel the contract within reasonable time period.
- 3) **Loss of right of recession:** In the following cases right of recession will be lost
  - a) The investor has not rescinded the contract within the reasonable time period.
  - b) The company goes into liquidation before the investor has started the proceedings to rescind the contract.
  - c) The investors expressly or impliedly affirm the contract after become aware of the misrepresentation.
    - i) Attempts to sell shares
    - ii) Executes transfer of shares
    - iii) Pays call money
    - iv) Receives dividend
    - v) Attending General meeting and exercising voting rights at General Meeting.

**NOTE:** A subscriber to the MOA has no right to claim compensation as the Company itself is not in existence when he signed the MOA. Further he has not bought the shares based on the prospectus.

**SIMILAR QUESTIONS:**

1. State the remedies available to a person who has been deceived by a false and misleading prospectus. (M16 - 4M)
- A. Refer above answer.
2. 'A' purchased from 'S' 1000 shares of a company on the basis of prospectus containing wrong statement. What remedies are available to 'A' against the company?
- A. A shall have no remedy against the company; there being no privity of contract between 'A' and the company'.
3. A purchased certain shares in a company relying upon the statements in the prospectus. Subsequently, A came to know that representations made in the prospectus were false. However, he did not take any action for five months. Thereafter, he wanted to rescind the contract, and took steps to have his name removed from the register of members.
- A. The court refused to grant the relief to A. It was held that the unexplained delay of five months precluded him from obtaining the relief.
4. A, the secretary of a company, made a false representation to B about the position of the company, and induced him (B) to purchase shares of the company. Relying upon the representation, B purchased certain shares. On becoming aware about company's true position, B wanted to rescind the contract for the purchase of shares.
- A. The court refused to grant the relief to B, and observed that a secretary of the company had no general authority to make such representation.
5. Who has remedy against any misstatement in the prospectus? Can a person who did not subscribe to shares sue for mis-statement in the prospectus? What conditions must be satisfied by such a subscriber before opting for remedies?
- A. Refer above answer.

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 7, 8, 9, 10)**

## SECTION 2: QUESTIONS FOR ACADEMIC INTEREST – FOR STUDENTS SELF STUDY

**(MAY GET SOME MCQs. SO, STUDENTS NEED TO READ THE SAME ON THEIR OWN)**

**Q.No.1. Define the term Securities?**

**(C) (NEW SM, OLD SM)**

### **DEFINITION OF SECURITIES [SEC. 2(81)]:**

Securities means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

### **“SECURITIES” INCLUDE:**

- 1) 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;
- 2) Derivative;
- 3) Units or any other instruments issued by any collective investment scheme to the investors in such schemes;
- 4) Security receipt as defined in clause (zg) under section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- 5) Units or any other such instrument issued to the investors under any mutual fund scheme.
- 6) 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;
- 7) Government securities;
- 8) Such other instruments as may be declared by the Central Government to be securities; and
- 9) Rights or interests in securities; (E.g., Renouncement's)

**NOTE:** Securities however, shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938.

**Q.No.2. What are the golden rules (Or) Important rules for framing Prospectus?**

**(C)**

### **GOLDEN RULE FOR FRAMING PROSPECTUS:**

- 1) The prospectus must present the whole picture of the Company
- 2) The prospectus must disclose all material facts truly, honestly and accurately.
- 3) All facts are likely to influence the decision regarding applying for shares must be disclosed
- 4) The prospectus should not contain any untrue or misleading statement.

No fact should be omitted, the existence of which might, in any degree, affect the nature or quality of privileges and advantages disclosed by the prospectus [*Rex Vs Kysant*].

