PART III

PROSPECTUS AND ALLOTMENT, AND OTHER MATTERS RELATING TO ISSUE OF SHARES OR DEBENTURES

Prospectus

S. 55. Dating of prospectus.—A prospectus issued by or on behalf of a company or in relation to an intended company shall be dated, and that date shall, unless the contrary is proved, be taken as the date of publication of the prospectus.

NOTES

Eng. Act, 1948 : sec. 37.
Eng. Act, 1985 : sec. 63.

Previous Act of 1913 : sec. 92(1), (3).

Companies Act, 1956

The provisions relating to prospectus (sections 55 to 68) have been drafted largely on the lines of the sections 38 to 46 of the English Act, 1948 (English Act, 1985 secs. 56 to 63).

Similarly the sections (69 to 75) relating to allotment of shares are larger based on sections 47 to 52 of the English Act, 1948 (English Act, 1985 secs. 80 to 88).

As regards the details to be disclosed in a prospectus, they have been relegated to Schedule II in the same way as they have been relegated to Schedule IV in the English Act, 1948. (English Act, 1985, Schedule III).

§ For definition of 'prospectus' see section 2(36), *ante*.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Date of publication of prospectus

The date of publication of the prospectus must be contrasted with the date of issue of the prospectus. The date which appears on the prospectus will be assumed to be the date of publication of the prospectus. The date of issue is the date on which the prospectus first appears as an advertisement. This distinction must be kept in mind as the time limit in the various provisions relating to the prospectus commences from the two different dates.

[1][**S. 55A. Powers of Securities and Exchange Board of India.**—The provisions contained in sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207 so far as they relate to issue and transfer of securities and non-payment of dividend shall,—

(a) in case of listed public companies;

(b) in case of those public companies which intend to get their securities listed on any recognized stock exchange in India.

be administered by the Securities and Exchange Board of India; and

(c) in any other case, be administered by the Central Government.

Explanation.—For removal of doubts, it is hereby declared that all powers relating to all other matters including the matters relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares shall be exercised by the Central Government, [2][*Tribunal*] or the Registrar of Companies, as the case may be].

NOTES

Companies (Amendment) Act, 2000

This section has been inserted by the Companies (Amendment) Act, 2000 to provide that the specified provisions of the Act in the case of listed public companies and public companies which intend to get their securities listed, will be administered by the Securities and Exchange Board of India. In respect of other companies, the said provisions will continue to be administered by the Central Government through the Department of Company Affairs and ROCs.

The object of the changes made in this section and section 621 is "to provide that the Securities and Exchange Board of India be entrusted with powers with regard to all matters relating to public issues and transfers including power to prosecute defaulting companies and their directors" [*Clause (iv) of the Statement of Objects and Reasons* annexed to the Bill].

Section 55A as inserted by clause 16 of the Companies (Second Amendment) Bill, 1999 has been amended substantially to give effect to the recommendations of the Parliamentary Standing Committee.*

Recommendations of Parliamentary Standing Committe

Government's views.—Section 55A needs substnatial amendments to clarify the doubts expressed and issues raised by Securities & Exchange Board of India. The power to administer Company Law is conferred upon Department of Company Affairs by Allocation of Business Rules. Intention of 55A is not to create a separate Companies Act exclusively applicable to Public Listed Companies. The function of registering Prospectus (Section 60), Statement in lieu of Prospectus (Section 70), Return of allotment (Section 75) will continue to be with the Registrar of Companies.

Powers to hear petitions regarding issue of shares at a discount (Section 79), redemption of irredeemable preference share (Section 80A), extension of time for issue of shares/debentures certificates (Section 113) will require to be retained with the Company Law Board as SEBI is not a quasi-judicial body.

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1. Section 55A inserted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 16 (w.e.f. 13-12-2000).
2. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 9.**

* 64th Report on the Companies (Second Amendment) Bill, 1999.

Powers to decide applications submitted to the Central Government.—Further issue of shares on conversion of loan/debenture into equity [Section 81(3) & (4)], depreciation methods (Section 205) and power to make rule and prescribe Schedule will remain with Central Government. Thus, the above aspect needs to be incorporated by suitable amendment in Section 55A of the Companies (Second Amendment) Bill, 1999.

Committee's recommendation.—The Committee recommends that Clause 16 may be amended suitably as indicated by the Department of Company Affairs [*Para 16.18*].

Section 55A implements the above recommendations.

Administration of certain sections by SEBI

SEBI has been empowered to administer the provisions of the sections specified in section 55A in so far as they relate to three matters:

(i) issue of securities;
(ii) transfer of securities;
(iii) non-payment of dividend

Explanation to this section clarifies that powers relating to all matters other than the three specified above, which may relate to these sections, shall be exercised by the Central Government, or the Company Law Board, or the Registrar of Companies.

In the absence of authorisation, SEBI cannot enforce the provisions of the Companies Act. *Bank of Baroda v. SEBI,* (2001) CLC 714 : (2000) 26 SCL 532 (SAT).

Companies (Second Amendment) Act, 2002 [11 of 2003]

Powers under the section which were being exercised by the CLB before the effective date of the Companies (Second Amendment) 2002 (11 of 2003) will become vested in the Tribunal after the enforcement of the (Second Amendment) Act, 2002 (11 of 2003). Notes on Clauses are reproduced :

Notes on clauses.—This clause seeks to amend sections 18, 19, 43, 49, 55A and 58A of the Companies Act, 1956 relating to alteration of memorandum of association to be registered within three months, effect of failure of such registration, consequences of default in complying with conditions constituting a company as private company, investments of company to be held in its own name, powers of Securities and Exchange Board of India so far as they relate to issue and transfer of securities and acceptance of deposits without issuing advertisement. It is proposed to confer the powers of the Company Law Board in the aforesaid sections upon the Tribunal. These amendments are of consequential nature. (*Clause* 8 of the Companies (Amendment) Bill, 2001).

Listed Public Company

Clause (23A) of section 2 inserted by the Companies Amendment Act, 2000 defines 'listed public companies' as "a public company which has any of its securities listed in any recognised stock exchange".

§ See Notes under relevant sections.

Companies intending to get listed

SEBI has no jurisdiction over companies which are not listed and which have not even applied to a stock exchange. An application to a stock exchange may show an intention to get listed and SEBI may acquire jurisdiction over such company. The application for exercise of SEBI jurisdiction was rejected because the applicants were not able to produce even a resolution of the Board of directors contemplating enlistment. The Bombay High Court pointed out that grievances of shareholders in such cases can be looked into by the Central Government under s. 55A(c) read with s. 237. The company in this case had offered to buy back shares which were allotted at a premium. The offer was to take back the shares from small investors at a price less than the allotment price but with interest. The court said that by this reason it became a purely commercial transaction. There was no

case for invoking the writ jurisdiction of the court. *Kalpana Bhandari v. SEBI,* (2003) 56 CLA 167 (Bom).

S. 56. Matters to be stated and reports to be set out in prospectus.— (1) Every prospectus issued—

(a) by or on behalf of a company, or

(b) by or on behalf of any person who is or has been engaged or interested in the formation of a company,

shall state the matters specified in Part I of Schedule II and set out the reports specified in Part II of that Schedule; and the said Parts I and II shall have effect subject to the provisions contained in Part III of that Schedule.

(2) A condition requiring or binding an applicant for shares in or debentures of a company to waive compliance with any of the requirements of this section, or purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus, shall be void.

(3) No one shall issue any form of application for shares in or debentures of a company, unless the form is accompanied [1][by a memorandum containing such salient features of a prospectus as may be prescribed[2]] which complies with the requirements of this section:

[3][*Provided* that a copy of the prospectus shall, on a request being made by any person before the closing of the subscription list be furnished to him:

Provided further that] this sub-section shall not apply if it is shown that the form of application was issued either—

(a) in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures; or

(b) in relation to shares or debentures which were not offered to the public.

If any person acts in contravention of the provisions of this sub-section, he shall be punishable with fine which may extend to [4][*fifty thousand rupees*].

(4) A director or other person responsible for the prospectus shall not incur any liability by reason of any non-compliance with, or contravention of, any of the requirements of this section, if—

(a) as regards any matter not disclosed, he proves that he had no knowledge thereof; or

(b) he proves that the non-compliance or contravention arose from an honest mistake of fact on his part; or

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1. Subs. by the Companies (Amendment) Act, 1988, (w.e.f. 31-5-1991) *vide* GSR dated 31-5-1991, for the words "by a prospectus".
2. See Form 2A under Companies (Central Govt's.) General Rules & Forms, 1956 inserted *vide* GSR 214(E), dated 3-10-1991 (w.e.f. 1-11-1991) *vide* Rule 4CC of the Rules read with Chapter VI, section I of SEBI (DIP) Guidelines, 2000.
3. Subs. by the Companies (Amendment) Act, 1988, (w.e.f. 31-5-1991) *vide* GSR dated 31-5-1991, for the words "provided that".
4. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 17 (w.e.f. 13-12-2000).

(c) the non-compliance or contravention was in respect of matters which, in the opinion of the Court dealing with the case, [5][were immaterial] or was otherwise such as ought, in the opinion of that Court, having regard to all the circumstances of the case, reasonably to be excused:

Provided that no director or other person shall incur any liability in respect of the failure to include in a prospectus a statement with respect to the matters specified in clause 18 of Schedule II, unless it is proved that he had knowledge of the matters not disclosed.

(5) This section shall not apply—

(a) to the issue to existing members or debenture-holders of a company of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant for shares or debentures will or will not have the right to renounce in favour of other persons; or

(b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange;

but, subject as aforesaid, this section shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently.

(6) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or under this Act apart from this section.

NOTES

Eng. Act, 1948 : Sec. 38. Previous Act : Secs. 93 (1), 93(4).
Eng. Act, 1985 : Secs. 56, 57 and 66.

Companies (Amendment) Act, 1988

Abridged form of prospectus.—Earlier, the application form for issue of shares was required to be accompanied by a full prospectus. The Amendment Act of 1988 permits a company to furnish along with the application for shares/debentures an abridged form of prospectus, instead of the full prospectus, which however, is to be furnished on demand. (See clause 8 of *Notes on clauses*). The abridged prospectus *i.e.* the memorandum containing salient features of the prospectus accompanying the application forms, shall be as per rules prescribed by the Central Government in this behalf. It is, however, open to a company to attach full prospectus along with the application forms.

Companies (Amendment) Act, 2000

(1) 'Abridged prospectus' defined.—The expression "Abridged prospectus" has been defined in sec. 2(1) to mean a memorandum containing such salient features of a prospectus as may be prescribed.

(2) Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

(3) Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of

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5. The words "were immaterial" were substituted for "was immaterial" by the Repealing and Amending Act (LII of 1964), s. 3 and Sch.

account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

(4) SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

(5) Penalty Enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5,000 rupees to 50,000 rupees. Sub-section (3) was accordingly amended.

Control over Capital Issues etc. by Securities and Exchange Board of India (SEBI)

Issue of capital by companies was, formerly, regulated by the Central Government under the Capital Issues (Control) Act, 1947. The control was exercised through the office of the Controller of Capital Issues, in the Ministry of Finance. With the setting up of the Securities and Exchange Board of India (SEBI), the Capital Issues (Control) Act was repealed by an Ordinance No. 9 of 1992 on 29-5-1992 (subsequently replaced by an Act of Parliament), and the office of the Controller of Capital Issues was also abolished. The issues of securities, *i.e.* shares (including rights and bonus issues) and debentures now is regulated by SEBI.

Certain powers under the Securities Contracts (Regulation) Act, 1956 have also been entrusted to SEBI for regulating the dealings in securities on the Stock Exchange and outside the Stock Exchange. These, *inter alia,* are the following:

Section 6	:	Calling of periodical returns from recognised Stock Exchanges, inspection of their books of accounts and direct enquiries to be made.
Section 10	:	Power to make or amend bye-laws of recognised Stock Exchanges.
Section 13A	:	Approval for establishing additional trading floors.
Section 17	:	Licensing of dealers in Securities in certain areas.

Besides, section 29A of the Securities Contracts (Regulation) Act, 1956 provides for further powers thereunder to be delegated to SEBI by the Central Government.

Administration of functions and powers laid down in the Companies Act, 1956

In respect of listed companies and companies which intend to get listed on the Stock Exchange(s), SEBI has been authorised to administer the functions contained in sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207.

Administration of functions and powers under the Depositories Act, 1996

SEBI has been entrusted with certain regulatory functions under the Depositories Act, 1996 which, *inter alia,* are the following :

Section 3	:	Issue of certificate of commencement of business by a Depository.
Sections 18 and 19	:	Power to call for information and for enquiry, and power to give directions to the Depositories, *inter alia,* to safeguard the interest of investors and for orderly development of securities market.
Section 22	:	Launching of prosecution for violation of the provisions of the Depositories Act.
Section 25	:	Power to make Regulations to carry out the purposes of the Depositories Act.
Section 26	:	Power to direct the Depository to make, amend or repeal its bye-laws.

Guidelines, Rules and Regulations etc. issued by SEBI under the SEBI Act

SEBI had issued Guidelines for Disclosure and Investor Protection on 11-6-1992 for observance by companies making public issue of shares and debentures (fully converti-

ble, partially convertible or non-convertible) as also rights and bonus issues. Subsequent to the issue of the said Guildelines, several clarifications (up to Serial No. XXVII) were also issued by SEBI on various aspects of the Guidelines. Under the Guidelines issued by SEBI, companies going in for public issue were divided into three categories, *viz.* new public companies, existing listed public companies and closely held/unlisted public companies, for regulatory purposes in regard to pricing of issues *etc.* The Guidelines for Disclosure and Investor Protection, it was clarified by SEBI, *vide* its erstwhile Clarification No. III, dt. 13-08-1992, did not apply to the issue of securities for raising of share capital or debentures and/or for rights or bonus issues by existing private/closely held and other unlisted companies, which were not going in for public offering and listing of their securities on the Stock Exchange.

The Guidelines dt. 11-6-1992 alongwith Clarifications thereto upto Clarification No. XXVI as also RMB (GI) Series circulars and other guidelines issued from time to time, have been replaced by Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, *vide* SEBI's RMB (Compendium) Series Circular No. 1 (1999-2000), dt. January 19, 2000; and subsequent circular No. 2 (1999-2000), dt. February 16, 2000; DIP (Compendium) Circular No. 3, dt. August 4, 2000 and Circular No. 4, dt. September 6, 2000 and they have to be read alongwith SEBI's clarification XXVII, dt. 26-11-1999. These Guidelines are applicable to : (i) all public issues by listed and unlisted companies, all offers for sale and rights issues by listed companies whose equity share capital is listed, except in case of rights issues where the aggregate value of securities offered does not exceed Rs. 50 lakhs, and (ii) unless otherwise stated, the provisions applicable to public issues by unlisted companies shall also apply to offers for sale to the public by unlisted companies. [*Para 1.4*].

The Guidelines issued by SEBI do not waive the compliance of the provisions of the Companies Act and other relevant laws as may be applicable to the issue of shares and/or debentures. With a view to provide greater degree of accountability and for safeguarding the interest of the investors, various Rules and Regulations have also been issued under the SEBI Act for observance by the various functionaries in the Capital Market, *e.g.* the Merchant Bankers, Registrars and Share Transfer Agents, Debenture Trustees, Underwriters, Bankers to the Issue, Portfolio Managers, Stock Brokers, sub-brokers and other intermediaries, *etc.*

SEBI has also issued Rules and Regulations to regulate the functioning of Mutual Funds, Asset Management Companies, Foreign Institutional Investors, Venture Capital Funds, Foreign venture Capital Investors, Depositories apart from Rules and Regulations in regard to Insider Trading, Substantial Acquisition of Shares and Takeovers, Buy-Back of Securities, Collective Investment Schemes, and for prevention of fraudulent and unfair trade practices.

§ For the Full text of SEBI (Disclosure and Investor Protection) Guidelines, 2000, Clarification No. XXVII, dated 26-11-1999 and RMB (GI) Series Circulars etc. as also the various Rules and Regulations issued by SEBI, see *Appendices* 151 to 245.

Section 11-A inserted in SEBI Act by SEBI Amendments Act, 2002 (w.e.f. 29-10-2002) empowers SEBI to regulate or prohibit issue of prospectus/offer document, or advertisement soliciting money for issue of securities. SEBI can specify—

(i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and

(ii) the manner in which such matters shall be disclosed by the companies;

It can by general or special orders—

(i) prohibit any company from issuing of prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;

(ii) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

SEBI's power to grant exemption from DIP Guidelines

SEBI may grant exemption from the application of any particular provision(s) of these guidelines:

(a) on an application made by any listed company or intermediary connected with the issue;

(b) of a technical violation or a possible technical violation; or,

(c) on being satisfied that the violation was caused or may be caused due to factors beyond the control of the applicant. [*Clause 17.2A.1*] [*Ins. by RMB (Compendium) Series Circular No. 9, dt. 2-5-2003*].

Consequence of Repeal of the Capital Issues (Control) Act [CIC Act]

The consequence of the repeal of the CIC Act is that the said Act is deemed to have existed only for those actions which were commenced, prosecuted and concluded. The repeal of the said Act, however, does not affect any action taken, any right, privilege, obligation or liability acquired, accrued or incurred, any penalty, forfeiture or punishment incurred in respect of offences committed under the said statute and investigation, legal proceedings or remedy in respect of the above-said. See *Sylhet Co-operative Central Bank Ltd. v. Dhirendra Nath Dey,* (AIR 1956 Assam 166).

Judicial review of erstwhile CCI administrative orders.—The terms and conditions on which the CCI (now abolished) approved a public issue were binding on the company. The court did not have proper power to modify them. An order of the CCI which on the face of it appeared to have been passed by application of mind could not be set aside by the court. *N. Parthasarthy v. CCI,* (1991) 72 Com Cases 651 : AIR 1991 SC 1420.

The Director-General under the MRTP Act filed a complaint before the Monopolies Commission that the company issued and allotted debentures in violation of the order of permission granted by CCI (now abolished). An interim order by the Commission against an unfair trade practice was held to be within the jurisdiction of the Commission. A writ petition against the interim order was not allowed. The writ was also found to be out of territorial jurisdiction and *mala fide. Sushil Kumar Dalmia v. MRTP Commission,* (1994) 79 Com Cases 568 (Cal).

Injunction to safeguard Prospectus against adverse criticism

The right of a newspaper by publishing an article to question the validity of a mega debenture issue passed by the Controller of Capital Issue and which was oversubscribed, was restrained by an interim injunction by the Supreme Court. The injunction was, however, subsequently vacated on the ground that such a restraint would be a deprivation of freedom of speech granted by Article 19(1)(a) of the Constitution. On a balance of convenience the Supreme Court felt that the adverse comments were not likely to frighten the subscribers to such an extent that they would withdraw their applications. *Reliance Petrochemicals Ltd. v. Indian Express Newspapers (Bombay) P. Ltd.,* (1989) 66 Com Cases 577 : AIR 1989 SC 190.

Prospectus—meaning.—Prospectus as defined in section 2(36) means "any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate". Section 67 provides that any reference in the Act or in the articles of the company to offering shares or debentures to the public shall be construed as offering them to any section of the public whether selected as members or debenture-holders of the company concerned or as clients of persons issuing prospectus or in any other manner; and invitations to the public to subscribe for shares or debentures shall be construed as including references to invitations to subscribe for them extended to any sections of the public, whether selected as members or debenture holders of the company concerned, or as clients of the person issuing the prospectus or in any other manner. By sub-section (3) of S. 67 no offer or invi-

tation shall be treated as made to the public, if the offer or invitation may properly be regarded, in all circumstances as not calculated to result directly or indirectly in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or the offer or invitation is otherwise a domestic concern of the persons making and receiving the offer or invitation.

Prospectus is defined as a document described or issued as a prospectus and includes several other documents inviting offers from the public for subscription to shares or debentures. It is doubtful whether a television or film advertisement, as distinguished from radio which appeals to the ear and not to the eye, may be treated as falling within the definition of prospectus, the definition of document in section 3(18) of the General Clauses Act notwithstanding.

Written invitation or offer of sale—whether prospectus.—A written invitation designed to induce persons invited to submit requests for purchasing or subscribing purchases will be a prospectus if it invites subscription or purchase for cash. *Government Stock and other Security Investment Co. Ltd. v. Christopher,* (1956) 1 All ER 490 : (1956) 26 Com Cases 210. An offer or invitation may be treated as made to the public if it is calculated to result directly or indirectly in the securities being made available for subscription or purchase by persons other than those receiving the offer: a mere offer made by a person holding shares proposing to dispose them of is however not a prospectus. A provisional letter of allotment is however not a prospectus because it purports to allot securities to the recipient. In reality such allotment is merely an offer which becomes effective when it is accepted. Where the recipient renounces his right in favour of another person, he clearly shows that he accepted the securities offered to him and by renouncing he assigns the benefit of the contract which already exists between him and the company. The renouncee does not subscribe for the securities; he acquires title to them by purchase. Therefore, if only the person to whom the offer is made may accept the offer and cannot renounce it, the letter of offer is not a prospectus.

Scope of section

Issue of prospectus, when obligatory.—It is obligatory to issue a prospectus, containing the prescribed particulars, except when the share are not offered to the public, or when the shares are offered to existing shareholders as rights issue, or when the issue relates to shares which are in all respects uniform with shares previously issued and quoted in a stock exchange. See section 56(5). In case of a rights issue, without any right to renounce and in which the shares remaining unsubscribed by the existing shareholders, are not to be offered to the public, an offer made by the brokers may not be regarded as an offer to the public, having regard to the provisions of section 67(3).

Offer of shares to the public without complying with the provisions of this section is a violation. Thus in a case before the Calcutta High Court a newspaper advertisement stated that some shares were still available for sale according to the terms of the prospectus of the company which could be obtained on application. This was held to be a prospectus. It invited the public to purchase shares and the directors were convicted for not complying with the requirements of S. 60(5). *Pramatha Nath Sanyal v. Kali Kumar Dutt,* AIR 1925 Cal 714.

Where a company sends circulars to dealers and agents numbering 50 or more for subscription in the share capital of the company, such circular would amount to inviting subscription from the public for subscription to its shares and will require registration of prospectus. See section 67.

When prospectus is not required to be issued

It would appear that the issue of a prospectus is not necessary in the following cases :

(1) When shares or debentures are offered to existing holders of shares or debentures [sub-section (5)].

(2) When the issue relates to shares or debentures uniform in all respects with shares or debentures previously issued and dealt in or quoted in a recognised stock exchange [sub-section (5)].

(3) Where a person is *bona fide* invited to enter into an underwriting agreement [sub-section (3)].

(4) Where shares are not offered to the public *e.g.* when shares are placed privately to less than 50 persons [see sec. 67(3) proviso] [sub-section (3)].

Department's views.—In view of section 56(5)(a) of the Companies Act, 1956, the issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require the issue or registration of a prospectus. (*Circular Letter No.* 8/81/56-PR, dated 4-11-1957). The offer of further shares with right of renunciation is a domestic concern of the persons receiving the offer and renouncing the offer and is not made by the company with intent to make a public offer and, therefore, the letter of offer to shareholder with right of renunciation does not require registration with the Registrar of Companies.

'Issued', "Issued to the public"

Section 56 applies only when a prospectus has been issued. The word 'issue' here obviously means issued to the public which further means issued generally and not merely to a set of selected persons. Section 2(22) says that 'issued generally in relation to a prospectus means issued to persons irrespective of their being existing members or debenture-holders of the body corporate to which the prospectus relates. Section 67 also says that the word 'public' shall include any section of the public whether selected as members or debenture-holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. These statutory provisions are a reflection of the fact that the expression 'offer to the public' cannot be definitely defined and it would always be a question of fact whether there has been a sufficiently general distribution of the prospectus so as to constitute an issue to the public. In *Nash v. Lynde,* (1929) AC 158, it was pointed out that there should be such publicity that everybody who chances to lay his hand upon a copy of the prospectus should have the right to apply even if the very first person closes any further subscription by himself subscribing for all the proffered shares (For further details, see Notes under section 67).

Note that the definition, includes any document described or issued as a prospectus.

Where a prospectus carried the remark 'for private circulation only' and was addressed to the members of certain gas companies only, it was held to be a public issue. *South of England Natural Gas & Petroleum Co., Re,* (1911) 1 Ch 573.

When a rights offer is made to the shareholders or debenture holders with a right to renounce, it will be treated as an offer to the public in certain circumstances. See in this regard PENNINGTON'S COMPANY LAW, 4th Edn., pages 219 and 220. The function of s. 56(1) is only to make it obligatory to issue prospectus except in the instances provided by clauses (a) & (b) of sub-section (5). When shares or debentures do not provide any right of renunciation and such shares or debentures remain unsubscribed, or not taken up by shareholders or debenture-holders to whom they are offered and the same are offered by the brokers of the company to certain persons only, without making a general offer to the public, the offer by the brokers will not be deemed to be an offer or invitation to the public. Such an offer or invitation made by the brokers cannot, in view of the terms of s. 67(3), be regarded as an offer to the public because the under-subscribed shares or debentures will only be allotted to those persons to whom the brokers have made an invitation or offer.

Where the issue is made to existing holders of shares or debentures, much will depend on whether the letters of allotment which the company issues are renounceable or non-renounceable. In the latter case it cannot normally be said that the offer is "calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving" the offer, and, consequenlty, the offer is not to the public. Where the company issues renounceable letters of allotment, the circle of original allottees can easily be broken by renunciation of those rights and com-

plete strangers may become the allottees; here the offer will normally be held to be made to the public. *Cf.* PALMER'S COMPANY LAW p. 5109 (25th Edn., 1992 Para 5.510). Where the offer was restricted to the members of a credit union, it was held to be not an offer to the public. *Corporate Affairs Commission v. Australian Central Credit Union,* 1986 LRC (Comm) 605.

Where an issuing house places the whole or part of a new issue privately with a few institutional investors, such as pension funds, which have agreed to hold the securities as long-term investments, the issue would not appear to be made to the public. Where a business is converted into a company and shares are offered to a small circle of friends, relations, or to selected customers or suppliers, the offer is not made to the public. "In such cases it is common to announce publicly that 'none of the shares will be offered to the public, the whole having been taken up by the vendors and their friends and customers.'" An offer by a promoter to a few of his friends, relations or customers has been held not to be an offer to the public. *Sherwell v. Combined Incandescent Mantles Syndicate,* (1907) WN 110.

In *Government Stock and Other Securities Investment Co. Ltd. v. Christopher,* (1956) 1 All ER 490, WYNN-PARRY J. considered whether an offer was made to the public in circumstances where the offer was made to all the shareholders of two companies who alone were entitled to accept the offer. Those who accepted the offer received non-renounceable letters of allotment. WYNN-PARRY J. said: "... that the test is not who receives the circular, but who can accept the offer put forward. In this case it can only be persons legally or equitably interested as shareholders in the shares of Union-Castle or Clan. In the case of those who accept, non-renounceable letters of allotment will be issued. In these circumstances the case appears to me to fall within section 55(2) of the English Companies Act, 1948."

The exemption provided by sub-section (5) is to some extent restricted by the interpretation of its scope and application by section 67. Where the prospectus is issued in more than one language, a copy of it as issued in each language should be delivered to the Registrar. *Emperor v Bengal Salt Co.,* AIR 1936 Cal 33.

Issued prospectus must be the same as registered with the Registrar. Where the prospectus registered with the Registrar was in English and the published version was in Bangla, and this version did not comply with the requirements of section 56, a prosecution under section 60(5) was held to be justifiable. *Superintendent and Remembrancer of Legal Affairs, Bengal v. Bengal Salt Co. Ltd.,* (1936) 6 Com Cases 21 : AIR 1936 Cal 33.

In order to comply with the requirements of the Foreign Exchange Regulations Act, many foreign collaborators are placing their shares in the market. For this purpose, the company itself or the directors are constituted attorneys for the sale. Such an offer requires the issue of a prospectus.

§ See also Notes under s. 67.

Circular containing offer for exchange of shares

Where a circular, which was in the form of a communication of an offer to exchange shares, and contained neither an offer to purchase shares nor an invitation to subscribe for shares in cash, was circulated among the shareholders and stockholders of a company, it was held that it was not a 'prospectus' within the meaning of the definition in section 2 (36). *Government Stock and other Securities Investments Co. Ltd. v. Christopher,* (1956) 1 All ER 490 : (1956) 26 Com Cases 210 (Ch D). The words "for subscription or purchase." were judicially interpreted in this case. The facts were that company *A* offered to acquire the shares of companies *B* and *C* in exchange for shares to be allotted in company *A*. WYNN-PARRY J. held that the offer did not constitute an offer for purchase of shares, the shares being still unissued, nor was it an offer for the subscription of shares, which expression meant taking or agreeing to take shares for cash. WYNN-PARRY J. deduced this conclusion from the judgments of KEKEWICH J. and the Court of Appeal in *Arnison v.*

Smith, (1889) 41 Ch D 348 : (1886-90) All ER Rep Ext 1332 (CA), and those in *Chicago Rly. Terminal Elevator Co. v. IRC,* (1896) 75 LT 157 and *Brown v. IRC,* (1900) 84 LT 71. But in *Akerhielm v. De Mare,* (1959) AC 789 (PC) and the Australian case of *Broken Hill Proprietary Co. Ltd. v. Bell Resources Ltd.,* (1984) 8 ACLR 609 this opinion was **not followed**.

Bonus shares are not issued "for subscription or purchase" and consequently an issue of bonus shares need not satisfy the statutory requirements of a prospectus.

Subscription

The word 'subscription' in the definition of prospectus means "taking or agreeing" to take shares for cash. It imports that the person agreeing to take the shares puts himself under a liability to pay the nominal amount thereof in cash.

Cost and expenditure of issue

It has been held that issue expenses are in the nature of a capital cost and not revenue expenditure. *Brooke Bond India Ltd. v. CIT,* (1997) 24 Corpt LA 219 (Raj); *Metro General Credits Ltd. v. CIT,* (1997) 11 SCL 137 (Mad). (In this case for income tax purposes). Similarly fees paid to ROC for increasing the authorised capital of the company is in the nature of capital expenditure *CIT v. M.P. Audhyogik Vikas Nigam Ltd.,* (1997) 11 SCL 1 (MP).

Contents of prospectus [Sub-section (1)]

A prospectus issued by or on behalf of a public company must contain the matters specified in Part I of Schedule II and set out the reports specified in Part II of that Schedule. Parts I and II of Schedule II have to be read in conjunction with the clarifications etc. given in Part III of the said Schedule.

The format of prospectus given in Schedule II of the Companies Act, 1956, was introduced by *Notification No.* SO 666(E), dated 3-10-1991, replacing the erstwhile Schedule II. Clause (l) under item No. 1 in Part I of Schedule II, which has been inserted *vide* Notification No. GSR 265(E) dt. 15-5-1997 requires the Board of Directors to make a declaration about monies received out of issue of shares and debentures to be transferred to separate bank account and disclosure about utilisation of issue proceeds and details of unutilised monies, if any, under appropriate separate head in the Balance-sheet. Sub-clause 9A in clause C in Part II has been added by the Depositories Act, 1996 requiring disclosure of details of option available to the investor to subscribe for securities under the depository mode.

The format of prospectus prescribed by Schedule II provides for disclosure of information regarding the company, its management, the project proposed to be undertaken by the company, the financial performance of the company for the last five years and management perception of risk factors, so as to enable the investors to take an informed decision regarding investment in shares or debentures offered through public issue. The company will also be required to furnish particulars in regard to other listed companies under the same management within the meaning of section 370(1B)* of the Companies Act which have made any capital issue during the last three years. The company will inform whether they have obtained credit rating for debenture/preference share issue. A declaration will also have to be furnished to the effect that all the relevant provisions of the Companies Act, 1956 and the guidelines issued by the Government have been complied with and no statement made in prospectus is contrary to the provisions of Companies Act, 1956 and rules made thereunder.

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* Although Sections 370 and 372 have ceased to be operative w.e.f. 31-10-1998, the concept of 'same management' within the meaning of section 370 (1B) will be applicable wherever a reference is made to that concept.

Abridged prospectus

The Government has prescribed the format of the abridged prospectus (i.e. memorandum containing the salient features of the prospectus) in Form No. 2A of Companies (Central Govt.'s) General Rules and Forms, 1956 pursuant to the provisions of section 56(3). The publication of prospectus by way of an advertisement must conform to the format of abridged prospectus.

§ See also Notes under s. 2(1) *ante.*

Compliance of SEBI Guidelines

Prospectus and Abridged Prospectus.—The prospectus, and the abridged prospectus, apart from containing the information as per the requirements of Schedule II of the Companies Act, 1956 and Form No. 2A of the Comapnies (Central Govt's) General Rules and Forms, 1956 respectively are also required to comply with disclosure requirements as given in the Guidelines for Disclosure and Investor Protection 2000 issued by SEBI. For SEBI Guidelines on Contents of Prospectus see Section I and for 'Contents of Abridged Prospectus', see Section II of Chapter VI of SEBI Guidelines, 2000. For text of SEBI Guidelines, 2000 see *Appendix* 162.

Writ petition against non-compliance.—Where a prospectus was issued without compliance with the disclosure requirements of the Companies Act and those of SEBI Guidelines, for example, the existing debt burden of the company was not disclosed, a writ petition was held to be maintainable for an order to SEBI to revoke its consent. *Federal Bank Ltd. v. Shamrao Vithal Co-operative Bank Ltd.*, (2001) CLC 352 (Kant).

Auditor's Report under Schedule II

The Institute of Chartered Accountants of India has issued a "GUIDANCE NOTE ON AUDITOR'S REPORT IN COMPANY PROSPECTUS," [For the text see *Appendix* 43(B.21)] stating that the Report to be included in a prospectus under Part II of Schedule II should be made by the auditor of the company and in case of joint auditors by all the joint auditors. It is clarified that an auditor of a company is eligible to make a report under Schedule II as well as clauses (1) and (2) of both Schedules III & IV as the expression "officer" in this connection does not include an auditor. The report should be signed by the auditor in his individual capacity in the same manner as in the case of other Audit Reports.

Audit Reports on Financial Information in Offer Documents & Auditor's Report to Management

In the context of the growth of the capital markets in India in the recent years and the consequent need for providing relevant and timely information to investors, the Securities & Exchange Board of India (SEBI) has issued SEBI (Disclosure & Investor Protection) Guidelines, 2000, which, *inter alia*, requires certain financial information to be disclosed in the offer document in addition to the requirements of Schedule II to the Companies Act, 1956. This information as prescribed for disclosure vide paragraphs 6.18.2 and 6.18.3 etc. of the guidelines is required to be audited by the Auditors.

Expression "five years" refers to "five financial years" ending 3 months before issue of prospectus

Department's Clarification.—The period of five years for which accounts have to be furnished in the prospectus in terms of Part II of Schedule II [see 1(A) in the Amended Schedule II] has been interpreted as referring to a simple period of five years ending on a date three months before the issue of prospectus and hence every company will have to furnish in the prospectus accounts upto a date not earlier than 6 months from the date of issue of the prospectus, irrespective of the fact whether or not financial year of the Company closes on a date three months before the date of issue of the prospectus. (*Circular No.* 5/72/CL-VI/65, dated 11-11-1968).

Text of Circular*.—Clause 24(1) in Part II of Schedule II has been recently amended, *vide* Notification No. GSR 129, dated 3-1-1968, [see 1(A) in the Amended Schedule II] whereby the companies are

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* Part II B.1 of the existing Sch. II corresponds to clause (24) in Part II of the pre-amended Sch. II.

now required to furnish in the prospectus the accounts up to a date not earlier than six months from the date of issue of the prospectus. The said amendment was made with a view to giving the prospective subscribers the latest financial position of the company and the gap of six months was kept having regard to practical considerations in the matter of preparation of such accounts.

A doubt has been raised whether the period of "five years", mentioned in the last para of the said clause 24(1), refers to the period of "five financial years immediately preceding the issue of the prospectus" earlier indicated in para (b) of the said clause or to a simple period of five years ending on a date three months before issue of the prospectus. In case the period of "five years" refers to the "five financial years", the companies will be required to furnish details of accounts up to a period not earlier than six months from the date of issue of the prospectus only when their financial year has already been completed on a date three months before the issue of the prospectus but no accounts for that year has been made till the date of issue of the prospectus. On the other hand, if the period of five years refers to a simple period of five years ending on a date three months before the date of issue of the prospectus, every company which issues a prospectus will be required to furnish accounts up to a date not earlier than six months from the date of issue of the prospectus.

The matter has been examined carefully in consultation with the Ministry of Law and it has been decided that the period of "five years" mentioned in last para of clause 24(1) refers to a simple period of five years ending on a date three months before the issue of prospectus and hence every company will have to furnish in the prospectus accounts up to a date not earlier than six months from the date of issue of the prospectus, irrespective of the fact whether or not the financial year of the company closes on a date three months before the issue of prospectus. (*Circular No. 5/72/CL-VI/65, dated 11-11-1968 issued by DCLA*).

Statements in prospectus should be true and accurate

A prospectus is required to give to the persons to whom it is addressed a full, accurate and fair picture of the state and prospects of the company. In framing the prospectus the following rules must be borne in mind:

(1) The prospectus should not contain any misrepresentation of any material fact, or any deceptive or misleading statement, or any ambiguous statement which is not true in every sense in which it might be reasonably understood.

(2) It should disclose every material fact and contract, subject to qualifications below mentioned.

(3) The provisions of section 62 (compensation for untrue statements) and section 63 (misstatement in prospectus) should also be borne in mind, and all the precautions taken accordingly.

Neglect of these precautions may give the allottee:

(a) the right to repudiate the contract to take shares and to claim refund of the money paid by him;

(b) the right to sue those for damages or compensation who have issued the prospectus and others who are, by statute or common law, responsible.

The "golden rule" as to framing a prospectus was laid down by KINDERSLEY V.C. in *New Brunswick, etc. Co. v. Muggeridge,* (1860) 1 Dr & Sm 363, 383 : 30 LJ Ch 242: "Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality, of the privileges and advantages which the prospectus holds out as inducements to take shares." The statement which was described by PAGE-WOOD V.C. in *Henderson v. Lacon,* (1867) LR Eq 249, 262 as a "golden legacy" was also quoted by the Supreme Court in *N. Parthasarathy v. Controller of Capital Issues,* (1991) 72 Com Cases 651 (SC).

LORD HALSBURY L.C. in *Aaron's Reefs v. Twiss,* 1896 AC 273 (HL) observed: "I do not care by what means it is conveyed, by what trick or device or ambiguous language; all those are expedients by which fraudulent people seem to think they can escape from the real substance of the transaction. If by a number of statements you intentionally give a

false impression and induce a person to act upon it, it is not the less false although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue."

The particulars set out in Parts I and II of Schedule II to this Act are intended to ensure that the disclosures made in the prospectus give a reasonably fair picture of the state of affairs. Besides particulars, it is mandatory for every prospectus to draw the attention of prospective subscribers to the penalties prescribed by s. 68-A for applications made in false names.

Application forms not to be issued without abridged prospectus [Sub-section (3)]

By sub-section (3) of section 56 there is a prohibition against issue of any form or application for shares in or debentures of a company unless the form is accompanied by a memorandum containing such salient features of a prospectus as may be presented *i.e* an abridged prospectus, provided that a full prospectus is made available to a person who asks for it before the closing of the subscription list. Sub-section (3), however, does not apply if the application form was issued either—

(a) in connection with the *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures; or

(b) in relation to shares or debentures which are not offered to public.

By sub-section (5) the provisions of section 56 do not apply to the issue to existing members or debenture holders of a company of a prospectus or form of application relating to shares or debentures whether an applicant for shares or debentures will or will not have the right to renounce in favour of other persons; or to the issue of a prospectus or form of application relating to shares or debentures which are or are to be in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted at a recognised stock exchange.

SEBI Circular, dt. 6-12-1991.—The Department of Company Affairs by its Notification No. GSR 614(E) dated October 3, 1991 has amended the Companies (Central Government) General Rules and Forms, 1956 by adding Rule 4CC which prescribed the format of the Memorandum in Form 2A under Section 56(3) of the Companies Act, 1956. Till October 3, 1991 a Memorandum (Abridged Prospectus) under Section 56(3) had not been prescribed, but with effect from November 1, 1991, every Company is mandatorily required to issue along with an application form for any issue of securities a Memorandum in Form 2A under Section 56(3).

In this context, the following provisions of Section 56(3) of the Companies Act, 1956 are relevant:—

> "No one shall issue any form of application for share s in or debentures of a Company unless the form is accompanied by a Memorandum containing such salient features of a prospectus as may be prescribed which complies with the requirements of this section".
>
> "If any person acts in contravention of the provisions of this sub-section, he shall be punishable with fine which may extend to five thousand rupees".

Merchant Bankers, particularly Lead Managers associated with Activity (*b*) as mentioned in the Certificate of *Inter se* Allocation of Responsibilities prescribed by us which reads:—

> "Design of prospectus and of advertisement/publicity material including newspapers advertisements and brochure/memorandum containing salient features ..... and SEBI".

are responsible for ensuring compliance with Section 56(3).

In order to bring the salient features of a prospectus, as required in Form 2A, to the attention of every applicant, it is necessary that the Lead Managers ensure the following:—

1. The Memorandum in Form 2A cannot contain matters extraneous to the contents of the prospectus as the very title of the Memorandum indicates "Form 2A—Memorandum containing salient features of Prospectus".
2. Every application form, distributed by the Company or by any one else, must be accompanied by a copy of Memorandum in the manner prescribed in Form 2A under Section 56(3).
3. The application form, therefore, may either be stapled to form part of the Memorandum, or, alternatively, the application form may be a perforated part of the Memorandum.

Failure on the part of the Lead Manager concerned to ensure the above will be considered a default under Clause 5(*a*) of our Circular No. MB/2/91 dated March 18, 1991 and accordingly TWO (2) penalty points will be levied.

It is presumed that Merchant Bankers are also aware that where prospectuses have been filed with the Registrar of Companies after November 1, 1991 the Memorandum must be in Form 2A under Section 56(3) and must not contain matters extraneous to the contents of the prospectus. Any violation of this requirement is punishable under Section 56(3) of the Companies Act, 1956 and our Circular mentioned above. [*Vide* SEBI's Circular Letter No. PMD/MBD(1)/12157/91, dated 6-12-1991 addressed to all Merchant Bankers].

Department's Press Note, dated 9-1-1992.—In terms of section 56(3) of the Companies Act, 1956 no one shall issue any form of application for shares/debentures of a company unless the form is accompanied by a memorandum containing such salient features of a prospectus as may be prescribed. Government have recently revised the format of this memorandum (abridged prospectus) to provide for greater disclosure of information to prospective investor so as to enable them to take an informed decision regarding investment in shares and debentures. It has, however, come to the notice of this Department that share/debenture application forms are being circulated by companies without complying with the legal requirements of section 56(3) of the Act. As a result the investors have no information when they are given only application forms. The share application form should be a part of the abridged prospectus, being attached to it along a perforated line. The abridged prospectus and the share application form should bear the same printed number. The investor may detach the share application form along with 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 be also followed while making available copies of the prospectus under section 56 of the Act. In this connection, it may be pointed out that contravention of the provisions of section 56(3), is punishable with fine which may extend to Rs. 5000. The Registrars of Companies are being advised to ensure strict compliance of these provisions of law and file necessary prosecution, in cases of default. (*Press Note No.* 1/92, F.M. 1/6/88-CL-V, dated 9-1-1992).

Format of the Letter of offer (LOO)

SEBI Circular, dt. 4-3-1992.—It has been noticed by us that disclosures appearing in the Letters of Offer (LOOs) submitted to us by the Merchant Bankers are not adequate and uniform in nature.

A company proposing to issue securities, on rights basis, to its existing shareholders should provide adequate disclosures to them. Though, the LOO cannot be considered as a public document, as it is not filed with the Registrar of Companies and, therefore, not available for public circulation, it should be accorded equal importance as given to a prospectus.

The reasons being that adequate disclosures should be encouraged, whether to existing shareholders or prospective shareholders and a rights issue with a renunciation facility may be deemed to be a public issue.

It has been noticed that a rights issue could be for various reasons, such as, setting up an entirely new project quite different from the existing line of activity, modernisation or expansion of the existing line of activity, working capital requirements, etc.

Whatever may be the reasons for the rights issue, in order to streamline the format in which the LOOs are issued to the shareholders of the company, it has been decided that the format of the LOOs should conform to the disclosures prescribed in the Memorandum in Form 2A under Section 56(3) of the Companies Act, 1956. The seriatim in which the disclosures appear should also be adhered to for ensuring uniformity.

In respect of financial results of the company, apart from the disclosures required under Para VI of the Memorandum, they should also conform to the Guidelines No: F.2/5/SE/76 dated February 5, and March 8, 1977 issued by the Stock Exchange Division of the Ministry of Finance.

In certain cases where the objects of the issue may not permit disclosures as prescribed in the Memorandum in Form 2A under Section 56(3) of the Companies Act, 1956, the Lead Manager should ensure that the disclosures as prescribed in the Memorandum are adhered to as far as possible.

All LOOs submitted to us after March 15, 1992 should be in the manner prescribed above. [*Vide* SEBI's Circular Letter No. MBD (1)/Cir/1751/92, dated 4-3-1992 addressed to all Merchant Bankers].

Printing of two application forms forming part of abridged prospectus

Department's Press Note, dated 10-4-1992.—In Press Note No. 1/92, dated 9-1-1992, it was brought to the notice of all concerned that as per the provisions of section 56(3) of the Companies Act, 1956, the share application form should be a part of the memorandum containing salient features of the prospectus (abridged prospectus), being attached to it along a perforated line. The abridged prospectus 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.

Representations have been made to the Government that one application form to every abridged prospectus might increase the printing charges and that the abridged prospectus with two application forms, forming part of the same, be allowed to be issued. The Government has accepted this suggestion. It is

open to the companies and their merchant bankers to print two application forms, accompanying the abridged prospectus, being attached to it, along the perforated line, bearing separate printed numbers. Care should, however, be taken that the abdridged prospectus is printed in such a way that it is easily readable. (*Press Note No.* 3, dated 10-4-1992.)

