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# **CONCEPT OF PROSPECTUS AND ALLOTMENT OF SHARES IN A COMPANY: LEGAL DISCOURSE WITH REFERENCE OT THE COMPANIES ACT 2013**

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## **ABSTRACT:**

The establishment of a company necessitates huge investment of money and resources. Prospectus is the document which records the financial status of the company. This paper endeavours to define the term company, provides for types of company, it defines the term 'Prospectus', the contents of prospectus, the statements imperative for a valid prospectus and the liability of the Directors or officers of the company for fraudulent mis-statements in the prospectus. Further, this paper provides for the term 'share', the types of shares, the procedure for allotment of shares in public and private companies and the liability for any such default in the allotment of shares. The paper stipulates the statutory provisions and the judicial precedents in order to illustrate the concept of Prospectus and allotment of shares.

## **INTRODUCTION:**

Section 2(20) of Companies Act, 2013 defines the term “company” as: “company” means a company incorporated under this Act or under any previous company law.

Every Company requires huge capital to run it and therefore to fulfil its requirements, it invites peoples (investors) to invest in their venture. However no one wants to invest anything without consideration. Therefore the company provides consideration by giving a part of profit to the investors.

There are rules by which the company can appoint investors to invest, can use the invested money and save the rights of investors. This paper provides for these rules on investment and the rights of the shareholders.

## **TYPES OF COMPANY:**

There are two types of companies, namely, private and public. The definition of private company is provided in section 2(68) and that of a public company in Section 2(71) of the Companies Act, 2013 as under:

Section 2(68): "private company" means a company having a minimum paid-up share capital of one-lakh rupees or higher paid-up share capital as may be prescribed, and which by its articles,-

- (i) restricts the right to transfer its shares;
- (ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:-

Provided further that--

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in the employment and have continued to be members after the employment ceased,

shall not be included in the number of members; and

- (iii) prohibits any invitation to the public to subscribe for any securities of the company.

Section 2(71): "public company" means a company which-

- (a) is not a private company;
- (b) has a minimum paid-up share-capital of five lakh rupees or such higher paid-up capital, as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

## **WHAT IS PROSPECTUS?**

Section 2(70) of the Companies Act, 2013 defines the term Prospectus as:

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

## **SALIENT FEATURES OF A PROSPECTUS:**

A prospectus is issued to enable the investor to know the soundness of the company's venture. Explanation to Section 26(13) of the Companies Act 2013 provides that: The date indicated in the prospectus shall be deemed to be the date of its publication. Section 26(4) of the Companies Act 2013 provides that: before issuance of the prospectus, a copy of it shall be delivered to the Registrar of Companies of that State where the company is located, for registration, signed by director or proposed director or by his duly authorized attorney.

In *Pramath Nath Sanyal v. Kali Kumar Dutt*<sup>1</sup>, the company made an advertisement by means of a newspaper stating, "some shares are still available for sale according to the terms of the prospectus of the company which can be obtained on application".

The Court held that the advertisement constituted a prospectus because it invited the public to purchase shares. The directors were therefore penalized for not complying with the requirements of filing a copy thereof with the Registrar of Companies under Section 27(9) of the Companies Act, 2013. The prospectus shall be issued within 90 days of its delivery to the Registrar for registration, otherwise it becomes invalid. This is stated in Section 26(8) of Companies act, 2013. Section 25 of the Companies act, 2013 states that: 'every document containing offer of securities to the public shall be deemed to be a prospectus'.

## **CONTENTS OF PROSPECTUS:**

The contents of the prospectus have been specified in Section 26 of The Companies Act, 2013 as under:

1. names and addresses of the registered office of the Company, Company Secretary, chief Financial Officer, auditors, legal advisors, bankers, trustees, if any, underwriters and such other persons as may be prescribed;
2. date of the opening and closing of the issue and declaration about the issue of allotment letters and refunds within the prescribed time;
3. procedure and time schedule for allotment and issue of securities;
4. capital structure of the company in the prescribed manner;
5. minimum subscription amount;
6. main objects of public offer;

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<sup>1</sup> AIR 1925 Cal. 714.

7. main objects and present business of the company and its location;
8. how the amount to be payed should be stated in the prospectus.

### **WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED:**

The prospectus is not required to be issued:

1. if someone is a bonafide invitee to purchase shares or provide debentures to the Company;
2. if the shares or debentures are not offered to the public;
3. if shares or debentures are offered to existing shareholders or debenture holders;
4. if a prospectus is published as a newspaper advertisement, it is not required to specify the contents of memorandum, names of signatories to the memorandum or the number of shares subscribed by them;<sup>2</sup>

### **LIABILITY FOR FRAUDULENT MIS-STATEMENTS IN PROSPECTUS:**

There are civil as well as Criminal liabilities for the fraudulent misstatements in prospectus.

#### **Section 34: Criminal liability for mis-statements in prospectus:**

Where a prospectus, issued, circulated or distributed under this Chapter, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

Provided that nothing in this section shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable ground to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

#### **Section 35: Civil liability for mis-statements in prospectus:**

- (1) Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the

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<sup>2</sup> Section 27 of the Companies Act 2013.

company and every person who--

- (a) is a director of the company at the time of the issue of the prospectus;
- (b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- (c) is a promoter of the company;
- (d) has authorised the issue of the prospectus; and
- (e) is an expert referred to in sub-section (5) of section 26,

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage. (2) No person shall be liable under sub-section (1), if he proves--

- (a) 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; or
- (b) 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.

(3) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in sub-section (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

- The aggrieved party has to prove that company's members knew the statements of the prospectus to be false or had done concealment of some material fact. This was held in *Derry v. Peek*<sup>3</sup>.
- Secondly, in order to succeed for an action for fraud, the investor must have taken the securities directly from the Company and not from his any intermediary agency/ open market.