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 6)**

**Q.No.3. Explain in brief the concept of Class Action Suit. (B) or Write about actions that can be taken by affected persons u/s 34, 35 and 36? (Sec 37)**

**(NEW SM, OLD SM, OLD PM)**

- 1) Suit may be filed or any other action may be taken under sec 34 or sec 35 or sec 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

**2) CLASS ACTIONS – GIFT OF COMPANIES ACT, 2013:**

- a) 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.
- b) 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.
- c) 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.
- d) The benefit of these type of suits is that if several people have been injured by one defendant, each one of the injured people need not file a case separately but all of the people can file one single case together against the defendant.

**ADDITIONAL INFORMATION FOR ACADEMIC INTEREST:**

**BIRTH OF CLASS ACTIONS:** The need for these types of suits was first felt in the context of securities market during the time of Satyam Scam, where a large group of people were cheated regarding their hard-earned money invested in Stock Market. During that time, it was felt that it was not at all viable regarding cost effectiveness for a small stakeholder to file a case independently against the defendant. Millions of cheated investors during that time formed a large group and filed the case against the company, but since there was no available legal remedy or law which can actually support this type of litigation of a group filing charges, it became tough for those investors to take a recourse or gain advantage in the Indian Judicial System by this method.

Class action suits in India were so far filed under the guise of public interest litigations. Courts were free to dismiss these. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and had their claims rejected.

**TEST YOUR KNOWLEDGE**

1. M applies for share on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement under Section 37 of the Companies act, 2013?
- A. No, N cannot bring an action for rescission of the contract to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

**Q.No.4. Distinguish between shelf prospectus and Red-herring prospectus.**

**(B)**

Shelf prospectus	Red-herring prospectus
Company can make one or more issue of securities through shelf prospectus.	Company can make issue of securities once through red herring prospectus.
It is valid for period of 1 year.	It is valid for period of 90 days.
It contains price of securities to be offered.	It contains price band.
Generally, it is used in case of issue of securities by fixed price method.	It is used in case when securities are issued by book building method.

### SECTION 3: PRACTICAL QUESTIONS FOR CLASSROOM DISCUSSION

**Q.No.1.** The Board of Directors of Reckless Investments Limited, having registered office at Mumbai, has allotted equity shares to the 550 investors of the company without issuing a prospectus. As no prospectus was issued, nothing was delivered to the Registrar of Companies, Mumbai for filing. Explain the remedy available to the investors in this regard. **(NEW SM-TYK)**

**PROVISION:** According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Further, where the limit crosses 200 investors the issue shall be deemed to be a public offer, as provided by Section 42. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the delivery of the prospectus to the Registrar for filing before its issue.



**ANALYSIS AND CONCLUSION:** In the given case, the company has violated the above provisions and therefore, the allotment made by it is void. The company will be required to refund the entire moneys received and will also be punishable under section 26 (9).

**Q.No.2.** The Board of Directors of Chandra Mechanical Toys 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. **(NEW SM-TYK)**

**PROVISION:** 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 SEBI in consultation with the CG.

It is provided that until the SEBI specifies the information and reports on financial information under this sub-section, the regulations made by the SEBI under the SEBI Act, 1992, in respect of such financial information or reports on financial information shall apply.

According to Section 26 (1)(c), 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 SEBI Act, 1992 and the rules and regulations made thereunder.

**ANALYSIS AND CONCLUSION:** Accordingly, the Board of Directors of Chandra Mechanical Toys Limited which proposes to issue the prospectus shall provide such reports on financial information as may be specified by the SEBI in consultation with the CG to comply with the above stated provisions and make a declaration about such compliance.

**Q.No.3.** An allottee of shares in the Company brought an action against a director Q in respect of false statements in the prospectus. The director contended that the statements were prepared by promoters and he has relied on them. Is the director liable under the circumstances? Decide referring to the provisions of the Companies Act, 2013. **(NEW SM-TYK, OLD PM, RTP N14, N15, MTP M18 (N))**

**PROVISION:** Sec 34 and 35 of Companies Act, 2013 - Criminal & Civil liability for misstatements in prospectus.

- a) Director will not incur criminal liability for misstatements in a prospectus provided he proves that
- i) the statement or omission was immaterial
  - ii) He had reasonable ground to believe that the statement was true and he continued to believe up to the time of issue of the prospectus, that the statement was true or the omission was necessary
- b) A person shall not be liable under sub-section (1) if he proves that-
- i) consent to become a director was withdrawn before the issue of prospectus;
  - ii) the prospectus was issued without his knowledge or consent and on becoming aware of its issue, he gave a reasonable public notice of it.
  - iii) 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.