Requirements as to application forms under SEBI Guidelines, 2000

Obligations of lead merchant banker

The Lead Merchant Banker shall ensure the following:

- Every application form distributed by the issuer company or anyone else is accompanied by a copy of the Abridged Prospectus.
- The application form may be stapled to form part of the Abridged Prospectus. Alternatively, it may be a perforated part of the Abridged Prospectus.
- The Abridged Prospectus shall not contain matters which are extraneous to the contents of the Prospectus.
- The Abridged Prospectus shall be printed at least in point 7 size with proper spacing.
- Enough space shall be provided in the application form to enable the investors to fill in various details like name, address, etc. [*Clause 5.13.1*]

See also under 'Contents of Prospectus' *post.*

Declaration of Nationality and Residentship of applicants

(a) In the application form meant for Indian Public, the declaration relating to Nationality and Residentship shall be shown prominently as under:

"Nationality and Residentship (Tick whichever is applicable)

(i) I am/We are Indian National(s) resident in India and I am/we are not applying for the said equity shares as nominee(s) of any person resident outside India or Foreign National(s).

(ii) I am/We are Indian National(s) resident in India and I am/We are applying for the said equity shares as Power of Attorney holder(s) of Non-Resident Indian(s) mentioned below on non-repatriation basis.

(iii) I am/We are Indian National(s) resident outside India and I am/we are applying for the said equity shares on my/our own behalf on non-repatriation basis." [*Clause 6.23.2.2(a)*]

Application by NRIs

(b) The application form meant for NRIs shall not contain provision for payment through NR(O) accounts. [*Clause 6.23.2.2(b)*]

(c) On the face of the form, the following legend shall be printed in a box:

"Attention NRI Applicants: Payment must be made through their Non Resident External (NRE)/Foreign Currency Non Resident (FCNR) accounts or through cheques/drafts sent from abroad and drawn on convertible rupee accounts in India. Forms accompanied by cheques drawn on NR(O) accounts are liable to be rejected".

Attention of NRIs shall be invited to the following:

(i) The name and address of at least one place in India from where individual NRI applicants can obtain the application forms.

(ii) Such applications as are accompanied by payment in free foreign exchange shall be considered for allotment under the reserved category.

(iii) Such NRIs who wish to make payment through Non-Resident Ordinary (NRO) accounts shall use the form meant for Resident Indians and shall not use the form meant for reserved category. [*Clause 6.5.4.2.1 and Clause 6.23.2.2(c)(a)*].

Instructions to investors

The application form should contain necessary instructions/provision for the following:

Details of applicant's bank account

(i) Instructions to applicants to mention the number of application form on the reverse of the instruments to avoid misuse of instruments submitted along with the applications for shares/debentures in public issues.

(ii) Provision in the application form for inserting particulars relating to savings bank/current account number and the name of the bank with whom such account is held, to enable the Registrars to print the said details in the refund orders after the names of the payees.

Disclosure of PAN/GIR Number

(iii) Disclosure of PAN/GIR number in respect of applications for monetary value of the investment of Rs.50,000 and above.

(iv) Giving an option to investors to either receive securities in the form of physical certificates or hold them in dematerialised form. [*Clause 6.23.2.2(c)(b)*]

Disclosure in offer document/application form.—The offer documents and application forms shall specifically indicate that the acknowledgement of receipt of application moneys given by the collection agents shall be valid and binding on the issuer company and other persons connected with the issue. [*Clause 5.10.9*].

Applications by mutual funds

(a) Lead Merchant Bankers shall clearly incorporate necessary disclosures under the heads "Procedure for applications by mutual funds" and "Multiple Applications" to indicate that a separate application can be made in respect of each scheme of an Indian mutual fund registered with the Board and that such applications shall not be treated as multiple applications.

(b) The applications made by the AMCs or custodians of a Mutual Fund shall clearly indicate the name of the concerned scheme for which application is being made. [*Clause 6.5.4.1*]

***Disclosures about Stock invests**

(a) The disclosures regarding manner of obtaining and mode of drawing stockinvests, non-utilisation of stockinvests by third party, time period for utilisation of stockinvests by the purchasers and disposal of applications accompanied by stock invest as specified by RBI shall be incorporated at the appropriate places in the offer document.

(b) Name of the bank through which the stockinvests shall be realised, shall be given in the prospectus.

(c) The following paragraph shall be incorporated at the appropriate places in the prospectus.

"Registrars to the Issue have been authorised by the company (through resolution of the Board passed on _____) to sign on behalf of the company to realise the proceeds of the Stockinvest from the issuing bank or to affix non allotment advice on the instrument or cancel the Stockinvest of the non allottees or partially successful allotees who have enclosed more than one stockinvest. Such cancelled stockinvest shall be sent back by the Registrars directly to the investors." [*Clause 6.5.4.3*]

Distribution of application forms [Sub-sec. (3)]

In practice, application forms are generally issued by "Lead Managers to the issue". Often brokers send the forms to their clients. The new proviso to sub-section (3) does not specify the person or body corporate to whom the intending applicant should take the request for a copy of the prospectus. However, such a request can be made to the company issuing the prospectus or managers or brokers to the issue, being agents of the company.

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* Stockinvest Scheme has been withdrawn w.e.f. 5-11-2003 [vide *RBI Circular No. DBOD. No. FSC. BC. 42/24.47.001/2003-04, dt. 5-11-2003*]. See Appendix 230.

Application forms through internet, etc..—Applications for new issues can be made available through alternative sources of supply such as through internet, newspapers, photocopies in addition to the present system of pre-printed applications. To enable this, the requirement of prenumbering of applications forms would be dispensed with and application numbers would be assigned by the collecting banker and/or registrar. [*SEBI Press Release No. 21/2001, dt. 31-1-2001*].

Liability of directors and others [sub-section (4)]

Section 56 imposes on the directors and other persons responsible a statutory duty to comply with its requirements, and the purview of the Act and the language employed both indicate an intention to protect subscribers who act on the faith of a prospectus, and there is the clearest indication that the directors are to incur a liability by non-compliance.

The mere fact that a prospectus has not complied with the requirements of this section however does not entitle a person who has taken shares on the faith of the prospectus to rescission or rectification of the register. His remedy is only against those responsible for the issue of the prospectus. *Re, Wimbledon Olympia,* (1910) 1 Ch 630; *Lynde v. Nash,* (1928) 2 KB 93; *Re, South of England Natural Gas, etc. Co.,* (1911) 1 Ch 573; *Shiromani Sugar Mills Ltd. v. Debi Prasad,* AIR 1950 All 508 : (1950) 20 Com Cases 296.

Limitation.—A suit for damages is governed by Article 36 and not by Article 120 of the Limitation Act, 1908 the wrong complained of being independent of contract, *Manavedan Tirumalpad (T.) (T.) Raja of Nilambur v. Amirchand Dass,* (1944) 14 Com Cases 125 : AIR 1944 Mad 431. **Affirmed** in *Amichand Doss Dwarkadoss v. T. Manvalan Tirumalpad,* (1945) 15 Com Cases 178 (Mad--DB). It may be noted that both these Articles have been merged into Article 113 of Limitation Act, 1963 and period prescribed is 3 years.

Directors' defences against contravention of section 56 [Sub-section (4)]

A director sued under this section can defend himself by showing that he had no knowledge of the matter not disclosed or that the contravention was due to an honest mistake of facts or that in the opinion of the court the matter not disclosed was either not material or the persons sued ought to be excused.

Ignorance of facts.—It has been said that the section does not impose on a director the duty to search for and obtain information as to facts not within his knowledge. Where there are certain contracts of the company about which the director is not clear whether they are of material nature so as to require a disclosure, he should disclose them because otherwise he runs the risk of being held liable if in the opinion of the court they are material. *Tait v. Macleay,* (1904) 2 Ch 631, 639 **reversed** on another point in appeal (1906) AC 24; *Watts v. Bucknall,* (1903) 1 Ch 766 (CA); *Brazilian Rubber Plantations and Estates Ltd., Re,* (1911) 1 Ch 425; *Hoole v. Speak,* (1904) 2 Ch 732.

The words 'knowingly issuing' means intentionally issuing a prospectus without inserting the contracts which were by the section required to be specified, although they were omitted under the *bona fide* belief that it was unnecessary to specify them *Twycross v. Grant,* (1877) 2 CPD 469 (CA); *Broome v. Speak,* (1903) 1 Ch 586; **affirmed** *sub nom. Shepheard v. Broome,* (1904) AC 342; *Tait v. Macleay,* (1904) 2 Ch 631, 637, 638; **reversed** (1906) AC 24, 31, or in ignorance raising from wilfully abstaining from enquiry *Watts v. Bucknall,* (1902) 2 Ch 628; **affirmed** (1903) 1 Ch 766, 774, 777. But a proof prospectus seen by the plaintiff two months before incorporation and not then authorised for publication has been held not to have been 'knowingly issued' *Baty v. Keswick,* (1901) WN 167 : (1901) 85 LT 18. And a director has escaped liability for culpable omission in a prospectus issued to the plaintiff without his authority although he subsequently adopted the prospectus, *Hoole v. Speak,* (1904) 2 Ch 732.

Honest mistake of fact.—A director need not be liable if the matter in question was not disclosed because labouring under an honest mistake of fact he thought that the matter was not important or an error is made in presenting a fact. An illustration is provided

in PALMER'S COMPANY PRECEDENTS in these words: "Thus, if by an honest mistake the directors state that AB is the vendor, whereas CD is the vendor, the directors will be absolved". 72 (17th Edn., 1956). The fact that in deciding whether a particular ought to be disclosed or not, the directors have taken legal advice, will be an evidence of their honesty.

Death of plaintiff.—The right of action against a promoter to recover the value of shares, on the ground that the prospectus is fraudulent is capable of transmission on the plaintiff's death to his legal personal representative, and he might accordingly prosecute the action. *Twycross v. Grant,* (1878) 4 CPD 40.

Prospectus published as newspaper advertisement

Section 66 provides that where any prospectus is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum of association or the signatories thereto or the number of shares subscribed by them. Subject to the provisions of section 66, the announcement of issue of capital to the public in newspapers and other publications, without complying with the requirements of Schedule II to the Act, will amount to contravention of section 56. In case the prospectus is issued in two or more languages, a copy in each language should be filed with the Registrar, *Superintendent and Remembrancer of Legal Affairs, Bengal v. Bengal Salt Co. Ltd.,* AIR 1936 Cal 33 : (1936) 6 Com Cases 21.

Exemption in favour of issue to members of securities already listed [Sub-s. (5)]

Disclosure requirements of the section do not apply in the following cases:

(a) where the prospectus or application form is issued only to the existing members or debentureholders either with or without the right of renunciation;

(b) where the shares or debentures comprised in the prospectus or application form are similar to those which were already issued once and are being dealt in or quoted on a recognised stock exchange.

Subject to these exceptions, the section applies to all issues whether made by the company at the time of its formation or subsequently.

Section does not affect other remedies [Sub-section (6)]

Section 56(6) of the Companies Act, 1956, clearly provides that nothing in this section shall limit or diminish any liability which any person may incur under the general law or under the Companies Act apart from this section. Thus any action which would lie, apart from section 56, will still be available. Accordingly, even if the prospectus complies with the section, it may still by reason of false or fraudulent statements give a subscriber the right to take legal proceedings for rescission of his contract, or for compensation or damages, under sections 62, 63 or in an action of *deceit.*

A person, not having any interest in the company, cannot come forward and allege that a future investor, may suffer on account of false statements in the prospectus and therefore the company should be restrained from proceeding in a particular manner. *Kisan Mehta v. Universal Luggage Manufacturing Co. Ltd.,* (1988) 63 Com Cases 398 (Bom).

Unfair practices in regards to prospectuses

Department's Views.—The examination of the prospectuses published by limited companies disclosed the following unhealthy practices which are not keeping with the spirit and objects underlying the provisions of the Companies Act.

(i) It was noticed in a prospectus issued by a company that shares which were reserved for subscription on the 'firm allotment' basis were included in the number of shares offered to the public for subscription. This was considered to be a misrepresentation of the proposed transaction to mislead the intending investors. Subsequently the company concerned filed a revised prospectus, showing the correct number of shares actually offered to the public.

(ii) In a Statement in lieu of prospectus filed by a company, an amount of Rs. 2,20,000 was shown as due to be reimbursed to the promoter/director on account of preliminary expenses incurred by him. A complaint was received at that time, alleging that the said promoter/director had misused the company's funds inflated his claim. On an enquiry by the Registrar of Companies, it was found that the actual

amount of expenditure claimed to have been incurred by the promoter/director was Rs. 1,84,603 only, apparently the claim had been reduced by the promoter/director. A further scrutiny showed that only a sum of Rs. 91,907 out of this authenticated claim was supported by vouchers. This led to the appointment of a Committee of the Board of directors of the company which reduced the claim to Rs. 1,50,000 and the Controller of Capital Issues also directed that the amount to be reimbursed shall be limited to Rs. 1,50,000.

(iii) A company, in its press announcement regarding the issues of its capital, stated that the shares comprised in the issue would be entitled to such dividend as might be declared in respect of the year ending the 30th June, 1961, but such dividend would be payable on the amount paid-up on the shares allotted for the period between the actual date of payment of allotment money or the call money on the said shares and the 30th June, 1961. In fact the company did not allot any of the new shares till the 1st July, 1961, thereby preventing the new shareholders from paying any allotment or call money before the 30th June, 1961. No dividend was, therefore, payable on the new shares for the year ended the 30th June, 1961, and the promise held out in the prospectus remained unredeemed. The explanation of the company for the delay in allotting the new shares was called for. It stated that it had received a very large number of applications, almost twice the number of shares offered for public subscription and so there was considerable delay in the allotment of shares. It was considered that the company ought not to have held out a promise which it could have foreseen that it was not likely to be able to honour.

(iv) During the scrutiny of the prospectus issued by a company, it was observed that the preliminary expenses (excluding brokerage and underwriting commission to the extent of Rs. 25,000 were estimated at Rs. 1,35,000 in respect of a total estimated project cost of Rs. 40 lakhs. As the estimate of the preliminary expenses was on the high side, the company was asked to furnish the break-up of this figure. From the company's reply, it was seen that a sum of Rs. 1,35,000 under the head 'Preliminary expenses' included an amount of Rs. 76,561 which was stated to have been spent by the company on travelling and other so-called preliminary investigation expenses. A further scrutiny showed that the bulk of the expenditure, included in this figure of Rs. 76,561, represented travelling expenses incurred in India and abroad by the managing director of the promoter company. This was on the face of it an attempt to remunerate the promoters in the guise of reimbursement of promotional expenses. (*Extract from the Sixth Annual Report Year ended 31st March, 1962.*)

Remedy of aggrieved person

An allottee may claim relief for misrepresentation, if he proves:

(i) that the misrepresentation was one of fact;

(ii) that he acted upon it; and

(iii) that it was material.

Where the name of the allottee is placed on the register of members or debenture-holders, as the case may be, and the allottee rescinds the allotment for a valid reason he can claim rectification of the Register.

To succeed in an action for deceit, the aggrieved person must prove in addition to the above three facts,

(i) that those acting on behalf of the company acted fraudulently;

(ii) that those purporting to act on behalf of the company were authorised to act in its behalf; and

(iii) that he suffered a loss or damage.

In order to obtain any personal remedy in damages, it is not enough to prove that the director sued had been guilty of gross negligence or that he made the statement without any reasonable grounds for believing it to be true. The test in such cases should be a subjective test as explained in *Akerhielm v. De Mare,* (1959) 3 All ER 485 (PC): "The question is not whether the defendant in any given case honestly believed the representation to be true in the sense assigned to it by the court on an objective consideration of its truth or falsity, but whether he honestly believed the representation to be true in the sense in which he understood it *albeit* erroneously when it was made. This general proposition is no doubt subject to limitations. For instance, the meaning placed by the defendant on the representation made may be so far removed from the sense in which it would be understood by any reasonable person as to make it impossible to hold that the defendant honestly understood the representation to bear the meaning claimed by him and honestly believed it in that sense to be true."

§ See also, Notes under section 62.

Stay order against public issue.—A hire-purchase financier sought to restrain the company from making its proposed public issue on the ground that the company had not mentioned its indebtedness to the financier in its prospectus. The company mentioned all its liabilities in the prospectus as also in the subsequent advertisement. The issue was permitted by SEBI. The latter did not withdraw its permission even after the complaint by the financier. No suit was filed by him against the company to recover his dues. The application for injunction seemed to have been filed only to harass the company and force it to come to terms. The application was dismissed with costs. *Kothari Orient Finance Ltd. v. Tele Data Informatics Ltd.*, (2002) 108 Com Cases 863 (Mad).

Penalty for default [Sub-sections (3) & (6)]

Any person who issues any form of application in relation to shares or debentures which are offered to the public without a memorandum containing the prescribed salient features of the prospectus shall be punishable with fine which may extend to Rs. 50,000. Sub-section (6) of this section makes it further clear that if any person incurs liability under the general law or under this Act, that would be in addition to the liability under this section.

Compoundable offence.—The offence is compoundable under section 621A.

NBFC as a merchant banker

I. SEBI (Merchant Bankers) Amendment Regulation 1997 has been notified in the Gazette of India, Extraordinary *vide* S.O. No. 837(E) and has been published on 9-12-1997. In terms of the said amendment with effect from 9-12-1997 a non banking financial company as defined under section 45-I(f) of RBI Act cannot act as a merchant banker. It has also been provided that a merchant banker other than a bank or public financial institution shall not carry on any business other than that of the securities market. The merchant banker is now required to take separate registrations for underwriting and portfolio management activities separately under respective Regulations. The registration criteria for merchant banker has also been changed and the applicant has to be a fit and proper person to be eligible to be granted certificate of registration or renewal thereof. The amendment has come into force with effect from 9-12-1997. [*SEBI (Merchant Bankers) Amendment Regulations 1997 : Ref. No. PR 157/97, dated 10-12-1997*].

II. The applicant for registration as a merchant banker shall be a body corporate other than a non-banking financial company as defined under clause (*f*) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934) as amended from time to time.

A registered merchant banker cannot associate itself with any business other than that of the securities market. No merchant banker, other than a bank or a public financial institution, who has been granted a certificate of registration under the SEBI Regulations shall carry on any business other than that in the securities market. However, a merchant banker who has been granted certificate of registration to act as primary or satellite dealer by Reserve Bank of India may carry on such busines as may be permitted by the Reserve Bank of India, subject to the condition that it shall not accept or hold public deposit. [*Vide* Regs. 6(a) and 13A of SEBI (Merchant Bankers) Regulations, 1992].

FDI in merchant banking, underwriting, etc.

Foreign direct investment and investment by NRIs and OCBs are allowed in merchant banking, underwriting etc. subject to the minimum capitalisation norms specified by Department of Industrial Policy and Promotion [*vide Press Note no. 1/2000, dated 11-2-2000*].

A 100 per cent NBFC can act only as holding company and specific activities must be undertaken by step down subsidiaries with minimum 25 per cent domestic equity—10 per cent equity to be brought upfront and balance over 24 months.

Malegam Committee Report on Disclosure Requirements in Offer Documents.— SEBI constituted a committee to review the existing disclosure requirements in offer documents and recommend additions thereto and notifications thereof. Accordingly committee submitted its report to SEBI with most of the recommendations of the report being accepted in view of the need to further strengthen the disclosure requirements in offer documents alongwith other issues relating to primary market reforms.

§ For the text of the Malegam Committee Report and Acceptance of the Recommendations of the Malegam Committee, dated 12-9-1995, see *Appendix* 231.

SEBI Guidelines, 2000

SEBI (Disclosure and Investor Protection) Guidelines, 1992 as updated by Clarifications thereon issued by SEBI from time to time were largely based on the recommendations of the Malegam Committee on disclosure requirements in the offer documents for issue of securities. SEBI has now issued consolidated guidelines called SEBI (Disclosure and Investor Protection) Guidelines, 2000 *vide RMB (Compendium) Series Circular No. 1 (1999-2000) dated 19-1-2000.* The SEBI Guidelines, 2000 is a compendium of the guidelines, circulars, and instructions issued by SEBI (Primary Market Department) from time to time to merchant bankers relating to issue of capital.

§ For text of the Guidelines, 2000, see *Appendix* 162.

Scheme of SEBI Guidelines, 2000

SEBI (Disclosure and Investor Protection) Guidelines 2000 lay down in detail, the obligations of the issuer companies and the Merchant Bankers/Lead Managers relating to public issue of securities. The said Guidelines *inter-alia* deal with the following matters :

—Pre and Post obligations of the issuer companies and Lead Managers.

—Contents of offer document, prospectus and abridged prospectus.

—Guidelines for bonus issue, prefrential issues, debt instrument.

—Guidelines for OTCEI Issue.

—Guidelines for issue of capital by Designated Financial Institutions.

—Guidelines for book building.

—Guidelines for advertisement.

The full text of the Guidelines is reproduced at *Appendix* 162.

Appointment of lead managers

Reg. 19 of SEBI (Merchant Bankers) Regulations, 1992

All issues (except rights issue not exceeding Rs. 50 lakhs) should be managed by at least one merchant banker functioning as lead manager[1]

The number of lead merchant bankers may not exceed in case of any issue of—

Size of issue	*Number of lead merchant bankers*
(a) Less than rupees fifty crores	Two
(b) Rupees fifty crores but less than rupees one hundred crores	Three
(c) Rupees one hundred crores but less than two hundred crores	Four
(d) Rupees two hundred crores but less than rupees four hundred crores	Five
(e) Above rupees four hundred crores	Five or more as may be agreed by the Board.

1. See Reg. 18 of SEBI (Merchant Bankers) Regulations, 1992 at *Appendix* 207.

Lead Manager's responsibilities

No lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue, mainly those of disclosures, allotment and refund are clearly defined, allocated and determined and a statement specifying such responsibilities is furnished to SEBI at least one month before the opening of the issue for subscription. [*Reg. 20*][2]

A Merchant Banker shall not lead manage the issue if he is a promoter or a director or associate of the issuer company.

Provided that a merchant banker holding the securities of the issuer company may lead manage the issue if;

(a) the securities of the issuer company are listed or proposed to be listed on the Over the Counter Exchange of India (OTCEI) and;

(b) the Market Makers have either been appointed or are proposed to be appointed as per the offer document.

"*Explanation* : For the purposes of this clause, a merchant banker shall be deemed to be an associate of the issuer if:

(i) either of them controls directly or indirectly, through itself, its subsidiary or holding company, not less than 15 percent of the voting power of the other; or

(ii) either of them, directly or indirectly, by itself or in combination with other persons, exercises control over the other; or

(iii) There is a common director, excluding nominee director, amongst the body corporate/ its subsidiary or holding company and the Merchant Banker.

Provided that the expression 'control' shall have the same meaning as defined under clause (c) of Regulation 2 of SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 1997." [*Clause 5.4.1.1.*]

Compliance Officer to be Appointed by Lead Merchant Banker

The merchant bankers shall appoint a senior officer as Compliance Officer to ensure that all Rules, Regulations, Guidelines, Notifications etc. issued by the Board, the Government of India, and other regulatory organizations are complied with.

The Compliance Officer shall co-ordinate with regulatory authorities in various matters and provide necessary guidance as also ensure compliance internally.

The Compliance Officer shall also ensure that observations made/deficiencies pointed out by the Board do not recur. [*Clause 8.13*].

PRE-ISSUE OBLIGATIONS OF LEAD MERCHANT BANKERS

The pre-issue obligations of lead merchant bankers include—

(1) execution of Memorandum of Understanding with the company;

(2) *inter-se* allocation of responsibilities amongst merchant bankers;

(3) appointment of intermediaries;

(4) exercise of due diligence;

(5) filing of offer document;

(6) publication/submission/despatch of offer document/issue material.

(7) collection of applications by bankers to the issue.

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2. SEBI (Merchant Bankers) Regulations, 1992 at *Appendix* 207.

(1) Execution of Memorandum of Understanding (MOU)

A merchant banker, before taking up the assignment relating to an issue of security by a company, is required to enter into an agreement (Memorandum of Understanding) with the company setting out their mutual rights, liabilities and obligations relating to such issue and, in particular, to disclosures, allotment and refund [*Reg. 18*].[3]

No company shall make an issue of security through a public or rights issue unless a Memorandum of Understanding (MOU) has been entered into between a lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue. [*Clause 5.3.1.1*].

The MOU shall contain such clauses as are specified at Schedule I to SEBI Guidelines, 2000 and such other clauses as considered necessary by the lead merchant banker and the issuer company. [*Clause 5.3.1.2*].

The MOU shall not contain any clause whereby the liabilities and obligations of the lead merchant banker and issuer company under the Companies Act, 1956 and Securities and Exchange Board of India (Merchant Bankers) Rules and Regulations, 1992 are diminished in any way [*Clause 5.3.1.2, proviso*]

The Lead Merchant Banker responsible for drafting of the offer documents shall ensure that a copy of the MOU entered into with the issuer company is submitted to SEBI along with the draft offer document. [*Clause 5.3.1.3*].

Lead Merchant Banker to comply with following:

(a) to obtain undertaking from the issuer as part of Memorandum of Understanding to be entered into by the Lead Merchant Banker with the issuer company to the effect that the issuer company shall not directly or indirectly release, during any conference or at any other time, any material or information which is not contained in the offer documents.

(b) to ensure that the issuer company obtains approval in respect of all issue advertisements and publicity materials from the Lead Merchant Banker responsible for marketing the issue and also ensure availability of copies of all issue related materials with the Lead Merchant banker at least till the allotment is completed. [*Clause 9.2*].

(2) Inter-se Allocation of Responsibilities

In case a public or rights issue is managed by more than one merchant banker the rights, obligations and responsibilities of each merchant banker shall be demarcated as specified in Schedule II to SEBI Guidelines, 2000. [*Clause 5.3.2.1*].

In case of under subscription of an issue, the Lead Merchant Banker responsible for underwriting arrangements shall invoke underwriting obligations and ensure that the underwriters pay the amount of devolvement and the same shall be incorporated in the *inter se* allocation of responsibilities (Schedule II) accompanying the due diligence certificate submitted by the Lead Merchant Banker to SEBI. [*Clause 5.3.2.2*].

(3) Appointment of intermediaries

Appointment of Co-managers.—Lead Merchant Bankers shall ensure that the number of co-managers to an issue does not exceed the number of Lead Merchant Bankers to the said issue and there is only one advisor to the issue. [*Clause 5.4.2.1*].

Appointment of Other Intermediaries.—Lead Merchant Banker shall ensure that the other intermediaries being appointed are duly registered with the SEBI, wherever applicable. [*Clause 5.4.3.1*].

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3. See SEBI (Merchant Bankers) Regulations, 1992 at *Appendix* 207.

Before advising the issuer on the appointment of other intermediaries, the Lead Merchant Banker shall independently assess the capability and the capacity of the various intermediaries to carry out assignment. [*Clause 5.4.3.1.1*].

The Lead Merchant Banker shall ensure that issuer companies enter into a Memorandum of Understanding with the intermediary(ies) concerned whenever required.[4] [*Clause 5.4.3.1.2*].

Bankers to the issue.—The Lead Merchant Banker shall ensure that Bankers to the Issue are appointed in all the mandatory collection centres as specified in clause 5.9. [*Clause 5.4.3.2*]

Registrars to the issue.—The Lead Merchant Banker shall not act as a Registrar to an issue in which it is also handling the post issue responsibilities. [*Clause 5.4.3.3*].

The Lead Merchant Bankers shall ensure that:

(a) the Registrars to Issue registered with SEBI are appointed in all public issues and rights issues;

(b) in case where the issuer company is a registered Registrar to an Issue, the issuer shall appoint an independent outside Registrar to process its issue.

The lead merchant banker shall ensure that Registrar to an issue which is associated with the issuer company as a promoter or a director shall not act as Registrar for the issuer company [*Clause 5.4.3.4*].

Registrars.—Where the number of applications in a public issue is expected to be large, the issuer company in consultation with the lead merchant banker may associate one or more Registrars registered with the Board for the limited purpose of collecting the application forms at different centres and forward the same to the designated Registrar to the Issue as mentioned in the offer document.

The designated Registrar to the Issue shall be primarily and solely responsible for all the activities as assigned to them for the issue management. [*Clause 5.4.3.4*].

Underwriters to the issue

Meaning of "underwriting".—"Underwriting" means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them. [*Clause 1.2.1(xxviii)*].

Underwriting not mandatory.—Issuers have the option to have a public issue or rights issue underwritten by the underwriter [*Clause 8.11.1*].

Agreement with company.—The underwriter shall enter into a valid agreement[5] with the body corporate on whose behalf he is acting as underwriter and the said agreement amongst other things may define the allocation of duties and responsibilities between him and such body corporate. [*Rule 4(b), SEBI (Underwriters) Rules, 1993*]. See *Appendix* 214.

Appointment of underwriters.—Issuers must appoint underwriters with the approval of the Lead Merchant Banker to the issue (LMB) [*Clause 8 of Sch. I to SEBI Guidelines, 2000 : MOU between LMB and issuer company*]

LMB should obtain underwriters' written consent before including their names as underwriters in the final offer document [*Clause 5.5.2.(b)*]

Exposure of underwriters.—While selecting underwriters and finalising underwriting arrangements, lead merchant bankers shall ensure that the underwriters do not overexpose

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4. See, for instance, Model Agreement with Registrars to the Issue (*Appendix* 212), with Underwriters (*Appendix* 216) and with Debenture Trustee (*Appendix* 218).
5. For Model Agreement between issuer company and underwriter, see *Annexure A* to SEBI *Operational Guidelines/Instructions for Registered Underwriters* at *Appendix* 216.

themselves so that it may become difficult to fulfil underwriting commitments [*Clause 16.1.9(a)*].

The overall exposure of underwriter(s) belonging to the same group or management in an issue shall be assessed carefully by the lead Merchant Banker [*Clause 16.1.9(b)*].

OTC Dealers registered with Board under Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules and Regulations, 1992 [see *Appendix* 222 and 144] shall be treated at par with the brokers of other stock exchanges in respect of underwriting arrangement. [*Clause 16.1.9 (c)*].

Worth of underwriters.—LMB should satisfy themselves about the ability of the underwriters to discharge their underwriting obligations [*Clause 5.5.1*].

The outstanding underwriting commitments should not exceed 20 times its net worth at any point of time [*Clause 5.5.4*].

Lead merchant banker's obligations in case of undersubscription.—In case of under subscription at an issue, the Lead Merchant Banker responsible for underwriting arrangements shall invoke underwriting obligations and ensure that the underwriters pay the amount of devolvement and the same shall be incorporated in the *inter-se* allocation of responsibilities (Schedule II) accompanying the due diligence certificate submitted by the Lead Merchant Banker to the Board. (*Clause 5.3.2.2*].

Minimum Underwriting Obligation.—In respect of every underwritten issue, the lead merchant banker(s) shall undertake a minimum underwriting obligation of 5% of the total underwriting commitment or Rs.25 lacs whichever is less. [*Clauses 5.5.3 and 8.11.2*].

Guidelines as to disclosures in offer document.—See Notes under 'Contents of Prospectus' *post*.

For Composite Issues

1. The Lead Merchant Banker shall ensure that the requirement of "minimum subscription" is satisfied both jointly and severally, i.e., independently for both rights and public issues.
2. If the company does not receive the minimum subscription in either of the issues the company shall refund the entire subscription received. [*Clause 6.3.8.3*].

Post-issue obligations as to underwritten issues

Extension of period of subscription

(i) If the issue is proposed to be closed at the earliest closing date, the lead Merchant Banker shall satisfy himself that the issue is fully subscribed before announcing closure of the issue.

(ii) In case there is no definite information about subscription figures, the issue shall be kept open for the required number of days to take care of the underwriters' interests and to avoid any dispute, at a later date, by the underwriters in respect of their liability. [*Clause 7.4.1.2(a)*]

Devolvement on underwriters

(i) In case there is a devolvement on underwriters, the lead Merchant Banker shall ensure that the underwriters honour their commitments within 60 days from the date of closure of the issue [*Clause 7.4.1.2(b)*].

(ii) In case of undersubscribed issues, the lead merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvements to the SEBI in the format specified at Schedule-XVII to SEBI Guidelines, 2000. [*Clause 7.4.1.2(c)*]

Allotment made to underwriters pursuant to the underwriting agreement is exempt from the provisions of Regulations 10, 11 and 12 [of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997] [*Clause (d) of Reg. 3(1)*].

Underwriting of public issue through book building process

(i) In case the issuer company is making an issue of securities:

(i) under sub-clause (a) of clause 11.3, 100% of the net offer to the public;

(ii) under sub-clause (b) of clause 11.3, the book built portion – 75% of the net offer to the public,

shall be compulsorily underwritten by the syndicate members/book runner(s):

Provided that nothing contained in sub-clause (i) shall apply to 50% of the net offer to the public, mandatorily to be allotted to the Qualified Institutional Buyers under proviso to clause 2.2.2 or clause 2.3.2 of these guidelines, in case the company is making an issue of securities under clause 2.2.2. or clause 2.3.2

(ii) (a) The 'syndicate members' shall enter into an underwriting agreement with the Book Runner(s) indicating the number of securities which they would subscribe at the predetermined price.

(b) The Book Runner(s) shall in turn enter into an underwriting agreement with the Issuer company.

(iii) In the event of the syndicate members not fulfilling their underwriting obligations the Book Runner(s) shall be responsible for bringing in the amount devolved. [*Clause 11.3.3*].

Appointment of Compliance Officer.—1. Every underwriter shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by the Board or the Central Government and for redressal of investors' grievances.

2. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him. [*Reg. 17-A*].

§ See also Notes under section 76.

(4) Exercise of due diligence by lead merchant banker[6]

The lead merchant banker, who is responsible for verification of the contents of a prospectus or the Letter of Offer in respect of an issue and the reasonableness of the views expressed therein, shall submit to SEBI at least two weeks prior to the opening of the issue for subscription, a due diligence certificate.[7]

The standard of due diligence shall be such that the merchant banker shall satisfy himself about all the aspects of offering, veracity and adequacy of disclosure in the offer documents. [*Clause 5.1.1*]

The liability of the merchant banker as referred to clause 5.1.1 above shall continue even after the completion of issue process [*Clause 5.1.2*]

(5) Filing of draft offer document

Public issue.—No company shall make any issue of a public issue of securities, unless a draft prospectus has been filed with SEBI (Board), through an eligible Merchant Banker, at least 21 days prior to the filing of Prospectus with the Registrar of Companies (ROCs). [*Clause 2.1.1*].

If, within 21 days from the date of submission of draft Prospectus, the Board specifies changes, if any, in the draft Prospectus, (without being under any obligation to do so)

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6. See also '*Disclaimer clause*' under '*Contents of Prospectus*' Ch. VI of SEBI Guidelines, 2000.
7. See Regulation 23 of SEBI (Merchant Bankers) Regulations, 1992 at *Appendix* 207.

issuer or the Lead Merchant banker shall carry out such changes in the draft prospectus before filing the prospectus with ROCs. [*Clause 2.1.1, proviso*].

Rights issue.—No listed company shall make any issue of security through a rights issue where the aggregate value of securities, including premium, if any, exceeds Rs.50 lacs, unless the (draft) letter of offer is filed with the Board, through an eligible Merchant Banker, at least 21 days prior to the filing of the Letter of Offer with Designated Stock Exchange (DSE). [*Clause 2.1.2*].

If, within 21 days from the date of filing of draft letter of offer, the Board specifies changes, if any, in the draft letter of offer, (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes before filing the draft letter of offer with DSE. [*Clause 2.1.2, proviso*].

Approval of offer document by Board of directors.—The draft offer document and final offer document shall be approved by the Board of directors of the issuer company and signed by all the directors (including the managing director), chief executive officer and chief financial officer of the issuer company. They shall also certify that all the disclosures made in the offer document are true and correct. [*Clause 6.1.2*] *Added by SEBI Circular No. 9, dt. 2-5-2003*]

Documents to be filed with draft offer document.—The Lead Merchant Banker shall furnish to the Board a due diligence certificate as specified in Schedule III to SEBI Guidelines, 2000 together with documents referred to in the Annexure thereto, along with the draft prospectus [*Clause 5.3.3.1*].

Other Certificates.—In addition to the due diligence certificate furnished alongwith the draft offer document, the Lead Merchant Banker shall also:

(i) certify that all amendments, suggestion or observations made by Board have been incorporated in the offer document;

(ii) furnish a fresh "due diligence" certificate at the time of filing the prospectus with the Registrar of Companies as per the format specified at Schedule IV to SEBI Guidelines, 2000.

(iii) furnish a fresh certificate immediately before the opening of the issue that no corrective action on its part is needed as per the format specified at Schedule V to SEBI Guidelines, 2000.

(iv) furnish a fresh certificate after the issue has opened but before it closes for subscription as per the format specified at Schedule VI to SEBI Guidelines, 2000 [*Clause,5.3.3.2*].

Certificates duly signed.—The Lead Merchant Banker shall furnish the following certificates duly signed by Company Secretary or Chartered Accountant in case of further issue of capital by listed companies along with the draft offer documents:

(a) all refund orders of the previous issues were despatched within the prescribed time and in the prescribed manner;

(b) all security certificates were despatched to the allottees within the prescribed time and in the prescribed manner;

(c) the securities were listed on the Stock Exchanges as specified in the offer documents [*Clause 5.3.4.1*].

Draft offer document on computer floppy.—The lead merchant banker shall submit the draft offer document on a computer floppy to the dealing office of the Board and to the Primary Market Department, SEBI, Head Office, as specified in Schedule XXIII. [*Clause 16.1.3(a)*]

In case of book built issues the lead merchant banker shall submit a printed and soft copy on a computer floppy, of the draft offer document incorporating the Board's observations and a printed copy of bid cum application form to the Primary Market Department, SEBI, Head Office at least five days before opening of bidding. [*Clause 16.1.3(b)*].

Format for Submitting Draft Offer Document on a Computer Floppy—Schedule XXIII

1. The soft copies of draft offer documents shall be submitted in both HTML and PDF formats in a floppy placed in a sealed envelope. The floppy (1.2 MB, write protect mode) should be submitted in a sealed envelope.
2. One floppy shall contain prospectus/letter of offer of a single issue only and in one single file.
3. They must go through the offer documents after conversion into HTML and PDF formats thoroughly to ensure that their internal notings, additions/deletions or corrections do not appear in the final format which is submitted to SEBI. It is to be ensured that the data given in the tables is in systematic order. It is to be understood that merchant bankers are fully responsible for the contents of soft copies of the offer documents.
4. The Merchant Bankers are required to submit an undertaking to SEBI while filing the offer document certifying that the information contained in the floppy is in HTML format and matches exactly with the contents of the hard copy.
5. The floppies containing the soft copy of the offer document should have a sticker duly pasted giving the following information :
   (a) the name of merchant banker
   (b) name of the issuer company
   (c) issue type (public/rights/offer for sale)
   (d) signature of the person who has signed the due diligence certificate.
6. If the requirements of this circular regarding submission of soft copy of the offer document are not fulfilled, the offer document would not be processed.
7. Merchant bankers are further advised to confirm to SEBI in writing, within one day of the posting of draft offer document on the website (if the next day is a holiday, on the first working day), that the contents of the draft offer document appearing on the website are in order.
8. The merchant bankers are advised to follow the procedure explained above in respect of the draft offer document, for the final offer document as well. The sticker mentioned at clause (5) above shall contain following additional information:
   (a) date of filing with Registrar of Companies/stock exchange
   (b) issue opening date.

Jurisdiction for filing offer document.—The offer documents (draft and final) of size upto Rs. 20 crores shall be filed by lead merchant bankers with the concerned regional office of SEBI under the jurisdiction of which the registered office of the issuer company falls. [*Clause 16.1.1(a)*].

Regional offices of SEBI.—The jurisdiction of regional offices/head office shall be as per Schedule XXII [*Clause 16.1.1(b)*].

Fee for filing.—The lead merchant banker shall pay requisite fee in accordance with regulation 24A of Securities and Exchange Board of India (Merchant Bankers) Rules and Regulations, 1992 [*Appendix* 207] along with draft offer document filed with the SEBI. [*Clause 5.2*].

Schedule IV to SEBI (Merchant Bankers) Regulations, 1992 lays down the fee payable:

1. Every merchant banker shall pay fees as set out below:

Size of the Issue including premium and intended retention of over-subscription (Rs.)	*Fees per offer document (Rs.)*
Upto 5 crores	10,000
More than 5 crores & upto 10 crores	15,000
More than 10 crores & upto 50 crores	25,000
More than 50 crores & upto 100 crores	50,000
More than 100 crores & upto 500 crores	2,50,000
More than 500 crores	5,00,000

2. Fees referred to in clause (1) above, shall be paid in the following manner:
   (a) The fees shall paid along with the draft of the offer document submitted to the Board under regulation 24.

(b) The fees shall be payable by a draft in favour of "Securities and Exchange Board of India" at Mumbai or at the respective regional offices where the draft offer document under regulation 24 is submitted.

The lead managers who are responsible for conducting due diligence exercise with respect to the contents of the offer document as per *inter se* allocation of responsibilities shall sign the due diligence certificate [*Clause 5.3.3.3*]. [Ins. by SEBI Circular No. 11, dt. 14-8-2003].

(6) Publication, submission and despatch of offer document/issue material

(A) Draft Offer Document to be made public

The draft offer document filed with SEBI shall be made public for a period of 21 days from the date of filing the offer document with the Board. [*Clauses 5.6.1 and 16.1.2(a)*].

The Lead Merchant Banker shall:

(*i*) while filing the draft offer document with SEBI, also file the draft offer document with the designated stock exchanges where the securities are proposed to be listed;

(*ii*) make copies of the draft offer document available to the public, host the draft and final offer documents on the websites of all the lead managers / syndicate members associated with the issue and also ensure that the contents of documents hosted on the websites are the same as that of their printed versions;

(*iii*) obtain and furnish to the Board, an in-principle approval of the stock exchanges for listing of the securities within 15 days of filing of the draft offer document with the stock exchanges. [*Clause 5.6.2*].

Lead merchant banker or stock exchanges shall make copies of draft offer document available to the public and may charge and appropriate sum to the person requesting for the copy of offer document. [*Clause 5.6.3 and Clause 16.1.2 (c) and (d)*].

No Complaints Certificate.—After a period of 21 days from the date the draft offer document was made public, the Lead Merchant Banker shall file a statement with the Board:

(i) giving a list of complaints received by it;

(ii) a statement by it whether it is proposed to amend the draft offer document or not; and

(iii) highlight those amendments. [*Clause 5.8.1*].

Submission of copies of draft offer document to SEBI/Stock Exchange.—The lead merchant banker shall make ten (10) copies of the draft offer document available to the dealing office of the Board, three (3) copies to the Primary Market department, SEBI, Head Office and 25 copies to the stock exchange(s) where the issue is proposed to be listed]. [*Clause 16.1.2(b).*

(B) Submission of final offer document

The Lead Merchant Bankers shall submit two copies of final printed copy of the final offer document to dealing offices of Board at least within 3 days of filing of offer document with ROC/concerned stock exchange as the case may be. [*Clause 16.1.4(a)*].

The lead merchant banker shall submit one final printed copy of the final offer document to Primary Market Department, SEBI, Head Office, within three (3) days of filing the offer document with Registrar of Companies/concerned Stock Exchange(s) as the case may be [*Clause 16.1.4.(b)*].

The lead merchant banker shall submit a computer floppy containing the final prospectus/letter of offer to Primary Market Department, SEBI, Head Office, as specified in Schedule XXIII within three (3) days of filing the final prospectus/letter of offer with the

Registrar of Companies/concerned Stock Exchange(s). Along with the floppy, the lead manager shall submit an undertaking to SEBI certifying that the contents of the floppy are in HTML format and are identical to the printed version of prospectus/letter of the offer filed with Registrar of Companies/concerned Stock Exchange as the case may be [*Clause 16.1.4(c)*].

Filing of Details about lead merchant banker.—Whenever offer documents (for public/rights issues, takeovers or for any other purpose) are filed with any Department/office of Board, the following details about themselves certified as correct] shall be given by the lead merchant banker in the forwarding letters:

(i) Registration No.
(ii) Date of Registration/Renewal of registration.
(iii) Date of expiry of registration.
(iv) If applied for renewal, date of application.
(v) Any communication from the Board prohibiting from acting as a merchant banker.
(vi) Any inquiry/investigation being conducted by the Board [*Clause 16.1.5(a)*].

The following details about the issuer company certified as correct shall be furnished by the lead merchant banker along with their forwarding letter while filing offer documents for public/rights issue/buyback/takeovers:

(*i*) Whether any promoter/director/group/associate company/entity of the issuer company and/or any company/entity with which any of the above is associated as promoter/director/partner/proprietor, is/was engaged in securities related business and registered with SEBI.
(*ii*) If any one or more of these persons/entities are/were registered with SEBI, their respective registration numbers.
(*iii*) If registration has expired, reasons for non-renewal.
(*iv*) Details of any enquiry/investigation conducted by SEBI at any time.
(*v*) Penalty imposed by SEBI (Penalty includes deficiency/warning letter, adjudication proceedings, suspension/cancellation/prohibitory orders).
(*vi*) Outstanding fees payable to SEBI by these entities, if any. [*Clause 16.1.5(b)*].

The draft and final offer documents submitted to the Board on computer floppies as per clauses 16.1.3 and 16.1.4(c) shall be accompanied by the information as per format in Schedule XXIIIA. [*Clause 16.1.5(c)*].

Offer documents not accompanied by the information referred to above may be rejected. [*Clause 16.1.6*].

Lead Merchant Bankers shall obtain similar information from other intermediaries to ensure that they comply with these guidelines and are eligible to be associated with the concerned issue [*Clause 16.1.7(a)*].

The intermediaries shall also indicate in their letters that they have obtained such information from other intermediaries. [*Clause 16.1.7(b)*].

Despatch of offer documents and issue material

The lead merchant banker shall ensure that for public issues offer documents and other issue materials are dispatched to the various stock exchanges, brokers, underwriters, bankers to the issue, investors associations, etc. in advance as agreed upon. [*Clause 5.7.1*].

In case of rights issue, lead merchant banker shall ensure that letters of offer are dispatched to all shareholders at least one week before the date of opening of the issue. [*Clause 5.7.2*].

Lead merchant bankers shall ensure that whenever there is a reservation for NRIs, 10 copies of the prospectus together with 1000 application forms are despatched in advance of the issue opening date directly along with a letter addressed in person to Adviser (NRI), Indian Investment Centre, Jeevan Vihar Bldg., Sansad Marg, New Delhi - 110001. [*Clause 16.1.8.1(a)*].

