

- (2) A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer.
- (3) The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.
- (4) Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

Explanation - For the purposes of sub-sections (2), (3) and (4) "*red-herring prospectus*" means a prospectus which does into have complete particulars on the price of the securities offered and the quantum of securities offered.

- (5) Every variation as made and highlighted in accordance with sub-section (4) above shall be individually intimated to the persons invited to subscribe to the issue of securities.
- (6) In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock -invest or return of subscription paid.
- (7) The applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.
- (8) Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations. Or the particulars of withdrawing of offer or opportunity for cancelling the post-dated cheques or stock invest or stop payments for such payments shall be void and the applicants shall be entitled to receive a refund or return of its post-dated cheques or stock invest or stop payments for such payments shall be void and the application had never been made and the applicants are entitled to receive back their original application and *interest at the rate of fifteen percent* for the date of encashment till payment of realisation.
- (9) Upon the closing of the offer of securities, a final prospectus stating there in the total capital raised, where by way of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of a listed public company with the Securities and Exchange Board and Registrar, and in any other cases with Registrar only.

Abridged Form of Prospectus

Section 56(3), as amended by the Amendment Act of 1988, states that no application form can be issued for shares or debentures of a company unless it is accompanied by an abridged prospectus which complies with the requirements of the Act. However full prospectus is to be furnished on a request being made by any person before the closing of the subscription list.

The Central Government has prescribed on 13-10-91 the salient features of 'abridged prospectus'. For the purpose, Rule 4cc has been inserted in the *Companies (Central Government's) General Rules and Forms, 1956*. As per the rule the 4cc, the salient features required to be included in the 'abridged prospectus' shall be in "Form 2A". The abridged prospectus contains information very much similar to a 'Prospectus' in a concise and compact manner so that cost of public issue of capital may be reduced.

The abridged prospectus (in Form 2A) and the share application form should bear the same printed number. The investor may detach the share application form along the perforated line after he has had an opportunity to study the contents of the abridged prospectus, before submitting the same to the company or its designated bankers. The same procedure may be also followed while making available copies of the prospectus under Section 56 of the Act.

LIABILITY FOR MIS-STATEMENTS OR OMISSION IN A PROSPECTUS

Where an untrue or fraudulent statement occurs in a prospectus there may be-(a) civil liability, and (b) criminal liability. The liability for fraudulent or misstatement in a Statement in lieu of Prospectus is the same as in the case of prospectus.

Civil Liability

A person who has been induced to subscribe for shares in a company on the strength of misstatement or omission in the prospectus may have a remedy either against the company or against the promoters or directors or experts.

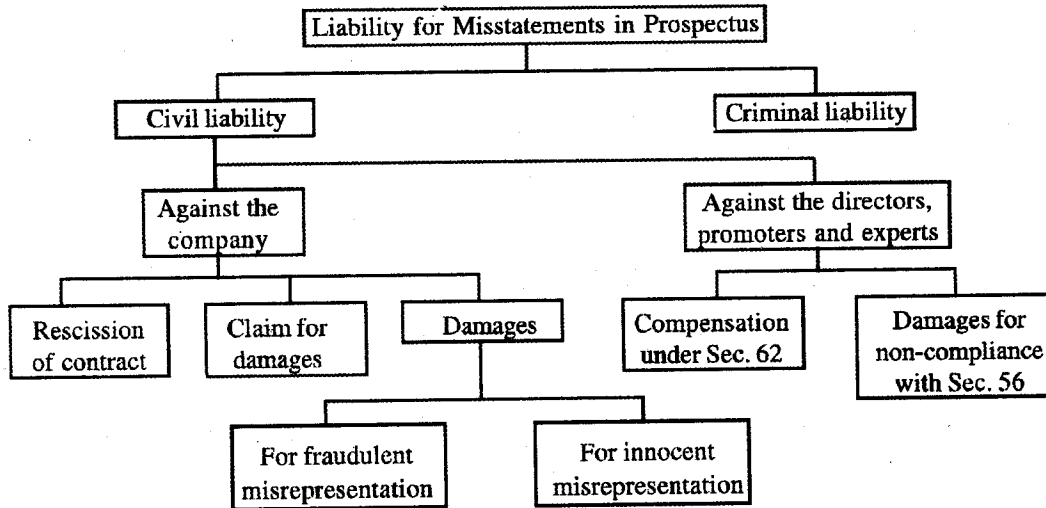
Remedies against the company : A person who has been induced to subscribe for shares may (a) *rescind the contract to take the shares*; (b) *claim damages*.

- (a) **Rescission of contract :** Where a person has purchased the shares of a company on the faith of a prospectus which contained an untrue or misleading, but not necessarily fraudulent statement, he can seek rescission of the contract i.e., *return the shares allotted to him get back his purchase money with interest and get his name removed from the register of members*. This remedy is available only to those persons who subscribed for any shares on the faith of the prospectus.
- (b) **Damages :** Any person induced by fraud to take up shares is entitled to sue the company for damages provided he has rescinded his contract in time. He cannot both retain the shares and get damages against the company. The company is liable in damages where the misrepresentation is an innocent one, unless it proves that it had reasonable grounds to believe.