**ANALYSIS:** In the given case, the director contended that the statements are prepared by promoters and he had relied on them. Relying on the statement made by promoters is not a ground included in the above defenses.

Therefore, in the present case the director Mr. Q cannot hide behind the excuse on the ground that he had relied on the promoters for making correct statements in the prospectus.

**CONCLUSION:** Accordingly, Director Mr. Q shall be held liable.

**Q.No.4.** Sudarshan Exports Limited 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's report and number of trees in A.P. State. The report was found untrue. Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's 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. (NEW SM-TYK)

OR

X Company. Ltd, intended to buy a rubber estate in Peru. Its prospectus contained extracts from an experts' report giving the number of rubber trees in the estate. The report was inaccurate. Will any shareholder buying the shares of the Company. On the basis of the above representation have any remedy against the Company? Can the persons authorizing the issue of prospectus escape from their liability? (N09 - 5M)

OR

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-M20)

**PROVISIONS:** 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.

**ANALYSIS & CONCLUSION:** In the present case, Mr. Alok purchased the shares of Sudarshan Exports Limited on the basis of the expert's report published in the prospectus. Mr. Alok can claim compensation for any loss or damage that he might have sustained from the purchase of shares, which has not been mentioned in the given case. Further, Section 35 also mentions punishment prescribed by section 36 i.e. punishment for fraud under section 447.

**CIRCUMSTANCES WHEN AN EXPERT IS NOT LIABLE:** An expert will not be liable for any mis-statement in a prospectus under the following situations:

- a) It states that having given his consent, the expert withdrew it in writing before delivery of the copy of prospectus for filing [Section 26 (5)], or
- b) It states 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 [section 35 (2) (b)];
- c) An expert will not be liable in respect of any statement not made by him in the capacity of an expert and included in the prospectus as such;
- d) It states 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 [Section 35 (2) (c)].

**Q.No.5.** The prospectus issued by a company contained a false statement that B a very well- known successful businessman was on its Board of directors. C acting upon this statement applied to the company for its shares. D who did not rely upon this statement but on the basis of other information about the company given in the prospectus applied for its shares. C and D were allotted shares by the company E was a subscriber to the Memorandum of Association of the company. F bought the shares through the stock exchange later on. Each of them wants to know whether they can seek remedies for misstatement in the prospectus. Advise them



As per Section 35 of Companies Act, Where any person subscribes for securities on the basis of misleading statements or Inclusion or omission of any matter In the prospectus resulting in any loss or damages, then the company and every person who has authorized the issue of such prospectus or a director, promoter and the other, whosoever is liable shall have to compensate every person who has sustained such loss or damage.

The right to claim compensation for any loss or damage sustained by reason of any untrue statement In a prospectus is available only to a person who has "subscribed" for securities on the faith of the prospectus containing untrue statement.

A subsequent purchaser of shares in the open market has no remedy against the company or the directors or promoters. It has been held in Peek v. Gurney, subsequent transferee are not eligible for any claim against the company.

**RIGHTS OF THE PERSONS MENTIONED IN THE QUESTION ARE AS UNDER:** Mr. C shall be eligible to claim damages as he has purchased on the basis of prospectus & also relied upon the misstatement.

Mr. D shall not be entitled to claim damages as though he has bought through prospectus but he never relied on the misstatement.

Mr. E being a subscriber to memorandum did not subscribed through prospectus hence, he is also not entitled to claim any damages.