Twenty copies of the prospectus and application forms shall be despatched in advance of the issue opening date to the various Investors Associations.[10] [*Clause 16.1.8.1(b)*].

(7) Collection of applications by bankers to the issue

By Bankers to the issue.—Applications from investors in the public or rights issue are collected by designated 'collection centres'.

"Collection Centre" means a place where the application for subscribing to the public or rights issue is collected by the Banker to an Issue on behalf of the issuer company. [*Clause 1.2.1(vi)*].

Agreement with issuer company

(1) Every banker to an issue shall enter into an agreement with the body corporate for whom it is acting as a banker to an issue.

(2) The agreement referred to in sub-regulation (1) shall contain the following clauses, namely:—

(a) the number of centres at which the application and application monies of an issue of a body corporate will be collected from the investors;

(b) the time within which the statement regarding the applications and application monies received from the investors investing in an issue of a body corporate will be forwarded to the registrar to an issue or the body corporate, as the case may be;

(c) that a daily statement will be sent by the designated controlling branch of the bankers to the issue to the registrar to an issue indicating the number of applications received on that date from the investors investing in the issue of a body corporate, and the amount of application money received. *Reg. 14 of SEBI (Bankers to an Issue) Regulations, 1994 (Appendix 220).*

Furnishing of Details of Shares Applications/Application Monies by Banker to an Issue

In terms of sub-regulation (2) of regulation 14 of the SEBI (Bankers to an Issue) Regulations, 1994, the agreement between a banker to an issue and the body corporate shall *inter alia* contain the clauses stipulating the time within which the statement regarding the application and application monies received from the investors will be forwarded to the registrar to an issue or the body corporate, as the case may be. Further, the agreement shall also stipulate that a daily statement will be sent by the designated controlling branch of the bankers to the issue, to the registrar to the issue indicating the number of applications received on that date and the amount of the application monies received.

In the interest of the investors it has been the endeavour of SEBI to reduce the time period involved between closure of the issue and listing of the securities. The SEBI (Disclosure and Investor Protection) Guidelines, 2000 specify a maximum period of 30 days for allotment after the closure of the issue. In the case of book built issues, the allotment is required to be done within 15 days of closure of issue. The registrar to the issue may be able to finalise the basis of allotment of securities only on timely receipt of details of collection figures, the applications and the application monies received.

Therefore, you are advised to ensure that the applications, details regarding the application and application monies received from the investors investing in the issue of a body

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10. For list of Investors Association, see *Appendix* 'F' to *Appendix* 233.

corporate and the final certificate are furnished to the registrar to the issue, the lead manager and the body corporate, before the expiry of 7 working days after the date of closure of issue.

These instructions shall be applicable to all issues including book built issues, opening on and from 1st June, 2001. You are advised to ensure that appropriate systems, procedure and infrastructure are in place at the collecting and controlling branches for compliance with the above. *BTI (GI Series) Circular No. 1 (2000-2001) dt. 11-5-2001.* [*Issued by SEBI, Primary Market Department*]

Fixation of date stamp and continuous serial number on application form.—All bankers to an issue have been advised to affix date stamp alongwith a continuous serial number generated by an automatic numbering machine (at the time of submission of the application form of public/rights issues by an investor, at the collecting branch) on the main part of the application form aswell as on the perforated part which remains with the investor. [*RBTI (GI Series) Circular No. 1 (1997-98), dated 1st September, 1997 issued by SEBI, Primary Market Division*].

Appointment of Compliance Officer.—1. Every banker to an issue shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the Board or the Central Government and for redressal of investors' grievances.

2. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him. [*Reg. 16A*].

Mandatory Collection Centres

The Lead Merchant Banker shall ensure that Bankers to the Issue are appointed in all the mandatory collection centres. [*Clause 5.4.3.2*].

The minimum number of collection centres for an issue of capital shall be-

(a) the four metropolitan centres situated at Mumbai, Delhi, Calcutta and Chennai

(b) all such centres where the stock exchanges are located in the region in which the registered office of the company is situated.

(c) the regional division of collection centres is indicated in Schedule VII to SEBI Guidelines, 2000. [*Clause 5.9.1*].

Additional Collection Centres

The issuer company shall be free to appoint as many collection centres as it may deem fit in addition to the above minimum requirement. [*Clause 5.9.2*].

Authorised Collection Agents

The issuer company can also appoint authorised collection agents in consultation with the Lead Merchant Banker subject to necessary disclosures including the names and addresses of such agents made in the offer document. [*Clause 5.10.1*].

Appointment.—The modalities of selection and appointment of collection agents can be made at the discretion of the Lead Merchant Banker. [*Clause 5.10.2*].

The lead merchant banker shall ensure that the collection agents so selected are properly equipped for the purpose, both in terms of infrastructure and manpower requirements. [*Clause 5.10.3*].

Duties.—The collection agents may collect such applications as are accompanied by payment of application moneys paid by cheques, drafts and *stockinvests. [*Clause 5.10.4*].

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* Stockinvest Scheme has been withdrawn w.e.f. 5-11-2003 [Vide *RBI Circular No. DBOD. No. FSC.BC.42/24.47.001/2003-04, dt. 5-11-2003*]. See *Appendix* 230.

The authorised collection agent shall not collect application moneys in cash. [*Clause 5.10.5*].

The applications collected by the collection agents shall be deposited in the special share application account with designated scheduled bank either on the same date or latest by the next working day. [*Clause 5.10.6*].

The application forms along with duly reconciled schedules shall be forwarded by the collection agent to the Registrars to the Issue after realisation of cheques and after weeding out the applications in respect of cheques return cases, within a period of 2 weeks from the date of closure of the public issue. [*Clause 5.10.7*].

*The applications accompanied by stockinvests shall be sent directly by the collection agent to the Registrars to the Issue along with the schedules within one week from the date of closure of the issue. [*Clause 5.10.8*].

Disclosure in offer document/application form.—The offer documents and application forms shall specifically indicate that the acknowledgement of receipt of application moneys given by the collection agents shall be valid and binding on the issuer company and other persons connected with the issue. [*Clause 5.10.9*].

Applications from other places

The investors from the places other than from the places where the mandatory collection centres and authorised collection agents are located, can forward their applications along with stockinvests to the Registrars to the Issue directly by Registered Post with Acknowledgement Due. [*Clause 5.10.10*].

The applications received through the registered post shall be dealt with by the Registrars to the Issue in the normal course. [*Clause 5.10.11*].

Collection by Registrars.—Where the number of applications in a public issue is expected to be large, the issuer company in consultation with the lead merchant banker may associate one or more Registrars registered with SEBI for the limited purpose of collecting the application forms at different centres and forward the same to the designated Registrar to the Issue as mentioned in the offer document.

The designated Registrar to the Issue shall be primarily and solely responsible for all the activities as assigned to them for the issue management. [*Clause 5.4.3.4*].

**Stock Invests.*—The lead merchant banker shall ensure compliance with the instruction issued by the RBI on handling of stock invest by any person including Registrars. [*Clause 7.4.1.1*].

Other obligations of Lead Merchant Bankers

The obligations of Lead Merchant Banker in respect of certain specific matters may be noted.

The Lead Merchant Bankers shall ensure that in case of the listed companies, a 48 hours notice of the meeting of the Board of Directors for passing resolution for determination of price is given to the Designated Stock Exchange. [*Clause 3.5.3*]

The final offer document, shall contain only one price and one set of financial projections, if applicable. [*Clause 3.5.4.*]

As to particulars to be disclosed in the offer document, attention is invited to the following clauses of Chapter VI of SEBI Guidelines ('Contents of Offer Document').

(a) Disclaimer clause [*Clause 6.3.3*].

(b) Presentation of capital structure of the company [*Clause 6.4*].

(c) Arrangements for disposal of odd lots [*Clause 6.5.2*].

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* **Stockinvest Scheme has been withdrawn w.e.f. 5-11-2003 [Vide *RBI Circular No. DBOD. No. FSC.BC.42/24.47.001/2003-04, dt. 5-11-2003*]. See *Appendix* 230.**

(d) Applications by mutual funds [*Clause 6.5.4.1*]
(e) Applications by NRIs [*Clause 6.5.4.2*].
(f) Key Managerial Personnel [*Clause 6.7.4*].
(g) Option to subscribe [*Clause 6.19.9*].

Agreements with depositories.—The lead manager shall ensure that the issuer company has entered into agreements with all the depositories for dematerialisation of securities. He shall also ensure that an option is given to the investors to receive allotment of securities in dematerialised form through any of the depositories [*Clause 5.14.1*]

Trading in demat form

In the case of public issues by unlisted companies, the lead merchant banker shall incorporate a statement in the offer documents that the trading in the securities shall be in dematerialised form only for all the investors [*Clause 6.34(c)*].

Appointment of Compliance Officer.—1. Every merchant banker shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by the Board or the Central Government and for redressal of investors' grievances.

2. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him and ensure that the observations made or deficiencies pointed out by the Board on/in the draft prospectus or the Letter of Offer as the case may be, do not recur. [*Reg. 28-A*].

PRE-ISSUE OBLIGATIONS OF ISSUER COMPANY

Execution of Memorandum of Understanding

§ See Notes *ante*.

Undertaking about transaction of promoters

The issuer shall submit an undertaking to SEBI to the effect that transactions in securities by the 'promoter' the 'promoter group' and the immediate relatives of the 'promoters' during the period between the date of filing the offer documents with the Registrar of Companies or Stock Exchange as the case may be and the date of closure of the issue shall be reported to the Stock exchanges concerned within 24 hours of the transaction(s). [*Clause 5.3.5.1*].

List of Promoters' Group and other details

The issuer company shall submit to the Board the list of the persons who constitute the Promoters' Group and their individual shareholding. [*Clause 5.3.6.1*].

The issuer company shall submit to the Stock Exchanges on which securities are proposed to be listed, the Permanent Account Number, Bank Account Number and Passport Number of the promoters at the time of filing the draft offer document to them. [*Clause 5.3.6.2*].

Appointment of Compliance Officer

An issuer company shall appoint a compliance officer who shall directly liaise with the Board with regard to compliance with various laws, rules, regulations and other directives issued by the Board and investors complaints related matter. [*Clause 5.12.1*].

The name of the compliance officer so appointed shall be intimated to SEBI. [*Clause 5.12.2*].

Issuer representatives are allowed to meet SEBI officials

Complaints have been received that company (issuers) representatives are not allowed to meet SEBI officers. It is brought to the notice of all concerned that the representatives of the companies are free to accompany the merchant bankers for the purpose of submis-

sion of clarifications/discussion with SEBI officials regarding offer documents submitted by them to SEBI. It is expected that this would expedite the clarifications from them and clearance of their offer documents faster. It has also been decided that copies of SEBI's correspondence on offer documents with merchant bankers will invariably be sent to the issuing companies as well. [*SEBI Press Release, dated 28-9-1995*].

SEBI GUIDELINES ON ISSUE OF SECURITIES TO THE PUBLIC

The conditions to be satisfied by companies proposing to issue securities to the public as laid down in SEBI Guidelines, 2000[11] are discussed hereinafter under the following headings:

1. General conditions for issue of securities
2. Project appraisal
3. Initial Public Offering by unlisted companies
4. Public issue by listed companies
5. Public issue by companies in information technology sector
6. Flexibility in pricing of securities.
7. Initial Public Offer through Stock Exchange On Line System (e-IPO)

(1) SEBI Guidelines, 2000—General Conditions for Issue of Securities

Applicability of the Guidelines

(i) SEBI Guidelines, 2000 shall be applicable to all public issues by listed and unlisted companies, all offers for sale and rights issues by listed companies whose equity share capital is listed, except in case of rights issues where the aggregate value of securities offered does not exceed Rs.50 lacs.

Provided that in case of the rights issue where the aggregate value of the securities offered is less than Rs.50 Lakhs, the company shall prepare the letter of offer in accordance with the disclosure requirements specified in these guidelines and file the same with the Board for its information and for being put on the SEBI website. [*Ins. by SEBI Circular No. 11, dt. 14-8-2003*]

(ii) Unless otherwise stated, all provisions in these guidelines applicable to public issues by unlisted companies shall also apply to offers for sale to the public by unlisted companies [*Clause 1.4*].

The following general conditions are to be satisfied by companies issuing securities through an offer document [*Clause 2.0*]

"Offer document" means Prospectus in case of a public issue or offer for sale and Letter of Offer in case of a rights issue [*Clause 1.2.1 (xx)*]

Conditions are to be satisfied at the time of filing of offer document

The companies issuing securities offered through an offer document, shall, satisfy the conditions at the time of filing draft offer document with SEBI and also at the time of filing the final offer document with the Registrar of Companies/Designated Stock Exchange. [*Clause 2.0*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Means of Finance

No company shall make a public or rights issue of securities unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, have been made. [*Clause 2.8*] [*Ins. Ibid*].

Filing of offer document

§ See Notes *ante*.

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11. For full text of the Guidelines, see *Appendix* 162.

Issue Opening Date

An issue shall open within 3 months from the date of issuance of the observation letter by the Board, if any or within 3 months from the 22nd day from the date of filing of the draft offer document with the Board, if no observation letter is issued. [*Clause 8.21.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Companies which are barred from issuing security

No company shall make an issue of securities if the company has been prohibited from accessing the capital market under any order or direction passed by SEBI [*Clause 2.1.3*].

Application for listing

No company shall make any public issue of securities unless it has made an application for listing of those securities in the stock exchange (s) [*Clause 2.1.4*].

"Stock Exchange" means a stock exchange which is for the time being recognised under section 4 of the Securities Contracts (Regulation) Act, 1956[12] [*Clause. 1.2.1 (xxvii)*].

Issue of securities in dematerialised form

No company shall make public or rights issue or an offer for sale of securities, unless—

(a) the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders; and

(b) the company gives an option to subscribers/shareholders/investors to receive the security certificates or hold securities in dematerialised form with a depository.

Explanation.—A 'depository' shall mean a depository registered with SEBI under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 [*Clause 2.1.5.1*].

§ See Notes under section 68B *post.*

Agreements with depositories

The lead manager shall ensure that the issuer company has entered into agreements with all the depositories for dematerialisation of securities. He shall also ensure that an option is given to the investors to receive allotment of securities in dematerialised form through any of the depositories. [*Clause 5.14.1*]

Partly paid up shares

No company shall make public or rights issue of equity shares or any security convertible at a later date into equity shares unless all the existing partly paid up shares have been fully paid or forfeited. [*Clause 2.7.1*].

Payment of Discounts/Commissions, etc.

No payment, direct or indirect, in the nature of a discount, commission, allowance or otherwise shall be made either by the issuer company or the promoters in any public issue, to the persons who have received firm allotment in such public issue [*Para 3.6.1*].

Freedom to determine the denomination of shares for public/rights issues and to change the standard denomination

An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with sub-section (4) of section 13 of the Companies Act, 1956 and in compliance with the norms as specified by SEBI in circular

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12. For list of recognised stock exchanges, see notes on section 2(39).

no. SMDRP/POLICY/CIR-16/99 dated June 14, 1999 and other norms as may be specified by SEBI from time to time [*Clause 3.7.1*].

The companies which have already issued shares in the denomination of Rs.10/- or Rs.100/- may change the standard denomination of the shares by splitting or consolidating the existing shares [*Clause 3.7.2*].

The companies proposing to issue shares in any denomination or changing the standard denomination in terms of clause 3.7.1 or 3.7.2 above shall comply with the following:

(a) the shares shall not be issued in the denomination of decimal of a rupee;

(b) the denomination of the existing shares shall not be altered to a denomination of decimal of a rupee;

(c) at any given time there shall be only one denomination for the shares of the company;

(d) the companies seeking to change the standard denomination may do so after amending the Memorandum and Articles of Association, if required;

(e) the company shall adhere to the disclosure and accounting norms specified by SEBI from time to time [*Clause 3.7.3*].

Promoters' contribution if no identifiable promoters

In case of public issue by companies where no identifiable promoter or promoter group exists, the requirements as to minimum promoters' contribution do not apply [See *clause 4.10.1 (b)*].

§ For further details, see Notes under sec. 81.

Retention of over-subscription

Over-subscription to the extent of 10% of the *net public offer* can be retained for the purpose of rounding off to the nearer multiple of 100 while finalising the allotment [*Clause 6.4.2(f)*].

Terms of the Issue

Minimum Number of Share Applications and Application Money in public issue

(i) In case of public issue at par, the minimum number of shares for which an application is to be made, shall be fixed at 200 shares of face value of Rs.10/- each.

(ii) Where the public issue is at a premium or comprises security, whether convertible or non-convertible, or the public issue is of more than one security, the minimum application moneys payable in respect of each security by each applicant, shall not be less than Rs 2000/- irrespective of the size of premium subject to applications being for a multiple of tradeable lots. [*Clause 8.6.1*]

Security Certificates to be in tradeable lots

(iii) The successful applicants shall be issued by the issuer company share certificates/instruments for eligible number of shares in tradeable lots.

(iv) The minimum tradeable lot, in case of shares of face value of Rs.10/- each, shall at the option of the issuer/offeror, be fixed on the basis of offer price as given below:

Provided that the maximum tradeable lot in any case shall not exceed 100 shares.

Offer price per share	Minimum Tradeable lot
Up to Rs 100	100 Shares
Rs 101- Rs 400	50 Shares
More than Rs. 400	10 Shares [*Clause 8.6.1*].

Minimum application

(v) The minimum application moneys to be paid by an applicant along with the application form shall not be less than 25% of the issue price.

(vi) The minimum number of instruments for which an application has to be made shall be not less than the tradeable lot [*Clause 8.6.1.*].

Offer for sale

(vii) In case of an offer for sale, the entire amount payable on each instrument shall be brought in at the time of application [*Clause. 8.6.1*].

Securities Issued to be Made Fully Paid Up

(a) If the subscription money is proposed to be received in calls, the calls shall be structured in such a manner that the entire subscription money is called within 12 months from the date of allotment.

(b) If the investor fails to pay call money within 12 months the subscription money already paid may be forfeited.

(c) If the issue size is above Rs.500 crores and is subject to monitoring requirement as per Clause 8.17.1 of Chapter VIII of the SEBI Guidelines, 2000 [see below], it shall not be necessary to call the entire subscription money within 12 months [*Clause 8.6.2.*].

Restriction on further Capital Issues

No company shall make any further issue of capital in any manner whether by way of issue of bonus shares, preferential allotment, rights issue or public issue or otherwise, during the period commencing from the submission of offer document to the Board on behalf of the company for public or rights issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or undersubscription, etc. [*Clause. 8.7.1*].

(a) No company shall, pending conversion of Fully Convertible Debentures (FCDs) or Partly Convertible Debentures (PCDs), issue any shares by way of bonus or rights unless similar benefit is extended to the holders of such FCDs or PCDs, through reservation of shares in proportion to such convertible part of FCDs/PCDs [*Clause. 8.7.2(a)*].

(b) The share so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus or rights issue was made [*Clause 8.7.2(b)*].

Period of subscription

Subscription list for public issues shall be kept open for at least 3 working days and not more than 10 working days.[13] [*Clause. 8.8.1(a)*].

Incentives to Prospective Shareholders

The issuer shall not offer any incentives to the prospective investors by way of medical insurance scheme, lucky draw, prizes, etc. [*Clause 8.14.1*].

Requirement of Monitoring Agency

In case of issues exceeding Rs.500 crores, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by one of the financial institutions [*Clause 8.17.1*].

A copy of the monitoring report as per the format specified at Schedule-XIX to SEBI Guidelines, 2000, shall be filed with the Board by the said monitoring agency, on a half yearly basis, till the completion of project, for the purposes of record [*Clause. 8.17.2*].

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13. Public issue made by infrastructure company may be kept open for a maximum period of 21 days. [*Cl. 8.8.1(b)*].

(2) Project Appraisal

Important Note.—These Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" as issued by SEBI Guidelines, 2000 discussed above.

Project appraisal not compulsory

SEBI (DIP) Guidelines, 2000 do not envisage compulsory appraisal of the project which is proposed to be financed partly/fully by the proceeds of issue of securities (equity shares or any security convertible into equity at a later date). However, a company which did not fulfil the entry/eligibility norms specified in the Guidelines was required to have its project appraised by PFI or scheduled commercial bank before making the public issue. This was the position prior to the amendment of certain provisions of the guidelines by DIP (Compendium) Circular No. 3, dated 4-8-2000. The amended guidelines, 2000 has modified the entry/eligibility norms and has dispensed with the compulsory project appraisal requirement. Where a company, however, has its project appraised, it is required to make certain disclosures in the offer document.

Public issue by infrastructure company.—An infrastructure company proposing to make a public issue is *exempt* from the eligibility entry norms set out in clauses 2.2. and 2.3 of the SEBI Guidelines, 2000 if—

(a) its project has been appraised by a Public Financial Institution (PFI) or Infrastructure Development Finance Corporation (IDFC) or Infrastructure Leasing and Financing Services Ltd. (IL&FS) or a bank which was earlier a PFI; *and*

(b) not less than 5% of the project cost is financed by any of the institutions referred to in above, jointly or severally, irrespective of whether they appraise the project or not, by way of loan or subscription to equity or a combination of both [*Clause 2.4.1(iii)*].

See also under '***Public issue by infrastructure company***' *post.*

Guidelines as to Disclosures in offer document

Under heading 'Appraisal'—

(a) The scope and purpose of the appraisal along with the date of appraisal shall be disclosed in the offer document.

(b) The offer document shall contain the cost of the project and means of finance as per the appraisal report.

(c) The weaknesses and threats, if any, given in the appraisal report, shall be disclosed in the offer document by way of risk factors [*Clause 6.6.4.1*].

Research reports

The lead merchant banker shall ensure that the following are complied with in respect of research reports—

(i) the research report is prepared only on the basis of published information as contained in the offer document.

(ii) no selective or additional information, or information extraneous to the offer document, shall be made available by the issuer or any member of the issue management team/syndicate to only one section of the investors or to any research analyst in any manner whatsoever including at road shows, presentations, in research or sales reports or at bidding centres etc.

(iii) no research report shall be circulated by the issuer or any member of the issue management team/ syndicate or their associates, commencing from a date 45 days immediately preceding the filing of draft offer document with SEBI and till 45 days after commencement of trading in the relevant securities; [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(iv) the advertisement code is observed while circulating the research reports, and that the risk factors are reproduced wherever highlights are given, as in case of an advertisement. [*clause 9.3.1*]

Project appraisal by companies making IPO : Bombay Stock Exchange norms for listing

Project appraisal is necessary for listing of public issue by new companies on the BSE (Bombay Stock Exchange). In this regard, threshold limits for listing will be as follows:

Category I (for companies with post-issue equity capital of Rs. 10 crore and above)

(i) Post-issue capital of Rs. 10 crore.

(ii) Post-issue networth of Rs. 20 crores.

(iii) The project/activity of the applicant must have been appraised by a financial institution as described in section 4A of the Companies Act, 1956 or State Finance Corporation or Scheduled Commercial Bank with a paid-up capital of Rs. 50 crore of category I merchant Banker with a networth of Rs. 10 crore.

Category II (for companies with post-issue equity capital of Rs. 5 crore and above, but less than Rs. 10 crore)

(i) Post-issue capital of Rs. 5 crore.

(ii) Post-issue networth of Rs. 20 crore.

(iii) The minimum market capitalisation should be of Rs. 50 crore. (The capitalisation will be calculated by multiplying post-issue subscribed number of equity shares with the issue price.)

(iv) The project/activity of the applicant must have been appraised by a financial institution as described in section 4A of the Companies Act, 1956 or State Finance Corporation or Scheduled commercial bank with a paid-up capital of Rs. 50 crore or category I merchant banker with a networth of Rs. 10 crore.

All the applications will continue to be scrutinised by the Listing Committee of the exchange.

(3) Initial Public Offerings by Unlisted Companies*

Important Note.—These Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" as issued by SEBI Guidelines, 2000 discussed above.

The following guidelines are *specific* to a public issue of securities by any *unlisted* company.

Eligibility

An unlisted company may make an initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date, only if it meets all the following conditions:

(a) The company has net tangible assets of at least Rs. 3 crore in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets:

Provided that if more than 50% of the net tangible assets are held in monetary assets, the company has made firm commitments to deploy such excess monetary assets in its business/project;

(b) The company has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three (3) out of immediately preceding five (5) years;

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* For procedure as to listing of NCDs and DSECs of an unlisted company *without making an initial public offer of equity shares,* see Notes under sec. 73 *post.*

Pricing of issue of securities

An unlisted company eligible to make a public issue and desirous of getting its securities listed on a recognised stock exchange pursuant to a public issue may freely price its equity shares or any securities convertible at a later date into equity shares [*Para 3.2.1*].

Differential Pricing

Any unlisted company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public.

Explanation:

The net offer to the public means the offer made to the Indian public and does not include firm allotments or reservations or promoters' contributions [*Clause 3.4.1*].

Composite issue.—In the public issue which is a part of a composite issue, differential pricing as at per clause 3.4.1 above is permissible. [*Clause 3.4.3*]

Justification for differntial pricing.—Justification for the price difference shall be given in the offer document [*Clause 3.4.4*]

Net offer to the public

In case of a public issue by an unlisted company, the net offer to public shall be at least 10% of 25% as the case may be, of the post-issue capital. [*Clause 8.3.1.*].

Promoters Contribution*

Extent of Contribution.—In a public issue by an unlisted company, the promoters shall contribute not less than 20% of the post issue capital [*Clause 4.1.1*].

Securities Ineligible for Computation of Promoters Contribution.—The securities issued or allotted to promoters are not to be taken into account for computing promoters' contribution in the following cases :

• ***Unlisted Companies.***—In case of public issue by unlisted companies, securities which have been issued to the promoters during the preceding one year, at a price lower than the price at which equity is being offered to public shall not be eligible for computation of promoters contribution:

Provided that the shares for which the difference between the offer price and the issue price for these shares is brought in by the promoters shall be considered eligible subject to issuer company complying with the applicable provisions of the Companies Act, 1956 (such as passing of revised resolution by shareholders or issuer's Board, filing of revised return of allotment with ROC, etc.) [*Clause 4.6.2*].

In respect of clause 4.6.2 above, shares acquired by promoters in pursuance to a scheme of merger or amalgamation approved by a High Court shall be eligible for computation of promoters contribution [*Clause 4.6.4.*]

• ***Promoters' contribution in companies formed by conversion of firms.***—In respect of companies formed by conversion of partnership firms, where the partners of the erstwhile partnership firm and the promoters of the converted company are the same and there is no change in management, the shares allotted to the promoters during previous one year out of the funds brought in during that period shall not be considered eligible for computation of promoters contribution unless such shares have been issued at the same price at which the public offer is made.

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* For common conditions regarding promoters contribution applicable to all public issues, including composite issues, see Notes under section 81 *post*.

Provided that if the partners capital existed in the firm for a period of more than one year on a continuous basis, the shares allotted to promoters against such capital shall be considered eligible. [*Clause 4.6.3*].

• ***Lock-in of excess promoters' contribution.***—In case of a public issue by unlisted company, if the promoters contribution in the proposed issue exceeds the required minimum contribution, such excess contribution shall also be locked in for a period of one year [*Clause 4.12.1*].

Lock-in of pre-issue share capital of an unlisted company

The entire pre-issue share capital, other than that locked-in as promoters' contribution, shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

Provided that where shares held by promoter(s) are lent to the SA under clause 8A.7, they shall be exempted from the lock in requirements specified above, for the period starting from the date of such lending to the date when they are returned to the same promoter(s) under clause 8A.13 or under clause 8A.15, as the case may be. [*Clause 4.14.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Clause 4.14.1 shall not be applicable to—

(i) pre-issue share capital held by Venture Capital Funds and Foreign Venture Capital Investors registered with the Board. However, the same shall be locked-in as per the provisions of the SEBI (Venture Capital Funds) Regulations, 1996 and SEBI (Foreign Venture Capital Investors) Regulations, 2000 and any amendments thereto,

(ii) pre-issue share capital held for a period of at least one year at the time of filing draft offer document with the Board and being offered to the public through offer for sale.

(iii) pre-IPO shares held by employees other than promoters, which were issued under employee stock option or employee stock purchase scheme of the issuer company before the IPO. However the same is subject to the issuer company complying with the requirements laid down in Clause 22.4 of SEBI(Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. [*Clause 4.14.2*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Lock-in of securities issued on firm allotment basis

Securities issued on firm allotment basis shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later [*Clause 4.14A*].

Disclosure of risks in relation to the first issue in offer document

The 'Risks in relation to first issue' (wherever applicable) shall be incorporated in a box format in case of a initial public issue: "This being the first issue of the company, there has been no formal market for the securities of the company. The issue price (has been determined and justified by the Lead Merchant Bankers and the issuer company as stated under justification of Premium paragraph—in case of premium issue) should not be taken to be indicative of the market price of the equity shares after the shares are listed. No assurance can be given regarding an active or sustained trading in the shares of the company nor regarding the price at which the equity shares will be traded after listing." [*Clause 6.2.1.2(iv)(a)*].

In case of issue proposed to be listed on the Over the Counter Exchange of India and/or where market maker has been appointed, the concluding sentence of the above risk factor shall read as under:

"No assurance can be given regarding the price at which the equity shares of the company will be traded after listing." [*Clause 6.2.1.2 (iv)(b)*].

Trading in dematerialised form only

In case of public issues by unlisted companies, the lead merchant banker shall incorporate a statement in the offer documents that the trading in the securities shall be in dematerialised form only for all investors. [*Clause 6.34(c)*].

(4) Public Issue by Listed Companies

Important Note.—These Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" as issued by SEBI Guidelines, 2000 discussed above.

"Listed Company" means a company which has any of its securities offered through an offer document listed on a recognised stock exchange and also includes Public Sector Undertakings whose securities are listed on a recognised stock exchange [*Clause 1.2.1(xviii)*].

Eligibility

A listed company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date.

Provided that the aggregate of the proposed issue and all previous issues made in the same financial year in terms of size (i.e. offer through offer document + firm allotment + promoters' contribution through the offer document), issue size does not exceed 5 times its pre-issue networth as per the audited balance sheet of the last financial year.

Provided that in case there is a change in the name of the issuer company within the last 1 year (reckoned from the date of filing of the offer document), the revenue accounted for by the activity suggested by the new name is not less than 50% of its total revenue in the preceding 1 full-year period. [*Clause 2.3.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*]

Public issue by listed company not satisfying the conditions

A listed company which does not fulfill the conditions given in the provisos to Clause 2.3.1 above, shall be eligible to make a public issue subject to complying with the conditions specified in Clause 2.2.2. [*Clause 2.3.2*] [*Subs. by Ibid*]

[For clause 2.2.2, see under the heading "Issue of Public Offerings by Unlisted Companies" *ante*].

Free Pricing

A listed company whose equity shares are listed on a stock exchange may freely price its equity shares and any security convertible into equity at a later date, offered through a public or rights issue [*Clause 3.1.1*].

Differential Pricing

A listed company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public.

Explanation:

The net offer to the public means the offer made to the Indian public and does not include firm allotments or reservations or promoters' contributions. [*Clause 3.4.1*]

A listed company making a composite issue of capital may issue securities at differential prices in its public and rights issue [*clause 3.4.2*].

Justification for the price difference shall be given in the offer document [*Clause 3.4.4.*].

Net offer to the public

The net offer to the public shall be at least 10% or 25%, as the case may be, of the issue size [*Clause 8.3.2*].

Promoters Contribution in case of Public Issues

In case of public issues by listed companies, the promoters shall participate either to the extent of 20% of the proposed issue or ensure post-issue share holding to the extent of 20% of the post-issue capital [*Clause 4.3.1*].

Promoters Contribution in case of Composite Issues

In case of composite issues of a listed company, the promoters contribution shall at the option of the promoter(s) be either 20% of the proposed public issue or 20% of the post-issue capital [*Clause 4.4.1*].

Rights issue component of the composite issue shall be excluded while calculating the post-issue capital [*Clause 4.4.2*].

Promoters participation in excess of the required minimum contribution to be treated as preferential allotment

In case of a listed company, participation by promoters in the proposed public issue in excess of the required minimum percentage referred in Clauses 4.3.1 and 4.4.1 above shall attract the pricing provisions of Guidelines on preferential allotment if the issue price is lower than the price as determined on the basis of said preferential allotment guidelines [*Clause 4.8.1*].

Exemption from requirement of Promoters Contribution

The requirement of promoters contribution shall not be applicable in case of public issue of securities by a company which has been listed on a stock exchange for at least 3 years and has a track record of dividend payment for at least 3 immediately preceding years [*Clause 4.10.1(a)*].

But, if the promoters participate in the proposed issue to the extent greater than higher of the two options available as per Clauses 4.3.1 and 4.4.1 above, the subscription in excess of such percentage shall attract pricing guidelines on preferential issue, if the issue price is lower than the price as determined on the basis of said guidelines on preferential issue. [*Clause 4.10.1(a), Proviso*].

The promoters have to disclose their existing shareholding and the extent to which they are participating in the proposed issue in the offer document. [*Clause 4.10.1, Proviso*].

Lock-in of excess promoters' contribution

In case of a public issue by a listed company, participation by promoters in the proposed public issue in excess of the required minimum percentage shall also be locked-in for a period of one year as per the lock-in provisions as specified in Guidelines on Preferential issue.[15] [*Clause 4.12.2*].

The excess promoters contribution as per Clause 4.10.1(a) above shall not be subject to lock-in [*Clause 4.12.2, Proviso*].

(5) SEBI Guidelines 2000.—Public Issue by Infrastructure Companies

Meaning of "infrastructure company"

Important Note.—These Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" as issued by SEBI Guidelines, 2000 discussedabove.

The following guidelines are specific to a public issue of securities by infrastructure companies.

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15. See Chapter XIII of SEBI (DIP) Guidelines, 2000 in Appendix 162.

"Infrastructure company" means a company wholly engaged in the business of developing, maintaining and operating infrastructure facility [*Clause 1.2.1(xv)*].

"Infrastructure facility" means the 'infrastructure facility' within the meaning of section 10(23G) of Income Tax Act, 1961 [*Cl. 1.2.1(xvi)*].

Clause (c) of Section 10(23G) of Income-tax Act defines 'infrastructure facility' as follows:

(c) "infrastructure facility" means—

(i) a road, highway, bridge, airport, port, rail system, a water supply project, irrigation project, sanitation and sewerage system or any other public facility of a similar nature as may be notified by the Board (CBDT) in this behalf in the Official Gazette and which fulfils the conditions specified in sub-section (4A) of section 80-IA[16];

(ii) a project for generation or generation and distribution of electricity or any other form of power where such project starts generating power on or after the 1st day of April, 1993;

(iii) a project for providing telecommunication services on or after the 1st day of April, 1995;

(iv) a project for housing which fulfils the conditions specified in sub-section (4F) of section 80-IA.[17]

Eligibility

The eligibility norms applicable to initial public offering by unlisted company under clause 2.2 and public issue by listed company under clause 2.3 do not apply to a public issue by an infrastructure company—

(a) whose project has been appraised by a Public Financial Institution or Infrastructure Development Finance Corporation (IDFC) or Infrastructure Leasing and Financing Services Ltd. (IL&FS) and

(b) not less than 5% of the project cost is financed by any of the institutions referred to in sub-clause (a), jointly or severally, irrespective of whether they appraise the project or not, by way of loan or subscription to equity or a combination of both. [*Clause 2.4.1.(iii)*].

Net offer to the public in relaxation of SC(R) Rules

An infrastructure company, satisfying the requirements in clause 2.4.1 (iii) of Chapter II (cited above), inviting subscription from public shall not attract the provisions of clauses 8.3.1 and 8.3.2 as to the requirement of net offer of 10% or 25% of post-issue capital to the public) [*Clause 8.3.3.*].

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16. Sub-section (4A) of section 80-IA of the Income-tax Act reads as follows:

(4A) This section applies to any enterprise carrying on the business of developing, maintaining and operating any infrastructure facility which fulfils all the following conditions, namely:—

(i) the enterprise is owned by a company registered in India or by a consortium of such companies;

(ii) the enterprise has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing, maintaining and operating a new infrastructure facility subject to the condition that such infrastructure facility shall be transferred to the Central Government, State Government, local authority or such other statutory body, as the case may be, within the period stipulated in the agreement;

(iii) the enterprise starts operating and maintaining the infrastructure facility on or after the 1st day of April, 1995.

17. Sub-section (4F) of section 80-IA reads as follows:

(4F) This section applies to an undertaking engaged in developing and building housing projects approved by a local authority subject to the condition that the size of the plot of land has a minimum of one acre, and the residential unit has a built up area not exceeding one thousand square feet:

Provided that the undertaking commences development and construction of the housing project on or after the 1st day of October, 1998, and completes the same before the 31st day of March, 2001.

Pricing of issue

An eligible infrastructure company shall be free to price its equity shares subject to the compliance with the disclosure norms as specified by SEBI from time to time [*Clause 3.2.2*]

Period of subscription

The public issue made by an infrastructure company satisfying the requirements in Clause 2.4.1(iii) above may be kept open for a maximum period of 21 working days [*Clause 8.8.1(b)*].

Minimum subscription

The requirement of minimum subscription shall not be applicable to an eligible infrastructure company, provided disclosures regarding the alternate source of funding is made in the offer documents. [*Clause 6.3.8.5*].

(6) Flexibility in pricing of securities

While framing the earlier Guidelines on Disclosure and Investor Protection, SEBI made the following observations in relation to pricing of issues:

Merchant bankers have represented to SEBI that issuers be allowed to fix the issue price, in consultation with the lead managers, as near to as possible the opening of the issue/filing of the offer documents with the Registrars of Companies/Stock Exchanges, instead of specifying the issue price in the offer documents submitted to SEBI for vetting, as at present. The matter has been considered and it is felt that there is justification in the representation made by the merchant bankers as in the present system, there is a considerable time gap between the approval granted by the General Body/the Board of Directors of the company and the actual date of issue and very often on account of subsequent developments in the capital market, the price indicated in the offer document does not reflect the true position. Accordingly, the issuers will be allowed to mention a price band of 20 per cent in the offer document submitted to SEBI for vetting and the actual price could be determined at the time of filing of the offer document with ROC/StockExchange which should be within the price band.

As far as SEBI is concerned, the draft offer documents submitted (for vetting) should contain suitable *Explanatory Notes* indicating the financial implications if the price were to be fixed at different ranges within the price band approved by the Board/General Body. The final offer document, however, will have only one price and one set of financial projections and it should be ensured that the cap in the band should not be more than 20 per cent of the floor price. [*Clarification : Primary Market Dept. of SEBI, Press Release,* dated 31-3-1994 and *RMB (DIP) Series Circular no. 1 (94-95) dated 6-4-1994.*]

The SEBI Guidelines, 2000 retain the aforesaid flexibility in pricing of issue of securities. Chapter III of SEBI Guidelines, 2000 on 'Pricing by Companies Issuing Securities' provides that companies eligible to make public issue can freely price their equity shares or any security convertible at later date into equity shares in the following cases:

Public/Rights Issue by Listed Companies

§ See Notes *ante* and under sec. 81.

Public Issue by Unlisted Companies

§ See Notes *ante.*

Infrastructure company

§ See Notes *ante.*

Initial public Issue by Banks

The banks (whether public sector or private sector) may freely price their issue of equity shares or any securities convertible at a later date into equity share subject to approval by the Reserve Bank of India. [*Clause 3.3.1*]

RBI Guidelines dated 20-3-2002.—For RBI Guidelines on Issue and Pricing of Shares by Private Sector Banks, see Notes under section 81.

Price Band

Issuer company can mention a price band of 20% (cap in the price band should not be more than 20% of the floor price) in the offer documents filed with the Board and actual price can be determined at a later date before filing of the offer document with ROCs. [*Clause 3.5.1*]

If the Board of Directors has been authorised to determine the offer price within a specified price band such price shall be determined by a Resolution to be passed by the Board of Directors. [*Clause 3.5.2*]

The Lead Merchant Bankers shall ensure that in case of the listed companies, a 48 hours notice of the meeting of the Board of Directors for passing resolution for determination of price is given to the Designated Stock Exchange. [*Clause 3.5.3*]

The final offer document, shall contain only one price and one set of financial projections, if applicable. [*Clause 3.5.4*]

(7) SEBI GUIDELINES ON INITIAL PUBLIC OFFER THROUGH THE STOCK EXCHANGE ON LINE SYSTEM (e-IPO)

The said set of guidelines have been issued under SEBI Compendium of Series Circular No. 5, dt. 30-11-2000 by inserting a new Chapter XIA to this main guidelines 2000. For the text, see *Appendix* 162.

SEBI GUIDELINES 2000.—CONTENTS OF THE PROSPECTUS

Schedule II to the Companies Act, 1956 sets out the matters to be specified in the prospectus. Chapter VI, Section I of SEBI (DIP) Guidelines, 2000 as to 'Contents of the Prospectus' follows the schematic order of Schedule II while laying down guidelines for disclosure of certain specific particulars and the manner of disclosure in respect of matters covered under Parts I and II of Schedule II to the Act. There are provisions as to disclosures in some other Chapters of the SEBI (DIP) Guidelines, 2000 which have some effect upon the requirements of disclosures in prospectus. Such provisions are being reproduced herein below so as to give the readers a complete view of the network of the provisions.

§ For the text of the SEBI (DIP) Guidelines, 2000 refer *Appendix* 162.

SEBI GUIDELINES 2000.—CONTENTS OF THE PROSPECTUS

Schedule II to the Companies Act, 1956 sets out the matters to be specified in the prospectus. Chapter VI, Section I of SEBI (DIP) Guidelines, 2000 as to 'Contents of the Prospectus' follows the schematic order of Schedule II while laying down guidelines for disclosure of certain specific particulars and the manner of disclosure in respect of matters covered under Parts I and II of Schedule II to the Act. An attempt has been made to collate the requirements of disclosure laid down in other Chapters of the Guidelines, 2000 also.

CONTENTS OF THE PROSPECTUS

The offer document shall contain all material information which shall be true and adequate so as to enable the investors to make informed decision on the investments in the issue [*Clause 6.1*].

The offer document shall also contain the information and statements specified hereunder [*Clause 6.1.1*].

Cover Pages

Front Outer Cover Page

(a) The front cover page of the prospectus shall be white and no patterns or pictures shall be printed on this page.

(b) The cover page paper shall be of adequate thickness (preferably minimum 100 gm. quality) [*Clause 6.2.1.1*].

The front outer cover page of the prospectus shall contain the following details only:

(i) The word "Prospectus"

(ii) The name of the issuer company and address of the registered office of the company along with telephone fax number and E.mail address.

(iii) The nature, number, price and amount of the instruments offered.

(iv) (a) The '*Risks in relation to the first issue*' (wherever applicable) shall be incorporated in a box format in case of a initial public issue:

"This being the first issue of the company, there has been no formal market for the securities of the company. The issue price (has been determined and justified by the Lead Merchant Banker and the issuer company as stated under Justification of Premium paragraph - in case of premium issue) should not be taken to be indicative of the market price of the equity shares after the shares are listed. No assurance can be given regarding an active or sustained trading in the shares of the company nor regarding the price at which the equity shares will be traded after listing."

(b) In case of issue proposed to be listed on the Over the Counter Exchange of India and/or where market maker has been appointed, the concluding sentence of the above risk factor shall read as under:

"No assurance can be given regarding the price at which the equity shares of the company will be traded after listing."

(c) If more than one merchant banker are associated with the issue, the *inter-se* allocation of responsibility of each Merchant Banker as demarcated and submitted to the Board in terms of clause 5.3.2, shall be disclosed in the offer document. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(v) The following *general risk* shall be incorporated:

"Investment in equity and equity related securities involve a degree of risk and investors should not invest any funds in this offer unless they can afford to take the risk of losing their investment. Investors are advised to read the risk factors carefully before taking an investment decision in this offering. For taking an investment decision, investors must rely on their own examination of the issuer and the offer including the risks involved. The securities have not been recommended or approved by Securities and Exchange Board of India (SEBI) nor does SEBI guarantee the accuracy or adequacy of this document."

Specific attention of investors shall be invited to the summarised and detailed statement of Risk Factors by indicating their page number(s) in the 'General Risks'.

(vi) '*Issuer's Absolute Responsibility*' clause shall be incorporated as under :

"The issuer, having made all reasonable inquiries, accepts responsibility for, and confirms that this offer document contains all information with regard to the issuer and the issue, which is material in the context of the issue, that the information contained in the offer document is true and correct in all material aspects and is not misleading in any material respect, that the opinions and intentions expressed herein are honestly held and that there are no other facts, the omission of which makes this document as a whole or any of such information or the expression of any such opinions or intentions misleading in any material respect."

(vii) (a) The name and address of only the Lead Merchant Banker who files the offer document with Board along with its telephone, fax number and E.mail address shall appear on the front outer cover page.

(b) The names of the other Lead Merchant Bankers, Co-Managers, etc. may be mentioned on the back cover page.

The name and address of the Registrar to the Issue along with the telephone number and fax number.

(viii) Issue Opening Date

(ix) Credit Rating, if applicable

(x) Name/s of stock exchanges where listing of the securities is proposed and the details of in principle approval for listing be obtained from these SEs [*Clause 6.2.1.2*].

Front Inside Cover Page

Index shall appear on the Front Inside Cover Page [*Clause 6.2.2.1*].

Inner Cover Pages

The other risk factors shall be printed in clear readable font (preferably of minimum point 10 size) starting on the first inner cover page to be numbered page i (and, if need be, shall continue on subsequent pages ii, iii, etc. as distinct from the page number of the offer document proper which would run as 1, 2, 3, etc.) in addition to appearing in the Part I of the Prospectus [*Clause 6.2.3.1*].

Presentation of risk factors

(i) The Risk factors shall be classified as those which are specific to the project and internal to the issuer company and those which are external and beyond the control of the issuer company.

(ii) The Risk factor shall be determined on the basis of their materiality.

(iii) Materiality shall be decided taking the following factors into account:

(a) Some events may not be material individually but may be found material collectively.

(b) Some events may have material impact qualitatively instead of quantitatively.

(c) Some events may not be material at present but may be having material impacts in future.

(iv) The Risk factors shall appear in the Offer Document in the following manner:

(a) Risks envisaged by Management

(b) Proposals, if any, to address the risks. [*Clause 6.2.3.2*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Back Cover Pages

Back Inside Cover Page and Back Outside Cover Page shall be in white [*Clause 6.2.4.1*].