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<sup>3</sup> (1889) 14 AC 337.

## **POWER TO ISSUE SECURITIES BY PUBLIC AND PRIVATE COMPANIES:**

This is provided in section 23 of the Companies Act, 2013 as under:

### **Section 23: Public offer and private placement:**

- (1) A public company may issue securities--
  - (a) to public through prospectus (herein referred to as "public offer") by complying with the provisions of this Part; or
  - (b) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed, also with the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and regulations made thereunder.
  
- (2) A private company may issue securities--
  - (a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or
  - (b) through private placement by complying with the provisions of Part II of this Chapter.

Example--For the purposes of this Chapter, "public offer" includes initial public offer or further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus.

Public offer of securities to the public can be made by the company or for sale of securities by the existing shareholders, through issue of a prospectus.

The term "private placement" in Section 23 is defined in clause (ii) of Explanation II to section 42 of the Companies Act, 2013 as under:

"private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section.

## **WHO CAN BECOME MEMBER OF A COMPANY?**

Section 2(55) of the Companies Act defines this. It states:

“Every person who has subscribed in the memorandum and has been registered in the register of members of company or who has agreed in writing to become member of the company and whose name is entered in the Register of members; or every person who is holding shares of the company and whose name is entered as beneficial owner in the records of the depository, shall be deemed to be a member of the Company.

**SHARE:** The term share is defined in Section 2(84) of the Companies Act, 2013 as under. Section 2(84): "share" means a share in the share capital of a company and includes stock.

## **ALLOTMENT OF SHARES:**

The prospectus is issued to invite the public to invest in their company by purchasing securities. When any person subscribes or gives application for purchase of securities, it is an offer to the company. The company can either accept or reject that offer. The allotment of shares by the company is acceptance to the offer and the person to whom the shares are allotted is called allottee. Section 39 of the Companies Act provides provisions for allotment of securities.

### **Section 39: Allotment of securities by company:**

- (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.
- (2) The amount payable on application on every security shall not be less than five percent 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 regulation in this behalf.
- (3) If the stated minimum amount has not been subscribed and the sum payable of application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

- (4) Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed.
- (5) In case of any default under sub-section (3) or sub-section (4), the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

## **GENERAL PRINCIPLES FOR ALLOTMENT<sup>4</sup> OF SHARES IN A COMPANY:**

This section provides the general principles for allotment of shares in a company:

1. The allotment should be made by proper authority, i.e. the Board of Directors of the company or a committee authorized to allot shares on behalf of the board. Allotment made without proper authority shall be invalid.
2. The allotment of shares must be made within a reasonable time as stipulated in
3. Section 6 of the Indian Contract Act, 1872;
4. The allotment must be absolute and unconditional. This is stipulated in section 7 of the Indian Contract Act, 1872;
5. The allotment must be duly communicated. Posting of allotment letter shall be taken as a valid communication even if the letter is lost in transit. This is according to Section 4 of the Indian Contract Act, 1872.

## **STATUTORY RESTRICTIONS ON ALLOTMENT<sup>5</sup>:**

The provisions for statutory restrictions are contained in section 39 of the Companies act which provides as under:

1. Any person who wants to purchase securities of a company is required to fill an application form. The amount of application form shall not be less than 5% of the value of one share.
2. The minimum subscription amount shall be 90% of the entire issuance of shares.
3. There is a minimum subscription amount stated in the prospectus. The company cannot allot its shares to any applicant unless the minimum subscription amount is raised by it.

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<sup>4</sup> Paranjape, Dr. N.V., *The New Company Law, 2013* 167 (Central Law Agency, Allahabad, 2014 6<sup>th</sup> edn.)

<sup>5</sup> *Id* at 167-169.

4. Section 39(3): If the minimum subscription amount is not raised within 30 days of the issuance of prospectus, the Company shall refund the whole amount of application money and the amount subscribed by its prospective shareholders.
5. Section 39(4): Whenever a company having a sharecapital makes any allotment, it shall file with the Registrar a return of allotment.
6. Section 39(5): In case of any default under section 39(3) or (4), the company and its officers who is in default shall be liable for a penalty of Rs. 1000 for each day during which the default continues or Rs, 1 lakh, whichever is less.
7. If the minimum subscription amount is raised within the thirty days of issue of prospectus, then opening of the subscription list will take place in following manner:
  - (A) No allotment shall be made until the beginning of the fifth day of issue of prospectus;
  - (B) The companies which have issued statement in lieu of prospectus instead of prospectus for allotment of shares, shall not make any allotment until the expiry of three days from the date on which the statement in lieu of prospectus is filed with the Registrar of Companies.
8. The listing of shares in the stock exchange is made compulsory. the advantage of listing is that they are freely marketable and there is considerable increase in their face-value.

### **CONCLUSION:**

The provision of private placement, global depository receipt<sup>6</sup> (issue of depository receipts in any foreign country by passing it through special resolution of the company) and issue of bonus shares has been introduced by Companies Act, 2013. These amendments have been made to make the Act in consonance with modern requirements. In the Companies Act 2013, the concept of issue of prospectus and allotment of shares is made such that it provides required capital to the company for carrying out its venture and concurrently, it protects the rights of investors. These amended provisions on the prospectus and the allotment of shares in the Companies Act 2013 have not been revised by the Companies Amendment Act 2020, thus these provisions would continue in operation.

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<sup>6</sup>[http://www.mca.gov.in/Ministry/pdf/Companies\\_Act\\_1956\\_13jun2011.pdf](http://www.mca.gov.in/Ministry/pdf/Companies_Act_1956_13jun2011.pdf)