Mr. F bought the shares through stock exchange after the issue got completed. Hence, he is also not entitled to claim any damages as he did not relied on the misstatement & did not buy shares on the basis of prospectus.

**Q.No.6.** A Company issued a prospectus. All statements in a prospectus issued by X & Co. Ltd. were literally true, but it failed to disclose that the dividends stated in it as paid were not paid out of revenue profits, but out of realized capital profits. The statement that the Company had paid dividends for a number of years was true. But the Company had incurred losses for all those years, however, no disclosure of this was made in the prospectus. An allottee of shares wanted to avoid the allotment on the ground that the prospectus did not disclose this fact which, in his opinion, was very material. Would he succeed?

(NEW SM, OLD PM, RTP M18 (N&O), M17 - 4M, M15, M17)

**PROVISION:**

- If a prospectus includes any misleading statement; 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 incurs any loss as a consequence thereof then Section 35 is attracted
- The Companies Act, 2013 only provides punishment for Company and responsible persons but does not provide legal remedies to aggrieved persons.
- But the Indian Contract Act, 1872 provides various remedies for contracts induced by coercion, undue influence, misrepresentation, frauds or mistake, which covers the present case.
- In order to claim compensation u/s 35, the subscriber has to prove that he has suffered losses.

**ANALYSIS:** In the given case, nothing is mentioned regarding whether applicant has suffered any loss or damage due to mis-statement in prospectus.

The non-disclosure of the fact that dividends are distributed out of capital profits is a concealment of material fact because normally Company distributes dividend only from revenue profits except in certain circumstances.

Hence it is covered under material misrepresentation and consequence of such misrepresentation on the contract is governed by the Indian Contract Act, 1872.

**CONCLUSION:** Hence, in the given case the allottee can avoid the contract of allotment of shares.

**Q.No.07.** A prospectus states that B and M. two leading businessmen of repute, have agreed to become the Directors of the company. In fact both B and M had liked the idea of starting such a-company and also expressed their willingness to help the company, but had not agreed to be its Directors. Subsequently, B and M clarified their position by way of an advertisement in a newspaper. Can a subscriber rescind the contract of purchase of shares in the company after the issue of this clarification?

**PROVISION:** If there is mis-statement in a prospectus, and which had induced any shareholder to subscribe or purchase shares of the company, the shareholder may rescind the contract and also claim damages from the company of any loss sustained by him, as a prospectus must make a full disclosure of all material facts and must not conceal any material fact.

**ANALYSIS:** In this case, there was a mis-statement in the prospectus in the sense that both B and M had only agreed to help the company and not become its Directors. The prospectus was, therefore, misleading, and as such a subscriber, who was led to buying shares by seeing the names of B and M as Directors of the company, both of whom are known to be businessmen of repute, is entitled to withdraw his offer. He can rescind the contract of purchase of shares in the Company and claim damages for any loss sustained by him.

**CONCLUSION:** Yes, a subscriber can rescind the contract to purchase shares after clarification issued by B and M.

**Q.No.8.** A deceitful prospectus was issued by the directors on behalf of company. Pavan received a copy of it, but did not take any shares in the company. The allotment of shares to applicants was completed. Several months later, pavan bought shares from stock market. He proceeded with suit against the directors of the issue of deceitful prospectus. Will he succeed?

**PROVISIONS:** The right to claim compensation for any loss or damage sustained by reason of any untrue statement in a prospectus is available only to a person who has "subscribed" for shares or debentures on the faith of the prospectus containing untrue statement.

The word "subscribed" denotes that the shares were acquired directly from the company by allotment. A subsequent purchaser of shares in the open market has no remedy against the company or the directors or promoters.

**ANALYSIS AND CONCLUSION:** Mr. Pavan has purchased the shares from the stock exchange and he has not acquired shares directly from the company; hence he cannot claim damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement.