Any 'notes' required to be given prominence shall appear immediately after the Risk Factors wherever they appear [*Clause 6.2.4.2.*].

PART I OF SCHEDULE II TO COMPANIES ACT, 1956

I. GENERAL INFORMATION

Disclaimer Clause

A prospectus shall contain the following disclaimer clause in bold capital letters:

"It is to be distinctly understood that submission of offer document to SEBI should not in any way be deemed or construed that the same has been cleared or approved by SEBI. SEBI does not take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed to be made or for the correctness of the statements made or opinions expressed in the offer document. Lead Merchant Banker, _____ has certified that the disclosures made in the offer document are generally adequate and are in conformity with SEBI (Disclosures and Investor Protection) Guidelines in force for the time being. This requirement is to facilitate investors to take an informed decision for making investment in the proposed issue.

It should also be clearly understood that while the Issuer Company is primarily responsible for the correctness, adequacy and disclosure of all relevant information in the offer document, the Lead Merchant Banker is expected to exercise Due Diligence to ensure that the Company discharges its responsibility adequately in this behalf and towards this purpose, the Lead Merchant Banker _____ has furnished to SEBI a Due Diligence Certificate dated _____ in accordance with SEBI (Merchant Bankers) Regulations 1992 which reads as follows :

(i) We have examined various documents including those relating to litigation like commercial disputes, patent disputes, disputes with collaborators etc. and other materials in connection with the finalisation of the offer document pertaining to the said issue;

(ii) On the basis of such examination and the discussions with the Company, its Directors and other officers, other agencies, independent verification of the statements concerning the objects of the issue, projected profitability, price justification and the contents of the documents mentioned in the Annexure and other papers furnished by the company—

WE CONFIRM that :

(a) the offer document forwarded to SEBI is in conformity with the documents, materials and paper relevant to the issue;

(b) all the legal requirements connected with the said issue, as also the guidelines, instructions, etc. issued by SEBI, the Government and any other competent authority in this behalf have been duly complied with; and

(c) the disclosures made in the offer document are true, fair and adequate to enable the investors to make a well informed decision as to the investment in the proposed issue.

(iii) We confirm that beside ourselves, all the intermediaries named in the prospectus are registered with SEBI and till date such registration is valid.

(iv) We have satisfied ourselves about the worth of the underwriters to fulfill their underwriting commitments.

The filing of offer document does not, however, absolve the company from any liabilities under section 63 or 68 of the Companies Act, 1956 or from the requirement of obtaining such statutory or other clearances as may be required for the purpose of the proposed issue. SEBI, further reserves the right to take up, at any point of time, with the lead merchant banker(s) any irregularities or lapses in offer document [*Clause 6.3.3.1*]."

Disclaimer Statement from the Issuer

A statement to the effect that the issuer accepts no responsibility for statements made otherwise than in the prospectus or in the advertisement or any other material issued by or at the instance of the issuer and that anyone placing reliance on any other source of information would be doing so at his own risk should be incorporated [*Clause 6.3.4.1*] .

Filing of offer document with the Board and ROC

(a) Under this head, the office of SEBI where the offer document has been filed shall be mentioned.

(b) The ROC where copy of the offer document, having attached thereto the Material Contracts and Documents referred to elsewhere in the offer document, has been filed shall also be mentioned [*Clause 6.3.5*].

(c) Names of Designated Stock Exchange and other exchanges where application has been made for listing of the present issue shall be mentioned. [*Clause 6.3.6*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Guidelines as to disclosures to be made in respect of certain specific matters under Schedule II to the Act

Names of Stock Exchanges [Item 1(c) of Part I of Sch. II]*

Names of Designated Stock Exchange and other exchanges where application has been made for listing of the present issue. [*Clause 6.3.6*]

Statement about refund of application money if minimum subscription is not received. [Item I(e) of Part I, Sch. II]

Minimum subscription clause

Following statement shall appear:

For Non-underwritten Public Issues.—"If the company does not receive the minimum subscription of 90% of the issued amount on the date of closure of the issue, or if the subscription level falls below 90% after the closure of issue on account of cheques having been returned unpaid or withdrawal of applications, the company shall forthwith refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay the amount, the company shall pay interest as per Section 73 of the Companies Act 1956" [*Clause 6.3.8.1*].

For Underwritten Public Issues.—"If the company does not receive the minimum subscription of 90% of the net offer to public including devolvement of Underwriters within 60 days from the date of closure of the issue, the company shall forthwith refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay the amount, the company shall pay interest prescribed under Section 73 of the Companies Act 1956" [*Clause* 6.3.8.2].

In the case of Composite Issues—

1. The Lead Merchant Banker shall ensure that the requirement of "minimum subscription" is satisfied both jointly and severally, i.e., independently for both rights and public issues.

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* On April 23, 2003, Ministry of Finance (MOF) issued a circular thereby withdrawing the concept of regional stock exchange. Pursuant to the aforesaid circular, amendments have been carried out in SEBI (DIP) Guidelines 2000 at the relevant places. The companies have been given flexibility to choose a Stock Exchange (defined as a Designated Stock Exchange in the guidelines) for a particular issue made under these guidelines. It is hereby clarified that for subsequent issues, the company has a freedom to choose some other stock Exchange as a Designated Stock Exchange.

"Designated stock exchange" means a stock exchange in which securities of the company are listed or proposed to be listed and which is chosen by the company for purposes of a particular issue under these guidelines.

Provided that where any of such stock exchanges have nationwide trading terminals, the company shall choose one of them as the designated stock exchange.

Provided further that the company may choose a different exchange as a designated stock exchange for any subsequent issue, subject to the above clause. [*Clause 1.2.1 (xvii-a)*].

2. If the company does not receive the minimum subscription in either of the issues the company shall refund the entire subscription received [*Clause 6.3.8.3*].

Offer for sale.—The requirement of minimum subscription shall not be applicable to offer for sale [*Clause 6.3.8.4.1*].

Public issue by infrastructure company.—The requirement of minimum subscription shall not be applicable to a public issue by an eligible infrastructure company, provided disclosures regarding the alternate source of funding is made in the offer documents [*Clause 6.3.8.5.1*].

In respect of an underwritten issue, the lead merchant banker shall ensure that the relevant details of underwriters are included in the offer document.

Declaration about underwriters.—(a) Names and addresses of the underwriters and the amount underwritten by them.

(b) Declaration by board of directors of the issuer company that the underwriters have sufficient resources to discharge their respective obligations. [*Clause 6.3.13*].

The lead merchant banker shall incorporate a statement in the offer document to the effect that in the opinion of the lead merchant banker, the underwriters' assets are adequate to meet their underwriting obligations. [*Clause 5.5.2(a)*].

Credit rating obtained [***Item I(j) of Part I of Sch. II***].

(i) If the rating has been obtained from more than one credit rating agencies, disclosures shall be made of all ratings including unaccepted rating.

(ii) All the credit ratings obtained during the previous three years before filing of the offer document for any of its listed debt-securities at the time of accessing the market through a rated debt-security shall be disclosed [*Clauses 6.3.12 and 2.5.4*].

Compliance Officer[18]

(a) The name, address telephone number, fax and E.mail number and address of Compliance Officer.

(b) The investor's attention shall also be invited to contact the compliance officer in case of any pre-issue/post-issue related problems such as non-receipt of letters of allotment/share certificates/refund orders/cancelled stockinvests, etc. [*Clause 6.3.14*].

II. CAPITAL STRUCTURE OF THE COMPANY

Paid-up capital [***Item II(c) of Part I/Sch. II***].

• Share Premium Account (after and before the issue) [*Clause 6.4.1(d)*].

• For the purposes of presentation of the capital structure in the specified format, the lead merchant banker shall take into account the following:

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18. **Appointment of Compliance Officer.**—An issuer company shall appoint a compliance officer who shall directly liaise with the SEBI with regard to compliance with various laws, rules, regulations and other directives issued by it and investors complaints related matter [*Clause 5.12.1*]

Compliance Officer to be Appointed by Lead Merchant Banker.—The merchant bankers shall appoint a senior officer as Compliance Officer to ensure that all Rules, Regulations, Guidelines, Notifications etc. issued by SEBI, the Government of India, and other regulatory organizations are complied with [*Clause 8.13.1*].

The Compliance Officer shall co-ordinate with regulatory authorities in various matters and provide necessary guidance as also ensure compliance internally [*Clause 8.13.2*].

The Compliance Officer shall also ensure that observations made/deficiencies pointed out by SEBI do not recur [*Clause 8.13.1*].

(a) Proposed issue amount = (Promoters' contribution in the proposed issue) + (firm allotment) + (offer through the offer document).

(b) Offer through the offer document shall include net offer to the public and reservations to the permitted reserved categories and shall not include the promoters' contribution in the proposed issue and firm allotment.

Net offer to the public shall mean the offer made to Indian public and does not include reservations/firm allotments/promoters' contribution [*Clause 8.4.1.*].

Notes to Capital Structure

1. After the details of capital structure, the following notes shall be incorporated:-

   (a) Note relating to promoters' contribution and lock-in period stating date of allotment, date when made fully paid up, nature of allotment (rights, bonus, etc.), number of securities, face value of securities, issue price of securities, percentage of promoters contribution to total issued capital and the date up to which the securities are locked-in.

   (b) An illustrative format of promoters contribution and lock-in is specified in Schedule VIII to SEBI Guidelines, 2000[19]

      (i) Percentage of contribution by the promoters whose name figured in the prospectus as promoters in the paragraph on "Promoters and their background" and the date up to which the securities are locked-in.

      (ii) An illustrative format of promoters contribution whose name figures in prospectus is specified in Schedule IX to SEBI Guidelines, 2000.

   (c) Statement that promoters contribution has been brought in not less than the specified minimum lot and from persons defined as promoters under the Guidelines.

   (d) Statement that the promoters undertake to accept full conversion, if the promoters contribution is in terms of the same optionally convertible security as is being offered to the public.

   (e) Details of all "buy-back" and 'stand by' and similar arrangements for purchase of securities by promoters, directors and lead merchant bankersshall be disclosed.[20]

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19. See *Appendix* 127.

20. **'Buy-back' and 'Stand-by' arrangements.**—In many cases, promoters and promoter groups enter into 'buy-back' arrangements in items whereof parties agree to subscribe to the shares with an agreement that after the issue closes, the shares allotted to such parties will be purchased back by the promoter or promoter groups. There are also 'stand-by' arrangements with parties to agree to subscribe to the shares in the event of a short-fall in the public subscription. The cost of these arrangements is often passed on to the company in some form. We would suggest that disclosure may be required in the prospectus of all such arrangements. [See para 12.5 of *Malegam Committees's Report* at *Appendix* 185.]

Safety Net or Buy Back Arrangement

Any safety net scheme or buy-back arrangements of the shares proposed in any public issue shall be finalised by issuer company with the lead merchant banker in advance and disclosed in the prospectus [*Clause 8.18.1*].

Such buy back or safety net arrangements shall be made available only to all original resident individual allottees [*Clause 8.18.2*].

Such buy back or safety net facility shall be limited upto a maximum of 1000 shares per allottee and the offer shall be valid at least for a period of 6 months from the last date of despatch of securities [*Clause 8.18.3*].

The financial capacity of the person making available buy back or safety net facility shall be disclosed in the draft prospectus [*Clause 8.18.4*].

[Please note that buy-back, stand-by or similar arrangement is not allowed with persons for whom securities are reserved for allotment on firm basis] [*Clause 8.5.(g)*]

(f) An over-subscription to the extent of 10% of the net offer to public can be retained for the purpose of rounding off to the nearer multiple of 100 while finalising the allotment.

(g) A disclosure to the effect that the securities offered through this public/rights issue shall be made fully paid up or may be forfeited within 12 months from the date of allotment of securities in the manner specified in clause 8.6.2.

(h) A note stating that:

(a) unsubscribed portion in any reserved category may be added to any other reserved category.

(b) The unsubscribed portion, if any, after such *inter se* adjustments amongst the reserved categories shall be added back to the net offer to the public.

(i) In case of under-subscription in the net offer to the public portion spill-over to the extent of undersubscription shall be permitted from the reserved category to the net public offer portion.

(j) Following details regarding major shareholders:—

(i) names of the ten largest shareholders as on the date of filing of the prospectus with the registrar of Companies;

(ii) number of shares held by shareholders at (i) above including number of shares which they would be entitled to upon exercise of warrant, option, rights to convert a debenture, loan or other instrument;

(iii) particulars as in (i) and (ii) above as on a date two years prior to the date of filing the prospectus with the Registrar of Companies;

(iv) particulars as in (i) and (ii) above as on a date 10 days prior to the date of filing of the prospectus with the Registrar of the Company;

(v) if the issuer company has made an initial public offering within the immediately preceding two years, the above information shall be given separately indicating the names of persons who acquired shares by subscriptions to the public issue and those who acquired the shares by allotment on a firm basis or by private placement.

(k) The details of:—

(i) the aggregate shareholding of the Promoters group and of the directors of the Promoters, where the promoter is a company;

(ii) aggregate number of securities purchased or sold by the Promoters Group and the directors of the promoter during a period of six months preceding the date on which the draft prospectus is filed with Board and to be updated by incorporating the information in this regard till the time of filing the prospectus with the Registrar of the Companies;

(iii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant dates.

(l) In the event of it not being possible to obtain information regarding sales and purchase of securities by any relative of the promoters, a statement to that effect shall be made in the prospectus on the basis of the transfers recorded in the books of the company.

Explanation I—

For the purpose of sub-clauses (i) to (iii) of clause (k) above, the term 'promoter' shall include -

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the person or persons named in the prospectus as promoter(s) :

Provided that a director/officer of the issuer company or person, if he is acting as such merely in his professional capacity, shall not be included in the Explanation.

Explanation II

'Promoter Group' shall include—

(a) the promoter;

(b) an immediate relative of the promoter (i.e. any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

(c) in case promoter is a company—

(i) a subsidiary or holding company of that company;

(ii) any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the Promoter;

(iii) any company in which a group of individuals or companies or combinations thereof who holds 20% or more of the equity capital in that company also holds 20% or more of the equity capital of the issuer company; and

(d) in case the promoter is an individual,—

(i) any company in which 10% or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the 'Promoter' or any one or more of his immediate relative is a member;

(ii) any company in which a company specified in (i) above holds 10% or more of the share capital;

(iii) any HUF or firm in which the aggregate share of the promoter and his immediate relative is equal to or more than 10% of the total share capital; and

(e) all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus "shareholding of the promoter group".

Explanation III.—The Financial Institution, Scheduled Banks, Foreign Institutional Investors (FIIs) and Mutual Funds shall not be deemed to be a promoter or promoter group merely by virtue of the fact that 10% or more of the equity of the issuer company is held by such institution:

Provided that the Financial Institutions, Scheduled banks, Foreign Institutional Investors, shall be treated as promoters or promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them [*Clause 6.4.2.1*].

III. TERMS OF THE PRESENT ISSUE

Terms of payments [Item III(a) of Part I/Sch. II]

The caption "Interest in Case of Delay in Despatch of Allotment Letters/Refund Orders in Case of Public Issues" shall appear and shall contain the following statement:

"The company agrees that as far as possible allotment of securities offered to the public shall be made within 30 days of the closure of public issue. The company further agrees that it shall pay interest @15% per annum if the allotment letters/refund orders have not been despatched to the applicants within 30 days from the date of the closure of the issue. However, applications received after the closure of issue in fulfillment of underwriting

obligations to meet the minimum subscription requirement shall not be entitled for the said interest." [*Clause 6.5.1.1*]

Arrangements for Disposal of Odd Lots

(a) Any arrangements made by the issuer company for providing liquidity for and consolidation of the shares held in odd lots, particularly when such odd lots arise on account of issues by way of rights, bonus, conversion of debentures/warrants etc., shall be intimated to the shareholders/investors.

(b) The company is free to make arrangements for providing liquidity in respect of odd lot shares through any investment or finance company, broking firms or through any other agency and the particulars of such arrangement, if any, may be disclosed in the offer documents related to the concerned issue of capital [*Clause 6.5.2.1*].

Lead Merchant Banker shall ascertain whether the companies coming for fresh issue of capital propose to set up trusts in order to provide service to the investors in the matter of disposal of odd lot shares of the company held by them and if so, disclosures relating to setting up and operation of the trust shall be contained in the offer document [*Clause 6.5.2.2*].

Whenever any issue results in issue of shares in odd lots, the issuer company shall as far as possible issue certificates in the denomination of 1-2-5-10-20-50 shares [*Clause 6.5.2.3*].

Justification for Differential Pricing

Any unlisted company or a listed company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public.

Explanation:

The net offer to the public means the offer made to the Indian public and does not include firm allotments or reservations or promoters' contributions [*Clause 3.4.1*].

A listed company making a composite issue of capital may issue securities at differential prices in its public and rights issue [*Clause 3.4.1*].

In the public issue which is a part of a composite issue differential pricing as per subclause 3.4.1 above is also permissible [*Clause 3.4.2*].

Justification for the price difference shall be given in the offer document for subclauses 3.4.1 and 3.4.2 [*Clause 3.4.3*].

Price Band

Issuer company can mention a price band of 20% (cap in the price band should not be more than 20% of the floor price) in the offer documents filed with SEBI and actual price can be determined at a later date before filing of the offer document with ROCs [*Clause 3.5.1*].

If the Board of Directors has been authorised to determine the offer price within a specified price band such price shall be determined by a Resolution to be passed by the Board of Directors [*Clause 3.5.2*].

The Lead Merchant Bankers shall ensure that in case of the listed companies, a 48 hours notice of the meeting of the Board of Directors for passing resolution for determination of price is given to the Designated Stock Exchange [*Clause 3.5.3*].

The final offer document, shall contain only one price and one set of financial projections, if applicable [*Clause 3.5.4*].

If in a draft offer document submitted to SEBI, a price band as per the provisions of clause 3.5.1 above is mentioned, suitable explanatory notes indicating the financial implications, if the price were to be fixed at different ranges within the price band approved by the company Board/General Body, shall be disclosed in the offer document [*Clause 8.9.1*].

How to apply.—Availability of forms, prospectus and mode of payment [Item III(c) of Part I/Sch. II].

Minimum Number of Share Applications and Application Money in public issue

(i) In case of public issue at par, the minimum number of shares for which an application is to be made, shall be fixed at 200 shares of face value of Rs.10/- each.

(ii) Where the public issue is at a premium or comprises security, whether convertible or non-convertible, or the public issue is of more than one security, the minimum application moneys payable in respect of each security by each applicant shall not be less than Rs 2000/- irrespective of the size of premium subject to applications being for a multiple of tradeable lots.

(iii) The successful applicants shall be issued by the issuer company share certificates/instruments for eligible number of shares in tradeable lots.

(iv) The minimum tradeable lot, in case of shares of face value of Rs.10/- each, shall, at the option of the issuer/offeror, be fixed on the basis of offer price as given below. Provided that the maximum tradeable lot in any case shall not exceed 100 shares:

Offer price per share	**Minimum Tradeable lot**
Up to Rs 100	100 Shares
Rs 101- Rs 400	50 Shares
More than Rs. 400	10 Shares

(v) The minimum application moneys to be paid by an applicant along with the application money shall not be less than 25% of the issue price.

(vi) The minimum number of instruments for which an application has to be made shall be not less than the tradeable lot.

(vii) In case of an offer for sale, the entire amount payable on each instrument shall be brought in at the time of application [*Clause 8.6.1*].

Securities Issued to be Made Fully Paid Up

(a) If the subscription money is proposed to be received in calls, the calls shall be structured in such a manner that the entire subscription money is called within 12 months from the date of allotment.

(b) If the investor fails to pay call money within 12 months the subscription money already paid may be forfeited.

(c) If the issue size is above Rs.500 crores and is subject to monitoring requirement, it shall not be necessary to call the entire subscription money within 12 months [*Clause 8.6.2.*]

Applications by mutual funds

(a) Lead Merchant Bankers shall clearly incorporate necessary disclosures under the heads "Procedure for applications by mutual funds" and "Multiple Applications" to indicate that a separate application can be made in respect of each scheme of an Indian mutual fund registered with the Board and that such applications shall not be treated as multiple applications.

(b) The applications made by the AMCs or custodians of a Mutual Fund shall clearly indicate the name of the concerned scheme for which application is being made [*Clause 6.5.4.1*].

Applications by NRIs

The Lead merchant banker shall ensure the following disclosures:

(a) The name and address of at least one place in India from where individual NRI applicants can obtain the application forms.

(b) "NRI applicants may please note that only such applications as are accompanied by payment in free foreign exchange shall be considered for allotment under the reserved category. The NRIs who intend to make payment through Non-Resident Ordinary (NRO) accounts shall use the form meant for Resident Indians and shall not use the forms meant for reserved category" [*Clause 6.5.4.2.1*].

(a) In the application form meant for Indian Public, the declaration relating to Nationality and Residentship shall be shown prominently as under:

"Nationality and Residentship (Tick whichever is applicable)

(i) I am/We are Indian National(s) resident in India and I am/we are not applying for the said equity shares as nominee(s) of any person resident outside India or Foreign National(s).

(ii) I am/We are Indian National(s) resident in India and I am/we are applying for the said equity shares as Power of Attorney holder(s) of Non-Resident Indian(s) mentioned below on non-repatriation basis.

(iii) I am/We are Indian National(s) resident outside India and I am/we are applying for the said equity shares on my/our own behalf on non-repatriation basis."

(b) The application form meant for NRIs shall not contain provision for payment through NR(O) accounts.

(c) On the face of the form, the following legend shall be printed in a box:

"Attention NRI Applicants: Payment must be made through their Non Resident External (NRE)/Foreign Currency Non Resident (FCNR) accounts or through cheques/drafts sent from abroad and drawn on convertible rupee accounts in India. Forms accompanied by cheques drawn on NR(O) accounts are liable to be rejected".

Attention of NRIs shall be invited to the following:

(a) Such applications as are accompanied by payment in free foreign exchange shall be considered for allotment under the reserved category.

(b) Such NRIs who wish to make payment through Non-Resident Ordinary (NRO) accounts shall use the form meant for Resident Indians and shall not use the form meant for reserved category [*Clause 6.23.2.1(a)*].

Tax benefit.—Any special tax benefits for company and its shareholders [*Clause 6.23.3*].

General instructions.—The application form should contain necessary instructions/provision for the following:

(i) Instructions to applicants to mention the number of application form on the reverse of the instruments to avoid misuse of instruments submitted along with the applications for shares/debentures in public issues.

(ii) Provision in the application form for inserting particulars relating to savings bank/current account number and the name of the bank with whom such ac-

count is held to enable the Registrars to print the said details in the refund orders after the names of the payees.

(iii) Disclosure of PAN/GIR number in respect of applications for monetary value of the investment of Rs.50,000 and above.

(iv) Giving an option to investors to either receive securities in the form of physical certificates or hold them in dematerialised form [*Clause 6.23.2.1(b)*].

Acknowledgement by collection agents.—The offer documents and application forms shall specifically indicate that the acknowledgement of reciept of application moneys given by the collection agents shall be valid and binding on the issuer company and other persons connected with the issue. [*Clause 5.10.9*].

Despatch of Refund Orders.—The following clause shall be incorporated in the prospectus:

"The company shall ensure despatch of refund orders of value over Rs.1500/- and share/debenture certificates by Registered Post only and adequate funds for the purpose shall be made available to the Registrars by the issuer company" [*Clause 6.5.5.1*].

Undertaking by the Issuer Company.—The following undertaking by the issuer company shall be incorporated in the offer document :

(a) that the complaints received in respect of the Issue shall be attended to by the issuer company expeditiously and satisfactorily;

[21][(b) that all steps for completion of the necessary formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed are taken within 7 working days of finalisation of basis of allotment.]

(c) that the issuer company shall apply in advance for the listing of equities on the conversion of Debentures/Bonds;

(d) that the funds required for despatch of refund orders/allotment letters/certificates by registered post shall be made available to the Registrar to the Issue by the issuer company;

(e) that the promoters' contribution in full, wherever required, shall be brought in advance before the Issue opens for public subscription and the balance, if any, shall be brought in *pro rata* basis before the calls are made on public;

(f) that the certificates of the securities/refund orders to the non-resident Indians shall be despatched within specified time;

(g) that no further issue of securities shall be made till the securities offered through this offer document are listed or till the application moneys are refunded on account of non-listing, undersubscription, etc.;

(h) that necessary cooperation with the credit rating agency(ies) shall be extended in providing true and adequate information till the debt obligations in respect of the instrument are outstanding [*Clause 6.5.6.1*].

Undertaking in case of debenture issue [Clause 6.5.6.2].—See Notes under sec. 117.

Utilisation of Issue Proceeds.—A statement by the Board of Directors of issuer company to the effect that–

(a) all monies received out of issue of shares or debentures to public shall be transferred to separate bank account other than the bank account referred to in sub-section (3) of section 73;

(b) details of all monies utilised out of the issue referred to in sub-item(i) shall be disclosed under an appropriate separate head in the balance-sheet of the company indicating the purpose for which such monies had been utilised; and

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21. Subs. by DIP (Compendium) Circular No. 3, dated 4-8-2000.

(c) details of all unutilised monies out of the issue of shares or debentures, if any, referred to in sub-item(i) shall be disclosed under an appropriate separate head in the balance-sheet of the company indicating the form in which such unutilised monies have been invested [*Clause 6.5.7.1*].

[22][The offer document shall contain a statement of the Board of Directors of the issuer company to the effect that—

(*i*) the utilisation of monies received under promoters' contribution and from firm allotments and reservations shall be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised.

(*ii*) the details of all unutilised monies out of the funds received under promoters' contribution and from firm allotments and reservations shall be disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilised monies have been invested.] [*Clause 6.5.7.2*]

IV. PARTICULARS OF THE ISSUE

Objects.—[*Subs. by SEBI Circular No. 11, dt. 14-8-2003*]

Whether the company proposes to raise funds for a purpose like fixed asset creation and/or for rotation such as working capital etc. shall be disclosed clearly in the offer document. [*Clause 6.6.1.2*].

Where the company proposes to raise funds for a purpose like fixed asset creation, the requirement of funds shall also be disclosed clearly. [*Clause 6.6.1.3*].

Project Cost.—[*Item IV(b) of Part I/Sch. II*].

Break-up of project cost.—

(a) Where the company proposes to undertake more than one activity i.e diversification, modernisation, expansion etc. the total project cost shall be given activitywise.

(b) Where the company is implementing the project in a phased manner, the cost of each phase including the phase, if any, which has already been implemented shall be separately given.

(c) The total project cost shall reflect the cost involved in each of the projects mentioned under the section on " Objects of the issue" [*Clause 6.6.2*].

Means of financing.—[*Item IV(c) of Part I/Sch. II*]

(a) An undertaking shall be given in the offer document by the issuer company confirming firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, have been made.

(b) The balance portion of the 'Means of Finance' for which no firm arrangement has been made shall be mentioned without specification. [*Clause 6.6.3*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Appraisal

(a) The scope and purpose of the appraisal along with the date of appraisal shall be disclosed in the offer document.

(b) The offer document shall contain the cost of the project and means of finance as per the appraisal report.

(c) The weaknesses and threats, if any, given in the appraisal report shall be disclosed in the offer document by way of risk factors [*Clause 6.6.4.1*].

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22. Added by DIP (Compendium) Circular No. 3, dated 4-8-2000.

Deployment of funds in the project

(a) Actual expenditure incurred on the project (in cases of companies raising capital for a project) upto a date not earlier than 2 months from the date of filing the prospectus with Registrar of Companies.

(b) Means and source of financing including details of "bridge loan" or other financial arrangement, which may be repaid from the proceeds of the issue.

(c) Year-wise break up of the expenditure proposed to be incurred on the said project.

(d) Investment avenues in which the management proposes to deploy issue proceeds pending its utilisation in the proposed project [*Clause 6.6.5*].

Name of monitoring agency, if applicable, to be disclosed.[23] [*Clause 6.6.6*]

V. COMPANY, MANAGEMENT AND PROJECT

Promoters and their Background.—[Item V(c) of Part I/Sch. II]

(a) (i) A complete profile of the promoters including their age, educational qualifications, experience in the business or employment and in the line of business proposed in the offer document , their business and financial activities, photograph, Voter ID Number, Driving License Number shall be disclosed.

(ii) A disclosure, confirming that the Permanent Account Number, Bank Account Number and Passport Number of the promoters have been submitted to the Stock Exchanges on which securities are proposed to be listed, at the time of filing the draft offer document to them. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(b) In case the promoters are companies, history of the companies and the promoters of the companies shall be furnished.

(c) Details in change of management of the companies, if any, including details of the persons who are holding the controlling interest together with the applicability and compliance of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997[24]. [*Clause 6.7.3*]

Key Managerial Personnel

(a) A paragraph on the key managerial personnel shall be incorporated giving full details of the personnel recruited as on the date of filing of the offer document with the Board indicating name, date of joining, qualification, details of previous employment etc.

(b) The Lead Merchant Banker shall verify and ensure that the persons whose name appear in this para are in the employment of the company as permanent employees.

(c) Any change otherwise than by way of retirement in the normal course in the key senior managerial personnel particularly in charge of production, planning, finance and marketing within one year prior to the date of filing the offer document with the Board shall be disclosed [*Clause 6.7.4*].

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23. **Requirement of Monitoring Agency.**—In case of issues exceeding Rs.500 crores, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by one of the financial institutions [*Clause 8.17.1*].

A copy of the monitoring report as per the format specified at Schedule-XIX to SEBI Guidelines, 2000, shall be filed with the Board by the said monitoring agency, on a half yearly basis, till the completion of project, for the purposes of record [*Clause 8.17.2*].

24. For text of the Regulations, see *Appendix* 167.

Plant and machinery, technology, process, etc.—[Item V(f) of Part I/Sch. II]

(a) Details in a tabular form to be given shall include the machines required to be bought by the company, cost of the machines, name of the suppliers, the date of placement of order and the date/expected date of supply.

(b) In case of machines yet to be delivered, the date of quotations relied upon for the cost estimates given, shall also be mentioned.

(c) Percentage and value terms of the plant and machinery for which orders are yet to be placed shall be stated and also be given by way of a risk factor.

(d) Details of second hand machinery bought/proposed to be bought, if any, including the age of the machines, balance estimated life, etc. shall also be given [*Clause 6.7.7*].

Collaboration, any performance guarantee or assistance in marketing by the collaborators.—[Item V(g) of Part I/Sch. II].

Following information regarding persons/entities with whom technical and financial agreements have been entered into to be given:

(a) place of registration and year of incorporation;

(b) paid up share capital;

(c) turnover of the last financial year of operation;

(d) general information regarding such persons relevant to the issuer [*Clause 6.7.8.1*].

The products.—[Item V(j) of Part I/Sch. II]

Nature of the product/s - consumer/industrial and end users.—[Sub-item (i)]

(a) Market including details of the competition, past production figures for the industry, existing installed capacity, past trends and future prospects regarding exports (if applicable), demand and supply forecasts (if given, should be essentially with assumptions unless sourced from a market research agency of repute), etc. to be given.

(b) Source of data used shall be mentioned [*Clause 6.7.11.2*].

Future prospects.—[Item V(k) of Part I/Sch. II]

Capacity & Capacity Utilisation

(a) A table shall be incorporated giving the existing installed capacities for each product, capacity utilisation for these products in the previous 3 years, proposed capacities for existing as well as proposed products and the assumptions for future capacity utilisation for the next three years (from the date of commencement of commercial production) in respect of existing as well as proposed products.

(b) If the projected capacity utilisation is higher than the actual average capacity utilisation by more than 25% during the previous 3 years, how the company proposes to achieve the projected levels of capacity utilisation in view of its failure to achieve levels of similar capacity utilisation in the past, shall be stated [*Clause 6.7.12.1*].

Stock Market Data.—[Last Para of Item V of Part I/Sch. II]

Particulars of:—

(a) high, low and average market prices of the share of the company during the preceding three years;

(b) monthly high and low prices for the six months preceding the date of filing the draft prospectus with Board which shall be updated till the time of filing the prospectus with the Registrar of Company/Stock Exchange concerned;

(c) number of shares traded on the days when the high and low prices were recorded in the relevant stock exchange during said period of (i) and (ii) above;

(d) the stock market data referred to above shall be shown separately for periods marked by a change in capital structure, with such period commencing from the date the concerned stock exchange recognises the change in the capital structure (e.g. when the shares have become ex-rights or ex-bonus);

(e) the market price immediately after the date on which the resolution of the Board of Directors approving the issue was approved;

(f) the volume of securities traded in each month during the six months preceding the date on which the prospectus is filed with ROC; and

(g) the volume of business transacted along with high, low and average prices of shares of the company shall also be stated for respective periods [*Clause 6.7.13.1*].

Additional Particulars

Management Discussion and Analysis of the Financial Condition and Results of the Operations as Reflected in the Financial Statements[25]

A summary of past financial results after adjustments as given in the auditors report for the past three years containing significant items of income and expenditure shall be given [*Clause 6.8.1*].

An analysis of reasons for the changes in significant items of income and expenditure shall also be given, *inter alia*, containing the following:

(a) unusual or infrequent events or transaction;

(b) significant economic changes that materially affected or (are likely to affect) income from continuing operations;

(c) known trends or uncertainties that have had or are expected to have a material adverse impact on sales, revenue or income from continuing operations;

(d) future changes in relationship between costs and revenues, in case of events such as future increase in labour or material costs or prices that will cause a material change are known;

(e) the extent to which material increases in net sales or revenue are due to increased sales volume, introduction of new products or services or increased sales prices;

(f) total turnover of each major industry segment in which the company operated;

(g) status of any publicly announced new products or business segment;

(h) the extent to which business is seasonal;

(i) any significant dependence on a single or few suppliers or customers;

(j) competitive conditions [*Clause 6.8.2*].

A statement by the directors whether in their opinion there have arisen any circumstances since the date of the last financial statements as disclosed in the prospectus which materially and adversely affect or are likely to affect the trading or profitability of the company, or the value of its assets, or its ability to pay its liabilities within the next twelve months [*Clause 6.8.3*].

One standard financial unit shall be used in the offer document [*Clause 6.8.4*]. [*Ins. by SEBI Circular No. 11, dt. 14-8-2003*].

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25. Particulars as per audited statements contained in the offer document should not be more than 6 months old from issue opening date [*Clause 8.12.1*].

Financials of Group Companies

The following information for the last 3 years based on the audited statements in respect of all the companies, firms, ventures, etc. promoted by the promoters irrespective of whether these are covered under section 370(1)(B) of the Companies Act, 1956 shall be given, wherever applicable:

(a) Date of Incorporation;
(b) Nature of activities;
(c) Equity Capital;
(d) Reserves (excluding revaluation reserve);
(e) Sales;
(f) Profit after tax (PAT);
(g) Earnings per share (EPS); and
(h) Net Asset Value (NAV);
(i) The highest and lowest market price of shares during the preceding six months with suitable disclosures for changes in capital structure during the period and the market value on the date of filing the prospectus with the Registrar of Companies;
(j) If any of the companies has made public or rights issue in the preceding three years, the issue price of the security, the current market price and particulars of changes in the capital structure, if any, since the date of issue and a statement regarding the cost and progress of implementation of the project in comparison with the cost and implementation schedule given in the offer document;
(k) Information regarding adverse factors related to the company and in particular regarding;
    (i) whether the company has become a sick company within the meaning of the Sick Industrial Companies (Special Provisions) Act, 1995 or is under winding up;
    (ii) whether the company has made a loss in the immediately preceding year and if so, the profit or loss figures for the immediately preceding three years [*Clause 6.9.1*].

In case, the issuer company has more than five listed group companies, the financial information may be restricted to the five largest listed companies to be determined on the basis of market capitalisation one month before the date of filing draft prospectus with the Board [*Clause 6.9.2(a)*].

The information regarding company(ies) which has become BIFR company or is under winding up or has a negative net worth shall be provided. [*clause 6.9.2.(b)*].

If the promoters have disassociated themselves from any of the companies/firms during preceeding three years, the reasons therefor and the circumstances leading to the disassociation shall be furnished together with the terms of such disassociation [*Clause 6.9.3*].

(a) In case there are common pursuits among these companies, the reasons and justification for the same shall be spelt out and the conflict of interest situations shall be stated.
(b) The related business transactions within the group shall also be mentioned.
(c) The significance of these transactions on the financial performance of the company/companies shall be stated [*Clause 6.9.4*].

Sales or purchase between companies in the promoter group when such sales or purchases exceed in value in the aggregate 10% of the total sales or purchases of the issuer and also disclose material items of income or expenditure arising out of transactions in the promoter group [*Clause 6.9.5*].

VI. PARTICULARS IN REGARD TO THE COMPANY AND OTHER LISTED COMPANIES UNDER THE SAME MANAGEMENT WITHIN THE MEANING OF SECTION 370(1B), WHICH MADE CAPITAL ISSUES DURING THE LAST THREE YEARS [*Item VI of Part I/Sch. II*]

Additional particulars

Promise *vis-a-vis* Performance

Issuer Company

(a) A separate para entitled "Promise Vs Performance—Last three issues" shall be given indicating whether all the objects mentioned in the respective offer documents relating to the earlier issues by the company were met and whether all projections made in the said offer documents were achieved.

(b) If not, non-achievement of objects/projections shall be brought out distinctly; shortfall and delays shall be quantified [*Clause 6.11.1*].

Listed Ventures of Promoters

(a) A separate para on issues of group/associate companies entitled "Promise Vs Performance - Last one Issue of group/associate companies" shall be given indicating whether all the objects mentioned in the respective offer documents relating to group/associate companies were met and whether all projections made in the offer documents were achieved.

(b) If not, non-achievement of objects/projections shall be brought out distinctly. Shortfall and delays shall be quantified [*Clause 6.11.2*].

Projections

[26][No forecast or projections relating to financial performance of the issuer company shall be given in the offer document.] [*Clause 6.12*].

Basis for Issue Price

Following information shall be disclosed for all issues irrespective of the issue price.

(a) Earnings per share i.e. EPS pre-issue for the last three years (as adjusted for changes in capital);

(b) P/E pre-issue;

(c) Average return on net worth in the last three years;

(d) Minimum return on increased net worth required to maintain pre-issue EPS;

(e) Net Asset Value per share based on last balance sheet;

(f) Net Asset Value per share after issue and comparison thereof with the issue price.

(g) An illustrative format of disclosure in respect of basis for issue price is given in **Schedule XV.**

(h) Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group i.e., companies of comparable size in the same industry (Indicate the source from which industry average and accounting ratios of the peer group has been taken) :

Provided that the projected earnings shall not be used as a justification for the issue price in the offer document.

Provided further that the accounting ratios disclosed in the offer document in support of basis of the issue price shall be calculated after giving effect to the consequent increase in capital on account of compulsory conversions out-

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26. Subs. by DIP (Compendium) Circular No. 3, dated 4-8-2000.

standing, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised. [*Clause 6.13.1*] [*Subs. by SEBI Circular No. 9, dt. 2-5-2003*].

SCHEDULE XV

BASIS FOR ISSUE PRICE [Clause 6.13.1(G)]

	Rs.
1. Adjusted Earning Per Share (EPS)	
(a) 1992-93	41.00
(b) 1993-94	8.39
(c) 1994-95	13.82
(d) Weighted Average	10.94
2. Price/Earning Ratio (P/E) in relation to Issue Price	
(a) Based on 94/95 EPS	37.63
(b) Industry P/E	
(i) Highest	61.2
(ii) Lowest	0.8
(iii) Average	25.3
[27](Based on Economic Times of 26/6/95)	
3. Return on Net Worth	
(a) 1992-93	27.36%
(b) 1993-94	28.77%
(c) 1994-95	33.45%
(d) Weighted Average	30.88%
4. Minimum Return on Total Net Worth after Issue Needed to maintain EPS at Rs.13.82	14.65%
5. Net Asset Value (NAV)	
(a) As at 31-3-1995	Rs. 46.40
(b) After issue	Rs. 94.29
(c) Issue price	Rs. 520.00

Accounting ratios.—[27][The issuer company and the lead merchant banker shall provide the accounting ratios as mentioned in clause 6.13.1 above to justify the basis of issue price:

Provided that, the lead merchant banker shall not proceed with the issue in case the accounting ratios mentioned above, do not justify the issue price] [*Clause 6.13.2*(i)].

Final price if issue is through book-building process.—[28][In case of book built issues, the offer document shall state that the final price has been determined on the basis of the demand from the investors.] [*Clause 6.13.2(ii)*].

VII. OUTSTANDING LITIGATIONS OR DEFAULTS

(a) All pending litigations in which the promoters are involved, defaults to the financial institutions/banks, non-payment of statutory dues and dues towards instrument holders like debenture holders, fixed deposits, and arrears on cumulative preference shares, by the promoters and the companies/firms promoted by the promoters, shall be listed in the prospectus together with the amounts involved and the present status of such litigations/defaults. The likely adverse effect of these litigations/defaults, etc. on the financial performance of the company shall also be mentioned.

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27. Added by DIP (Compendium) Circular No. 3, dated 4-8-2000.
28. *Ibid.*

(b) Further, the cases of pending litigations, defaults, etc. in respect of companies/firms/ventures with which the promoters were associated in the past but are no longer associated shall also be disclosed in case their name(s) continue(s) to be associated with particular litigation(s).

(c) (i) The above information is required to be furnished in addition to the litigations against the company or against any other company whose outcome could have a materially adverse effect of the position of the company.

(ii) Further, all the litigations against the promoter or directors involving violation of statutory regulations or criminal offence shall be furnished in the offer document.

(d) (i) The pending proceedings initiated for economic offences against the directors, the promoters, companies and firms promoted by the promoters shall be disclosed separately indicating their present status.

(ii) The details of the past cases in which penalties were imposed by the concerned authorities.

(e) Outstanding litigations, defaults, etc., pertaining to matters likely to affect operations and finances of the company including disputed tax liabilities, prosecution under any enactment in respect of Schedule XIII to the Companies Act, 1956 (1 of 1956) shall be furnished in the prospectus in the prescribed format.

(f) The lead merchant banker shall ensure to appropriately incorporate in the prospectus and as risk factor(s), information regarding pending litigations, defaults, non payment of statutory dues, proceedings initiated for economic offences/Civil offences (including the past cases, if found guilty), any disciplinary action taken by the Board/stock exchanges against the company/Promoters and their other business ventures (irrespective of the fact whether they fall under the purview of Sec 370 (1B) of the Company's Act, 1956)/Directors.

(g) The name(s) of small scale undertaking(s) or any other creditors to whom the company owes a sum exceeding Rs. 1 lakh which is outstanding more than 30 days; and

(h) (i) If any of the above mentioned litigations, etc., arise after the filing of the offer document, the facts shall be incorporated appropriately in the prospectus (and as risk factors).

(ii) In case there are no such cases a distinct negative statement is required to be made in this regard in the prospectus [*Clause 6.14*].

Additional particulars

Disclosure on Investor Grievances and Redressal System

The offer documents shall disclose the arrangements or any mechanism evolved by the company for redressal of investor grievances.

1. The company shall disclose the time normally taken by it for disposal of various types of investor grievances.
2. Similar disclosure shall be made in regard to the listed companies under the same management within the meaning of Section 370(1B) of the Companies Act for the period of 3 years prior to the date of filing of the offer documents with ROC/Stock Exchange [*Clause 6.16*].

PART II OF SCHEDULE II

B. Financial Information—Report to be set out

The following additional disclosure is to be made:

Other provisions relating to accounts of the issuer company

(a) All significant accounting policies and standards followed in the preparation of the financial statements shall be disclosed.

(b) Statements of Assets and Liabilities and Profit and Loss or any other financial information shall be incorporated after making the following adjustments, wherever quantification is possible:

(i) Adjustments/rectification for all incorrect accounting practices or failures to make provisions or other adjustments which resulted in audit qualifications;

(ii) Material amounts relating to adjustments for previous years shall be identified and adjusted in arriving at the profits of the years to which they relate irrespective of the year in which the event triggering the profit or loss occurred;

(iii) (a) Where there has been a change in accounting policy, the profits or losses of the earlier years (required to be shown in the offer documents) and of the year in which the change in the accounting policy has taken place shall be re-computed to reflect what the profits or losses of those years would have been if a uniform accounting policy was followed in each of these years.

(b) If an incorrect accounting policy is followed, the re-computation of the financial statements shall be in accordance with correct accounting policies;

(iv) (a) Statement of profit or loss shall disclose both the profit or loss arrived at before considering extraordinary items and after considering the profit or loss from extraordinary items.

(b) An illustrative format of the disclosure of profits and losses on this basis is specified at Schedule X to SEBI Guidelines, 2000 (given below).

(v) (a) The statement of assets and liabilities shall be prepared after deducting the balance outstanding on revaluation reserve account from both fixed assets and reserves and the networth arrived at after such deductions.

(vi) A suggested format of assets and liabilities is specified at Schedule XI to SEBI Guidelines, 2000 (given below).

(c) The turnover disclosed in the Profit and Loss Statement shall be bifurcated into:—

(i) turnover of products manufactured by the company;

(ii) turnover of products traded in by the company; and

(iii) turnover in respect of products not normally dealt in by the company but included in (ii) above, shall be mentioned separately.

(d) The offer document shall disclose details of 'Other Income' in all cases where such income (net of related expenses) exceeds 20% of the net profit before tax, including:

(i) the sources and other particulars of such income; and

(ii) an indication as to whether such income is recurring or non-recurring, or has arisen out of business activities/other than the normal business activities.