Remedies against the directors, promoters and experts : Any person who has purchased shares or debentures on the faith of the prospectus containing the untrue statement may sue (a) every director; (b) every person whose name appeared in the prospectus as a proposed director; (c) every promoter; and (d) every person who authorised the issue of the prospectus; The aggrieved person may claim (1) compensation under Section 62; (2) damages for non-compliance with the requirements of Section 56; (3) damages under the general law.

Defences available to a director : A director may escape liability if he proves: (i) that the prospectus was *issued without his knowledge or consent* and that on becoming aware of its issue, he gave reasonable public notice to that effect; (ii) that after the issue of prospectus and before

allotment, he on becoming aware of the untrue statement in it, *withdrew his consent and gave reasonable public notice of the withdrawal* and the reasons for it; (iii) that he had *reasonable grounds to believe* and did believe upto the time of allotment of shares or debentures *that the statement was true*; (iv) that *he made the statement upon the authority of an expert whom he had reasonable ground to believe*; (v) that the statement was a correct and true copy of an official document.



Criminal liability of directors : Every person who authorised the issue of a prospectus containing an untrue statement shall be *punishable with imprisonment which may extend to two years or with fine which may extend to Rs. 5,000 or with both*. The accused person, however, may not be liable if he proves; (a) that the statement was immaterial, or (b) he had reasonable ground to believe and did believe upto the time of the issue of the prospectus that the statement was true. (Section 63). The punishment for issuing an application for shares or debentures which is not accompanied by a prospectus is a fine upto Rs. 5,000.

Minimum Subscription (Section 69)

Where the public company for the first time invites the public to subscribe for its shares, it cannot allot those shares until the minimum amount stated in the prospectus has been subscribed. This amount stated in the prospectus is known as the '*minimum subscription*'.

The minimum subscription is not a sum fixed by the articles or calculated as a percentage of the shares issued under the prospectus. It is the minimum amount stated in the prospectus which in the opinion of the directors must be raised in order to provide for : (a) the purchase price of any property purchased or to be purchased; (b) the preliminary expenses and any underwriting commission payable by the company; (c) repayment of money borrowed by the company in respect of any of the foregoing matters; (d) working capital; and (e) any other expenditure stating the nature and purpose thereof and the estimated amount in each case.

The object of the '*minimum subscription*' provision is to prevent the company getting underway until it has raised the capital needed to carryout the objects in which it has invited the public

to participate. This also affords protection to the creditors by ensuring that a limited company is not able to incur commitments if it is grossly under-capitalised.

All moneys received from applicant shall be deposited and keep deposited in a scheduled bank until minimum subscription has been received by the company. An allotment made in contravention of the restriction of the minimum subscription is not void but only voidable and the applicant may avoid the allotment within the time specified in Section 71(1).

Where such minimum subscription is not received by the company *within 120 days from the first issue of the prospectus*, all moneys received from applicants shall be returned within 130 days of the issue of the prospectus. On failure to pay, the directors shall be jointly and severally liable to *repay that money with interest at the rate of 12 per cent per annum.*[Sec. 69(5)].

As per the guideline the promoters should make their subscription in advance before the public issue opens and give a certificate to this effect to the regional stock exchange concerned. *The SEBI's guidelines* provides in this regard that companies will undertake in the prospectus, letters of offer, advertisement or publicity literature etc., to refund the amount at the end of 90 days from the date from the closure of the issue, if not subscribed up to 90% and to pay interest @ 15% p.a. if refunds are delayed by more than 10 days after this period.

The minimum subscription stated in the prospectus must be reckoned exclusively of any amount payable otherwise than in cash. *The amount payable on application on each share must not be less than five per cent of the nominal amount of the shares. All moneys received from applicants for shares are required to be deposited in a scheduled bank until the certificate to commence business is obtained.*

Underwriting Commission. [Section 76]

The Board of Directors enters into underwriting contracts with underwriters. When a company offers its shares to the public, it often wants that the whole issue should be taken up. Consequently a company is usually willing to pay a small commission on all the shares offered to the public to any one who undertakes to take up all the shares, that the public do not take. This is known as '*underwriting*'. It consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriters a commission on all shares, whether taken by the public or by the underwriters. It is, thus, *in the nature of an insurance against the possibility of inadequate subscription.*

Sec. 76 prescribes certain conditions subject to which underwriting may be paid. A company may pay a commission (called an *underwriting commission*) to any person in consideration of his subscribing or agreeing to subscribe for shares, or procuring or agreeing to procure subscription for any shares in the company. Underwriting commission may be paid only if the following conditions are satisfied.

1. The payment of the commission must be *authorised by the articles of association* The authority in memorandum is not sufficient. [*Republic of Bolivia Exploration Syndicate Ltd. (1914)*].
2. The Commission can be paid only on shares issued to the public.
3. The payment of commission must be strictly by way of '*Commission*' and not merely a device to issue shares at a discount.