**Q.No.9.** A prospectus was issued on the basis of the report of an expert who examined the property purchased by the company. If such report contained false statements of facts which were relied upon by a shareholder, what will be his 'remedy'?

**PROVISION:** According to provisions of the Companies Act, 2013 where a prospectus contains an untrue statement purported to be made by an expert, such an expert is liable to compensate the allottee's for any loss that may be caused to them by reason of such untrue statement.

**ANALYSIS:** In the given problem, the prospectus was issued on the faith of the report of the expert and the report contained false statements of facts. Expert Statement made the prospectus misleading entitles the allottee's to claim compensation for loss suffered by them (if any) from the expert.

**CONCLUSION:** The shareholder is entitled to claim compensation from the expert.

**Q.No.10.** A company issued a prospectus advertising that the company has a great "potential turnover" of a million bags of cement in a year. It is discovered later that while the company did have the installed capacity of one million bags, it had never produced more than six lakh bags of cement in a year. Buyers of the shares seek remedy against the misleading statement to rescind the contract. Will they succeed? Explain with reasons.

**PROVISION:** If a contract is induced by fraud then the contract becomes voidable at the option of the aggrieved party then investor can rescind the contract if all the following conditions are satisfied:

- a) The Prospectus was issued by or on behalf of the company;
- b) The Prospectus contained misrepresentation of facts;
- c) The misrepresentation was material;
- d) Investor must have subscribed the shares on the faith of the prospectus;
- e) Investor must cancel the contract within reasonable time period.

**ANALYSIS AND CONCLUSION:** In the given case, company issued a prospectus advertising that the company has a great "potential turnover" of a million bags of cement in a year. It is discovered later that while the company did have the installed capacity of one million bags, it had never produced more than six lakh bags of cement in a year.

The term 'potential turnover' is only an expression of opinion of the company. It does not literally mean that a million bags have to be produced. Thus it cannot be termed as mis-statement and thus the buyers will not succeed.

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#### SECTION 4: PRACTICAL QUESTIONS FOR STUDENTS SELF PRACTICE

**Q.No.1.** 4000 copies of document in the form of prospectus were sent out and distributed among the members of certain gas companies only. Will it be referred as a prospectus issued to the public?

**PROVISIONS:** Any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate is treated as Prospectus [Sec 2(70)].

**REF CASE:** south of England natural gas and petroleum co. Ltd.

**ANALYSIS:** If a document inviting persons to buy shares is issued for example to all advocates, or to all doctors, or to all foreigners living in India, or to all shareholders in a particular company it will be deemed to be issued to the public within the meaning of the act.

**CONCLUSION:** Document so sent and distributed was a prospectus issued to the public, because public is general word and includes any section of the public

**Q.No.2.** An advertisement in Newspaper read as 'Some shares are still available for sale according to the terms of the prospectus of the Company which can be obtained on application', Is advertisement published in newspaper prospectus?

**PROVISIONS:** Any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate is treated as Prospectus [Sec 2(70)].

**REFERENCE CASE LAW:** Pramatha Nath Sanyal vs. Kali Kumar Dutt,

**ANALYSIS:** An Advertisement in a newspaper read as 'Some shares are still available for sale according to the terms of the prospectus of the Company which can be obtained on application'.

**CONCLUSION:** It was held to be a prospectus as it invited public to purchase shares.

**Q.No.3.** Managing director of XYZ Ltd, circulated several copies of a document marked as "strictly confidential" which contain particulars of proposed issue of shares to its client who further passed it on to a relation, information in document is not complete in relation to the public issue of shares. Later on, subscriber suffered a loss and seeks for compensation from company by reasons of omission in the document. Will he succeed?

**PROVISIONS:** Any notice, circular, advertisement, or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate is treated as Prospectus [Sec 2(70)].