SCHEDULE XI

STATEMENT OF ASSETS AND LIABILITIES [*Clause 6.18.7.(vi)*]

As at March 31

			(Rupees in lac)			
A.	Fixed Assets : Gross Block	440	750	900	922	1350
	Less Depreciation	(55)	(107)	(170)	(250)	(320)
	Net Block	385	643	730	672	1030
	Less : Revaluation Reserve	(100)	(95)	(89)	(83)	(75)
	Net Block after adjustment for Revaluation Reserve	285	548	641	589	955
B.	Current Assets, Loans and Advances :					
	Inventories	485	420	720	1030	3200
	Sundry Debtors	28	30	30	500	2500
	Cash and Bank Balances	13	14	22	200	400
	Loans and Advances	78	100	85	1100	2000
	Other Current Assets	70	80	55	200	220
		674	644	912	3080	8320
C.	Liabilities and Provisions : Secured Loans	376	607	616	620	460
	Unsecured Loans	3	3	-	-	4000
	Current Liabilities and Provisions	250	180	330	460	1100
		(629)	(790)	(946)	(1080)	(5560)
D.	Networth	330	402	607	2589	3715
E.	Represented by					
	1. Share Capital	300	300	400	1600	2000
	2. Reserves	130	197	296	1072	1790
	Less Revaluation Reserve	(100)	(95)	(89)	(83)	(75)
	Reserves (Net of revaluation reserves)	30	102	207	989	1715
	Networth	330	402	607	2589	3715

SCHEDULE -XII

TAX SHELTER STATEMENT [*Clause 6.18.7.(viii)*]

Year Ended March 31

	1991	1992	1993	1994	1995
	(Rupees in lac)				
Tax at Notional Rate	28	70	89	546	675

Adjustments : Export Profits	(4)	(5)	(20)	(100)	(120)
Difference between Tax Depreciation and Book Depreciation	(6)	(8)	(9)	(10)	(10)
Other Adjustments	3	3	4	4	5
Net Adjustments	**(7)**	**(10)**	**(25)**	**(106)**	**(125)**
Tax Saving thereon :	(3)	(5)	(13)	(49)	(58)
Total Taxation	25	65	76	497	617
Taxation on extraordinary items	-	53	(68)	682	852
Tax on profits before extra ordinary items	**25**	**12**	**144**	**(185)**	**(235)**

SCHEDULE XIII

CAPITALISATION STATEMENT [*Clause 6.18.7.(iii)*]

	Pre-issue as at 30-6-1995		As Adjusted for issue		
	(Rupees in lac)				
Short-Term Debt		1870			1870
Long Term Debt		4370			4370
Shareholders Funds					
Share Capital	4000			4450	
Reserves	14570		37520		
Total Shareholders Funds	18570		41940		
Long Term Debt/Equity		0.24:1		0.10:1	

Note: Since 31-3-1995 (which is the last date as of which financial information has been given in para of this document) share capital was increased from Rs.3000 lacs to Rs.4000 lacs by the issue of bonus shares in the ratio of 1 share for every 3 shares.

C. Statutory and other information

Option to subscribe.—[Items (9) and (9A) of Part II of Sch. II].

The lead merchant banker shall incorporate a statement in the offer document and in the application form to the effect that the investor shall have an option either to receive the security in the form of physical certificates or to hold the securities in dematerialised form with a depository. [*Clause 6.19.9(b) and Clause 8.20.1*].

Trading in dematerialised form only[29]

In case of public issues by unlisted companies, the lead merchant banker shall incorporate a statement in the offer documents that the trading in the securities shall be in dematerialised form only for all investors. [*Clause 6.34(c)*].

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29. Added by RMB (Compendium) Series Circular No. 2 (1999-2000), dt. 16-2-2000.

Presentation of financials in case of change of denomination

In case of change in standard denomination of equity shares, the compliance with the following shall be ensured while making disclosure in the offer document—

(i) all the financial data affected by the change in denomination of shares shall be clearly and unambiguously presented in the offer document;

(ii) comparison of financial ratios representing value per share and comparison of stock market data in respect of price and volume of securities shall be clearly and unambiguously presented in the offer document;

(iii) the capital structure incorporated in the offer document shall be clearly presented giving all the relevant details pertaining to the change in denomination of the shares [*Clause 8.21.2*].

PART III

"**Declaration**: That all the relevant provisions of the Companies Act, 1956, and the guidelines issued by the Government or the guidelines issued by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992, as the case may be, have been complied with and no statement made in prospectus is contrary to the provisions of the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or rules made thereunder or guidelines issued, as the case may be." [*Subs. by Notfn. No. 650(E), dt. 17-9-2003*].

[*(Department of Company Affairs) [F. No. 2/13/2002-CL.V*]

SEBI GUIDELINES 2000.—CONTENTS OF ABRIDGED PROSPECTUS

The Lead Merchant Banker shall ensure the following:

(i) Every application form distributed by the issuer Company or anyone else is accompanied by a copy of the Abridged Prospectus.

CONTENTS OF ABRIDGED PROSPECTUS

6.20 The abridged prospectus shall contain the disclosures as specified under Section I of Chapter VI. [Under the heading *Contents of Prospecuts*].[30]

6.20.1 The disclosure requirement as specified shall also be applicable in case of abridged prospectus.

6.21 General Information

6.21.1 Name and address of registered office of the company

6.21.2 Name/s of stock exchanges where listing of the securities is proposed.

6.21.3 Date of opening, closing and earliest closing of the issue

6.21.4 Disclaimer Clause [*Clause 6.3.3*].

6.21.5 Name and address of lead managers.

6.21.6 Name and address of registrars to the issue.

6.21.7 Name and address of trustee under debenture trust deed (in case of debenture issue)

6.21.8 Rating for the proposed debenture/preference shares issue, if any, obtained from any other Credit Rating Agency [*Clause 6.3.12*].

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30. The clauses in bold italics in brackets denote the clauses of Chapter VI-Section I 'Contents of Prospectus' of SEBI Guidelines, 2000 as to guidelines on disclosures to be made under that particular heading.

6.21.9 (a) The name, address telephone number, fax number and address of Compliance Officer.

(b) The investor's attention shall also be invited to contact the compliance officer in case of any pre-issue/post-issue related problems such as non-receipt of letters of allotment/share certificates/refund orders/cancelled stockinvests, etc.

6.21.10 Provisions of sub section (1) of section 68A of the Companies Act, relating to punishment for fictitious applications.

6.21.11 Declaration about the issue of allotment letters/refunds within a period of 30 days and interest in case of delay in dispatching refund/allotment letters @ 15% p.a. or at the rate as may be specified. [See *Clause 6.23.2 below*].

6.21.12 Risk Factors and Issue Highlights.

6.21.13 The Risk Factors and management perception on the same shall be printed along with Issue Highlights with equal treatment in printing in all respects [See *Clause 6.28 below*].

6.22 Capital Structure of the company

6.22.1 Following details shall appear

(a) Authorised, issued, subscribed and paid up capital (Number of instruments, description, aggregate nominal value)

(b) Size of present issue giving separately promoters contribution, firm allotment/reservation for specified categories and net offer to public.

(c) (Number of instruments, description, aggregate nominal value and issue amount shall be given in that order, Name(s) of group companies to be given, in case, reservation has been made for shareholders of the group companies)

(d) Paid-up Capital

(i) after the issue

(ii) after conversion of securities (if-applicable)

(e) Share Premium Account (before and after the issue)

6.22.2 A disclosure to the effect that the securities offered through this public/rights issue shall be made fully paid up or forfeited within 12 months from the date of allotment of securities in a manner as specified in clause 8.5.2 of Chapter VIII of SEBI Guidelines, 2000.[31]

6.23 Terms of the present issue

6.23.1 Authority for the issue, terms of payment and procedure and time schedule for allotment and issue of certificates.

6.23.2 The caption "Interest in Case of Delay in Despatch of Allotment Letters/Refund Orders in Case of Public Issues" shall appear. [*Clause 6.5.1.1*].

6.23.2 How to apply - availability of forms, prospectus and mode of payment

6.23.2.1 Applications by NRIs.—See Notes *ante*.

6.23.3 Any special tax benefits for company and its shareholders

6.24 Particulars of the issue

6.24.1 Objects

6.24.2 Project Cost [*Clause 6.6.2*]

6.24.3 Means of financing [*Clauses 6.6.4.1, 6.6.5 and 6.6.6*]

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31. For text of the Guidelines, see *Appendix* 127.

6.25 Company, Management and Project

6.25.1 History and main objects and present business of the company

6.25.2 Promoters and their Background [***Clause 6.7.3***]

6.25.3 Names, address and occupation of manager, managing director, and other directors (including nominee-directors, whole-time directors (giving their directorships in other companies)

6.25.4 Location of the Project

6.25.5 Plant and machinery, technology, process, etc [***Clause 6.7.7***]

6.25.6 Collaboration, any performance guarantee or assistance in marketing by the collaborators [***Clause 6.7.8.1***]

6.25.7. Infrastructure facilities for raw materials and utilities like water, electricity, etc.

6.25.8 Schedule of implementation of the project and progress made so far, giving details of land acquisition, civil works, installation of plant and machinery, trial production, date of commercial production etc.

6.25.9 The products

6.25.9.1 Nature of the product/s - consumer/industrial and end users

6.25.9.2 Market including details of the competition, past production figures for the industry, existing installed capacity, past trends and future prospects regarding exports (if, applicable), demand and supply forecasts (if given, should be essentially with assumptions unless sourced from a market research agency of repute), etc. to be given. 6.25.9.3 Source of data used shall be mentioned.

6.25.9.3 Approach to marketing and proposed marketing set up

6.25.9.4 Export possibilities and export obligations, if any (in case of a company providing any "service" particulars, as applicable, be furnished)

6.25.10 Future prospects [***Clause 6.7.12.1***]

6.25.11 Stock Market Data—See Notes *ante.*

6.26 Following particulars in regard to the listed companies under the same management with the meaning of Section 370(1B) which made any capital issue in the last three years.

(a) Name of the company
(b) Year of issue
(c) Type of issue (public/rights/composite)
(d) Amount of issue
(e) Date of closure of issue
(f) Date of despatch of share/debenture certificate completed
(g) Date of completion of the project, where object of the issue was financing of a project
(h) Rate of dividend paid

6.27 Basis for Issue Price.—See Notes *ante.*

6.28 Management perceptions of risk factors (e.g. Sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/time overrun) [***Clauses 6.2.3.1 and 6.2.3.2***].

6.29 Outstanding litigations

6.30 Whether all Payment/Refunds, Debentures, Deposits of banks or companies, Interest on Deposits, Debenture Interest, Institutional Dues have been paid up to date.

If not, details of the arrears if any to be stated.

6.31 Any material development after the date of the latest balance sheet and its impact on performance and prospects of the company.

6.32 Expert opinion obtained if any

6.33 Change, if any, in directors and auditors during the last three years and reasons thereof.

6.34 Option to Subscribe.—See Notes *ante.*

6.35 Material contracts and time and place of inspection

6.36 Financial Performance of the Company for the Last Five Years: (Figures to be taken from the audited annual accounts in tabular form)

(a) Balance Sheet Data: Equity Capital, Reserves (State Revaluation Reserve, the year of revaluation and its monetary effect on assets) and borrowings

(b) Profit and Loss data: Sales, Gross profit, Net profit, dividend paid, if any

(c) Any change in accounting policies during the last three years and their effect on the profits and the reserves of the company

(d) Lead Merchant Banker shall ensure that the financial information about the issuer company appearing in the abridged prospectus, is as per Auditors' report of the prospectus.

6.37 Statements after minimum subscription clause

(a) Minimum subscription clause [***Clause 6.3.8***] shall appear followed by the statement given below:

(b) "No statement made in this Form shall contravene any of the provisions of the Companies Act, 1956 and the rules made thereunder".

SEBI GUIDELINES 2000—CONTENTS OF ABRIDGED PROSPECTUS

Form of Abridged Prospectus

Form 2A of the Companies (Central Government Rules and Forms), 1956 prescribes the format of the abridged prospectus (Memorandum containing salient features of the prospectus) envisaged in section 56(3) of the Act.

"Abridged Prospectus" means the memorandum as prescribed in Form 2A under subsection (3) of section 56 of the Companies Act, 1956. [*Clause 1.2.1(i)*].

§ Section II of Chapter VI of the Guidelines sets out the contents of 'Abridged Prospectus'. For the text of the Contents of Abridged Prospectus refer SEBI (DIP) Guidelines, 2000 in *Appendix* 16.

Standard offer Document for Mutual Fund Schemes

Standard Offer Documents Format for Mutual Fund Schemes has been prescribed by SEBI *vide* F.No. II MARP/MF/CIR/06/793/98, dated 31-3-1998.

All offer documents of mutual fund schemes filed with SEBI on or after April 1, 1999, shall be in accordance with this new prescribed format.

§ For the full text of the prescribed Standard Offer Document and a copy of the memorandum containing key information for any scheme of mutual fund, see *Appendix* 186.

SEBI (Collective Investment Scheme) Regulation 1999

Collective Investment Scheme means any scheme or arrangement with respect to property of any description—

(a) the purpose of which is to enable the investors to participate in the scheme or arrangements by way of subscriptions and to receive profits or income or pro-

duce arising from the management of such property or the investments made thereof;

(b) in which the subscriptions of the investors by whatever name called, are pooled and are utilised for the purposes of the schemes or the arrangement; and

(c) in which the property or such subscriptions are managed on behalf of the investors, who do not have day to day control over the management or operation of the scheme, whether or not such properties or subscription and the investments made thereof are evidenced by identifiable properties or otherwise.

Such scheme can only be launched by a collective investment management company registered with SEBI under SEBI (Collective Investment Schemes) Regulations, 1999 and incorporated under Companies Act, 1956.

Scheme Property includes subscription of money or money's worth (including Bank deposits) to the scheme, property acquired, directly or indirectly, with or with the proceeds of subscription of money or money's worth and income arising directly or indirectly from subscription money or property.

NOTE : The expression "units or other instruments issued by any collective Investment Scheme" to the investors in such scheme has been brought within the definition of the term "securities" in the Securities Contract (Regulation) Act, 1956.

Collective Investment Scheme (CIS) provides two tier structure of a trust and Collective Investment Management Company (CIMC). It is mandatory for CIS firms to get registered under the Companies Act, 1956. The CIS shall be constituted in form of trust and duly approved by SEBI and executed by CIMC in favour of trustee.

Registration.—CIMC to launch new schemes or raise money from investors under existing scheme are required to get certificate of registration from SEBI Board. At the time of making application CIMC shall have atleast 50% independent directors and minimum networth of Rupees three crores.

It shall have to comply with conditions like credit rating, appraisal & audit of existing scheme, appointment of trustees, compliance with accounting and valuation norms etc. All these conditions must be complied with within one year from the date of grant of provisional registration.

Salient Features of Regulation

—CIMC shall not carry any business except that of managing the scheme;

—CIMC shall launch only close-ended schemes;

—Scheme shall not be kept open for subscription beyond 90 days;

—Duration of scheme shall be for minimum period of three years;

—Scheme shall be approved by trustees and mandatory credit rating required for each CIS by recognised credit rating agency;

—CIS cannot guarantee assured returns and can only mention indicative returns based on projections;

—The scheme shall be launched by an offer document and money raised & units issued and then listed on recognised stock exchanges;

—Insurance policy shall be taken for protection of scheme property;

—Advertisement is to be made as per SEBI advertisement guidelines;

—Maximum permitted issue expenses is 7% of the corpus mobilised for schemes of duration upto 8 yrs and 9% for duration exceeding 8 yrs;

—Management fees payable to CIMC shall consist of basic fees and incentive fees;

—Collective investment company shall pay fees of Rupees 5 lacs at the time of provisional registration and balance of Rupees 5 lacs at the time of grant of registration;

—Existing companies, which fail to apply for registration or which have been refused registration by SEBI shall wind up their schemes.

§ For text of the SEBI (Collective Investment Schemes) Regulations, 1999 refer *Appendix* 188.

Book Building Processes for Issue of Shares

§ See Notes under section 72 under the same heading.

SEBI (Employees Stock Option Scheme and Employees Stock Option Purchase Scheme) Guidelines, 1999 (ESOS & ESPS)

SEBI has issued guidelines on the aforesaid subject effective from 19-6-1999.

§ For full text of the guidelines see *Appendix* 174.

Relevant Rules and prescribed form.—The salient features of the abridged prospectus under sub-section (3) have been prescribed in Form 2A under Rule 4CC of the Companies (Central Government's) Genral Rules and Forms, 1956, with effect from the 1st November, 1991, *vide* GSR No. 614(E), dated 3-10-1991. Every form of application for shares in or debentures of a company through public issue must accompany the abridged prospectus as per prescribed particulars. See *Appendix* 1.

It may be noted that the abridged prospectus in Form 2A is not required to be filed with the Registrar. This is, however, required to be signed by all the directors, who have signed the main prospectus, as prescribed in Schedule II.

Checklist of Pre-Issue Activities for Public Issue

For Check List of pre-issue activities for public issue of equity shares, See Chapter II of SEKHAR, GUIDE TO SEBI CAPITAL ISSUES, DEBENTURES AND LISTING, (pp. 507-515), Third Edn., 2003.

Practical Hints

(i) It should be checked whether the authorised capital is large enough to accommodate the increased subscribed capital. If not, the memorandum should be altered.

(ii) Arrangements should be made for the underwriting of the shares, as laid down in SEBI Guidelines.

(iii) Compliance of guidelines issued by SEBI for disclosure and investor protection should be ensured.

(iv) If the existing shares of the company are already listed on a recognised stock exchange or the new shares are proposed to be listed on a recognised stock exchange, the provisions of the listing agreement must be kept in mind.

(v) The allotment of shares would have to be done in consultation with the stock exchange.

(vi) In view of the complicated nature of the provisions relating to the issue of a prospectus and the onerous nature of the liabilities and severity of the penalties, it behoves on all those who are about to take part in the issue of a prospectus to act with great care and caution and as a general rule under legal advice. Having regard to the definition of 'prospectus' in section 2(36), the word 'issued' here obviously means 'issued to the public'. See *Re, South of England Natural Gas and Petroleum Co. Ltd.*, (1911) 1 Ch 573. Even an offer to a single person may be an offer to the public. *Cf. Lynde v. Nash*, (1928) 2 KB 93 [**Reversed** on another point in *Nash v. Lynde*, 1929 AC 158.]

Secretarial Practice Notes—Prospectus

Before a prospectus is issued check whether:

(i) the prospectus is dated?

(ii) it contains matters and reports as specified in Parts I & II of Schedule II subject to Part III?

(iii) every application form for shares/debentures is accompanied by a memorandum containing salient features of prospectus (abridged prospectus) in Form No. 2A?

(iv) a copy of the prospectus is made available to any person on a specific request before closing of the subscription list.

(v) ensure that every application form contains necessary instructions to the applicant for the following:—

(a) mentioning the name of applicant and number of application form on the reverse of the cheque/draft

(b) mentioning the permanent account number or fact of non-allotment of PA No./GIR No. where the face value of the equity shares/debentures applied for is Rs. 50,000 or more and the income tax circle/ward/district.

(vi) the listing requirements are followed where the issue is for Rs. 3 crores or more and listing is proposed, as also guidelines issued by SEBI for disclosure and investor protection.

(vii) the expert's opinion, if any, indicated in the prospectus is of one who is not interested in the formation or promotion or in the management of the company.

(viii) the prospectus has stated matters referred to in section 60(2).

(ix) a copy of the prospectus is delivered to the Registrar duly signed by all the persons named in the prospectus as directors or proposed directors or through their agents along with documents specified in section 60(1)(a) and (b).

(x) prospectus is issued within 90 days of delivery to the Registrar of Companies. [sec. 60(4)].

Documents Involved: (1) Prospectus and documents attached thereto, (2) Minutes of Board/General Meeting, (3) Contracts entered into with brokers, bankers, Registrars and Share Transfer Agents, underwriters *etc.* (4) Abridged prospectus.

S. 57. Expert to be unconnected with formation or management of company.—A prospectus inviting persons to subscribe for shares in or debentures of a company shall not include a statement purporting to be made by an expert, unless the expert is a person who is not, and has not been, engaged or interested in the formation or promotion, or in the management, of the company.

NOTES

Previous Act : Section 97

Companies Act, 1956

This section is new and was added by the Joint Committee as they were of the view "that no person who is connected either with the formation or with the management of a company should function as an expert". (*Report* : para 25).

The term "*engaged or interested*" in this section does not include engagements of a professional nature. For example, a firm of chartered accountants which has rendered its professional services in the formation of a company may also give their report in the prospectus.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of

account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Statement by experts in prospectus

A chartered accountant or a solicitor who is engaged in the preparation of memorandum and articles of association of a company or any financial or collaboration scheme purely in their professional capacity without any financial stake in the company would not be considered as either engaged or interested in the formation or promotion of the company as the purpose of section 57 is that any expert opinion given in the prospectus should not be influenced by one's personal interest. A statement by any of the above persons would not amount to a contravention of section 57.

S. 58. Expert's consent to issue of prospectus containing statement by him.—A prospectus inviting persons to subscribe for shares in or debentures of a company and including a statement purporting to be made by an expert shall not be issued, unless—

(a) he has given his written consent to the issue thereof with the statement included in the form and context in which it is included, and has not withdrawn such consent before the delivery of a copy of the prospectus for registration; and

(b) a statement that he has given and has not withdrawn his consent as aforesaid appears in the prospectus.

NOTES

Eng. Act, 1948 : Sec. 40(1).
Eng. Act, 1985 : Sec. 61.

Companies Act, 1956

This section, adopted from section 40 of the English Act, enacts "a wholesome rule intended to protect an intending investor by making the expert a party to the issue of the prospectus and making him liable for untrue statements". (*Company Law Committee Report* para 59).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

Consent and authorisation.—The expert's consent should be endorsed on or annexed to the registration copy of the prospectus [section 60(1)]. By consenting to the issue of the

prospectus the expert does not undertake liability in respect of anything in the prospectus except his own statement [sections 62(1) and 63(2)]. However, obtaining of consent from the various persons named in the prospectus shall not be construed as obtaining their authorisation for issue of prospectus. The process of obtaining consent is for the specific purpose of inclusion of the name of the intermediary in the prospectus and does not tantamount to authorisation for issue of prospectus.

§ See also Notes under section 62 as to the effect of statements of experts included in the prospectus.

Secretarial Practice Notes : Statement by expert in prospectus

Check whether:

(i) expert had given his written consent to issue such statement?

(ii) such statement had been included in the correct form and context as given by the expert?

(iii) the expert had not withdrawn his consent before the delivery of a copy of the prospectus for registration?

(iv) statement that the expert had given and had not withdrawn his consent appeared in the prospectus?

(v) the expert was not engaged or interested in the formation or promotion or in the management of the company?

[1][**S. 58-A. Deposits not to be invited without issuing an advertisement.**—(1) The Central Government may, in consultation with the Reserve Bank of India, prescribe the limits up to which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members.

(2) No company shall invite, or allow any other person to invite or cause to be invited on its behalf, any deposit unless—

(a) such deposit is invited or is caused to be invited in accordance with the rules made under sub-section (1), [2][* *]

(b) an advertisement, including therein a statement showing the financial position of the company, has been issued by the company, in such form and in such manner as may be [3][prescribed, and]

[4][(c) the company is not in default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposit.]

(3) (a) Every deposit accepted by a company at any time before the commencement of the Companies (Amendment) Act, 1974, in accordance with the directions made by the Reserve Bank of India under Chapter III-B of the Reserve Bank of India Act, 1934, shall unless renewed in accordance with clause (b), be repaid in accordance with the [5][terms and conditions of such deposit].

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1. Ins. by the Companies (Amendment) Act XLI of 1974, s. 7 (w.e.f. 1-2-1975).
2. The word 'and' omitted by the Companies (Amendment) Act, 1996
3. The word 'prescribed' subs. by the Companies (Amendment) Act, 1996.
4. Clause (c) inserted by the Companies (Amendment) Act, 1996, w.e.f. 1-3-1997.
5. Subs. by the Companies (Amendment) Act, 1988, s. 9 for the words "terms of such deposit" w.e.f. 1-9-1989, *vide* GSR No. 788(E) dated 28-8-1989, 1989 Chartered Secretary p. 691.

(b) No deposit referred to in clause (a) shall be renewed by the company after the expiry of the term thereof unless the deposit is such that it could have been accepted if the rules made under sub-section (1) were in force at the time when the deposit was initially accepted by the company.

(c) Where, before the commencement of the Companies (Amendment) Act, 1974, any deposit was received by a company in contravention of any direction made under Chapter III-B of the Reserve Bank of India Act, 1934, repayment of such deposit shall be made in full on or before the 1st day of April, 1975, and such repayment shall be without prejudice to any action that may be taken under the Reserve Bank of India Act, 1934 for the acceptance of such deposit in contravention of such direction.

[6][(3A) Every deposit accepted by a company after the commencement of the Companies (Amendment) Act, 1988, shall, unless renewed in accordance with the rules made under sub-section (1), be repaid in accordance with the terms and conditions of such deposit.]

(4) Where any deposit is accepted by a company after the commencement of the Companies (Amendment) Act, 1974, in contravention of the rules made under sub-section (1), repayment of such deposit shall be made by the company within thirty days from the date of acceptance of such deposit or within such further time, not exceeding thirty days, as the Central Government may, on sufficient cause being shown by the company, allow.

(5) Where a company omits or fails to make repayment of a deposit in accordance with the provisions of clause (c) of sub-section (3), or in the case of a deposit referred to in sub-section (4), within the time specified in that sub-section,—

(a) the company shall be punishable with fine which shall not be less than twice the amount in relation to which the repayment of the deposit has not been made, and out of the fine, if realised, an amount equal to the amount in relation to which the repayment of deposit has not been made, shall be paid by the Court, trying the offence, to the person to whom repayment of the deposit was to be made, and on such payment, the liability of the company to make repayment of the deposit shall, to the extent of the amount paid by the Court, stand discharged;

(b) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine.

(6) Where a company accepts or invites, or allows or causes any other person to accept or invite on its behalf, any deposit in excess of the limits prescribed under sub-section (1) or in contravention of the manner or condition prescribed under that sub-section or in contravention of the provisions of sub-section (2), as the case may be,—

(a) the company shall be punishable,—

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6. Ins. by the Companies (Amendment) Act, 1988, s. 9 w.e.f. 1-9-1989 *vide* GSR No. 788(E), dated 28-8-1989, 1989 Chartered Secretary p. 691.

(i) where such contravention relates to the acceptance of any deposit, with fine which shall not be less than an amount equal to the amount of the deposit so accepted;

(ii) where such contravention relates to the invitation of any deposit, with fine which may extend to [7][ten lakh rupees] but shall not be less than [8][fifty thousand rupees];

(b) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine.

(7) (a) Nothing contained in this section shall apply to,—

(i) a banking company, or

(ii) such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(b) Except the provisions relating to advertisement contained in clause (b) of sub-section (2), nothing in this section shall apply to such classes of financial companies as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

[9][(8) The Central Government may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, by order, issued either prospectively or retrospectively from a date not earlier than the commencement of the Companies (Amendment) Act, 1974 (41 of 1974), grant extension of time to a company or class of companies to comply with, or exempt any company or class of companies from, all or any of the provisions of this section either generally or for any specified period subject to such conditions as may be specified in the order :

Provided that no order under this sub-section shall be issued in relation to a class of companies except after consultation with the Reserve Bank of India.][10]

[11][(9) Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the [12][*Tribunal*] may, if it is satisfied, either on its own motion or on the application* of the depositor, that it is necessary so to do to safeguard the interests of the company, the depositors or in the public interest, direct, by order, the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order:

Provided that the [12][*Tribunal*] may, before making any order under this sub-section, give a reasonable opportunity of being heard to the company and the other persons interested in the matter.

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7. The words "one lakh rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 18 (w.e.f. 13-12-2000).
8. The words "five lakh rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 18 (w.e.f. 13-12-2000).
9. Ins. by Companies (Amendment) Act 46 of 1977, s. 3 (w.e.f. 24-12-1977).
10. Exemption granted acceptance of deposits by issue of Commercial Paper by Companies satisfying NBC (Acceptance of Deposits through Commercial Paper) Directions, 1989, w.e.f. 1-1-1990 by GSR 1075(E), dated 29-12-1989.
11. Ins. by the Companies (Amendment) Act, 1988, s. 9 w.e.f. 1-9-1989, *vide* GSR No. 788(E), dated 28-8-1989, 1989 Chartered Secretary p. 691.
12. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 9.**

* w.e.f. 31-5-1991 the prescribed form of application is Form No. 4 under CLB Regulations, 1991 Regn 37. The form is to be filed alongwith a fee of Rs. 50/- under CLB (Fees on Application & Petitions) Rules, 1991.

(10) Whoever fails to comply with any order made by the [13][*Tribunal*] under sub-section (9) shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of [14][not less than rupees five hundred] for every day during which such non-compliance continues.]

[15][(11) A depositor may, at any time, make a nomination[16] and the provisions of sections 109A and 109B shall, as far as may be, apply to the nomination made under this sub-section.]

Explanation.—For the purposes of this section "deposit" means any deposit of money with, and includes any amount borrowed by, a company but shall not include such categories or amount as may be prescribed in consultation with the Reserve Bank of India.

NOTES

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under sections 13, 18 and 19 shall become transferred to the Tribunal to be exercised by it in place of the Company Law Board. The Commentary and the procedure should be read keeping this changeover in mind.

Companies (Amendment) Act, 1974

Object of section.—The object of enacting the provisions of sections 58A and 58B was stated in the notes on clauses; thus: "It has been the practice of the companies to take deposits from the public at high rate of interest. Experience has shown that in many cases deposits so taken by the companies have not been refunded on the due dates. In many such cases either the companies have gone into liquidation or the funds are depleted to such an extent that the companies are not in a position to refund the deposits. It is accordingly considered necessary to control the companies inviting deposits from the public. The issue of an advertisement in such form and in such manner as may be prescribed including therein a statement showing the financial position of the company seeking deposits from the public is being made obligatory. Provision has also been made for the Central Government to make rules in consultation with the Reserve Bank of India. Penal provisions have also been included. There is also a provision for the refund of the amount of deposits received by a company in violation of the requirements of the law. The provisions of the Act relating to a prospectus are also made applicable to the issue of such advertisements as contemplated in this clause. The clause will be applicable to all companies other than the banking companies and those specified by a Government in consultation with the Reserve Bank of India". (*Clause* 6).

The Joint Committee of Parliament which redrafted the sections in their present form, have explained them as follows:

Invitation or acceptance of deposits [Sub-section (2)].—This sub-section provides that no company shall invite or accept any deposit except after the publication of an advertisement specifying therein the financial condition, management structure and other particulars of the company. The Committee feel that such advertisement should not be necessary for the acceptance of deposit from the directors or shareholders of the company. It would be enough if acceptance by a company of deposits is made in accordance with the rules made by the Central Government after the consultation with the Reserve Bank of India. So far as invitation by a company of deposits from the public is concerned, such invitation should, however, be made in accordance with the rules made by the Central Government under sub-section (1) and such invitation shall not be made except after the

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13. Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 9.
14. The words "not less than rupees fifty" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 18 (w.e.f. 13-12-2000).
15. Ins. by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).
16. Prescribed Form No. is 2B *vide* Rule 4CCC of the Companies (Central Government's) General Rules and Forms, 1956 *vide* GSR 23(E), dt. 12-1-1999.

publication in the prescribed form of an advertisement including therein the financial position of the company. [*Joint Committee Report,* para 22(i).]

Refund of deposits [Sub-sections (3) and (4)].—As regards refunding of deposits, the Committee feel that the deposits which have so far been accepted by the companies may have been either utilised by them or invested in long-term securities and, as such, the companies may not be in a position to refund the deposits within thirty days from the commencement of the Amending Act. Consequently, if the provisions, as contained in the Bill as introduced in the Lok Sabha are maintained, most of the companies may be forced to take loans from nationalised or other banks for the repayment of the deposits and such loans may put undue strain on the financial position of the companies. The Committee, therefore, feels that the provisions with regard to refund of deposits should be liberalised and, accordingly, the Committee recommend that:

(a) Pre-Amending Act deposits, which were accepted in accordance with the directions made by the Reserve Bank under Chapter III-B of the Reserve Bank of India Act, 1934, should be allowed to continue in accordance with the terms of such deposits. But no such deposit shall be renewed after the expiry of the term thereof, unless the deposit is such that it could have been accepted by the company if the rules made by the Central Government under sub-section (1) were in force at the time when the deposit was accepted by the company.

(b) Pre-Amending Act deposits, which were accepted by companies in contravention of the aforesaid directions made by the Reserve Bank should, however, be refunded in accordance with the terms of such deposits. But where such deposits are not refundable earlier, they should be refunded in a phased manner, namely, one-third of such deposits would be refunded before the first April, 1974, another one-third before the first April, 1975 and the balance before the first April, 1976. Such refund will, however, be without prejudice to any action which may be taken under the Reserve Bank of India Act, 1934 for the acceptance of the deposit in contravention of directions made by the Reserve Bank of India.

(c) Post-Amendment Act deposits, which are accepted in contravention of the rules made by the Central Government under sub-section (1), should be refunded within thirty days from the date of acceptance of such deposits or within such further time, not exceeding thirty days, as the Central Government may, on sufficient cause being shown by the company, allow, [*Report* : para 22(ii)].

Penalties for default.—As regards these, the Committee say 'where there has been an omission or failure to refund any deposit in accordance with the provisions indicated above, a fine should be imposed on the company for such contravention and the amount of the fine should not be less than twice the amount in relation to which the refund has not been made and out of the fine, if realised an amount equal to the amount of the deposit which has not been refunded will be paid by the Court trying the offence to the depositor and, on such payment, the liability of the company to make the refund shall stand discharged. Further, where there has been an omission or failure to make any refund of the deposit in accordance with the provisions indicated above, every officer of the company who is knowingly guilty of the omission or failure, or who has knowingly or wilfully authorised such omission or failure, shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine'.

Companies (Amendment) Act, 1977

Objects and reasons.—Sub-section (8) in sec. 58A was inserted by the Amendment Act, 1977 empowering the Govt. to grant exemption *etc.* The Statement of Objects and Reasons appended to the Bill stated thus: "In the Companies Act, 1956, section 58A relating to acceptance of deposits was inserted by the Companies (Amendment) Act, 1974, which came into force on the 1st February, 1975. Prior to the coming into force of this section, acceptance of deposits by companies was regulated by the directions issued by the Reserve Bank of India under Chapter III-B of the Reserve Bank of India Act, 1934.

Clause (a) of sub-section (3) of section 58A provides that every deposit accepted by a company at any time before the commencement of the said amendment Act of 1974, shall, if it is not renewed by a company in accordance with the provisions of that section, be repaid in accordance with the terms of such deposit. Clause (c) of that sub-section provides that any deposit received by a company in contravention of the aforesaid directions of the Reserve Bank shall be repaid in full on or before 1st April, 1975. Sub-section (5) of that section provides for penalty for the contravention of the provisions of the section. A review of the cases of contraventions shows that sometimes they are due to circumstances beyond the control of the companies, namely, strikes, riots, power-cuts recession, *etc.* Sub-section (7) of section 58A empowers the Central Government to give total exemption to a company from the provisions of the section after consulting the Reserve Bank of India. There is, however, no power to grant partial relaxation like extension of time in deserving cases for the repayment of deposits. A study group constituted by the Reserve Bank of India under the chairmanship of Shri James S. Raj recommended that section 58A of the Act may be suitably amended to grant extension of time to comply with or to exempt any company from the provisions of that section. It is proposed to accept this recommendation and amend section 58A suitably."

Sachar Committee Recommendations

This section attracted the attention of Sachar Committee, which made the following recommendations: "As section 58-A now exists, there is no penalty in case of default by companies in paying deposits as and when they mature for payment, if the deposits were accepted in accordance with the RBI directions. Sub-section (5) which is the penal section would not cover cases of such default. It is a glaring and a serious lacuna. Therefore, it would be appropriate to make suitable provision to take care of such a situation. As observed earlier, the depositor has the usual civil remedy to enforce his rights, but such a course is not only costly but also time consuming, which many depositors may not be able to afford. Even applying for winding up of the company on the ground of its inability to pay its debts is a costly exercise.

We recommend that section 58-A should be amended to provide for the following:

(i) in cases where ten per cent of deposits which have matured for repayment, and in respect of which, in spite of claims having been made by the depositors, the same have remained unpaid for over a period of six months, the company and the directors should be deemed to be in default, and the company should be subjected to penalties unless, before the expiry of the said period the company applies to the Court and makes out a case that in spite of all reasonable efforts by the directors, the company may not be able to repay the debts and therefore, seeks extension of time for repayment. The Court at that stage should hear the Registrar and the depositors who are affected and make appropriate orders which the Court may in the circumstances, and having regard to all the matters considers it necessary. The Company should bear all costs and expenses in giving effect to the order of the Court. In the event the company and its directors neglecting to apply to the Court, it should be also treated as default for which the company should be penalised.

We may make it clear that this provision of a company in default in case where ten per cent of the matured deposits have not been repaid would not be capable of being avoided by moving the Government under any of the powers under section 58-A. Sub-section (8) of section 58-A which permits the Central Government to grant exemption to any company from all or any provisions of section 58-A, in our opinion, only deals with a situation of a company having accepted deposits in excess of the prescribed limits. There is no power to deal with or to give exemption or relaxation to the company for payment of the deposits which have matured for repayment. In our view, such application do not fall under any of the powers given to the Central Government under section 58-A. It may, however, be better to be specific and make this position clear so that the public and the companies in general do not remain under any misapprehension.

(ii) A depositor who has not been paid either the interest or the principal or both should have a right to move the Court without any authorisation as presently required under section 621 of the Companies Act, 1956.

(iii) Companies which have defaulted in paying either the interest or the principal, or both, should be prohibited from inviting or accepting further deposits notwithstanding that the further deposits so invited or accepted are within the prescribed percentage. No company should be allowed to invite or accept deposit only with a view to pay off the earlier deposits accepted by the company.

In the Chapter on Winding up, we have recommended that a company which accepts further deposits only with a view to pay-off the earlier deposits should be deemed to be unable to pay its debts, and on this ground liable to be wound up on a petition by the Registrar.

(iv) At present the limit for acceptance of the deposits is worked out on the basis of paid-up capital plus free reserves. In the Chapter on Accounts and Audit, we have given a definition of "free reserves". In the Chapter on Inter-Corporate Investments, we are laying down that the ceiling on the inter-corporate investment should be worked out with reference to "free reserves" unlike the existing pattern which is worked out on the basis of subscribed capital in case of investment and paid-up capital plus free reserves in case of loans. We see no justification why there should be separate criteria in the matter of inter-corporate investment, loans and for deposits. In all these cases, the overall consideration is to take into account the health of the company. We would, therefore, suggest that the percentage for acceptance of deposits should be worked out with reference to "free reserves". (*Para* 10.11 *of the Report*)

Companies (Amendment) Act, 1988

Sub-sections (3A), (9) and (10) have been inserted by the Amendment Act of 1988 (w.e.f. 1-9-1989). Clause 9 of Notes on clauses stated thus, "As a measure of protecting the interests of depositors, this clause provides for compulsory repayment of deposits unless renewed in the manner specified. It is intended to empower the Company Law Board to take cognizance of any case of non-payment of deposits on maturity and to provide adequate relief to the depositors. Non-compliance of the orders of the Company Law Board would attract penalty. A certain number of depositors, or depositors holding specified percentage of the total deposits due for payment, may seek relief from the Company Law Board on the company's failure to make repayment as provided in law."

Companies (Amendment) Act, 1996

In sub-section (2), a new clause (c) has been inserted by the Companies (Amendment) Act, 1996. The clause is to the effect that a company which is already in default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms of such deposit, is not to invite any further deposit. Following Notes on clauses were appended to the Bill based on the report of the Parliamentary Committee on Home Affairs.

Notes on clauses.—"The Committee welcomes the amendment proposed to be made through this clause in section 58A of the Companies Act, 1956, to debar such companies as default in making timely repayment of deposits to the public from accepting further deposits till the default in this behalf is made good by them. The Committee, however, feels that the penal provisions which presently exist in the Act to bring to book the companies which harass the depositors are seldom invoked or even if they are invoked, the necessary will to pursue them to their logical end is lacking on the part of official enforcement machinery. The Committee is, accordingly, of the view that the enforcement machinery be geared up to ensure more vigorous implementation of these penal provisions so that the depositors, particularly, the small investors who cannot afford to wage protracted legal battles with the defaulting companies, do not continuously suffer on getting their hard-earned money back. The Committee also recommends that strict norms of accountability be laid down in this regard and such of the officials as show laxity in dealing firmly with the companies fiddling with public money are held liable and proceeded against under the rules." [*Clause* 4]

Companies (Amendment) Act, 1999

With effect from 31st October, 1998, the Companies (Amendment) Act, 1999 has inserted sub-section (11) in this section to give every holder of fixed deposits, freedom to nominate at any time, a person to whom his deposits will vest in the event of his death. Where the deposits are held by more than one person jointly, the joint holders may together make such nomination.

Companies (Amendment) Act, 2000

Penalty enhanced.—(1) the Amendment Act of 2000 enhanced the maximum penalty amount from one lac rupees to ten lac rupees and minimum penalty from five thousand rupees to fifty thousand rupees under sub-section (6)(a)(ii).

(2) The Amendment Act of 2000 has also enhanced the penalty amount from fifty rupees to five hundred rupees under sub-section (10).

Companies (Second Amendment) Act, 2002 [11 of 2003]

The power of Company Law Board has been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in sub-sections (9) and (10) of this section Notes on clauses of the Bill stated, thus:

Notes on clauses.—"This clause seeks to amend sections 18, 19, 43, 49, 55A and 58A of the Companies Act, 1956 relating to alteration of memorandum of association to be registered within three months, effect of failure of such registration, consequences of default in complying with conditions constituting a company as private company, investments of company to be held in its own name, power of Securities and Exchange Board of India so far as they relate to issue and transfer of securities and acceptance of deposits without issuing advertisement. It is proposed to confer the powrs of the Company Law Board in the aforesaid sections upon the Tribunal. These amendments are of consequential nature. (*Clause* 8 of the Companies (Amendment) Bill, 2001)."

Scope of Section 58A and Rules framed thereunder

Acceptance of deposits by a company is in the nature of a civil contract between the company and the depositor and non-repayment of a deposit is in the nature of a civil liability, which can be enforced by a depositor through a Civil Court.

The Companies (Acceptance of Deposit) Rules, 1975 prescribe the terms and conditions for acceptance of deposits and do not prescribe for any contravention or penalty for non-payment of deposits on the date of maturity. Repayment of deposits has now been made obligatory under sub-section (3A) itself, along with the provisions made in sub-section (9) empowering the Company Law Board [Now Tribunal] to grant extension of time for making repayment of deposits.

The company which has defaulted in repayment of deposits or interest due thereon on maturity is prohibited to invite deposits from the public under sub-section (2)(c).

The Company Law Board [now Tribunal] may extend time for repayment of deposits *suo motu* or on the application of any depositor or depositors. It may be noted that no such application can be made by a company, which has not repaid its deposits on the date(s) of maturity. The order may be passed if it is necessary to do so to safeguard the interest of the company, the depositors of such company or in the public interest. Before passing such an order, the Board is required to follow the rules of natural justice by giving a reasonable opportunity of being heard to the company and other persons interested in the matter, including the depositors. Failure to repay the deposits within the period extended by the Board is punishable under sub-section (10). The powers of Company Law Board [now Tribunal] under section 58A(9) have also been conferred on it in respect of non-banking financial companies under section 45QA(2) of Reserve Bank of India Act, 1934.

Besides approaching the Company Law Board the aggrieved depositor could also approach Consumer Forum under the Consumer Protection Act, 1986. The depositors who have not been repaid their deposits could also pursue their remedy in a Civil Court and could present a petition for winidng up the company under section 433(e) read with section 434. The position has since changed in view of section 10GB, inserted by the Companies (Second Amendment) Act, 2002 (11 of 2003) according to which civil court will have no jurisdiction in respect of any matter which the Tribunal or Appellate Tribunal may be empowered to determine under this Act or under any other law. [Refer to Notes under section 10 GB]. Since the Tribunal can be empowered to determine only company matters there would seem to be no bar upon a depositor exercising his contractual and consumer rights against the company in other forums, like consumer forums and civil courts.

It may be noted that except the powers under sub-section (9) statutorily conferred on CLB, the other powers under this section continues to vest with Central Government.

A depositor may now nominate, under sub-section (11), any person who will be entitled to the repayment of deposit and interest thereon by the company, in the event of death of the depositor.

Constitutional validity of section 58-A and deposit Rules

Section 58-A and the Rules framed under it are not *ultra vires* the legislative power of Parliament. *Ahmedabad Manufacturing and Calico Printing Co. v. Union of India,* (1983) 53 Com Cases 904 (DB—Guj).

In *Delhi Cloth & General Mills Co. Ltd. v. Union of India,* AIR 1983 SC 937 : (1983) 54 Com Cases 674, the Supreme Court has held that s. 58-A is constitutionally valid. It is not outside the legislative competence of Parliament to enact such a provision as it falls within the scope of Entries 43 and 44 of List I of the Seventh Schedule to the Constitution. The Companies (Acceptance of Deposits) Rules, 1975, have been framed in the exercise of powers conferred by s. 58-A and s. 642. Section 642 provides for placing before Parliament any rules framed in exercise of those powers. Parliament, while considering such rules is empowered to suggest modifications. There is, therefore, no excessive delegation of essential legislative functions **followed** in *Velayudhan T. Achari v. Union of India,* (1993) 77 Com Cases 197 (SC) **affirming** *Kanta Mehta v. Union of India,* (1987) 62 Com Cases 769 (Del) **overruling** *Chennai Bottling Co. P. Ltd. v. Asst. ROC,* (1987) 61 Com Cases 770 (Mad).

Right of depositors : Payment of deposit is *chose-in-action*

Depositor's right to claim payment of deposit is a *chose-in-action* which the law has always recognised as property. There is no doubt that a charge over such a *chose-in-action* can validly be granted to a third party. *In Re Bank of Credit and Commerce International SA (No. 8),* (1988) A.C. 214.

Amounts received towards performance guarantee

Rule 2(b)(iv) of the Companies (Acceptance of Deposits) Rules, 1975 specifically excludes any amount received by one company from another company. It also excludes any amount received by way of security for the purpose of business and vide Rule 2(d)(vi). Therefore, if an amount is deposited towards a performance guarantee, it cannot be treated as a deposit.

Overriding effect of provisions of Reserve Bank of India Act

The provisions of Chapter III-B of the Reserve Bank of India Act, which regulate non-banking financial companies, have overriding effect to the extent to which they are at variance with the provisions of the Companies Act, 1956 (implying thereby the provisions of sections 58A and 58AA), as section 45 of that Act says that "notwithstanding anything inconsistent therewith in any other law" the provisions in the RBI Act will prevail.

Third Amendment Rules, 2001 [*GSR 873(E), dt. 28-11-2001*] [*w.e.f. 28-11-2001*]

(i) *Prohibition on acceptance of public deposits by companies with net owned funds of less than Rs. 1 crore.*

Under Rule 3(e) companies with less than Rs. 1 crore Net Owned Fund are prohibited from accepting public deposits.

'Net owned funds' has the same meaning as assigned to it in the RBI Act, 1934 [Rule 2(e)].

Definition of Net Owned Fund (NOF)

The expression "NOF" has been defined in the *Explanation* to section 45IA of the RBI Act.

I. "Net owned fund" (NOF) means—

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting therefrom—

(i) accumulated balance of loss;

(ii) deferred revenue expenditure; and

(iii) other intangible assets; and

(b) further reduced by the amounts representing—

(1) investments of such company in shares of—

(i) its subsidiaries;

(ii) companies in the same group;

(iii) all other non-banking financial companies; and

(2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,—

(i) subsidiaries of such company; and

(ii) companies in the same group,

to the extent such amount exceeds ten per cent of (a) above.

II. "Subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956 (1 of 1956).

(ii) *Penal rate of interest (other than for small depositors)*

Rule 8A has been incorporated in Companies (Acceptance of Deposits) Rules, 1975 to provide for penal rate of interest on public deposits. A penal rate of interest of 18 per cent. would have to be paid for the overdue period in the case public deposits matured and claimed but remaining unpaid.

(iii) *Penal rate of interest for small depositors*

In the case of deposit made by small depositors, the penal rate of interest would be 20 per cent. compoundable on an annual basis.

Complaints, prosecution and penalties for default [Sub-sections (5) and (6)]

Sub-section (5) lays down that where a company fails to repay a deposit in accordance with the provisions of sub-section 3(c) or sub-section (4), apart from levy of fine of not less than twice the amount of deposit on the Company, every officer of the company who is in default shall be punishable for a term which may extend to five years and shall also be liable to fine.

Sub-section (6) provides that a company which accepts or invites any deposit in excess of the prescribed limits, or in contravention of the manner or condition prescribed under sub-section (1) of section 58A, or in contravention of sub-section (2) thereof, shall be punishable (i) where the contravention relates to acceptance of deposit with fine of not be less than the amount of deposit, and (ii) where the contravention relates to invitation of any deposit with fine which may extend to rupees ten lakhs but shall not be less than rupees fifty thousand.

Every officer of the company who is in default shall also be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine.

It may be noted that the penalties prescribed under sub-section (5)/(6) for contravening the provisions of the section are unduly severe and the court has to approach the matter with great caution. See generally, *H. Nanjundiah v. Govindan (V.), ROC, Maharashtra,* (1986) 59 Com Cases 356 (Bom). Section 58A(6), Clause (b) does not stipulate that prosecution of the company is a *sine qua non* for prosecuting any defaulting officer of the company. Though an officer cannot be convicted without a finding that the company had committed the offence, such finding can be recorded even if the company has not been arraigned as an accused. The officers can contend in defence that the company itself had not committed any offence. Where the company is not prosecuted due to some legal impediment, the officers cannot get rid of their liability for that reason alone. Whether the company had received deposits from the public or whether the officers had done so on its behalf is a question of fact which can be decided at the trial. *Rama Bhushanam v. ROC,* (2002) 47 CLA 74 : (2002) 36 SCL 344 : (2002) CLC 508 : (2002) 3 Comp LJ 385 : (2002) 112 Com Cases 238 (AP).

The Madras High Court has held in *Asst. ROC, Madras v. R. Narayanaswamy,* (1985) 57 Com Cases 787 (Mad) that the offence of non-payment of excess deposits within the prescribed time is not a continuing offence. The directors of the company who were not in office at the time when the default took place were not liable to be prosecuted for the default. But the Andhra Pradesh High Court has held that the offence under the section is of continuing nature. A fresh period of limitation commences with every successive day of default. *Hyderabad Vanaspathi Ltd. v. ROC,* (1986) 59 Com Cases 654 (AP); *Sujani Textiles (P.) Ltd. v. Asst. ROC,* (1980) 50 Com Cases 276 (Mad).

The punishment can go beyond 3 years of imprisonment. There is therefore no period of limitation for initiating prosecution under S. 468 of the Criminal Procedure Code, 1973. The proceedings can be taken against the directors and officers only without joining the company as a party. *Satish Kumar Jhunjhunwalla v. ROC,* (1987) 61 Com Cases 110 (Cal).

Failure to file a return as required by Rule 10 of the Companies (Acceptance of Deposits) Rules, 1975, which is punishable by Rule 11 is a continuing offence and there is no period of limitation within which proceedings may be taken. *U.P. Paper Corporation Pvt. Ltd. v. ROC,* (1987) 61 Com Cases 728 (Cal). In a subsequent case the Calcutta High Court noted that there is no continuing penalty for the contravention of Rule 10 and

therefore the same cannot be regarded as a continuing offence. *Ramnugger Cane and Sugar Co. Ltd. v. Asst. ROC,* (1990) 3 Corpt LA 180 at 181 : 1989 Cr LJ 2395 (Cal—DB). *S.P. Punj v. ROC,* (1991) 71 Com Cases 509 (Del). The Karnataka High Court has taken the view that an offence under the Rules is complete on 30th June each year and therefore the filing of a complaint after the expiry of six months from that date is barred by limitation. *Shree Dharma Sugar Industries P. Ltd. v. ROC,* (1989) 66 Com Cases 337 (Kar).

Where a complaint was filed by the Registrar of Companies, it was held that the Magistrate who took cognizance, also had the power to revoke the order of cognizance and, therefore, objections should be made before him. A petition to the High Court for quashing the proceedings would be premature at that stage. *Ramakrishna Flour and Besan Mills P. Ltd. v. ROC, M.P.,* (1994) 79 Com Cases 528 (MP).

Before this section came into force on 1-2-1975, acceptance of deposits in excess of prescribed limits was punishable by Regulations framed under Chapter III of Reserve Bank of India Act, 1934. That provision imposed a lesser penalty than that prescribed under this section. Thus any infringement in respect of deposits received before 1-2-1975 even if committed after that date shall be punishable only under Reserve Bank of India Act, 1934. *Sun Paper Mills Ltd. v. Asstt. ROC,* (1986) 59 Com Cases 320 (Mad). This decision was **followed** in *Chennai Bottling Co. (P.) Ltd. v. Asstt. ROC, Madras,* (1987) 61 Com Cases 770 (Mad) where the court added that even the maximum fine which was permitted under the original provision and which was equal to the amount of deposits, was not called for in this case. A lenient view was taken because it was found on facts that the petitioner company had in pursuance to a scheme of repayment framed by the court, repaid the offending deposits which were taken before s. 58A was introduced. This case was **overruled** by Supreme Court in *Velayndhan T. Achari v. UOI,* (1993) 77 Com Cases 197 (SC) on other grounds.

For framing of a charge against certain directors of a company for failure to refund deposits in time, all that is necessary at that stage is to show on the fact of things, *prima facie*, that they were officers-in-charge. Accordingly, such a charge has been held to be valid and not liable to be quashed. *Marthanda Varma (H.H.) v. ROC,* (1988) 64 Com Cases 125 (Karn). If a person is shown as director in the return, he is an officer of the company for purposes of this section (*ibid*). Where the auditors certified non-compliance with the relevant provisions, it was held to be a sufficient *prima facie* evidence for framing of charges. The proceedings were not liable to be quashed. *Mohanlal Rathi v. Addl. ROC,* (1992) 1 Comp LJ 207 (Del).

Where there was no evidence that part-time directors had exercised any control in the matter, they were to be relieved from their liability. *Jagjivan Hiralal Doshi v. ROC,* (1989) 65 Com Cases 553 (Bom). The court observed in this case that though the responsibility of full-time directors and part-time directors are equal, by exercising judicial discretion the part-time directors were to be relieved of the liability since there was no evidence that they exercised any control over the matter. It was also observed that if in a given case, evidence about their knowledge of the facts which constitute negligence, misfeasance, *etc.* is there, they should not be relieved of their liability.

A prosecution under section 58A(3)(a) for failure to repay deposits accepted before the commencement of the Amendment Act of 1974 is not violative of Article 20 of the Constitution of India. *Thiagarajan (S.) v. Asst. ROC,* (1986) 59 Com Cases 328 (Mad).

Where prosecution should have been launched under R. 11 read with R. 3A of the Companies (Acceptance of Deposits) Rules, but it was launched under S. 58A read with R. 3A and the Magistrate also okayed it without applying his mind to the matter the proceeding was quashed. *Bengal Tools Ltd. v. ROC, West Bengal* (1991) 71 Com Cases 85 (Cal). The court ordered that a fresh complaint may be filed in accordance with the law.

The prosecution under this section was not quashed merely because the company was not impleaded. *Satish Kr. Jhunjhunwala v. ROC,* (1987) 61 Com Cases 110 (Cal).

A prosecution for criminal misappropriation of depositor's money was quashed because of the rescheduling by the CLB. Repayments according to the new schedule were directed to be made by sending bank drafts. *Prudential Capital Markets Ltd. v. Kaupaga Vinayagar Estates P. Ltd.*, (1999) 98 Com Cases 385 (Mad). The prosecution in *NAR Nagarjan v. Addl. ROC*, (2003) 116 Com Cases 543 (Mad) was quashed because no witness was produced nor the Registrar was appearing, trial was not commenced, only adjournments were being granted for 18 years, the company was meanwhile wound up and the accused directors had repaid all the depositors.

The Managing Director of a chit fund company was held liable to be convicted when there was enough proof of the fact that he was running the business of the company in violation of the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1973. *Chikarmane (B.N.), Dy. Chief Officer, Department of Non-Banking Companies, RBI v. Arihant Finance and Chit Fund P. Ltd.*, (1991) 2 Comp LJ 128 (Bom). It was the case of a non-banking financial company. There was failure in repayment of deposits which was also in contravention of RBI directions. The person sought to be prosecuted was described in the complaint as executive director (finance). The report attached to the complaint stated that he signed salary cheques, and was also a signatory of various bank accounts. He also signed agreements on behalf of the company. The court said that the complaint was not to be quashed. *Reserve Bank of India v. DK Kapur*, (2001) 105 Com Cases 639 : (2001) 25 SCL 456 : (2000) 39 CLA (Delhi).

Repeated prosecution.—A company and its directors were convicted of offences of failure to comply with the conditions of advertisement and of failing to maintain the prescribed liquidity of assets. There was also the subsequent conviction of the same directors for acceptance of deposits in excess of the prescribed limits. The second conviction was for a different and not for the same offence. Hence, the bar of prohibition was not attracted. *Bharat Plywood and Timber Products P. Ltd. v. ROC*, (2002) 108 Com Cases 601 : (2001) 33 SCL 230 : (2001) 4 Comp LJ 361 : (2001) Cr LJ 3888 (Ker).

Powers of CLB for rescheduling, or to direct, repayment of deposits

Deposits made by a registered society are not excluded from the power of the Company Law Board to order payment. Section 58A, which is designed to protect the interest of investors does not make a distinction between large and small investors. The company could not adequately make out its case for granting a period of four years to repay the remaining deposit amount. The company was directed to pay the balance of the deposit amount together with contracted rate of interest calculated up to the date of repayment. *Airforce Naval Housing Board v. Kiran Overseas Exports Ltd.*, (1999) 95 Com Cases 900 (CLB—SR) : (1999) 32 CLA 116. Another similar order was passed in *Air Force Naval Housing Board v. Asian Alloys Ltd.*, (1998) 4 Comp LJ 540 : (1998) 17 SCL 239 (CLB).

Where the Company Law Board received petitions from depositors for direction of repayment and the conduct of the company was irresponsible, the CLB rejected rescheduling and ordered the company to pay interest to date and renew deposits for future tenure of two years with additional interest of two per cent. The Registrar of Companies was to initiate prosecution in case of non-compliance. *Thapar Agro Mills Ltd., Re*, (1998) 93 Com Cases 170 : (1997) 25 CLA 102 : (1997) 12 SCL 702 : (1997) 2 Comp LJ 270 (CLB—NB).

No rescheduling was ordered where a scheme for arrangement with the depositors was pending before the High Court under s. 391 and was still not disposed off. *Vilasini Jayaprakash v. St. Mary's Finance Ltd.*, (2000) 99 Com Cases 54 : (2000) CLC 426 (Ker).

Non-payment of deposits on the ground of non-realisation of debts was held to be not justified. The company was ordered to pay all matured deposits within one month of the date of the order alongwith interest up to date at the contracted rate. *Cebon India Ltd., Re*, (1998) 3 Comp LJ 522 : (1998) 17 SCL 152 (CLB—NR).

A company which was not able to pay back deposits had suffered 50% erosion of its net worth. The matter was also reported to the Board of Industrial Finance and Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985. The proposal of financial restructuring was also there before some financial institutions. In these circumstance the CLB formulated the view that the company would not be ordered to repay all deposits immediately. If the company's proceeding before the BIFR became prolonged, its net worth would further deteriorate. Therefore, repayment deserved to be postponed for two years, although the company had not sought rescheduling. The company was directed to pay urgent attention to repayment to depositors who were in indigent circumstances. *Savita Jain v. Viniyoga Clothex Ltd.*, (1998) 4 Comp LJ 542 : (1998) 17 SCL 309 (CLB—NR).

In *Modern Denim Ltd., Re,* (1998) 1 Comp LJ 333 : (1998) 28 CLA 210 (CLB—NR) the CLB laying down the balanced approach to rescheduling said that safeguarding the interests of the company, that of depositors, and general public interest, a reasonable opportunity should be given to all concerned for deciding time and conditions of repayment. Another case in which extension of time was granted is *Lloyds Finance Ltd., Re,* (1999) 34 CLA 19 (CLB—Mumbai). In *Ramanathan (P.R.) v. SMH Finance P. Ltd.*, (2000) 4 Comp LJ 160 : (2000) 27 SCL 537 (CLB—SB) the CLB ordered rescheduling for repayment and also allowed the branch of companies involved in the case to sell their assets and properties in accordance with the law and under the supervision of depositors Committee.

A company had taken deposits and was not able to pay back according to the schedule because of the changed circumstances of the business of production of soft drinks. On the application of the company, the Company Law Board allowed extension of time for repayment but did not permit reduction of the rate of interest. *Pure Drinks (New Delhi) Ltd., Re,* (1995) 83 Com Cases 174 (CLB—NR).

Where a company was not able to pay back because of severe recession in industry, closure of plant due to unprecedented floods and the resulting liquidity crunch and it was asking for approval of a scheme of repayment spread over four years, the CLB approved it and set June 30th, 1999 by which the entire outstandings must be paid with interest and subject to certain conditions. *Nuchem Ltd., Re,* (1997) 3 Comp LJ 338 : (1997) 13 SCL 54 (CLB—NB).

It would be necessary for a complainant under S. 58-A(9) to specify in the complaint or to furnish afterwards the terms and conditions of the deposits and the dates of maturity because without such particulars it would be very difficult for CLB to come to a positive conclusion as to the alleged violation *Kanak Vinod Mehta (Mrs.) v. Jyoti Wire Industries Ltd.*, (1991) 72 Com Cases 366 (CLB).

Where the Company was able to convince the CLB as to the reasons for its inability to refund deposits as they mature, the company was ordered to pay the principal amount at once and the interest as directed. *Ambalal Sarabhai Enterprises Ltd.*, (1991) 2 Comp LJ 447 (CLB). But where a company was not able to give a convincing proof of its sincerity because neither its application for relief was accepted by BIFR nor it had filed a schedule for repayment as promised, the company was ordered to pay back within a period specified in the order *Genlec Ltd.. Re,* (1991) 2 Comp LJ 150 (CLB).

Even where a notification had been issued declaring the company a relief undertaking under the Bombay Relief Undertakings Special Provisions Act, 1958 and the application of the company before the BIFR was pending the CLB ordered, because of the substantial amount and large number of applicants involved, that the company should pay back all the matured deposits according to the dates specified in the order excepting the deposits held by Financial Institutions. The CLB also held that the State Government had no authority to suspend the liabilities arising under a Central Act and hence proceedings under section 58-A were not barred by the notification. *Nirlon Ltd., Re,* (1992) 73 Com

Cases 190 (CLB); *Modi Carpets Ltd., Modi Nagar, Re,* (1991) 3 Comp LJ 305 (CLB); *Modi Industries Ltd., Re,* (1992) 8 Corpt LA 1 (CLB).

The CLB has the jurisdiction to take care in the interest of all depositors though it has only one depositor before it. An order was made for time-bound refund of all depositors. *Pure Drinks (New Delhi) Ltd., Patiala, Re,* (1991) 3 Comp LJ 307 (CLB).

Where a deposit receipt was issued by the company in the name of two minors, the company was directed to pay back the amount. The CLB held that this was no defence that the amount represented by the receipt was paid to the company in lieu of the appointment of the minors' father as a director in the company. *Karishma A. (Miss) v. Premier Nitrates and Chemicals Pvt. Ltd.,* (1997) 90 Com Cases 285 (CLB—Mad).

Where after filing a complaint before CLB the party also filed a civil suit against the company claiming repayment with interest of the amount deposited or lent, it was held that this did not preclude the party from obtaining the necessary relief from the CLB for which the later is empowered under the section. *Vijay Kumar Gupta v. Eagle Paint & Pigment Industries P. Ltd.,* (1997) 13 SCL 179 : (1997) 26 Corpt LA 236 : (2000) 6 Comp LJ 543 (CLB—Cal).

Where a large number of depositors made complaints as to non-payment of their deposits by the company, it was held that the CLB has the power to call for a scheme of repayment. The company was directed to file its scheme within two months for consideration of the CLB. *Mukesh Sood v. Incab (Industries) Ltd.,* (1996) 23 Corpt LA 178 (CLB). In another case of the same kind involving failure to make refunds, the CLB found defaults in other respects also and also found that the company had assets free of encumbrances. The company was ordered to pay overdue interest amount at once and to make arrangement for repayment of the principal amount within the extended period of two years at 2% extra interest. The directors were also asked to pay special and sympathetic consideration to those depositors who were asking for immediate refund because of difficult circumstances like old age, hospitalisation, death, marriage *etc. Thapar Agro Mills Ltd., Re,* (1997) 2 Comp LJ 270 (CLB—PB).

In *Pure Drinks (New Delhi) Ltd., Patiala, Re,* (1992) 73 Com Cases 190 (CLB), the Company Law Board held that there was no merit in the contention that CLB had no power to frame a scheme for payment to depositors and that it could pass orders only on individual applications. The main objective of the amendment of 1988 was safeguarding the interest of the company, the depositors and the public interest. It would, therefore, be appropriate, in the interest of the company, to allow sufficient time for repayment; in the interest of the depositors, to provide for enhanced rate of interest and in the interest of public, to ensure the functioning of the company as a going concern without any cash crunch.

Since the repayment of deposits is only likely to be deferred or delayed when the company is presently unable to do so, it is difficult to see what protection is granted to the depositors by the amendment. Further, the amendment does not specify the maximum time for which the Board may extend the period of repayment, nor does it indicate the rate at which interest is payable during the extended period.

In another matter of the same company in *Pure Drinks (New Delhi) Ltd., Re,* (1997) 89 Com Cases 685 : (1997) 3 Comp LJ 314 : (1997) 26 Corpt LA 134 (CLB—NB) it was held that repayment of intercorporate deposits was outside the purview of the proceedings under the section. The company had already been granted several extensions but even so one more extension was granted subject to this warning that any further default would attract penal consequences.

The company was avoiding repayment in respect of only one depositor, a registered society. The ground of avoidance was that there was adverse liquidity position. The deposit was of fifty lakh rupees of which thirty two lakhs remained outstanding. The Company Law Board found no justification for seeking extension of time. The company was or-

dered to repay the amount with up-to-date contracted interest by quarterly instalments. It was also held that a registered shareholder was entitled under s. 58A(9) to file an application for an order of repayment. *Air Force Naval Housing Board v. Kiran Overseas Exports Ltd.*, (1999) 1 Comp LJ 130 : (1999) 95 Com Cases 900 (CLB—SB). In another proceeding against the same company, the vice-chairman was directed to reassure payment according to the approved schedule failing which there would be automatic penal action against him. *Air Force Naval Housing Board v. KHSL Industries Ltd.*, (1998) 3 Comp LJ 106 : (1998) 16 SCL 631 (CLB—NB).

In *DCM Ltd., Re,* (1998) 5 Comp LJ 451 (CLB—NB) rescheduling was allowed because of liquidity problems with this direction that hard cases should be considered on priority basis by constituting a committee for that purpose. In *DCM Financial Services Ltd., Re,* the Company Law Board, using the powers under s. 45QA of the RBI Act, 1934, ordered production of details so that the CLB could frame its schedule and guidelines for repayment. The company was ordered to pay matured deposits at once and for this purpose to postpone other liabilities and bring in more funds from other sources and to constitute a committee to attend on preferential basis hard cases, if any. See also *Dinesh Mahesh Finance Co. Ltd. v. Lunar Diamonds Ltd.*, (1999) 3 Comp LJ 303: (1998) 17 SCL 145 (CLB—NB) where repayment was ordered as rescheduled. *Hindustan Financial Management Re*, (1999) 19 SCL 226 (CLB—NB) rescheduling for payment within 54 months at 10.5%; *Onida Finance Ltd. Re*, (1999) 19 SCL 115 (CLB—NB) 5 year rescheduling at 10% interest. *Members of Public Holding Deposits in the Company v. DCM Financial Services Ltd.*, (1998) 18 SCL 1 (CLB—NB), four-year rescheduling for payment on contract rate of interest and 10% after default and penal consequences.

Where the chairman of the company undertook to repay all deposits within 18 months from the date of maturity and filed an affidavit to that effect, the undertaking of the chairman was approved on the condition that non-compliance would constitute a default on the part of the chairman as well as the company and shall attract penal provisions under s. 58-A(10). *SRG Infortec (India) Ltd. Re,* (1998) 17 SCL 150 (CLB—NB).

A company which was sponsored jointly with PSIDC suffered losses and deposits could not be refunded because of the financial crisis. The Company Law Board accepted the undertaking by the company that it would start paying off deposits fifteen days after receipt of the order. *Cephem Milk Specialities Ltd. Re*, (1998) 17 SCL 191 (NB).

In *Hoffland Finance Ltd. Re*, (1999) 19 SCL 93 (CLB—NB), 18 months rescheduling for return of deposit was allowed. The situation was directed to be watched by a Committee of Investors and a CLB representative, and penal provisions of s. 58B to be attracted in case of failure of compliance. A repayment scheme was approved by the CLB in *Global Infrastructure & Technologies Ltd. Re,* (2001) 29 SCL 34 (CLB—Mumbai).

A company was directed to repay the deposit amount alongwith interest in three equal quarterly instalments, regardless of its proposed rehabilitation as a Sick Industrial Company. *Jason John v. Artech Power Products Ltd.*, (2000) 4 Comp LJ 152 : (2000) 27 SCL 88 (CLB—SB). The CLB ordered repayments in all these cases subject to penal consequences if the order was not complied with. *Poombavathy v. Chola Finance Ltd.*, (2000) 4 Comp LJ 150 (CLB); *Saroja (R) v. EBF Finance Ltd.*, (2000) 4 Comp LJ 151 (CLB); *Jyothi Sangh Trustee Mandal v. HMT Ltd.*, (2000) 4 Comp LJ 154; *Thangam Nagarajan v. Chola Finance Ltd.*, (2000) 4 Comp LJ 156 (CLB); *Mohd. Mazharuddin Iqbal v. Asra Estates P.Ltd.*, (2000) 4 Comp LJ 157 (CLB); *Mayur Agencies and Exports v. Thambi modern Spinning Mills Ltd.*, (2000) 4 Comp LJ 159 (mutual agreement between parties for settlement of principal and interest). See also *Ramnathan (P.R.) v. SMH Finance P. Ltd.*, (2000 4 Comp LJ 160 : (2000) 27 SCL 537 (CLB).

A company's repayment plan was approved because it showed sincerity in making repayments. The company's secured creditors were not likely to be affected by rescheduling. *DCL Finance Ltd. Re,* (2001) 29 SCL 131 (CLB).

Further extension of time.—Where a company could not keep up repayment as re-scheduled by the CLB and sought extension of time for atleast nine months to enable to sell its surplus lands and start repayments, the CLB held that the company's request deserved to be accepted. *Cable Corpn. of India Ltd. Re,* (2002) 40 SCL 346 (CLB).

Rescheduling repayment of deposits under s. 45QA of the RBI Act

A non-banking financial company was lagging behind in repayments. The *suo motu* power of the Company Law Board under s. 45QA of the RBI Act could be exercised in the public and depositors' interest. The delay in repayments was unavoidable because of very poor inflow of cash. The scheme which was proposed by the company was modified and approved and the company directed to carry out repayments accordingly. *Hindustan Financial Management, Re,* (1999) 1 Comp LJ 344 (CLB—NB). Another case in which this power was exercised by the Company Law Board in similar circumstances is *Members of the Public Holding Deposits in Kothari Oriented Finance Ltd. v. Kothari Orient Finance Ltd.,* (1999) 1 Comp LJ 149 (CLB—SB).

Another case in which the power under s. 45QA of the RBI Act, 1934 was exercised is *Suresh Chandra Gupta v. Sunrise Securities Ltd.,* (1998) 3 Comp LJ 345 : (1998) 17 SCL 179 (CLB—NB). The factors which slowed down the process of repayment, as noted by the CLB, were non-realisation of lease rentals, substantial reduction in the business of merchant banking, stock broking and financial services due to depressed capital market. The company submitted a scheme of repayment under which 95% of deposits were to be paid back in 8 months. Depositors made no objection to the scheme. The scheme was approved.

Using the power under S. 45-QA of the RBI Act, 1934, a defaulting NBFC was directed to repay the deposits having regard to the cash flow projection. Guidelines were also provided to the company for keeping in mind in implementing the scheme of repayment. *Allianz Capital & Management Services Ltd. Re,* (2000) CLC 592 (CLB–NB).

In the exercise of s. 45QA power, the CLB cannot formulate any opinion for the purpose of rescheduling where the Central Government has deprived the company of its Nidhi status and the scheme as proposed is not supported by necessary documents like projected cash flow statements, balance sheet and profit and loss account. *Kuber Mutual Benefits Ltd. Re,* (2000) 36 CLA 252 (CLB—NB).

It has been held that the activities of NBFCs accepting deposits from public are excluded from purview of S. 58A and are to be registered by Chap. IIIB of the RBI Act, 1934. The rescheduling application are, therefore, to be considered under s. 45QA. Such application has to be made by an aggrieved depositor and not by the defaulting company itself. *Manipal Finance Corpn. Ltd. Re,* (2003) 52 CLA 102 : (2002) 40 SCL 939 (CLB—Chennai), *Manipal Sowbhagya Nidhi Ltd. Re,* (2003) 52 CLA 102 : (2002) 40 SCL 939 (CLB).

Conflict of authority between RBI and CLB

The Company Law Board in its decision in *B. Bharathi v. Rockland Leasing Ltd.,* (1999) 95 Com Cases 471 (CLB—NB) : (1998) 4 Comp LJ 90 : (1998) 17 SCL 243 talked of the apparent conflict of authority between the Company Law Board and Reserve Bank. The Board (CLB) said that the Reserve Bank Directions are for all companies generally prescribing three year repayment schedule ending with year 2001. The Company Law Board directs repayment on case to case basis. The Board considered the effect of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. [Reported in (1998) 92 Com Cases (St.) 47].

Complicated questions as to repayment

The company disputed the title of the depositor and claimed partial discharge. The depositor disputed the genuineness of the documents on which the company was relying. The Company Law Board held that it could not adjudicate on such disputes. The parties were relegated to the civil court. *Anandarama Reddy v. Page Investments and Financial*

Services Ltd., (1999) 95 Com Cases 451; (1999) 1 Comp LJ 328 : (1999) 32 CLA 16 (CLB—SB).

In extraordinary cases of hardships the CLB may order special treatment for such hard cases even if they are also a part of a scheme of rescheduling. *Promila v. DCM Financial Services Ltd.*, (2001) 107 Com Cases 358 : (2001) 4 Comp LJ 149 : (2001) 33 SCL 118 (Delhi).

No jurisdiction to decide directorship for fixing responsibility for non-compliance

The CLB has no jurisdiction under s. 45QA to go into the question whether a person ceased to be a director and, therefore, was not responsible for complying with the orders passed under that section for refund of deposits. *Dheepa Rajappa v. A Siva Subramanian*, (2002) 47 CLA 25 (CLB).

Secured creditors are not depositors

The Company Law Board does not have the power to order repayment of sums advanced by secured creditors. The term "deposit" does not extend to such sums. The court said that their interest is not prejudiced by an order for refund of deposits unless their security is put at risk. *United Western Bank Ltd. v. CLB*, (2001) 107 Com Cases 63 : (2001) 45 CLA 31 : (2001) 4 Comp LJ 194 (Kant).

Liability of signing officer

Where the officer who signed deposit receipts on behalf of the company was a mere employee, he would not be under any civil liability towards depositors. No decree could be had against such an employee. *B.N. Narayan v. Lakshmi*, (1999) 97 Com Cases 956 (Kant).

Time-barred complaint

A complaint filed six months after an advertisement was inserted inviting deposits without approval was quashed. Though it was not clear whether the Department had come to know of the advertisement that very day, the Department was supposed to have knowledge from the fact that the company had filed an application for approval that very day. *Additional ROC v. Perfect Benefit Fund Ltd.*, (1999) 97 Com Cases 731 (Mad). A deposit was made by the partner of a firm which had dealership agreement with the company. The company filed a suit against the firm for recovery of sums due to it. The deposit amount was subsequently appropriated towards the suit amount and the plaint was amended to seek only the reduced amount. An application was filed by the partner before the CLB five years after the appropriation for seeking direction for repayment. It was held that the remedy under the section was not available in the circumstances of the case. *Pushpa Singh v. BPL Ltd.*, (2002) 110 Com Cases 82 (CLB).

In *Pinna NR (Dr.) v. Commissioner of Police*, (2000) 23 SCL 340 (AP), the RBI issued directions to the State Government for follow up action against a defaulting NBFC for protecting the interests of depositors.

Dismissal and restoration of application.—Where an application under s. 58A(9) for refund of deposit was dismissed for non-prosecution and the Company Law Board found on an application for restoration of the application that the applicants were elderly people and their counsel could not appear due to illness and the amounts involved were very large and the delay in seeking restoration was just only marginal, the Board ordered restoration of the applications. *Bimala Mallick (Mrs.) v. Martin Burn Ltd.*, (1995) 84 Com Cases 956 : (1995) 4 Comp LJ 272 (CLB—EB).

Remedy under writ jurisdiction for refund of deposits

Public interest litigation.—The Calcutta High Court in its decision in *State of West Bengal v. Union of India*, AIR 1996 Cal 181 at 216 allowed the writ petition filed in the interest of depositors by way of public interest litigation and observed that a public interest litigation filed by the State against non-banking financial companies alleging that they

were diverting the money of small depositors to subsidiary companies and were unable to return their deposits, the petition cannot be dismissed on the ground of alternative remedy under the Companies Act. The provisions of the Companies Act can hardly be said to be efficacious remedies for helpless small depositors belonging to the weaker section of the society to get their money with interest on the basis of which it can be said that such remedies are alternative remedies. Sub-sections (3A), (4), (5), (9) and (10) of S. 58A of the Companies Act, 1956 deal with refund of deposits. By a notification issued under sub-sec. 7(a)(ii) of S. 58A of the Companies Act, the Central Government exempted the companies which are financial institutions within the meaning of S. 451 of the R.B.I. Act, 1934, from any of the provisions of S. 58A except the provisions relating to advertisement contained in Cl. (b), sub-sec. (2) of the section. That apart, examination of the sub-sections will indicate that although prosecution and punishment have been provided, there is no provision for securing refund of the small depositors. In fact, the various provisions cannot be treated as an alternative remedy at all, the same being not at all efficacious and adequate.

Acceptance of deposits in excess of limits

Rule 3(ii) and Rule 11 of the Companies (Acceptance of Deposits) Rules, 1975 makes it an offence to accept deposits beyond the prescribed limits. The entire amount borrowed by a company in excess of the permitted limits and treated as deposits under rule 2(b)(ix) would be repayable within 30 days with interest at the market rate subject to the ceiling envisaged in the rules. *Vijay Kumar Gupta v. Eagle Paint & Pigment Industries P. Ltd.*, (1997) 13 SCL 179 : (1997) 26 CLA 236 : (2000) 6 Comp LJ 543 (CLB—Cal).

Permission to retain excess deposits on NBFC becoming industrial company.—A non-banking finance company gave up financing and became an industrial company. The industrial company was not entitled to hold as much deposit as it was holding in its capacity as NBFC. On its application to the Company Law Board, the company was permitted to retain excess deposits and repay them on maturity. *Nagarjuna Finance Ltd., Re,* (1999) 97 Com Cases 171 : (1999) 2 Comp LJ 344 : (1999) 21 SCL 172 : (1999) 33 CLA 295 (CLB—SR).

Authorities competent to take action.—Unlike in the case of the contravention of provision of the Reserve Bank of India Act, where the authority in writing of the Bank is necessary for launching a prosecution (section 45-P), under the Companies Act, complaint may be made by a shareholder or the Registrar or a person authorised by the Central Government, (section 621).

Notification.—"In exercise of powers conferred by sub-section (1) of section 621 of the Companies Act, 1956 (1 of 1956) the Central Government hereby authorises the Chief Officer, Deputy Chief Officer and Assistant Chief Officers attached to the Department of Non-Banking Companies, Reserve Bank of India, for the purpose of that sub-section in respect of an offence punishable under sub-section (6) of section 58A of that Act." [*Notification No.* G.S.R. 473 (E), dated 26-9-1978].

§ See also Notes under S. 633 under the heading "Relief against acceptance of deposits beyond limits."

Small-Scale Units exempted* : [Sub-section 7(a)(ii)]

Revised limits for exemption to small-scale industrial units.—*Notification* **G.S.R. No. 73(E), dated 2-2-1996.**—In exercise of the powers conferred by sub-clause (ii) of clause (a) of sub-section (7)

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* Investment ceiling in respect of SSI undertaking shall not exceed Rs. 5 crore *vide* Notfn. SO 1013(E), dt. 9-10-2001 (for the text see *Stop Press Pages*) earlier *vide* Notfn. No. SO 1288(E), dated 24-12-1999 and Press Note no. 15 (1999 series) the investment limit in fixed assets in Plant and Machinery in respect of small scale/ancillary industrial undertaking, whether held on ownership term or on lease or on hire purchase has been reduced to Rs. 1 crore. Earlier as per the *Notification No.* SO 857(E), dt. 10-12-1997 issued by Ministry of Industries, Deptt. of Industries and Promotion u/s. 11B(1) and s. 29B(1) of the IDR Act, 1951, the limit in terms of Investments in Fixed Assets pertaining to Plant & Machinery for Small Scale Industry was raised to Rs. 3 crores. Corresponding effect under section 58A of the Companies Act, 1956 has, however, so far not been given by the Department of Company Affairs.

of section 58A of the Companies Act, 1956 (1 of 1956) and in supersession of the notification of the Government of India in the Ministry of Industry, Department of Company Affairs No. G.S.R. 48(E), dated the 21st January, 1986, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the Reserve Bank of India, hereby specifies the following companies as the companies to which the provisions of section 58A of the Companies Act, 1956, shall not apply, namely:—

Companies which are Small Scale Industrial Units and fulfil the following conditions, namely:—

(a) The paid-up capital of the company does not exceed Rs. 25 lakhs;

(b) The company accepts deposits from not more than 100 persons;

(c) There is no invitation to public for deposits; and

(d) The amount of deposits accepted by the company does not exceed Rs. 20 lakhs or the amount of its paid-up capital, whichever is less.

Explanation.—For the purpose of this notification.—

(i) "deposit" has the same meaning as in clause (b) of rule 2 of the Companies (Acceptance of Deposits) Rules, 1975.

(ii) a "Small Scale Industrial Unit" means any industrial undertaking registered with the Directorate of Industries of Small Scale Industries, as the case may be, of the State Government and in respect of which the investment in plant and machinery is not in excess of 60 lakhs of rupees in value.*

[*Gazette of India, Extraordinary Part-II, Section 3, Sub-section (i), Ministry of Law, Justice & Company Affairs, New Delhi, the 2nd Feb., 1996.*]

Exemption under the notification will be available to a company being a Small Scale Industrial unit till its status as such remains unaffected. Further the calculation of aggregate of paid-up capital and free reserves has to be made as on the date of the last audited Balance-Sheet. It therefore follows that changes occurring subsequent to the last audited balance-sheet will not affect the exemption granted by the notification.

There has been a series of notifications granting the specified Small Scale Industrial undertakings exemption from the application of the provision of S. 58-A and Rules made thereunder, subject to different conditions specified in respective notifications. Deposits accepted by such a unit at the relevant time in accordance with and to the extent permissible under the notification for the time being in force will continue to be exempt till maturity even though subsequently there may be amendments, or a new notification which prohibits acceptance of similar deposits.

Department's Circular.—The exemption of small-scale units does not necessarily cover any ancillary industrial unit unless such unit is itself eligible to be treated as a small-scale one. (*Department's Circular Letter* 4/13/77, dated 5-5-1977).

Applicability and exemption, Non-Banking Financial Companies [Sub-section (7)(b)]

Sub-section (7)(b) provides that the provisions of section 58A shall not apply to such classes of financial companies as the Central Government may, after consultation with Reserve Bank of India, specify in this behalf. The Central Government has specified all classes of financial companies to which no provision of section 58A shall apply, except to comply with the advertisement provisions of sub-section (2)(b), where deposits are invited and accepted by such companies.

Notification No. SO 523(E), dated 18-9-1975.—"In pursuance of clause (b) of sub-section (7) of section 58-A of the Companies Act, 1956 (1 of 1956), the Central Government, after consultation with the Reserve Bank of India, hereby specifies all classes of financial companies as the companies to which no

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* Investment ceiling in respect of SSI undertaking shall not exceed Rs. 5 crore *vide* Notfn. SO 1013(E), dt. 9-10-2001 (for the text see *Stop Press Pages*) earlier *vide* Notfn. No. SO 1288(E), dated 24-12-1999 and Press Note no. 15 (1999 series) the investment limit in fixed assets in Plant and Machinery in respect of small scale/ancillary industrial undertaking, whether held on ownership term or on lease or on hire purchase has been reduced to Rs. 1 crore. Earlier as per the *Notification No.* SO 857(E), dt. 10-12-1997 issued by Ministry of Industries, Deptt. of Industries and Promotion u/s. 11B(1) and s. 29B(1) of the IDR Act, 1951, the limit in terms of Investments in Fixed Assets pertaining to Plant & Machinery for Small Scale Industry was raised to Rs. 3 crores. Corresponding effect under section 58A of the Companies Act, 1956 has, however, so far not been given by the Department of Company Affairs.

provisions of section 58-A of the Companies Act, 1956, [except the provisions relating to advertisement contained in clause (b) of sub-section (2) of that section] shall for the purposes of that clause, apply.

Explanation.—For the purposes of this notification, 'financial company' means a non-banking company which is a 'financial' within the meaning of clause (c) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934), s. 523 (E)—Gaz. of India, 18-9-1975, Pt. II, S. 3(ii), Ext. (No. 374), dated 18-9-1975."

Power of extension and exemption [Sub-section (8)]

Under this sub-section, Government may grant extension of time to a company or class of companies for complying with the provisions or exempt the companies from complying with the provisions of this section. Government have framed Rules called 'The Companies (Application for Extension of time for Exemption under sub-section (8) of section 58A) Rules, 1979', and exemption from the provisions of this section be sought under these rules. Exemption or extension of time can be granted either retrospectively or prospectively. For text of Rules refer *Appendix* 11.

A claim for exemption which was rejected without giving opportunity was held to be illegal. *Career Savings and Investment (India) Ltd. v. UOI*, 2000 CLC 1665 : (2000) 39 CLA 92 : (2001) 29 SCL 163 (Raj).

DCA Guidelines for filing statutory application under section 58A(8)*

An application submitted under section 58A(8) of the Companies Act, 1956 should be in accordance with the Companies (*Application for Extension of Time or Exemption under sub-section (8) of section 58A),* Rules, 1979 and be accompanied by the following:—

1. Application fee as per details given below:-
   (*GSR 501, dated 6-7-1999 refers*)

Companies with authorized capital	Amount of fee
(a) Less than Rs. 25,00,000/-	Rs. 500/-
(b) Rs. 25 lacs or more but less than Rs. 5 crores	Rs. 1000/-
(c) Rs. 5 crores or more	Rs. 2000/-

   Application fee shall be paid by Demand Draft drawn in favour of Pay & Accounts Officer, Department of Company Affairs, New Delhi.
2. Copies of latest audited accounts and balance sheets of the company
3. A copy of the Memorandum and Articles of Association of the company.
4. Original newspaper clippings of the public Notices published in English and vernacular langauge of the region in which registered office of the company is situated in the manner specified in Form 2 appended to the Rules.
5. Certified copy of Resolution of the Board of Directors approving the proposal of the company.
6. Copy of previous approval/order, if any, obtained under section 58(A) from the Central Government granting exemption/extension of time during last ten years.
7. Certificates from the statutory Auditors :
   (a) to the effect that the company has not contravened any other provisions of section 58A of the Companies Act, 1956 and the Companies (Acceptance of Deposits) Rules, 1975 except those for which the application is submitted.
   (b) To the effect that the deposits held by the company are within limits and that no contravention of the provisions of section 58A of the Companies Act, 1956 and the Companies (Acceptance of Deposits) Rules, 1975 exists at present.
8. Deposit position of the company as at 31st March during the current year and the past two years showing the details as under:—

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* *Source* : dca.nic.in/guidelines 58A(8).

Year ended on	Rule under which accepted	B/F	Accepted/ Renewed	Total	Repaid	Balance outstanding	Net Worth	Date on which relevant limits became available
1	2	3	4	5	6	7	8	9

9. One copy each of the advertisement issued in newspapers pursuant to Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975.

Extension of time for repayment [Sub-section (9)]

Sub-section (9), gave to the Company Law Board vast powers to act *suo motu*, or on the application of any depositor or depositors, in case of delay in repayment of deposits after the date of maturity. However, the only right given to depositors was to approach the Company Law Board to extend the time for repayment of deposits.

Earlier, the power of CLB under sub-section (9) was restricted in respect of non-banking non-financial companies. The power in this regard was also give to CLB in respect of Non-Banking Financial Companies (NBFCs) consequent upon insertion of section 45QA in Reserve Bank of India Act, 1934, w.e.f. 9-1-1997.

Where some of the refund warrants issued by the company were encashed by persons other than the depositor and the company said that its liability was over after properly posting the refund warrants, it was held that the matter had become too complicated to be handled in a summary jurisdiction of the CLB. The applicant should approach the civil court for redressal of his grievances. *A.B. Appanna v. Southern Petrochemical Industries Corpn. Ltd.*, (2003) 45 SCL 43 : 2003 CLC 775 : (2004) 118 Com Cases 114 : (2004) 58 CLA 228 (CLB, Chennai).

Where the amount was taken initially as a deposit but was subsequently returned, the CLB held that it did not qualify as a deposit so as to attract the jurisdiction under this sub-section. *Yatrini Vinod Chandra Mehta v. RPG Cables Ltd.*, (2004) 49 SCL 576 (CLB).

As per changes made in sub-section (9) and (10) by the Companies (Second Amendment) Act, 2002 the power of CLB is now vested within Tribunal Constituted under Part 1B of the Act.

Repayment of deposits

Where out of the 19 alleged FDRs 9 were paid off prematurely with interest but no proof was offered of the existence of the remaining FDRs, it was held that no order could be passed without proof. *BCC Finance Ltd. Re,* (2002) 2 Comp LJ 335 (CLB). Where a company had defaulted in repayments on maturity, the CLB invoked *suo motu* power under s. 58A(9). The company accepted its liability and contended that while it was financially sound and stable, it suffered from liquidity problem and that brought about the default. The company prayed for sanction of scheme for clearance of all matured deposits in a phased manner over a period of time. The CLB sanctioned the scheme having regard to the interest of the company, interest of depositors and also public interest at large. *Morepen Laboratories Ltd. Re,* (2003) 48 SCL 720 (CLB).

Following press notes have been issued for the guidance of depositors to enable them to make use of the expeditious remedy of approaching the Company Law Board and its regional centres in cases involving defaults in repayment of deposits:

1. Rules for repayment of company deposits made stringent.—"As a measure of protecting the interests of depositors, section 58A of the Companies Act, 1956, has been amended by the Companies (Amendment) Act, 1988, to provide for repayment of deposits, unless renewed in accordance with the prescribed rules. The amended provisions of sub-section (9) thereof empower the Company Law Board to take cognizance of any case of non-repayment of deposits on maturity and to direct the company to make repayment of such deposits within such time and subject to such conditions, as may be specified in the order. Non-compliance with the orders of the Company Law Board would attract penalty by way of imprisonment, which may extend to three years and shall also be liable to a fine of not less than Rs. 50 [*increased to Rs. 500 by Amendment Act, 2000 w.e.f. 13-12-2000*] for every day till such non-compliance continues. The amended provisions shall come into force with effect from September 1, 1989.

2. The aggrieved depositors may make an application (in now in duplicate) to the Company Law Board in the prescribed form, with an application fee of Rs. 50 [*increased to Rs. 500 by Amendment Act, 2000 w.e.f. 13-12-2000*] at the following address:

1. In respect of companies which have their registered offices located in Delhi, Haryana, U.P., Punjab, Rajasthan, Himachal Pradesh and Jammu & Kashmir.	Company Law Board, Northern Region Bench, 5th Floor, "A" Wing, Shastri Bhavan, New Delhi-110 001.
2. In respect of companies which have their registered offices located in West Bengal, Orissa, Bihar, Assam, Meghalaya, Tripura, Manipur and Nagaland.	Company Law Board, Eastern Region Bench, 9, Old Post Office, Street (6th Floor), Calcutta-700 001.
3. In respect of companies which have their registered, offices located in Tamil Nadu, Karnataka, Andhra Pradesh, Kerala and Union Territory of Pondicherry.	Company Law Board, Southern Region Bench, Block I, V-Floor, Shastri Bhavan. 26, Haddows Road, Madras-600 006.
4. In respect of companies which have their registered offices located in Maharashtra, Gujarat, Madhya Pradesh, Goa, Daman and Diu.	Company Law Board, Western Region Bench, NTC House, 2nd Floor, 16, N.M. Marg, Ballard Estate, Bombay-400 038.