**ANALYSIS AND CONCLUSION:** As per question, circulation was only made to a client after referring the document as "strictly confidential" hence there is no public issue. So no penalty would be attracted like of public issue.

**Q.No.4.** Karthik had subscribed for 1,000 Shares of a Company on the basis of a Prospectus which contain misleading statements. Karthik was allotted these, but after 2 months, he transferred them to Arun. Arun wants to avoid the further liability on the calls in respect of these shares on the grounds of misleading

statements in Prospectus. Is Arun's action valid?

**PROVISION:** Investor can rescind the contract if all the following conditions are satisfied:

- a) The Prospectus was issued by or on behalf of the company
- b) The Prospectus contained misrepresentation of facts
- c) The misrepresentation was material
- d) Investor must have subscribed the shares on the faith of the prospectus
- e) Investor must rescind the contract within reasonable time period

**ANALYSIS AND CONCLUSION:** In the above case, Arun acquired the shares only by transfer and not on the basis of the Prospectus. No remedy is available for a purchaser of Shares / Debentures from the secondary market. Arun cannot bring any action. [Peek vs Gurney] Hence, Arun cannot bring any action for rescission, on grounds of mis-statement in Prospectus.

**Q.No.5.** Modern Furniture limited was willing to purchase teakwood estate in Chattisgarh State. Its prospectus contained some important extracts from an expert report giving the number of teakwood trees and other relevant information in the estate in Chhattisgarh State. The report was found inaccurate. Mr. 'X' purchased the shares of Modern Furniture Limited on the basis of the above statement in the prospectus. Will Mr. 'X' have any remedy against the Company? When will an expert not be liable? State the provisions of the Companies Act, 2013 in this respect. (OLD PM)

a) **REMEDY OF MR. X AGAINST THE COMPANY:**

**PROVISION AND ANALYSIS:**

- i) If a prospectus includes any misleading statement; 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 incurs any loss as a consequence thereof then Section 35 is attracted
- ii) The Companies Act, 2013 only provides punishment for Company and responsible persons but does not provide legal remedies to aggrieved persons.
- iii) But the Indian Contract Act, 1872 provides various remedies for contracts induced by coercion, undue influence, misrepresentation, frauds or mistake, which covers the present case.
- iv) In order to claim compensation u/s 35, the subscriber has to prove that he has suffered losses. In the given case, nothing is mentioned regarding whether Mr. X has suffered any loss or damage due to mis-statement in prospectus.

**CONCLUSION:** Therefore he cannot claim any compensation against the Company or an expert.

b) **WHEN EXPERT IS NOT LIABLE:** An expert will not be liable for any mis statements in the prospectus under the following situations:

- i) **Section 26(5):** if having given his consent, he withdraw it in writing before delivery of the copy of prospectus for registration or
- ii) **Section 35(2):** if 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. An expert will not be liable for any statement not made him in the capacity of an expert and included in the prospectus as such.

**Q.No.6.** M applies for share on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement? Decide under the provisions of the Companies Act, 2013? (OLD PM, N08 - 4M)

**PROVISION:**

- a) As per sec 37 of the Companies Act, 2013 a suit may be filed or any other action may be taken u/s 34 or 35 or 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.
- b) Sec 19 of the Indian Contract Act, 1872 states that when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.



- c) Allotment of shares is a contract and such contract can be rescinded (or cancelled) if there is a mis-statement in prospectus (which is regarded as mis-representation).
- d) The prospectus and any statement therein have no legal binding either on the Company or its directors, promoters or experts to a person who has not purchased securities in response to it
- e) However, in the case of *Peek vs Gurney* it has been held that a purchaser of shares in the open market cannot be said to have been influenced by mis-representation in the prospectus.

**ANALYSIS:** In the given case N obtained shares from M through transfer and not contracted with the Company on the basis of prospectus containing mis-statement.