The Company Law Board (Bench) Rules, 1975, have been suitably amended prescri-bing the application form [*Form No. 11 R. 36A*]. The application can either be filed personally or may be sent by post.

3. It is clarified for the information of the depositors that even the deposits, which had matured before the amended provisions of section 58A of the Companies Act, 1956, came into force but have not been repaid, would be covered by the said amended provisions of law. It may also be stated that the Company Law Board may, if it is satisfied, also pass orders under section 58A(9) of the Companies Act, 1956, on its own motion." [*Press Note issued by the DCA, No.* 1/6/88-CL-V, dated 29-8-1989 : (1989) 66 Com Cases 147 (St).]

Non-payment of Matured Deposits Remedies available to Investors

Press Release, dt. 18-6-2001.—The procedure of filing an application for non-payment of matured deposits or investments by a company before the CLB provides for filing Form No. 4 prescribed under the CLB Regulations, 1991 in duplicate along with photocopy of deposit receipts accompanied by a demand draft of Rs. 50 drawn in favour of Pay and Accounts Officer, Department of Company Affairs (DCA) payable at New Delhi, Mumbai, Kolkata and Chennai as the case may be. Each depositor is required to file separate Form No. 4. Those having more than one deposits in the same company may file only one Form No. 4 application. Jurisdiction of the Bench is as per the location of registered office. There are four CLB Benches located at New Delhi, Mumbai, Kolkata and Chennai with the Principal Bench in Delhi. In case of non-compliance of CLB orders by Non-Banking Financial Company (NBFC), depositors are required to lodge a complaint with the Reserve Bank of India in the area of registered office of the Company.

For non-compliance of CLB orders by other companies, complaints are to be filed with the Registrar of Company (ROC) of a State wherein registered office of the Company is situated. Besides, there are procedures under Sections 397 and 398 of the Companies Act, 1956. Requisite fee towards a petition is

Rs. 5,000 and Rs. 50 towards application by way of demand draft favourable to Pay and Accounts Officer, DCA, involving large depositors or investors at Delhi or Chennai. Petition accompanied by affidavits verifying application from all the petitioners drawn on non-judicial stamp paper of requisite value duly attested by Notary Public or Oath Commissioner may are to be filed. [*Press Release issued by PIB on 18-6-2001*].

Investors Grievances Relating to Deposits, Mutual Funds, Collective Investment Scheme, Companies in Liquidation and other Investor Complaints

Press Note 3/2001, dt. 2-7-2001.—The Department of Company Affairs receives from general public a number of complaints relating to Deposits, Mutual Funds, Collective Investment Schemes, companies in liquidation and also other investor complaints.

2. The complaints relating to deposits in Banking Companies and Non-Banking Financial Companies are dealt with RBI. Investors complaints relating to Non-Banking Non-Financial Companies (Listed) are dealt with by the Securities and Exchange Board of India (SEBI). The complaints in respect of Non-Banking Non-Financial Companies (Unlisted) are dealt with by the Department of Company Affairs. The public are advised to approach these regulatory bodies for redressal of their grievances in the first instance itself. Similarly, complaints against companies in liquidation should be addressed to the concerned Official Liquidators attached to the High Courts.

3. In the case of deposits from Non-Banking Non-Financial Companies, the depositors should, in the first instance, approach the Company Law Board and if the orders passed by the above Board are not honoured then they should approach the concerned Registrar of Companies with a certified copy of the order of CLB.

4. Investors complaints of Unlisted companies are dealt with by the Department of Company Affairs. These may be, in the nature of non-registration of transfer of shares, non-refund of share application money, non-receipt of dividends, non-receipt of duplicate shares, non-issue of share certificates, non-receipt of debenture certificates, bonus shares, share certificates on conversion, after endorsement *etc*. On receipt of a complaint, the same is registered and number is given. The Department pursues the matter with the company and in the case of non-settlement of the complaint, the matter is referred to Registrar of Companies for prosecution. The status of the complaint is also displayed it the Website of the Department at http://www.nic.in/dca. [*No. 5/13/2001-CL.V, issued by DCA*]

Power of CLB to order re-payment of Deposits by NBFCS' covered under RBI Act

The CLB has been empowered by the insertion of section 45QA in the RBI Act, 1934 by the RBI Amendment Act, 1997 w.e.f. 9-1-1997 to order repayment of deposits. The new section is as follows:

"S. 45QA. Power of Company Law Board to order repayment of deposit.—(1) Every deposit accepted by a non-banking financial company, unless renewed, shall be repaid in accordance with the terms and conditions of such deposit.

(2) Where a non-banking financial company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board constituted under section 10E of the Companies Act, 1956 (1 of 1956), may, if it is satisfied, either on its own motion or on an application of the depositor, that it is necessary so to do to safeguard the interests of the company, the depositors or in the public interest, direct, by order, the non-banking financial company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order :

Provided that the Company Law Board may, before making any order under this sub-section, give a reasonable opportunity of being heard to the non-banking financial company and the other persons interested in the matter."

Application to CLB under sec. 45QA of RBI Act..—By virtue of section 45QA of the Reserve Bank of India Act, 1934, the Company Law Board constituted under section 10E of the Companies Act, 1956 is now clothed with powers to order repayment of deposits accepted by a non-banking financial companies (NBFCs) in case of default in making the payment of principal amount and interest thereon.

Regulation 37 of the Company Law Board Regulations, 1991 has accordingly been amended *vide* Notification No. GSR 433(E), dated 1st August, 1997. Applications for refund of deposits and interest thereon under section 45QA of Reserve Bank of India Act, 1934 can be made in the prescribed Form No. 4 of the Company Law Board Regulations, 1991 in duplicate alongwith a fee of Rs. 50 by way of a Demand Draft/Pay Order in favour of pay & Accounts Officer, Department of Company Affairs to the Bench Officer,

Company Law Board, at New Delhi/Calcutta/ Mumbai/Chennai under whose jurisdiction the Registered Office of the defaulting company falls. [*Press Note No. 1 of 1997, dated 10th September, 1997 issued by CLB*].

§ For the text of RBI Amendment Act, 1997, see *Appendix* 59.

Enforcement of CLB orders

The orders of the Company Law Board directing repayment of deposits and also for recovering deposits of the company with other companies are enforceable under s. 634A. The CLB can fall back on the assistance of the courts of competent jurisdiction for execution of its orders. *Edpuganti Bapanaiah v. Nagarjuna Finance Ltd.*, (2002) 47 CLA 20 : (2002) 35 SCL 717 : (2002) 111 Com Cases 496 (CLB).

Penalty for non-compliance of order of CLB [Sub-section (10)]

Non-compliance of order passed is punishable under sub-section (10) with imprisonment up to 3 years and fine of not less than Rs. 500/- per day for each day of default.

Non-Compoundable offence.—The offence is not compoundable under section 621-A.

Cognizable offence.—Section 58AAA makes every offence connected with, or arising out of, acceptance of deposits under section 58A or section 58AA a cognizable offence under the Code of Criminal Procedure, 1973.

Complaint by Registrar of Companies.—The Registrar of Companies has been held to be competent to file a complaint even in the matter of non-banking financial companies. The case before the Madras High Court was that of *Vishwapriya Financial Services and Securities Ltd. v. ROC*, (2002) 108 Com Cases 160 (Mad). A non-banking financial company issued an advertisement for public deposits. There was a failure to furnish to the Registrar the requisite statement with details. The court said that the question whether the company was exempt from the requirement or whether the statement had to be filed only with the RBI could be gone into at the trial. The court also ruled out the contention that the wording of the advertisement did not amount to an invitation. The Registrar was competent to file the complaint. The fact that the notification empowered other officers did not affect the Registrar's powers.

Default in payment of deposits—consequences of

The following consequences follow in case of default by the company in repayment of deposits and interest thereon on due date of maturity:—

(i) The company shall not accept or invite fresh deposits or renew existing deposits *vide* Section 58A (2)(c)/58AA (4);

(ii) A director of a public company, which has failed to repay its deposits or interest on due date and such default persists for a period of one year, shall not be eligible to be appointed as a director of the company and any other public company for a period of 5 years from the date of default. [*s. 274(1)(g)*];

(iii) The company shall not make any inter-corporate loan or investment or give guarantee or provide security, *vide* Section 372A(4).;

(iv) The offences under Section 58A and 58AA connected with or arising out of acceptance of deposits shall be cognizable under the Code of Criminal Procedure, 1973, *vide* Section 58AAA.

(v) The company shall not, directly or indirectly, purchase its own shares or other securities in terms of section 77A, *vide* section 77B(1)(c).

(vi) A defaulting company cannot pay under Sch. XIII even permitted amount of remuneration to managerial personnel in the event of loss or inadequacy of profits.

(vii) A defaulting company cannot issue shares with differential rights in terms of section 86.

It may be noted that the Act has imposed severe penalties by way of compulsory imprisonment and fine under sub-section (6)/(10) of Section 58A and sub-section (9) of Section 58AA, and these offences are not compoundable under section 621A.

Disqualification of Directors under Sec. 274(1)(g) Rules, 2003

§ For full text of the Rules, see *Appendix* 44 and see Notes under Section 274(1)(g) *post*.

Nomination facility [sub-section (11)]

Press release dated 23-7-1999.—Under the Companies (Amendment) Act, 1999, the shareholders have been allowed to nominate a person for their shares, debentures and deposits. The form in which the nomination has to be filed has been notified by the Department of Company Affairs under the amended Companies Act. Earlier, holders of shares and debentures in a company did not enjoy the nomination facility for shares, debentures and deposits which caused hardships to them. They were required to obtain a letter of succession from the competent authority. The facility of nomination is intended to make the company law in tune with the present day economic policies of liberalization and deregulation. This is also intended to promote investors confidence in capital market and to promote the climate for intercorporate investment in the country. [*PIB Press Release, New Delhi, dated July 23, 1999*].

Amendment in Nomination Forms for Investors under section 109A

Press Release, dt. 9-11-2000.—The Government (Department of Company Affairs) has issued a Notification amending Form 2B of nomination form in the Companies (Central Government's) General Rules and Forms, 1956. The amending Notification has been issued under Clauses (a) and (b) of Sub-section (1) of Section 642 read with Sub-section (II) of section 58A and Section 109A of the Companies Act, 1956. Under the amendment, the nomination can be made by individuals only applying or holding shares or debentures on their own behalf singly or jointly. Non-individuals including society, trust, body corporate, partnership firm, Karta of Hindu Undivided Family, holder of power of attorney cannot nominate. If the shares are held jointly, all joint holders will sign the nomination form. In the amended form, space has been provided as a specimen, if there are more joint holders, more sheets can be added for signatures of holders of shares or debentures and witness.

A minor can be nominated by a holder of shares or debentures or deposits and in that event the name and address of the Guardian shall be given by the holder. The nominee shall not be a trust, society, body corporate, partnership firm, Karta of Hindu Undivided Family or a power of attorney holder. A non-resident Indian can be a nominee on repatriable basis. Nomination will stand rescinded upon transfer to share or debenture or repayment or renewal of deposits made. Transfer of share or debenture in favour of a nominee and repayment of amount of deposits to nominee shall be valid discharge by a company against the legal heir. The intimation regarding Nomination or Nomination Form shall be filled in duplicate with Company or Registrar and Share Transfer Agents of the Company who will return one copy thereof to the share or debentures or deposits holder. This is the fourth amendment effected in the year 2000 and 77th since 1956 when the Companies Act was enacted and enforced. All the amendments effected in the Companies (Central Government's) General Rules and Forms, 1956, so far, have been intended to safeguard the interests of shareholders, debenture holders and depositors. Relevant notification is published in 'From the Government' Column. (*PIB Press Release dt. 9-11-2000*).

Sub-section (11) has been inserted by the Companies (Amendment) Act, 1999, w.e.f. 31-10-1998 giving freedom to deposit holder, in case of a non-banking non-financial company, to nominate at any time a person in Form No. 2B prescribed under Rule 4CCC of the Companies (Central Government's) General Rules and Forms, 1956 (*Appendix 1*) to whom his deposits will vest in the event of his death. For nomination, provisions of new section 109A and 109B inserted by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998) will apply to such nomination made under this sub-section. In case the deposits are held by more than one person jointly, the joint holders may together make such nomination. During the life time of the depositholder(s) such nomination can be varied or cancelled in the prescribed manner.

Nomination in NBFCs.—A deposit holder, in case of a non-banking financial company, may nominate a person in Form DA-1 under Rule 2(1) of the Banking Companies (Nomination) Rules, 1985 in terms of section 45ZA of the Banking Regulation Act, 1949. In case the deposits are held by more than one person jointly, the joint holders may together make such nomination. During the life time of the deposit holder(s) such nomination can be varied or cancelled in the prescribed manner.

§ For the text of the Nomination Form and relevant extract of Banking Companies (Nomination) Rules, 1985, see *Appendix* 55.

Companies (Acceptance of Deposits) Rules, 1975— Departmental Instructions

Deposit—meaning of.—The term 'deposit' means any deposit of money with and includes any amount borrowed by a company but shall not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. See Explanation to section 58A, Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975, *inter alia*, excludes amounts received from the Government, loans obtained from financial institutions, inter-corporate deposits, security deposits, amount raised by issue of secured debentures or bonds or with an option to convert them into shares *etc.* from the expression 'deposit' for purposes of section 58-A. Rule 2(b)(ix) also exempts deposits received from directors by public/private companies or from its shareholders by a private company, provided that they had not made deposits out of borrowed funds.

It has been held that borrowings by a private company from its directors and members would have to be treated as deposits under Rule 2(b)(ix) of the Companies (Acceptance of Deposit) Rules, 1975 unless at that very time a declaration was filed that the lending directors and members had themselves not borrowed the amounts from others. *Vijay Kumar Gupta v. Eagle Paint & Pigment Industries P. Ltd.*, (1997) 13 SCL 179 : (1997) 26 Corpt LA 236 : (2000) 6 Comp LJ 543 (CLB—Cal).

Borrowing by the company from its promoter group for payment of the maturity amount and interest to debentureholders was held as not amounting to taking of public deposits, which has been prohibited by RBI directions of Aug. 28, 2000. *Gujarat Lease Finance Ltd. Re*, (2002) 50 CLA 150 (Guj) : (2000) 36 SCL 838.

Violation of deposit rules, money advanced not a deposit

A financial company advanced huge amounts to the respondent company which it claimed were in the nature of a deposit. It filed a petition before the CLB for an order of refund in accordance with deposit rules. The CLB found that deposit rules were not observed while taking the amount and, therefore, it refused to accept the advance as a regular deposit. The jurisdiction of the CLB was, therefore, not attracted. *Girija Smelters Ltd. v. Saraswathi Finance Corpn.*, (2002) 40 SCL 720 (CLB—Chennai).

An unsecured loan for which no receipt was given by the company and was repayable at 18% interest per annum was held to be not a deposit. An application before the CLB was held to be not maintainable. *V. Srinivas v. Machines and Machine Tools P. Ltd.*, (2002) 110 Com Cases 55 (CLB). For the distinction between loans and deposits, the CLB relied upon *VEA Annamalai Chettiar v. SUVS Veerappa Chettiar*, AIR 1956 SC 12.

Department's view.—The amounts received under Rule 2(b)(ix), being not deposits, are not subject to the limits specified in Rule 3. (*Department's Letter No.* 1/101/75-CL-XIV, dated 21-10-1976).

§ See also notes on s. 2(12) under the heading "Fixed deposit is not debenture" Department's Clarification.

Meaning of 'Public'

As per its normal connotation, the expression 'public' includes a section of the public also. As a matter of fact, sub-section (1) makes a distinction between the public and members of the company. However, neither sub-section (1) nor sub-section (2) excludes from its ambit the employees of the company. It is, therefore, felt that the employees and ex-employees are also to be regarded as those falling in the category of 'public' and the deposits accepted from them would as much attract the provisions of section 58-A and the rules made thereunder as deposits from other categories of 'public' (*Circular No.* 8/48/84-CL-X, dated 18-12-1984).

Meaning of 'Shareholder'

Any amount received by a private company from its shareholders is not regarded as 'deposit' in terms of sub-clause (IX) of clause 2(b) of the Deposits Rules. The expression 'shareholder' has also been used elsewhere in the Deposit Rules. In *Rameshwarlal Sanwarmal v. CIT*, (1980) 2 SCC 377 : AIR 1980 SC 372, the Supreme Court has held that the word 'shareholder' can mean only a registered shareholder, *i.e.*,

it is only the person whose name is entered in the register of shareholders of the company as the holder of the shares who can be said to be a shareholder of the company and not the person beneficially entitled to the shares.

If a shareholder-depositor ceases to be a member the deposit made by him cannot be treated as exempted deposit. [(*Department's Letters Nos.* 1/1/80-CL-V and 7/33/78-CL-X, dated 3-5-1980).]

Subsidy under Out-right Grant or Subsidy Scheme, 1971

The subsidy received from the Central Government under Out-right Grant and Subsidy Scheme can be treated as 'Free Reserve' as defined in Rule 2(d) of the Companies (Acceptance of Deposits) Rules, 1975 if all the following conditions are fulfilled:—

(i) The subsidy under the Central Government Outright Grant or Subsidy Scheme, 1971 is received in cash;

(ii) The subsidy is utilised for the purpose for which it is received; and

(iii) The period of 5 years from the commencement of production has lapsed and the subsidy has not become recoverable in terms of the conditions of the grant. (*Circular No.* 3/5/84-CL-X, dated 5-12-1984).

Exemption of deposits accepted from directors or shareholders or firms

The amount received by a company in the joint names of a director and a non-director, or in the case of a private company in the joint names of shareholder and a non-shareholder will not be exempted from the definition of deposit. If all the partners of a lending firm are not directors on the Board of the borrowing company, the deposits accepted from such a firm will also not fall within the purview of the said rules. (*Circular No.* 1/1/80-CL-V, dated 3-5-1980.)

The loan taken by a private company from a firm, all of whose partners are shareholders of the borrowing company will stand on the same footing as loans taken from the shareholders themselves. Such loans are not to be regarded as deposits. (*Circular No.* 3/13/84-CL-X, dated 27-11-1984).

The deposit by a director out of borrowings from a third party would not be entitled to exemption under the rules. The company would have to file a declaration by the concerned members or directors that the deposit was made by them from their own sources and not from borrowings from others. *Vijay Kumar Gupta v. Eagle Paint & Pigment Industries P. Ltd.,* (1997) 26 Corpt LA 236 : (1997) 13 SCL 179 : (2000) 6 Comp LJ 543 (CLB—EB).

Deposits from HUF, trusts and firms in which directors are interested.—The exemption under sub-clause (*ix*) of clause (*b*) of Rule 2 of the Companies (Acceptance of Deposits) Rules, 1975 would apply only to deposits received from directors. The exemption will not apply to HUF, in which all the co-parceners are directors, to trusts in which all the directors are trustees, or firms in which all the partners are directors of the company.

Exemption of promoters' deposits

Department's view.—The Department has expressed the view that there cannot be a blanket exemption of promoters contribution in the shape of unsecured loans to the company in fulfilment of the margin money requirements stipulated by financial Institutions from the definition of deposits. The Government can however consider such exemption in individual cases on merits in the exercise of the powers vested in it under S. 58A(8). (*Department's Letter No.* 4/6/81, dated 20th June 1981.)

Paid-up capital and free reserves : interpretation of Explanation to Rule 3(3)

It is essential to deduct the amount of unprovided depreciation from the aggregate of paid-up share capital and free reserves for determining the limits up to which deposits can be accepted by a company, for purposes of Explanation to Rule 3 of the Companies (Acceptance of Deposits) Rules, 1975. (*Circular No.* 4/28/81-CL-X, dated 2-9-1981). The limits up to which a company can accept deposits are to be computed with reference to aggregate of paid-up capital and free reserves as appearing in the latest audited balance-sheet of the company and any change arising thereafter is to be disregarded (*Circular No.* 2/18/81-CL-X dated, 27-7-1981).

The Department reiterated its earlier view in the following circular: "According to Explanation under Rule 3 of the Companies (Acceptance of Deposits) Rules, the permissible limits for acceptance of deposits under Rule 3(2)(*i*) and 3(2)(*ii*) of the said rules are required to be computed with reference to the aggregate of the paid-up share capital and free reserves appearing in the latest audited balance-sheet of the company as reduced by the amount of accumulated balance of loss, balance of deferred revenue expen-

diture and other intangible assets, if any, as disclosed in the said balance-sheets. This position was reiterated in the *Department's letter No.* 3/18/81-CL-X, dated 27 July, 1981 addressed to the Institute of Company Secretaries of India wherein it was also clarified that any change arising after the date of the relevant balance-sheet has to be disregarded.

"The question whether any change in the paid-up share capital of the company occurring after the close of the financial year of the company should or should not be taken into account for the purpose of reckoning the limits under Rule 3 of the Deposit Rules has again been examined. There are several elements, other than the paid-up share capital, which go into computation of net worth on the basis of which the limits laid down under Rule 3 of the Companies (Acceptance of Deposits) Rules for acceptance of deposits are worked out. By taking into account only the increase in the share capital of the company and at the same time ignoring the other components of the net worth, the position would get distorted.

"In view of the position set out above no change in the provisions of Explanation below Rule 3 of the Companies (Acceptance of Deposits) Rules, 1975 which have been reiterated in the *Department's letter No.* 3/18/81-CL-X, dated 27 July, 1981 is considered necessary". (*Letter No.* 4/2/84-CL-X, dated 25 July, 1984.)

In *Malayala Manorama Co. Ltd. v. ROC, Kerala,* (1990) 69 Com Cases 339, 345 (Ker) the return of deposits as on March 31, 1984 showed the aggregate share capital and free reserves with reference to the balance-sheet as on December 31, 1983, whereas it should have been as per the balance-sheet for the year ending March 31, 1982. The Registrar of Companies accepted the returns because the petitioner had been following that practice for all the years. The return was held to be valid. No manipulation was likely to be there because all the earlier balance-sheets were already there with the Registrar.

Amount standing to the credit of premium account and capital redemption reserve

The Department has clarified by its *Circular No.* 3/77, dated 15th April, 1977, that the amount standing to the credit of share premium account will be treated as part of the company's paid-up share capital and not its free reserves having regard to the provisions of S. 78(1).

The Department has also clarified that the amount standing to the credit of capital redemption reserve is to be treated as a free reserve for the purposes of Rule 2(d). *Department's Letter No.* 4/18/76-CL-XIV, dated 29th December, 1976.

Surplus in the profit and loss account—whether forms part of "Free Reserve"

The amount of "Surplus" shown in the profit and loss account carried forward under the heading 'Reserve and Surplus' appearing in the balance-sheet of a company, may be treated as part of "free reserve" as defined under the Companies (Acceptance of Deposits) Rules, 1975. [*Department's Letter No.* 3/1/80-CL-X, dated 16-2-1982.]

Amount raised by issue of bonds or debentures under rule 2(b)(x)

Rule 2(b)(x) of the Companies (Acceptance of Deposits) Rules, 1975 applicable to non-banking non-financial companies, excludes from the term 'deposit' "any amount raised by the issue of bonds or debentures by the mortgage of any *immovable property* of the company or with an option to convert them into shares in the company, provided that in the case of such bonds or debentures secured by the mortgage of any immovable property the amount of such bonds or debentures shall not exceed the market value of such immovable property."

In case of debentures which are partly convertible into shares, only the convertible portion of the debentures is exempt in terms of the provisions of Rule 2(b)(x) of the Rules.

Even in regard to the convertible portion of debentures, once the period of conversion is over, the unconverted portion of debentures would acquire the character of loan and would fall within the definition of deposits like other loans provided they are not secured by mortgage of immovable property of the company in terms of clause (x) of Rule 2(b) of the Rules. Similarly where the period for the exercise of option for conversion has expired, the convertible portion of the debentures in respect of which no option has been exercised for conversion by the debenture holders, would acquire the character of loan and would fall within the purview of deposits as defined in the Companies (Acceptance of Deposits) Rules, if these debentures are not secured in the manner mentioned above. (*Department's Circular No.* 4/12/81-CL-X, dated 30-3-1984)

Unsecured debentures with option for conversion—whether deposit

Unsecured debentures with an option to convert a part of them into shares of the company concerned are not covered in rule 2(b)(x) of the Companies (Acceptance of Deposits) Rules, 1975.

Further only so long as option to convert unsecured debentures into shares remains in force such unsecured debentures shall not be subject to discipline of section 58-A of the Companies Act, 1956 and the rules made thereunder. [*Department's Letter No.* 4/12/81-CL-X, dated 10-3-1981.]

Unsecured bonds or debentures, later secured by mortgage

Any amount raised through issue of bonds or debentures does not *ipso facto* become exempt deposit under rule 2(b)(x). But, it would be treated as exempt deposit if later on it is secured by mortgage of an immovable property. In re, *East India Hotels Ltd.*, (1980) 50 Com Cases 381 (Cal). Accordingly, any amount raised by issue of secured bonds or debentures will not fall under the exempted category of deposits so long the trust deed is not executed and charge filed with the Registrar within a reasonable period.

Payment of interest on compound basis

The payment of compound interest or payment of interest on cumulative time deposit scheme does not contravene the ceiling on the interest prescribed in the Companies (Acceptance of Deposits) Rules, 1975. The rules provide that no company shall accept/renew any deposit at a rate of interest exceeding 15 per cent p.a. [*Now 12.5% per annum*] The restriction is that at the time of acceptance of deposits no company shall offer interest of more than 15 per cent. [*Now 12.5% per annum*]. Moreover, the rules do not specify whether the interest should be simple or compound. The term 'Interest' is a generic term which may be simple or compound. [*Department's Letter No.* 4/17/81-CL-X, dated 12-4-1982].

Ceiling on Rate of Interest on deposits [w.e.f. 29-9-2003]

No company shall invite or accept or renew any deposits in any form, on a rate of interest exceeding the maximum rate of interest prescribed by the Reserve Bank of India that the Non Banking Financial Companies can pay on their public deposits per annum at rests which shall not be shorter than monthly rests. [See Rule 3 of the Companies (Acceptance of Deposits) Rules, 1975 as amended by GSR No. 774(E), dated 29-9-2003.

Increase in rate of interest on deposit is prospective

Where there is upward revision in the rate of interest on fixed deposits and deposits made under the fresh advertisement attract a higher rate of interest but old deposits continue to attract interest at a lower rate, the depositor in the earlier scheme is bound by the earlier advertisement inviting deposits from the company and has no remedy against the company.

Premature repayment at reduced interest

Repayment before the period of maturity was offered at reduced rate of interest in exercise of the power under cl. 11 of the rules framed by the company. The depositor accepted the same. He was estopped from challenging the reduction saying subsequently that his consent was not taken in advance. *Umanath Baliga v. SRP Tools Ltd.*, 2003 CLC 1139 : (2003) 47 SCL 146 (CLB).

Renewal of deposits

Renewal tantamounts to receiving fresh deposits. The word 'renew' also amounts to 'acquire again'. Therefore, the renewal amounts to receiving fresh deposits within the meaning of section 58-A, *Sujani Textiles Pvt. Ltd. v. Assistant Registrar of Companies*, (1980) 50 Com Cases 276 (Mad); *Jagjivan Hiralal Doshi v. ROC*, (1989) 65 Com Cases 553 (Bom).

Period for acceptance and renewal of deposits.—No company shall accept or renew any deposit which is repayable on demand or on notice or after a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposits. [See Rule 3(1)(a) as amended by GSR No. 39(E), dated 10-1-1992].

Alteration of terms and conditions of deposits

Department's Circular.—"It has come to the notice of the Government that several companies which had accepted and/or invited deposits by issuing advertisement under Section 58A(2) of the Companies Act, 1956 with the particulars prescribed in Rule 4(2) of the Companies (Acceptance of Deposits) Rules, 1975 had subsequently, during the last few months of the financial year ending 31-3-1980 made announcement in various newspapers altering the terms and conditions of the deposits already accepted or invited *e.g.*, by offering higher rates of interest or re-advertising the earlier rates of interest *etc.* While making announcements about alterations in terms and conditions of deposits, some of these companies had also invited deposits, *inter alia*, by indicating that deposits were continued to be accepted, that the higher rates would be applicable in case the existing deposits were renewed or in case fresh deposits were made and that necessary application forms for accepting deposits were available with the company and/or

its agents. Such announcements tantamount to invitation of deposits and as these are not in conformity with the provisions of Section 58A(2) of the Companies Act read with Rule 4(2) of the Companies (Acceptance of Deposits) Rules, 1975, the penal provisions of Section 58A(6)(a)(ii) read with Section 58A (6)(b) of the Companies Act, 1956 become attracted.

2. The Chambers of Commerce, *etc.* may suitably advise their constituents to refrain from making any announcement of the aforesaid nature which would render the company and every officer of the company in default liable to prosecution for violation of the provisions of Section 58A(2) read with Rule 4 (2) of the Companies (Acceptance of Deposits) Rules, 1975." (*Circular No.* 4/26/79-CL-X, dated 7th April 1980.)

Effect of reduction of limits due to losses

If the deposits were accepted at a point of time when they were within limits, they are to be repaid according to the date of maturity. If due to subsequent losses, *etc.*, the deposits already accepted exceed the limit, which has become reduced due to losses, there is no contravention of the provisions of the Companies (Acceptance of Deposits) Rules, 1975. (*Department's Letter No.* 3/17/79-CL-X, dated 30th June 1979).

Management charges in addition to brokerage for inviting deposits

Department's Clarification.—The following clarification regarding whether the management charges could be paid in addition to the brokerage and would not be subject to the limits set-out in rule 3(1)(d) of the Companies (Acceptance of Deposits) Rules, 1975, may be noted:

"The question as to whether the management charges/manager's fee could be paid in addition to brokerage for inviting deposits from the public by companies with reference to rule 3(1)(d) of the Companies (Acceptance of Deposits) Rules, 1975, has been examined by the Department and it is felt that the charges paid to agents, whether it is called service charges or manager's fees or any other such names, would amount to payment of brokerage. If such a brokerage is in excess of the rates specified in the Companies (Acceptance of Deposits) Rules, 1975, it would be in contravention of rule 3(1)(d) of the Rules. However, the companies may reimburse the actual expenses incurred by the agents or managers such as advertising expenses, printing charges, *etc.*, but should not pay additional remuneration to the agents as it would be against the interest of the depositors." [*DCA*, dated 14th October, 1988 : (1989) 65 Com Cases 163 (St).]

Ceiling on processing and maintenance charges.—The Reserve Bank of India exercising its powers under Residuary Non-banking Companies (Reserve Bank) Directions, 1987 (para 4A as amended by notification, dated 19-4-1993) reduced the period of deposit and this was held to be valid but the fixation of the ceiling of Rs. 10 per customer as maintenance and processing charges was held to be arbitrary because it was insufficient to meet the expenses involved in collection and issue of deposit receipts and maintenance of deposit accounts. *Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India*, (1996) 85 Com Cases 808 (Cal). The matter came before the Supreme Court in *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.*, (1996) 85 Com Cases 920 (SC), wherein it was found that no material was put before the court to show that Rs. 10 per customer by way of expenses was inadequate. Hence, there was no occasion for the court to interfere in the matter. The court said that the aggrieved companies should better make a representation to the Reserve Bank itself.

Matured deposits remaining unclaimed/unpaid

The matured deposits which remain unclaimed/unpaid are deposits within the meaning of Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975 and are required to be treated as such for calculating the limits prescribed in Rule 3 thereof. (*Circular No.* 3/5/83-CL-X, dated Oct., 1982). Return of deposit is to be filed so long such deposits are not repaid in full.

Transfer of matured deposits to Investor Education and Protection Fund.—Matured deposits and interest accrued thereon which have remained unclaimed and unpaid for a period of 7 (seven) years from the date they became due for payment are to be credited to the Investor Education and Protection Fund established under section 205C of the Act.

Liquid deposits under rule 3-A and utilization of revolving deposits

Under Rule 3-A of Companies (Acceptance of Deposits) Rules, 1975, a company is required to deposit 10% (raised to 15% w.e.f. 1-4-1992) of its deposits maturing during the year. This amount can only be

utilised for repayment of deposits and has to be kept at the level of 15% [w.e.f. 1-4-1992 *vide* GSR 39(E), dated 10-1-1992] of deposits maturing. (*Circular No.* 3/13/80-CL-X, dated 20-5-1980.)

Rule 3A, which lays down the method of maintenance of liquid assets by companies accepting deposits from the public, is prospective and not retroactive. *Delhi Cloth & General Mills v. UOI*, (1983) 54 Com Cases 674 (SC); *T. Velayudhan Achari v. UOI*, (1993) 77 Com Cases 197 (SC).

Investment of amount equivalent to deposits maturing in revolving deposits.—Rule 3A of the Companies (Acceptance of Deposits) Rules, 1975 provides that every company shall before the 30th day of April of each year deposit or invest a sum equal to 15% of the deposits maturing during the year ending on the 31st March next, which shall be utilised for the purpose of repayment of deposits. Strictly speaking, the company is required to make a fresh investment every year and utilise the proceeds thereof for repayment of deposits. However, a recurring deposit which complies with the provisions of sub-rule (2) would be sufficient compliance such that the amount so invested shall not at any time fall below 15% of the amount of deposits maturing during the relevant period.

Failure to maintain liquidity is not continuing offence.—The degree of liquidity required by Rules 3A and 11 of the Companies (Acceptance of Deposits) Rules, 1975 and a company's failure to maintain the requisite liquidity has been held to be not a continuing offence. The limitation period of six months would apply. *Sivandhi Adityan v. Addl. ROC*, (1995) 83 Com Cases 616 (Mad).

'Nil Return' not necessary

Unless a company accepts a deposit within the meaning of the Rules, the Rules do not become applicable to that particular company and consequently there is no need to submit a 'nil' return under rule 10 (*Department's Letter no.* 4/1/76-CL-XIV, dated 5th February 1976).

Application of section 58-A to guarantee companies

All the provisions of section 58-A and the rules made thereunder are applicable to guarantee companies. (*Circular No.* 3/8/84-CL-X, dated 6-9-1984.) Normally, such companies have no share capital and, therefore, in their case the deposits should not exceed the prescribed limits of its free reserves, if any.

Prohibition on acceptance of public deposits by private companies [section 3 (1)(iii)(*d*)]

Under sub-section (1C) of section 43A (which ceased to be effective on the commencement of the Amendment Act, 2000), a private company which accepted deposits from the public, other than from its members, directors or their relatives, on invitation made by advertisement, was deemed to be a public company. The concept of 'deemed public company' has been abolished by the Amendment Act, 2000. The prohibition on acceptance of deposits from the public is, however, retained by incorporation of clause (d) in sub-section (1)(iii) of section 3.

Articles of a private company must prohibit invitation or acceptance of deposits from persons other than the members, directors or their relatives. The prohibition extends to deposits accepted from members of the public. It is open to a private company to accept deposits privately from its members, directors and their relatives. A company cannot be incorporated as a private company after the commencement of the Companies (Amendment) Act, 2000 unless its Articles provide for the aforesaid provisions.

The company must take a declaration from the director/member at the time of accepting deposit from him that he has not deposited the money out of funds borrowed by him from others. [*Rule 2(b)(ix), as amended by 2nd Amendment Rules, 2001 (GSR 689(E), dt. 25-9-2001)*].

Provisions relating to prospectus to apply to advertisement [S. 58-B]

The provisions relating to the prospectus should, as far as practicable, apply to an advertisement referred to in section 58-A. [*Report :* para 22 (iv)].

As the provisions of section 58-A apply also to private companies, private companies should also comply with the provisions of the Act relating to a prospectus in respect of the advertisement to be made as prescribed under sub-section (2), clause (b) of section 58-A.

Advertisement for inviting deposits

Announcement in newspapers about alteration in the terms and conditions for accepting deposits and also indicating that "deposits are continued to be accepted" or "that the higher interest rate would be applicable in case the existing deposits are renewed" or "in case fresh deposits are made, necessary application forms for accepting deposits are available with the company and or its agents", *etc.* tantamounts to invitation of deposits for purposes of Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975. The intention behind Rule 4(1) is that the advertisement to be published in the vernacular newspaper should be in the language of that paper, otherwise the very purpose of publication of the advertisement in the vernacular newspaper will be defeated. The advertisement should, therefore, be in the language of the vernacular newspaper (*Circular No.* 1/1/79-CL-V, dated 5-2-1979.)

Rule 4(1) does not make any distinction in treatment between English and regional language texts of advertisement. So both the texts should be given equal treatment (*Department's Letter No.* 4/1/77-CL-XIV/XI, dated 31-3-1978).

Signature by director/agent on the copy of advertisement

As per rule 4(4) of the Companies (Acceptance of Deposits) Rules, 1975, the copy of advertisement for accepting deposits is required to be signed by every person named therein as director, before the same is delivered to the Registrar for registration. Similar provisions regarding the registration of prospectus under section 60(1) expressly provide that before any prospectus is issued, a copy thereof signed by every person who is named therein as a director or by his agent authorised in writing, shall be delivered to the Registrar for registration. The said expression is not included in Rule 4(4). However, section 58-B makes the provisions of the Act relating to prospectus applicable to an advertisement issued under section 58-A. Accordingly, the aforesaid provisions of section 60(1) become also applicable to an advertisement issued for acceptance of deposits. Thus, the copy of advertisement can also be signed on behalf of the director concerned by his agent, if so authorised in writing in this behalf. In that case, Rule 4(4) will be deemed to have been complied with.

Department's Clarification I.—Under sub-rule 4 of Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975, it has been stipulated that no advertisement shall be issued by or on behalf of a company unless, on or before the date of its issue, there has been delivered to the Registrar for registration a copy thereof signed by every person who is named therein as a director. It may be noted that it would be treated as sufficient compliance with the aforesaid provisions of the Companies (Acceptance of Deposits) Rules, 1975, if the advertisement is signed by every director or by his agent authorised in writing. (*Circular No.* 23/75, dated 25-9-1975).

Department's Clarification II.—It is not necessary that an agent is authorised by a director through a power of attorney. The authorisation may well be in the form of a letter signed by the director. (*Department's Letter No.* 4/3/77-CL-XIV, dated 22nd July, 1977).

Department's Clarification on advertisement referred to in section 58-B

The advertisement referred to in section 58-B is the one required to be issued by the companies for inviting or accepting deposits. Such an advertisement is covered under the definition of "Prospectus" laid down in section 2(36) of the Act, as amended recently. Accordingly, an advertisement for inviting or accepting deposits is a prospectus and ordinarily all the provisions of the Act relating to prospectus automatically become applicable in relation to such an advertisement. However, the words "so far as may be" appearing in section 58-B of the Act are significant in this context. Having regard to these words the Central Government is of the opinion that wherever in respect of certain matters relating to advertisement specific provision has been made in section 58-A or in the Companies (Acceptance of Deposits) Rules, 1975, the corresponding provisions in the Act relating to prospectus would not apply to the advertisement. To illustrate, according to section 56(1) of the Act, every prospectus is required to contain information on the matter specified in Schedule II. This requirement will not apply to an advertisement for deposits because Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975 prescribes the form in which such an advertisement is required to be issued. The other provisions governing the prospectus including those relating to civil and criminal liabilities for mis-statement (sections 62 and 63) penalty for fraudulently inducing persons to make deposits with any company (section 68, *etc.*) will *mutatis mutan-*

dis apply to the advertisement for deposits. (*Circular No.* 7/75, dated 7-6-1975 Dept. of Company Affairs.)

Need for advertisement in case of renewal of existing deposits

Department's view.—'Rule 4 of the Companies (Acceptance of Deposits) Rules, 1975 requires every company intending to invite or allowing or causing any other person to invite deposits to issue an advertisement for the purpose. A question has been raised as to whether an intimation to a depositor on the eve of maturity of his deposit indicating the date of maturity coupled with a statement that the depositor may renew his deposit if deemed necessary would amount to an invitation, and hence call for issue of an advertisement. This Department has considered the matter and is of the view that such an intimation would amount to an invitation, and hence the company should comply with the requirements of sub-rule (1) of Rule 4 of the said Rules. In short, there must be a valid advertisement in force which would permit such an invitation. (*Circular No.* 5 of 1976, dated the 10th March, 1976 on File No. 4/3/76-CL-XIV.)

Auditing Practice

Rule 10 of the Companies (Acceptance of Deposits) Rules, 1975 requires every company accepting deposits to file with the Registrar by 30th June every year a return of deposits in the prescribed form duly certified by the auditor. The Institute of Chartered Accountants of India has advised its members to make sure that the requirements of the Rules have been complied. See Guidance Note on Certificate to be issued by the auditor of a company pursuant to the Companies (Acceptance of Deposits) Rules, 1975 in Chapter 24 of the *Compendium, of Guidance Notes,* September, 1985, pp. 130-142, published by the Institute. For the text of the Guidance Note see *Appendix* 318(B-12).

Moratorium to relief undertakings

Department's Circular.—A moratorium has been granted to relief under undertakings in terms of the following Departmental Circular: "Several States have promulgated Acts to provide financial assistance to relief undertakings, like, the Bombay Relief Undertakings (Special Provisions) Act, 1958, the Rajasthan Relief Undertakings (Special Provisions) Act, 1961, *etc.* Under the said enactments, the State Government may, by notification, *inter alia*, direct that in relation to any relief undertaking and in respect of the period for which the relief undertaking continues as such, any right, privilege, obligation or liability accrued or incurred before the undertaking was declared a relief undertaking and any remedy for the enforcement thereof shall be suspended and all proceedings relating thereto pending before any court, tribunal, officer or authority shall be stayed including the proceedings under S. 58A(9)". The said provisions have come up for judicial scrutiny by different High Courts in *Tiruppur Cotton Spg. and Wvg. Mills Ltd. v. Khimji Poonja and Co.*, (1988) 64 Com Cases 349 (Mad); *Jaysynth Dyechem v. Mewar Textiles Mills Ltd.*, (1988) 64 Com Cases 334 (Raj) and *Mohan Bai v. Jai Kishan,* AIR 1988 Raj 22. The *ratio decidendi* of these cases is that having regard to the provisions of the said Act, the monetary liabilities of the relief undertakings during the notified period stand suspended and any proceedings, including proceedings under section 58A(9) of the Companies Act, 1956, shall remain stayed. Action under section 58A(9) of the Act can be considered only after the expiry of the period for which the relief undertakings have been so notified. [*Circular No.* 3 of 1990, dated 19-2-1990.]

Moratorium to Sick Industrial Companies

Where a company proposed a scheme of repayment of 75% of deposits in 1997 and balance in 1998, the proposal was accepted by the CLB subject to the approval of the BIFR if the company was declared sick under SICA. *Montari Industries Ltd. Re,* (1997) 89 Com Cases 661 : (1997) 3 Comp LJ 351 (CLB—N. Delhi). Where the company was already under reference to BIFR the petitioner under s. 58A(9) was told to approach the BIFR for necessary approval to continue the proceedings. *Uniplas India Ltd., Re,* (1997) 90 Com Cases 74 (CLB—N. Delhi); *Deepak Insulated Cable Corporation Ltd. v. UOI,* [Writ Appeal No. 9750/96 decided on 5-1-2000 : (2001) 104 Com Cases 401 (Kant—DB). A subsequent ruling of Company Law Board in *Usha D Rohra (Smt.) v. Electrex Ltd.*, (2000) 39 CLA 226 : (2000) 28 SCL 275 : (2000) 4 Com LJ 401 : (2001) 106 Com Cases 406 (CLB) held that a claim for refund of deposit money filed against a sick industrial company is not a suit for recovery of money due within the meaning of s. 22 of SICA. Such claim, therefore, falls outside the prohibition on recovery of dues without the consent of the BIFR as envisaged under the section.

Jurisdiction

Where for the purpose of making a term deposit with a company a cheque was given at Bombay and was encashed by the company through its account also at Bombay and further still the refund cheques, which were dishonoured and became the cause of litigation, were also on a Bombay bank, but the deposit receipts carried the remark: "subject to Anand (Gujarat) Jurisdiction", it was held that this remark was of a unilateral nature and, therefore, it did not have the effect of ousting the jurisdiction of the competent courts and so the Bombay courts had jurisdiction to entertain proceedings arising out of the dishonour of the cheques. *R.S.D.V. Finance Co. P. Ltd. v. Shree Vallabh Glass Works Ltd.*, (1993) 78 Com Cases 640 (SC). The court further held that when under a State legislation [Bombay Relief Undertakings (Special Provisions) Act, 1955, as applied to Gujarat] an undertaking is declared relief undertaking, it will not operate to stay proceedings against the properties of the company outside that State.

Writ petition for police protection to defaulters.—A writ petition was filed alleging that the police was not protecting the defaulters from depositors. The Police Department denied the allegation. There were depositors in other parts of the country. The court said that there was no cause of action within the territorial jurisdiction of the court. The petition was dismissed because it was an abuse of the process of the court. *Al-Faih Fincom Ltd. v. Central Economic Intelligence Bureau,* (2003) 114 Com Cases 404 (AP).

Remedy before Consumer Forum set up under Consumer Protection Act, 1986

The Reserve Bank of India has invited attention of the members of the public to the order, dated August 26, 1993 of the National Consumer Disputes Redressal Commission, New Delhi in Revision Petition No. 409 of 1992 that the default on the part of a company or a firm to carry out its obligations to repay the principal amount of deposit and/or interest thereon, constitutes 'deficiency' in service. The aggrieved depositors thus can file a complaint before the Consumer Forum to seek relief under the Consumer Protection Act, 1986. The Commission held that an order directing payment of outstanding amounts due to the depositor can be passed under the provisions of section 14 of the Consumer Protection Act.

Based on the above award, it is open to depositors to approach the Consumer Redressal Forum for relief in cases of default in repayment of their deposits by companies, including Non-Banking Financial Companies, Residuary Non-Banking Companies, Miscellaneous Non-Banking Companies and unincorporated bodies like individuals, firms, associations of persons, *etc.* [*RBI Press Release No.* 1996-97/110, dated 21-8-1996].

Under NBFC Directions, 1998 also the depositor can approach the appropriate Forum under the Consumer Protection Act for relief in case of any deficiency of the company in servicing its deposits—*vide* paragraph 4(12) of the Directions at *Appendix* 51.

The power of the CLB under section 58-A read with section 45QA of RBI Act does not have the effect of debarring a depositor from going to a Consumer Form even after exercising a remedy under the above sections. Where the CLB has ordered rescheduling, even there the depositor can approach a Consumer Forum for any defaults by the company in implementing orders. *Prudential Capital Markets P. Ltd. v. State of AP*, (2000) 27 SCL 482 (AP).