**CONCLUSION:** No, N cannot bring an action of rescission, on the ground of mis-statement as u/s 37.

**Q.No.7.** Peek Ltd. Company issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid shares of the Company in good faith on the stock exchange. Subsequently, the Company was wound up and the name of Mr. X was in the list of contributors. Decide:

Whether Mr. X is liable to pay the unpaid amount?

Can Mr. X sue the directors of the Company to recover damages? (OLD PM, M16 - 4M, RTP N17)

**AS PER PRACTICE MANUAL:**

- a) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining value of the shares. At the time of winding up he is liable as a contributory. The related case law in this subject matter is *Peak vs. Gurney*.
- b) No, X cannot sue the directors to recover damages for the misstatement in the prospectus. The shareholder must have relied on the statement in the prospectus in applying for shares offered by it to hold the responsible persons liable. If a person purchases shares in the open market, the prospectus is non-operative as far as he is concerned. In the present case, Mr. X purchased shares on the stock exchange even if he did so, on good faith he had not relied on the statement in prospectus.

**AS PER OUR OPINION:**

**ANALYSIS:** In the given case Mr. X obtained shares from secondary market and not contracted with the Company on the basis of prospectus containing misstatement.

**CONCLUSION:**

- a) Mr. X is liable to pay the unpaid amount on the shares.
- b) X cannot sue the directors to recover damages for the misstatement in the prospectus.

**Q.No.8.** XYZ Ltd issued a prospectus inviting the public for subscription of its equity shares stating in it that the Company possess good financial health and paying dividends to its equity Shareholders consistently and regularly @ 20% over the last five years. The fact was, Company was running in losses since the last three years and it was paying dividends to its shareholders out of accumulated profits. Mr. Amit read the prospectus and bought 500 shares from the Company. Discovering the misstatement made by the Company in the prospectus, he wants to rescind the contract and claim the damages from the Company.

Referring the provisions of Companies Act, 2013 decide whether Mr. Amit will succeed?

(M04 - 4 M, M13 - 4M, RTP M18)

**PROVISION:**

- a) If a prospectus includes any misleading statement; 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 incurs any loss as a consequence thereof then Section 35 is attracted
- b) The Companies Act, 2013 only provides punishment for Company and responsible persons but does not provide legal remedies to aggrieved persons.
- c) But the Indian Contract Act, 1872 provides various remedies for contracts induced by coercion, undue influence, misrepresentation, frauds or mistake, which covers the present case.
- d) In order to claim compensation u/s 35, the subscriber has to prove that he has suffered losses.

**ANALYSIS:** In the given case, nothing is mentioned regarding whether Mr. Amit has suffered any loss or damage due to mis-statement in prospectus.

The non-disclosure of the fact that dividends are distributed out of capital profits is a concealment of material fact because normally Company distributes dividend only from revenue profits except in certain circumstances.

Hence it is covered under material misrepresentation and consequence of such misrepresentation on the contract is governed by the Indian Contract Act, 1872.

**CONCLUSION:** Hence, in the given case the allottee can avoid the contract of allotment of shares.

**Q.No.9.** With a view to issue shares to the general public a prospectus containing some false information was issued by a Company. Mr. X received a copy of the prospectus from the Company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the Company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply; X sold these shares at a heavy loss. Mr. X claims damages from the Company for the loss suffered on the ground the prospectus issued by the Company contained a false statement. Referring to the provisions of the Companies Act, 2013 examine whether X's claim for damages is justified.  
(NEW SM - TYK, OLD PM, N06 - 4M, M17 - 4M, MTP M18 (N&O))

**PROVISION AND ANALYSIS:** Sec 2(70) of the Companies Act, 2013, "prospectus" means any document described or issued as a prospectus and includes a RHP (sec 32) or shelf prospectus (sec 31) or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

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

**CONCLUSION:** Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed. It was held in the case of *Peek vs Gurney* that the above mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus.

**Q.No.10.** Rahul purchased shares in a company on the basis of a prospectus which contained the name of certain persons as its Directors. Before the shares were allotted, some of these Directors retired. Rahul wants to withdraw his application for the purchase of shares. Can he do so?

**PROVISION:** if a prospectus contains a wrong statement, a person, making an offer to purchase shares on the basis of the prospectus, is entitled to withdraw his offer. Even if statement becomes untrue after the prospectus has been issued but before the offer to purchase shares is accepted, i.e., before the allotment is made, the offeree naturally gets the right to withdraw his offer.

**ANALYSIS:** In this case, before allotment was made in favour of Rahul by the company, the persons mentioned in the prospectus did not continue to be Directors consequent upon their retirement, as such Rahul gets the right to withdraw his offer of purchasing the shares in the company.

**CONCLUSION:** Yes, Rahul can withdraw his offer to purchase shares in the company. A prospectus must make a full, frank and honest disclosure of all material facts with scrupulous accuracy and no material facts should be concealed.

## SECTION 5: SECTION NUMBERS

CONCEPT	SECTION NO.
Definition of Prospectus	2(70)
Modes of Issuing Securities	23
Deemed prospectus	25
Matters to be stated in prospectus	26
Variation of objects referred to in prospectus	27



Offer for Sale	28
Issue securities in dematerialized form	29
Shelf Prospectus	31
Red herring prospectus	32
Criminal liabilities for mis-statement in prospectus	34
Civil liabilities for mis-statement in prospectus	35
Penalties for fraudulently inducing a person to invest money	36
Actions by affected person	37

## PENALTY

SECTION	PARTICULARS	PENALTY
Section 23	Public offer of securities by a Company without issuing a prospectus in contravention	No punishment prescribed u/s 23 As per sec.450, The Company and every officer of the Company who is in default shall be punishable with fine up to Rs.10,000 and where the contravention is continuing one, with further fine up to Rs.1000 for every continuing day.
Section 26- Matters to be stated in prospectus	If a prospectus is issued in contravention of provisions of Sec 26	Company, Every other person who is knowingly a party to default Company: Rs 50,000 to 3 Lac Other person who is knowingly a party to default <b>Imprisonment:</b> Max 3 Years or, <b>Fine:</b> Rs 50,000 to 3 Lac, or both
Section 33	Non-compliance of provisions of Abridged Prospectus	Company - Rs.50,000 for each default
Section 34	Criminal liability for misstatement in prospectus	Every person who authorizes the issue of misleading prospectus Punishable for fraud u/s 447
Section 35	Civil liability for misstatement in prospectus	Company and other specified persons Liable to <ul style="list-style-type: none"> <li>• compensate the Loss sustained</li> <li>• Punishable u/s 36</li> </ul>
Section 36	Fraudulently inducing the person to invest money	Any person Punishable for fraud u/s 447
Section 447- Punishment for Fraud	Section 447- Punishment for Fraud	Any person who is found to be guilty of fraud <ol style="list-style-type: none"> <li>Involving an amount of at least Rs 10 Lac or 1% of the turnover of the company, whichever is lower Fine: At least amount involved in the fraud, which may extend to 3 times the amount involved in the fraud, and Imprisonment: 6 months to 10 years Also, if fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.</li> <li>Where fraud involves an amount less than Rs 10 Lac or 1% of the turnover of the company, whichever is lower, and does not involve public interest, Fine: May extend to Rs 50 Lac Imprisonment: May extend to 5 years, or both</li> </ol>

## TIME - LIMITS

PARTICULARS	TIME – LIMIT
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Condition for deemed allotment u/s 25	sale to the public was made within six months after the allotment or agreement to allot
Validity period of shelf prospectus	maximum period of 1 year from the date of opening of the first offer
Validity period of a prospectus after its filing with ROC	Not more than 90 days after it was delivered to ROC.
Filing of RHP with ROC	at least 3 days prior to the opening of the subscription list and the offer

**THE END**

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