Remedy under Indian Penal Code and CrPC

A complaint was filed against a company and its directors alleging cheating because of its inability to pay back deposits. The complaint was held to be maintainable. The court, while framing charges, could include the charge of criminal breach of trust by amending charges. The contention of a director that he was not the person incharge at the time of the offence was held to be not sufficient in itself for quashing the complaint because that fact could be examined at the trial. *K. Gopi Nair v. K. Ramakutty,* (2003) 115 Com Cases 59 (Ker).

Violation of Deposit Rules as unfair trade practice

Violation of Deposit Rules may in certain circumstances amount to an unfair trade practice in reference to depositors, under section 36A of the MRTP Act, 1969 [*Since Repealed*]. *Director General of Investigation and Registration v. Iofic Leasing Ltd.*, (1991) 71 Com Cases 62 (MRTPC). On facts it was found that the terms of deposits caused confusion about interest rates and period of deposit. The claim of the company that all deposits were covered by bank guarantees was also found to be false because only five deposits were so covered. The company claimed to be in leasing business but in fact carried on no leasing business. It was also doubtful whether interest offered was viable.

The mutual benefit financial companies (Nidhi Companies) notified under section 620A of the Companies Act, 1956 and Chit Fund Companies have been exempted from compulsory registration provision with the RBI and also from the stipulations of Minimum NOF of Rs. 50 Lakhs, maintenance of assets in Government Securities/guaranteed Bonds and compulsory transfer of profit to reserve fund; these companies will, however, continue to be regulated by the provisions of the directions issued to them by the RBI, other relevant provisions of Chapter III-B of the RBI Act and other Acts as applicable to them. [*RBI's Press Release, dt. 6-3-1997*].

NON BANKING FINANCIAL COMPANIES

Regulation of deposits accepted by NBFCs under Reserve Bank of India Act, 1934

The activities of the non-banking financial companies accepting deposits from public are regulated by the provisions of Chapter III-B of the Reserve Bank of India Act, 1934. It was generally felt that these provisions were neither adequate to regulate the business activities of these companies nor did they provide adequate protection to the depositors. Reserve Bank of India Act, 1934 was, therefore, amended by promulgation of the Reserve Bank of India (Amendment) Ordinance, 1997 on 9-1-1997 which was subsequently replaced by the Reserve Bank of India (Amendment) Act, 1997. The changes made, in main, relate to stipulation of compulsory registration of NBFCs with RBI with minimum net own funds as specified (section 45IA), maintenance of liquid assets (section 45IB), creation of reserve funds and transfer of certain percentage of profits every year to the fund (section 45IC), empowering RBI to issue directions, encompassing aspects such as income recognition, Accounting Standards, capital adequacy, provision for bad and doubtful debts, *etc.*, (section 45JA), issue of directions by RBI to NBFCs and the auditors relating to annual accounts, disclosure of liabilities or any other matter, and to order special audit (section 45MA), prohibit acceptance of deposits by NBFCs and alienation of assets (section 45MB), to file winding up petition (section 45MC), power to conduct inspection (45N), and empowering RBI to impose fine (section 58G).

Winding up of NBFCs.—The Reserve Bank has been empowered to file petition for winding up of an NBFC in certain circumstances as mentioned under the provisions of section 45MC.

By virtue of the provisions of section 651A inserted by the Companies (Second Amendment) Act, 2002, a petition for winding up of NBFC has to be filed with the Tribunal.

§ For details see Notes under section 433 under the heading "Winding up of NBFC".

Enforcement of Repayment of Deposit by the Company Law Board

Every deposit accepted by an NBFC is required to be repaid, unless renewed, as per the terms and conditions of the deposit. Where an NBFC fails to repay any deposit, the Company Law Board (CLB), either on its own or on being approached by a depositor/depositors, may direct the NBFC to repay the deposit forthwith, or within such time and subject to such conditions as may be specified. This power has been vested in the Company Law Board under section 45QA of the Reserve Bank of India Act. The aggrieved depositor has to make his application (in duplicate) to the concerned Company

Law Board Bench, in the prescribed Form No. 4 appended to the Company Law Board Regulations, 1991. The application is required to be accompanied by a fee of Rs. 50/- by way of a Bank draft made in favour of the Pay and Accounts Office, Department of Company Affairs, New Delhi/Mumbai/Calcutta/Chennai, as the case may be. [*Section 45QA*]

In case of non-compliance with the orders of the CLB, the RBI has been authorised to take penal action against the NBFC under section 58E of the Reserve Bank of India Act, 1934.

Nomination Facility.—Nomination facility for deposits held by the non-banking financial institution has been introduced on the lines of bank deposits under section 45ZA of the Banking Regulation Act, 1943. [*Section 45QB*].

The primary purpose of these provisions of RBI Act is to regulate the acceptance of public deposits by Non-Banking Financial Companies of all categories, with a view to safeguard the interest of the depositors.

§ For the Text of the Reserve Bank of India Act, 1934, as amended by the Amendment Act of 1997, See *Appendix* 59.

Directions issued by the Reserve Bank of India pursuant to powers vested in it under the Reserve Bank of India Act, 1934

For the purposes of carrying out its regulatory functions, the RBI has categorised the Non-Banking Financial Companies (NBFCs) into following three categories :

I. Non-Banking Financial Companies;
II. Residuary Non-Banking Companies; and
III. Miscellaneous Non-Banking Companies.

Directions have been issued by the RBI separately for each of the aforesaid categories of NBFC's.

The RBI regulates the activities of NBFCs through seven sets of Directions, Rules *viz.*—

(i) NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998
(ii) NBFC Prudential Norms (Reserve Bank) Directions, 1998
(iii) NBFC Auditors Report (Reserve Bank) Directions, 1998
(iv) RNBC (Reserve Bank) Directions, 1987
(v) Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977.
(vi) Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977.
(vii) RBI (NBFC) Returns Specifications, 1997.

The text of the Directions issued by Reserve Bank of India are given in *Appendices* 51 to 65.

Public deposits by private limited NBFCs

The provisions of section 3(1) the Companies Act, 1956 have been amended in terms of which the definition of 'private company' has been modified. The additional requirement imposed by the amendment for a private company is that any invitation or acceptance of deposits from persons other than its members (shareholders), directors or their relatives is prohibited. It is advised that the NBFCs which were hitherto private limited companies and were intending to take or holding public deposits are now public limited companies under the Companies Act, 1956. It is presumed that they have done the needful as required of them under the Companies Act. They may approach RBI for change in the certificate of registration to reflect the new name as a public limited company. [*Para 3 of Clarification Circular No. DN BSC (PD) CC No. 18/02.01/2001-02, dt. 1-1-2002 issued by RBI*]. For full text, see *Appendix* 62.

Hybrid Debt Capital Investments[1].—It refers to capital instrument which possesses certain characteristics of equity as well as of debt. Subordinated debt investments with a minimum maturity period of 60 months or above at the time of their initial offer, which are (a) unsecured and subordinated to the claims of the creditors (b) free from restrictive clauses, (c) not redeemable at the instance of the holder or attract the consent of the supervisory authority of the NBFC, will only be exempt from the definition of deposit.

Clarification regarding the secured debentures issued by NBFCs which are outside the purview of Public Deposits : Para 2(1)(xii)(f).[1].—The provisions of para 2(1)(xii)(f) of NBFC Acceptance of Public Deposit (RB) Directions, 1998, whereby secured debentures fall outside the purview of public deposits, having been erroneously interpreted by some NBFCs; it has been clarified that following shall be treated as part of public deposit :

(*a*) the debentures which are partly secured;

(*b*) the debentures which are secured by assets of third party;

(*c*) debentures which have matured for redemption, but have not been repaid and are overdue; and

(*d*) debentures against which a charge has not been created in favour of the independent-debenture trustees within the stipulated period of 90 days and the extended period of further 90 days shall be treated as part of public deposit.

Partial Exemption from RBI Act to Nidhi, Insurance, Stock Broking Companies etc.

RBI Notification No. 164/CGM (CSM)-2003, dt. 8-1-2003.—(1) The provisions of Section 45-IA, 45-IB, 45-IC, 45MB and 45MC of the Reserve Bank of India Act, 1934 (2 of 1934) and provisions of Non-Banking Financial Companies Acceptance of Public deposit (Reserve Bank) Directions conained in Notification No. DFC. 118/DG (SPT)-98, the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 contained in Notification No. DFC. 119/DG(SPT)-98 dated January 31, 1998 shall not apply to any non-banking financial company not holding or accepting public deposit as defined in paragraph 2(1)(xii) of the Notification No. DFC. 118/DG(SPT)-98 dated January 31, 1998, and—

(a) doing the business of insurance, holding a valid certificate of registration issued under Section 3 of the Insurance Act, 1938.

(b) being a stock exchange, recognised under Section 4 of the Securities Contracts (Regulation) Act, 1956; and

(c) doing the business of a stock-broker or sub-broker holding a valid certificate of registration obtained under Section 12 of the Securities and Exchange Board of India Act, 1992.

2. The provisions of Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 shall not apply to any non-banking financial company—

(a) Notified under Section 620A of the Companies Act, 1956, known as Nidhi Companies; and

(b) doing the business of chits, as defined in clause (b) of Section 2 of the Chit Funds Act, 1982.

Government Companies exempted.—Government companies conforming to section 617 of the Companies Act, 1956 and falling in the category of NBFCs have been exempted from the applicability of the provision of the RBI Act relating to maintenance of liquid assets section 45-IB and creation of Reserve Fund section 45-IC and Directions contained in paragraphs 4 to 7 of NBFC Acceptance of Deposits (RB) Directions, 1998

1. RBI Circular No. DNBS. (PD) CC No. 12/02 01/99-2000, dated 13th January, 2000.

relating to acceptance of public deposits etc. The registration requirements for these companies will, however, continue under section 45 IA of the RBI Act, 1956.*

Conversion of NBFCs from the category of "deposit taking companies" to "non-deposit taking companies"

RBI Circular dated 27-6-2001.—"As you are aware the bank issues (*i*) Certificates of Registrations (CoR) to eligible companies with authorisation to accept public deposits and (*ii*) to companies not so eligible and not presently holding public deposits issues CoR without authorisation to accept public deposits. The companies at (*i*) above which are so authorised can accept public deposits to the extent of their eligibility as determined by Directions issued in this regard. It is observed that some of the NBFCs which have accepted and held public deposits have since repaid entire public deposits or placed necessary amounts in escrow accounts thus becoming a non-public deposit taking company. They do not submit the periodical returns to the bank under the impression that they need not submit such returns since they are not holding public deposits any longer. It is clarified that the companies having CoR with authorisation to accept deposits, though they may no longer hold public deposit, are required to continue to furnish returns on liquid assets, prudential norms, annual return on deposits, etc. in terms of Directions. However, in order to these NBFCs holding CoR with authorisation to accept public deposits but not holding public deposits that—

(*i*) the company may comply with all the requirements as applicable to a public deposit taking NBFC irrespective of their not holding public deposit *viz.*,

(*a*) it would have to submit all the returns namely, the quarterly return on liquid assets, half yearly return on the prudential norms and annual return on deposits. In case the company chooses to retain 'A' category certificate but does not submit the statutory returns, an appropriate adverse action for not complying with the directions of Reverve Bank of India would be taken against it including a review of the CoR granted to it;

(*b*) it would have to comply with all the prudential norms including the CRAR and the exposure norms; so that there would be few supervisory concerns if the company chooses to accept public deposits again without prior specific approval of RBI; or

(*ii*) the company may surrender the CoR issued to it with authorisation to accept public deposits and obtain another CoR which does not authorise it to accept public deposits so that it can enjoy the freedom from submission of returns as also the exemptions from CRAR and exposure norms. Such company when it intends to take public deposits, would obtain prior specific approval of RBI.

Accordingly, the NBFCs which have branded their CoR as a public deposit taking company, but currently not holding public deposits are advised to exercise the option within 30 days of the receipt of this letter failing which puntitive measures would be initiated against them for non-submission of the returns. [*Circular No. DNBS. (PD) CC No. 16/02.01/2000-01 dated 27-6-2001, issued by Dept. of Non-Banking Supervision, RBI.*]

Regulation of Fund utilisation by Residuary Non-Banking Companies

Challenging the validity of the directions, the affected companies contended that blocking of the entire amount in specified deposits would leave nothing in their hands for business purposes. Rejecting this contention the Supreme Court, in a lengthy judgment, laid down certain principles of universal importance. The court said that the power of the Reserve Bank to issue directions [S. 45K(3)] in respect of any matter relating to or connected with the receipt of deposits is wide enough to include directions as to the manner of investment and treatment in the balance-sheet. The mere fact that a wrong section was mentioned in the exercise of the power would not invalidate the rules. It is enough that the power is there under one section or the other. Furthermore, the Reserve Bank was right in taking the stand that if such companies wanted to carry on business, they should invest their own working capital and find such resources elsewhere with which the Reserve Bank may have no concern. The court can only examine the validity of the exercise of the power in terms of the provisions of the governing Act and cannot sit to advise the Reserve Bank as to its financial and economic policies. *Peerless General Finance and Investment Co. Ltd. v. RBI,* (1992) 75 Com Cases 12 (SC).

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* Paragraph 9A of NBFC Acceptance of Public Deposits (RB) Directions, 1998; RBI Circular vide ref. DNBS (PD) CC No. 12/02.01) 99-2000, dt. 13-1-2000; Notification No. DNBS 138/CGM (VSNM)-2000, dated 13-1-2000.

Mutual Benefit Financial Companies—Special features of Un-notified Nidhi Companies

A new class of companies has been created i.e., the potential Nidhi Companies. These companies have been distinguished from notified Nidhi Companies, and have been termed as Mutual Benefit Financial Companies (MBC). On the lines of the exemptions accorded to notified Nidhi Companies, MBCs, in existence as on 9th January, 1997 and having NOF of Rs. 10 lakhs (to be enhanced to Rs. 25 lakhs by 31st December, 2000), have also been exempted from the provisions of section 45-IA (Compulsory registration with RBI), Section 45-IB (Maintenance of liquid asset) and Section 45-IC (Creation of Reserve Fund) as also NBFC Directions on acceptance of Public Deposits and Prudential Norms. [*Circular No.* DNBS. (PD) CC. No. 12/02. 01/99-2000, dated 13th January, 2000, issued by RBI].

Prohibitions.—Mutual benefit financial companies are subjected to certain restrictions and prohibitions as to:

(a) acceptance or renewal of deposits except from its shareholders;

(b) payment of any brokerage, commission, incentive *etc.*, to any person for collecting deposits for it;

(c) issue of advertisement in any form for inviting deposits from its shareholders.

Relaxations.—Mutual benefit financial companies enjoy certain exemptions/relaxations as follows:

(a) It may accept deposits from shareholders repayable on demand or on notice or repayable after any period as may be agreed upon;

(b) It may accept deposit from its shareholders without any limit;

(c) Application with prescribed particulars is not required for soliciting deposits from shareholders;

(d) There is no requirement for disclosing in the Direction's report information/particulars as to depositors and amount due to depositors and remaining unclaimed;

(e) There is no ceiling on the rate of interest payable on deposits accepted from shareholders;

(f) There is no restriction on repayment of deposits before maturity; and

(g) There is no requirement of submitting Auditors Certificate to RBI to the effect that full liabilities as to the depositors are reflected in annual accounts.

§ For Guidelines issued by Central Government for declaration of 'Nidhi', see Notes under section 620A.

§ For further Notes see under section 620A *post.*

Clarifications on New Regulatory Framework for NBFCs:

Press Release 1997-98/605, dated 9-1-1998.—After the amendment of the Reserve Bank of India Act in 1997, the Reserve Bank of India announced the new regulatory framework for Non-Banking Finance Companies (NBFCs) on January 2, 1998. Certain issues were raised about the operational aspects of the new framework. Clarifications have been given in the form of "Question" and "Answers". For Press Release, see *Appendix* 62.

Reserve Bank of India (Non-Banking Financial Companies) Returns Specifications, 1997

NBFCs are required to maintain liquid assets at a specified percentage of such deposits as were outstanding at the end of the second preceding quarter and to furnish a statutory return on quarterly basis to the RBI. For the purpose of ensuring compliance with the maintenance of percentage of assets by NBFCs, the RBI (NBFCs) Returns Specifications, 1997 specifies the form, the manner and the period of submission of the returns. All NBFCs irrespective of the size of their net owned funds and whether they accept public

deposits or not, shall have to furnish the statutory return on liquid assets. In case any company does not accept deposit, it should submit a 'NIL' return.

§ For text of the Specifications, 1997, see *Appendix* 54.

RBI Guidelines for issue of Commercial Paper

Circular No. IECD.2/08.15.01/2001-02, dt. 23-7-2001.—Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, primary dealers and satellite dealers were also permitted to issue CP to enable them to meet their short-term funding requirements for the operations. To keep pace with several developments in the financial market, and in the light of recommendations made by an Internal Group, Reserve Bank, in exercise of the powers conferred by sections 45J, 45K and 45L of the Reserve Bank of India Act, 1934 (2 of 1934) had issued revised guidelines for issue of CP vide Notification No. IECD/1/08.15.01/2000-01 dt. 10-10-2000 as amended *vide* Notification No. IECD/2/08-15-01/2000-01, dt. 30-4-2001, replacing all earlier directions/guidelines on the subject. Full text of the guidelines for issue of CP incorporating all the amendments issued till date is given at *Appendix* 63.

Acceptance of Deposits from NRIs : FEM (Deposits) Regulations, 2000

FEM (Deposit) Regulations, 2000 framed under FEMA, 1999 relate to deposits between a person resident in India and a person resident outside India. For text of the Regulations, see *Appendix* 110.

I. Acceptance of deposit by a company in India from NRIs on *repatriation* basis [Schedule 6].—A company incorporated in India including NBFC registered with Reserve Bank has been granted general permission to accept deposits from NRIs on repatriation basis subject to terms and conditions specified in the Schedule. General permission has also been granted for repayment of deposits by the company which has accepted deposits under the Scheme by inward remittance or by credit to NRE/FCNR account maintained with an authorised dealer/bank in India subject to the conditions specified in paragraph (x) of Schedule 6.

II. Acceptance of deposits by Indian proprietorship concern/firm or a company from NRI on *non-repatriation* basis.—General permission has been granted to Indian proprietorship concern/firm or a company (including Non-Banking Finance Company) registered with Reserve Bank to accept deposits from NRIs on non-repatriation basis subject to the terms and conditions specified in Schedule 7.

OCBs cannot invest in deposits.—An Indian company, a proprietorship concern or a firm in India shall not accept deposits from OCB's on non-repatriation basis. [*AP (DIR Series) Circular No. 14, dt. 16-9-2003*].

Relevant Extracts of FEM (Deposits) Regulations, 2000

Acceptance of deposits by persons other than authorised dealer/authorised bank.—(1) A company registered under Companies Act, 1956 or a body corporate or created under an act of Parliament or State Legislature may accept deposits from a nonresident Indian on repatriation basis, subject to the terms and conditions mentioned in Schedule 6.

(2) An Indian company, a proprietorship concern or a firm in India may accept deposits from a nonresident Indian on non-repatriation basis, subject to the terms and conditions mentioned in Schedule 7. [*Regulation 7 of FEM (Deposit) Regulations, 2000*].

SCHEDULE 6

[*See Regulation 7(1)*]

ACCEPTANCE OF DEPOSITS BY A COMPANY INCORPORATED IN INDIA (INCLUDING A NON-BANKING FINANCE COMPANY REGISTERED WITH RESERVE BANK) ON REPATRIATION BASIS FROM A NON-RESIDENT INDIAN OR A PERSON OF INDIAN ORIGIN RESIDENT OUTSIDE INDIA.

A company incorporated in India (including a non-banking finance company registered with the Reserve Bank) may accept deposits from NRIs, on repatriation basis subject to the following conditions.

(i) The deposits are received under a public deposit scheme.

(ii) If the deposit accepting company is a non-banking finance company, it should be registered with the Reserve Bank and should have obtained the required credit rating as stipulated under the guidelines issued by Reserve Bank for such companies.

(iii) The amount representing the deposit is received by inward remittance from outside India through normal banking channels or by debit to the Non-Resident (External) Account or Foreign Currency (Non-Resident) (Bank) Account maintained with an authorised dealer/ authorised bank in India.

(iv) If the deposit accepting company is a non-banking finance company the rate of interest payable on deposits shall be in conformity with the guidelines/directions issued by Reserve Bank for such companies. In other cases the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under the Companies (Acceptance of Deposit) Rules, 1975.

(v) The maturity period of deposits shall not exceed 3 years.

(vi) The company accepting the deposits shall comply with the provisions of any other law, rules, regulations, orders issued by the Government of India or any other competent authority, as are applicable to it in regard to acceptance of deposits.

(vii) The amount of aggregate deposits accepted by the company shall not exceed 35% of its net owned funds.

(viii) The payment of interest net of taxes may be made by the company to the depositor by remittance through an authorised dealer or by credit to the depositor's NRE/FCNR(B)/ NRNR/NRO/NRSR account as desired by him.

(ix) The amount of deposits so collected shall not be utilised by the company for re-lending (not applicable to a Non-Banking Finance Company) or for undertaking agricultural/plantation activities or real estate business or for investing in any other concern, firm or a company engaged in or proposing to engage in agricultural/plantation activities or real estate business.

(x) The repayment of the deposit may be made by the company to the depositor by remittance from India through an authorised dealer or by credit to the depositor's NRE/FCNR(B) account maintained with an authorised dealer in India, provided the depositor continues to be a nonresident at the time of repayment. While applying to the authorised dealer for remittance of maturity proceeds of deposit or credit thereof to NRE/FCNR(B) account , the company should certify that the amount of deposit was received either by inward remittance from outside India through normal banking channels or by debit to the depositor's NRE/FCNR(B) account, as the case may be.

(xi) The amount representing repayment of deposit may also be credited to the depositor's NRNR/NRO or NRSR account, at the depositor's option.

SCHEDULE 7

[See Regulation 7(2)]

ACCEPTANCE OF DEPOSITS BY INDIAN PROPRIETORSHIP CONCERN/FIRM OR COMPANY (INCLUDING NON-BANKING FINANCE COMPANY REGISTERED WITH RESERVE BANK) ON NON-REPATRIATION BASIS FROM NON-RESIDENT INDIANS AND PERSONS OF INDIAN ORIGIN RESIDENT OUTSIDE INDIA

A proprietorship concern or a firm in India, may accept deposits on non-repatriation basis from NRIs, and a company incorporated in India (including a non-banking finance company registered with Reserve Bank) may accept deposits on non-repatriation basis from NRIs/*[* * *], subject to the following conditions :

(i) In the case of a company, the deposits may be accepted either under private arrangement or under a public deposit scheme.

(ii) If the deposit accepting company is a non-banking finance company, it should be registered with the Reserve Bank and should have obtained the required credit rating as stipulated under the guidelines issued by Reserve Bank for such companies.

(iii) The maturity period of deposit shall not exceed 3 years.

(iv) If the deposit accepting company is a non-banking finance company the rate of interest payable on deposits shall be in conformity with the guidelines/directions issued by Reserve Bank for such companies. In other cases the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under the Companies (Acceptance of Deposit) Rules, 1975

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* The words '/OCBs' omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.

(v) The amount of deposit shall be received either by inward remittance from outside India through normal banking channels or by debit to NRE/FCNR(B)/NRO/NRNR or NRSR account. Where, however, the deposit is made out of funds held in NRSR account of the depositor, payment of interest as also the repayment of deposit shall be made only by credit to NRSR account of the depositor concerned. In all other cases, the maturity proceeds/interest shall be credited to NRO Account.

(vi) The proprietorship concern/firm/company accepting the deposit should comply with the provisions of any other law, rules, regulations or orders made by Government or any other competent authority, as are applicable to it in regard to acceptance of deposits.

(vii) The proprietorship concern, firm or company accepting the deposit shall not utilise the amount of deposits for relending (not applicable to a Non-Banking Finance Company) or for undertaking agricultural/plantation activities or real estate business or for investing in any other concern or firm or company engaged in or proposing to engage in agricultural/plantation activities or real estate business.

(viii) The amount of deposits accepted shall not be allowed to be repatriated outside India.

III. Acceptance of deposits from NRIs/OCBs by issue of Commercial Paper

General permission has been granted to Indian companies to accept deposits from NRIs/OCBs by issue of a commercial paper subject to terms and conditions specified in sub-regulation (2) of Regulation 8 of FEM (Deposit) Regulations, 2000.

Housing Finance Companies—Special features of

Housing Finance Company (HFC) means a company incorporated under this Act which primarily transact or has as one of its principal objects, the transacting of business of providing finance, whether directly or indirectly. The deposit mobilisation by HFCs is regulated by National Housing Bank established under the National Housing Bank Act, 1987. The Bank has issued the Housing Finance Companies (NHB) Directions, 2001. Notification No. NHB. HFC. DIR. 1/CMD-2001 in this behalf. (For text see *Appendix* 64)

Financial Services Act, 1986 [English Act]

The Securities and Investment Board (SIB) brought an action against two overseas companies alleging that they carried on investment business in England without authorisation, made misleading statements and issued investment advertisements contrary to the Act. Solicitors who aided them with knowledge of the contravention were also brought under the charge. The SIB claim was for compensation for loss suffered by investors. The court refused to strike out the case against the solicitors. It was held that a court could order a person knowingly concerned in a contravention of the Act as well as the contravener himself to repay the moneys invested under the unlawful transactions whether or not the sums invested were capable of being identified as a separate fund of money. *Securities and Investment Board v. Pantell SA (No. 2),* (1992) BCLC 58 (Ch D). Their appeal to have their names struck out was rejected by the Court of Appeal. *Sub nom Securities and Investment Board v. Pantell SA (No. 2),* (1993) BCLC 146 (CA).

[1]Guidelines for Entry of NBFCs into Insurance Sector

Issued on June 9, 2000.—1. Any non-banking financial company (NBFC) registered with RBI having net owned fund of Rs. 2 crore would be permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation.

2. All NBFCs registered with RBI which satisfy the eligibility criteria given below will be permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards. The maximum equity contribution such an NBFC can hold in the joint venture company will normally be 50 per cent. of the paid-up capital of the insurance company. On a selective basis, the Reserve Bank of India may permit a higher equity contribution by a promoter NBFC initially, pending divestment of

1. Issued by the Reserve Bank of India pursuant to the announcement made by the Governor, Reserve Bank of India on 27-4-2000 in the Statement of Monetary and Credit Policy for the year 2000-2001.

equity within the prescribed period [see Note (1) below]. The eligibility criteria for joint venture participant will be as under, as per the latest available audited balance-sheet:

(i) the owned fund of the NBFC should not be less than Rs. 500 crore,

(ii) the CRAR of the NBFC engaged in loan and investment activities holding public deposits should be not less than 15 per cent. and for other NBFCs at 12 per cent. irrespective of their holding public deposits or not,

(ii) the level of net non-performing assets should be not more than 5 per cent. of the total outstanding leased/hire purchase assets and advances taken together,

(iv) the NBFC should have net profit for the last three continuous years,

(v) the track record of the performance of the subsidiaries, if any, of the concerned NBFC should be satisfactory,

(vi) regulatory compliance and servicing public deposits, if held.

The provisions of the RBI Act would be applicable for such investments while computing the net owned funds of the NBFC.

3. In case where a foreign partner contributes 26 per cent. of the equity with the approval of the Insurance Regulatory and Development Authority/Foreign Investment Promotion Board, more than one NBFC may be allowed to participate in the equity of the insurance joint venture. As such participants will also assume insurance risk, only those NBFCs which satisfy the criteria given in paragraph 2 above, would be eligible.

4. No NBFC would be allowed to conduct such business departmentally. A subsidiary or company in the same group of an NBFC or of another NBFC engaged in the business of a non-banking financial institution or banking business will not normally be allowed to join the insurance company on risk participation basis.

5. NBFCs registered with RBI which are not eligible as joint venture participant, as above can make investments up to 10 per cent. of the owned fund of the NBFC or Rs. 50 crore, whichever is lower, in the insurance company. Such participation shall be treated as an investment and should be without any contingent liability for the NBFC. The eligibility criteria for these NBFCs will be as under:

(i) The CRAR of the NBFC (applicable only to those holding public deposits) should not be less than 12 per cent. if engaged in equipment leasing/hire purchase finance activities and 15 per cent. if it is a loan or investment company;

(ii) The level of net NPA should be not more than 5 per cent of total outstanding leased/hire purchase assets and advances;

(iii) The NBFC should have net profit for the last three continuous years.

6. All NBFCs registered with RBI entering into insurance business as agents or investors or on risk participation basis will be required to obtain prior approval of the Reserve Bank. The Reserve Bank will give permission to NBFCs on case to case basis keeping in view all the relevant factors. It should be ensured that risks involved in insurance business do not get transferred to the NBFC and that the NBFC business does not get contaminated by any risks which may arise from insurance business.

Notes

(1) Holding of equity by a promoter NBFC in an insurance company or participation in any form in insurance business will be subject to compliance with any rules and regulations laid down by the IRDA/Central Government. This will include compliance with section 6AA of the Insurance Act as amended by the IRDA Act, 1999, for divestment of equity in excess of 26 per cent. of the paid-up capital within a prescribed period of time.

(2) For applications received during the financial year 2000-2001, any fresh capital infused after the audited balance-sheet date for 1999-2000 would also be taken into account. The unaudited and certified balance-sheet as on a latest date may be reckoned for determining the eligibility criteria and the audited balance-sheet for the above date would be submitted to the RBI as soon as possible.

(3) For subsequent years, the eligibility criteria would be reckoned with reference to the latest available audited balance-sheet for the previous year.

SEBI (Collective Investment Schemes) Regulations, 1999

SEBI has prescribed regulations for Collective Investment Schemes, 1999 vide Notification No. SO 1035(E), dt. 15-10-1999. New Schemes were banned till such Regulations were notified.

For full text of the Regulations and various Press Releases issued before the regulation came into being, see *Appendix* 188.

In *Securities and Exchange Board of India v. Libra Plantation Ltd.,* (1998) 18 SCL 296 (Bom), High Court ordered RBI to freeze the accounts of all such companies in different banks till the regulatory frame work became effective. for detail see under section 34.

Investor's Protection Bill 1999

A Bill under this title was published as Bill No. 98 of 1999 in Gazette of India, Extra-Ordinary section 2, dated 3-12-1999. The Preamble of the Bill shows that its purpose is to provide for protection of interests of depositors in the financial establishments. For text of the Bill refer (2000) 2 Comp LJ 298 (St.)

Rules and Prescribed Forms.—To cover various aspects contained in section 58A, the Government has formulated the following rules:

(a) The Companies (Acceptance of Deposits) Rules, 1975. [See *Appendix* 10]

(b) The Companies (Application for Extension of Time or exemption under sub-section (8) of Section 58A) Rules, 1979. [See *Appendix* 11]

(c) The Company Law Board Regulations, 1991. [See *Appendix* 3]

(d) The Companies (Central Government's) General Rules & Form, 1956, Rule 4CCC and Form 2B for nomination.

(e) The Banking Companies (Nomination) Rules, 1985, Rule 2(1) and Form DA 1 for nomination.

(f) Non-banking Financial Companies and Miscellaneous Non-banking Companies (Advertisement) Rules, 1977.

The Companies (Acceptance of Deposits) Rules, 1975, contain elaborate provisions for accepting, renewing, repaying deposits and for maintenance of various registers and records. In accordance with the Rules, a company which accepts and/or renews deposits is under an obligation to file a return in the prescribed form with the Registrar of Companies on or before 30th June every year and a copy of the return should also be filed with the Reserve Bank of India, Bombay.

Application before CLB

Application made by an aggrieved depositor be made in form No. 4 prescribed under CLB Regulations, 1991 (See Regulation 37) under section 58A(9) of the Act or section 45QA of the Reserve Bank of India Act, 1934, along with an application fee of Rs. 50/- and the following documents:

(1) Copy of deposit receipt

(2) Copy of correspondences exchanged with the company.

No affidavit is required to accompany the application made by a depositor.

CLB has also *suo motu* powers to order repayment of deposits even though no formal application has been made.

For text of the Company Law Board Regulations, 1991, as amended by the Company Law Board (Amendment) Regulations, 1997 (w.e.f. 1-8-1997), refer *Appendix* 3.

ICSI Guidance Note on Compliance Certificate (August, 2003)

• The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of maintenance of registers. The relevant paragraph 1 of the

Form prescribed under Rule 3 of the Companies (Compliance Certificate) Rules, 2001 states :

***"Paragraph 1.*— The company has kept and maintained all registers as stated in Annexure "A' to this certificate, as per the provisions and the rules made thereunder and all entries therein have been duly recorded."**

Register of Deposits under Rule 7 of the Companies (Acceptance of Deposits) Rules, 1975

Prescribed Check List.—Check whether:

(i) the particulars in respect of each depositor have been entered in the register;

(ii) the register has been preserved in good order for a period of eight calendar years from the financial year in which the latest entry was made.

Note : A private company has to maintain register of deposits in respect of deposits accepted/invited from the relatives of directors.

• Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

***Paragraph 2.*—The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Return of Deposits under Section 58A

Prescribed Check List.—Check whether

(i) the company has on or before 30th day of June, filed with the Registrar a return in the form annexed to Companies (Acceptance of Deposits) Rules 1975 duly certified by the auditor of the company;

(ii) a copy of the return has simultaneously been furnished to Reserve Bank of India.

• Also check whether intimation has been given to the Company Law Board in respect of any default made by the company in repayment of any deposits from small depositors within 60 days from the date of default. Intimation shall be given on monthly basis.

NBFC—Return of Deposits and text of advertisement

Prescribed Check List.—Check whether a—

(a) copy of Return of Deposits of a non-banking non financial company has been filed with the Reserve Bank of India pursuant to rule 10 of the Companies (Acceptance of Deposits) Rules, 1975;

(b) text of Advertisement inviting deposits by a non-banking financial company has been filed with the Reserve Bank of India pursuant to rule 5 of the Non-Banking Financial Companies And Misc. Non-Banking Companies (Advertise-ment) Rules, 1977.

• Paragraph 23 under Rule 3 relates to Borrowing by way of Deposits by NBNFCs NBFCs & Deposits from Small Depositors and reads as follows:

***Paragraph-23.*—The company has complied with the provisions of sections 58A and 58AA read with Companies (Acceptance of Deposit) Rules, 1975/the applicable directions issued by the Reserve Bank of India/any other authority in respect of deposits accepted including unsecured loans taken, amounting to Rs..... raised by the company during the year and the company has filed the copy of advertisement/statement in lieu of advertisement/necessary particulars as required with the Registrar of Companies..... on..... The company has also filed return of deposit with the Registrar of Companies/Reserve Bank of India/other authorities.**

Prescribed Check List

(a) Borrowings by way of Deposits by Private Companies

Check whether:

(i) the company has altered its Articles of Association to include the restrictive provisions under section 3(1)(iii)(d) limiting the sources of deposits and thereafter has accepted the deposits only from such sources.

(ii) the company has accepted deposits from its directors only after obtaining the written declaration as required under Rule 2(b)(ix) of the Companies (Acceptance of Deposits) Rules, 1975.

(iii) the company has accepted deposits from its members only after obtaining the written declaration as required under Rule 2(b)(ix) and in case of a non-financial company, whether the concerned depositor has continued to be a member of the company upto 24-9-2001 [Rule 2(b)(ix) amended by the Companies (Acceptance of Deposits) Second Amendment, Rules, 2001] (if a financial company, whether the concerned depositor has continued to remain a member of the company all throughout the term of the deposit and also if he happened to be a joint-member, whether his name appeared first amongst the joint-members).

(iv) the non-financial company has accepted deposits from any of the relatives of its directors upto 24-9-2001 and if yes, whether the company has delivered to ROC before accepting such deposits, the Statement in lieu of advertisement under Rule 4A of the Rules.

(v) the company has accepted any deposits from other sources exempted under Rule 2(b) of Deposit Rules in confirmity with the stipulations thereunder.

(vi) the company has accepted any deposits in pursuance of the exemption granted to Small Scale Industrial Units and if yes, whether the conditions specified in respective Notification i.e. G.S.R. No. 73(E) dated 2-2-1996 have been duly fulfilled.

(vii) the company has accepted any deposits prior to 13-12-2000 [Date of commencement of the Companies (Amendment) Act, 2000] in confirmity with section 58A and Deposits Rules and if yes, whether in respect of any outstandings thereof, the company has filed the Return of Deposits with ROC before 30th June with a copy to RBI.

(b) Borrowings by Way of Deposits by NBNFCs (Non-banking Non-financial Companies)

Check whether:

(i) the net owned fund of public company inviting deposit is not less than rupees one crore as per rule 3(1)(e) of the Companies (Acceptance of Deposits) Rules, 1975..

(ii) the company is not in default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposit;

(iii) approval of the Board in terms of section 292 (1) has been obtained to invite deposits and draft advertisement approved;

(iv) the advertisement has been issued on the authority and in the name of the Board; [and bears the date of approval of the text of the advertisement approved by the Board];

(v) the advertisement contains the particulars specified in rules 4(2) (a) to (k) of the Companies (Acceptance of Deposits) Rules, 1975 [including a reference to nomination facility available to the depositor]. In case deposits were accepted

without invitation, check that a statement in lieu of advertisement has been delivered to the ROC before accepting deposits (rule 4A);

(vi) a copy of the advertisement duly signed by majority of directors was filed with the ROC for registration, before publishing the same;

(vii) advertisement has been published in a leading English newspaper and one vernacular newspaper circulating in the State where the registered office is situated within the prescribed time [within 90 days after the date of filing with ROC];

(viii) proper scrutiny of the fixed deposit application forms, particularly the name(s), amount, address and other relevant particulars, has been done;

(ix) deposits repayable on demand or on notice or after a period of thirty six months have not been accepted;

(x) no deposits were accepted for a period of less than six months and more than three years;

(xi) deposits have been accepted within the limits prescribed in rule 3(2);

(xii) the rate of interest on deposits is within the prescribed limit;

(xiii) the rate of brokerage is within the prescribed limits;

(xiv) the company deposits/invests on or before 30th April of each year not less than the prescribed limit of the deposits maturing during the year, in specified securities (rule 3A);

(xv) proper receipts were issued to the depositors on the acceptance of deposits [signed by the duly authorised officer of the company and contained particulars specified in Rule 6(2)];

(xvi) register of deposits has been maintained with particulars specified in rule 7;

(xvii) return of deposits duly certified by the auditor of the company has been filed with the ROC and Reserve Bank of India on or before 30th June giving the position as on 31st March (Rule 10);

(xviii) payment of interest has been made on time;

(xix) deposits were repaid on time. In case of repayment of deposits before maturity, the company has complied with the requirements of the Rules in this regard [see Rule 8];

(xx) where the company has obtained any extension of time or exemption under section 58A(8), the terms thereof have been complied with;

(xxi) in case any order has been made by the Company Law Board under section 58A(9), it has been complied with;

(xxii) the company has complied with applicable directions issued by RBI, if any.

(xxiii) the company has paid a penal rate of interest of eighteen per cent for the overdue period in case of public deposits matured and claimed but remaining unpaid.

(c) Borrowings by Ways of Deposits by NBFCs :

Check whether:

(i) the company having Net Owned Fund of two crores of rupees and above, has obtained minimum investment grade or other specified credit rating for fixed deposits from any one of the approved credit rating agencies at least once a year;

(ii) the copy of rating as specified above has been sent to the Reserve Bank of India along with return on prudential norms;

(iii) the company has informed the Reserve Bank of India about upgrading or downgrading of its credit rating to any level from the level previously held by it, within fifteen working days of its being so rated;

(iv) no deposits were accepted or renewed for a period less than twelve months and more than sixty months from the date of acceptance or renewal thereof;

(v) the company has complied with the provisions of Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977;

(vi) the company has delivered to RBI, a statement in lieu of advertisement containing all particulars required to be included in the advertisement pursuant to NBFC and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977 and complied with other requirements of para 4(13) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998;

(vii) the rate of brokerage is within the prescribed limits;

(viii) the rate of interest on deposits is within the prescribed limits;

(ix) no deposits were accepted or renewed which are repayable on demand;

(x) register of deposits has been maintained and particulars specified in para 4(16) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 have been entered therein;

(xi) deposits were repaid in time. In case of repayment of deposits before maturity, the company has complied with the provisions of para 4(14) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998;

(xii) proper receipts were issued to the depositors on the acceptance of deposits [*duly signed by an authorised officer of the company*] [*Para 4(15)*];

(xiii) no public deposits were repaid within a period of three months from the date of its acceptance;

(xiv) the company has complied with the provisions of para 4(9) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 for permitting an existing depositor to renew the deposit before maturity for availing of benefit of higher rate of interest.

(xv) the company has complied with the provisions of para 4(12) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 regarding particulars to be specified in application form soliciting public deposits;

(xvi) the company has complied with the provisions of para 4(10) of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 for payment of interest on overdue public deposits;

(xvii) if the company is an equipment leasing company or a hire purchase finance company, it has complied with the provisions of para 4(4) (a) & (b) and para 5 of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 for acceptance or renewal of deposits;

(xviii) if the company is a loan company or an investment company, it has complied with the provisions of para 4(4) (c), (d) & (e) and para 5 of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998 for acceptance or renewal of deposits.

Check Further :

In addition to the above points, also check whether

(a) the company has filed with RBI Annual Return on deposits in accordance with para 8(3);

(b) the company has intimated RBI of the occurrence of any change in respect of the matters specified in para 8(4);

(c) the Board's report included the following information:—

—total number of accounts of public deposit of the company which have not been claimed by the depositors or not paid by the company after the date on which deposit became due for repayment;

—total amounts due under such accounts remaining unclaimed or unpaid beyond the date referred to above;

(d) in case of loan granted, the loan was not in excess of 75% of the amount of public deposit and was at a rate of interest 2% above the interest rate payable on deposit.

For Check List relating to acceptance of deposits from small depositors, see sec. 58AA.

Secretarial Practice Notes for MNBCs : Deposits

I. Acceptance of deposits

Check whether :

1. Deposits repayable on demand or on notice or repayable after a period of less than 6 months and more than 36 months have not been accepted.
2. The rate of interest on deposit does not exceed 12.5% p.a.
3. Proper receipts have been issued to depositors on acceptance of deposits.
4. Rate of brokerage paid to the broker does not exceed one per cent where deposit is for a period not exceeding one year.
5. Brokerage for deposit, exceeding one year but less than two years and for a period exceeding 2 years, does not exceed one and a quarter per cent and one and half per cent respectively.
6. duly signed by authorised officers of the company.

II. Repayment of deposit

Check whether :

1. the Company has not made any repayment before expiry of three months from the date of its acceptance.
2. In case deposit is repaid after 3 months but before expiry of 6 months, no interest has been paid.
3. In case of repayment of deposit after 6 months but before maturity, interest has been paid one per cent less than the rate at which the Company would have ordinarily paid.
4. In case of overdue deposit, the rate of interest, if any, paid by the company on such deposit was as per the MNBC Directions.

III. Exemptions from RBI directions for MNBCs

Check whether :

MNBC has been exempted by RBI from all or any of the provisions of directions issued for MNBC, either generally or for any specific period and conditions specified therefor.

Secretarial Practice Notes for Residuary Non-Banking Companies (RNBCs)

I. Acceptance of Deposits

Check whether :

1. Deposit repayable on demand or notice have not been accepted.
2. Deposits were not accepted for a period less than 12 months and more than 84 months.
3. The rate of interest on deposit is not less than 6% p.a. in case deposit is in lumpsum and 4% if deposit is under daily deposit scheme.
4. The deposits accepted are within the limits laid down for RNBCs.
5. A written application has been received from depositor for acceptance of deposit.

6. Such application was in the form supplied by the company and accompanied by a statement by the company containing all particulars to be included.
7. Proper receipts are issued to the depositors on acceptance of deposits.
8. Such receipts were signed by the duly authorised officer of the company.
9. A register of deposits was being maintained.
10. The return of deposits has been filed with the RBI within appropriate time.
11. Nomination has been received from deposit holder in prescribed form.

II. Exemptions from RBI directions for RNBCs

Check whether :

RNBC has been exempted by RBI from all or any of the provisions of directions issued for RNBC, either generally or for any specific period and the conditions specified therefor.

Documents Involved: (1) Minutes of Board Meeting, (2) Copy of Advertisement/Statement in lieu of advertisement (3) Correspondence with Registrar/RBI (4) Board's report under section 217, (5) Annual Report, (6) Application for soliciting Deposits, (7) Receipts of Deposits issued to depositors, (8) Register of Deposits, (9) Return of Deposits, (10) Application for extension of time or exemption, if any.

[1][**S. 58AA. Small depositors.**—(1) Every company, which accepts deposits from small depositors, shall intimate to the [2][*Tribunal*] any default made by it in repayment of any such deposits or part thereof or any interest thereupon.

(2) The intimation[3] under sub-section (1) shall,—

(a) be given within sixty days from the date of default;

(b) include particulars in respect of the names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon.

Explanation.—For removal of doubts, it is hereby declared that the intimation under this section shall be given on monthly basis.

(3) Where a company has made a default in repayment of any deposit or part thereof or any interest thereupon to a small depositor, the [2][*Tribunal*], on receipt of intimation under sub-section (1) shall,—

(a) exercise, on its own motion, powers conferred upon it by sub-section (9) of section 58A;

(b) pass an appropriate order within a period of thirty days from the date of receipt of intimation under sub-section (1):

Provided that [4][*the Tribunal*] may pass order after expiry of the period of thirty days, after giving the small depositors an opportunity of being heard:

Provided further that it shall not be necessary for a small depositor to be present at the hearing of the proceeding under this sub-section.

(4) No company shall, at any time, accept further deposits from small depositors, unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon:

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1. Inserted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 19 (w.e.f. 13-12-2000).
2. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 10.**
3. Alongwith a fee of Rs. 1000/-.
4. **Subs. for "the Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 10.**

Provided that nothing contained in this sub-section shall apply to—

(a) any deposit which has been renewed by the small depositor voluntarily; or

(b) any deposit, whose repayment has become impracticable due to the death of the small depositor or whose repayment has been stayed by a competent court or authority.

(5) Every company, which has on any occasion made a default in the repayment of a deposit or part thereof or any interest thereupon to a small depositor, shall state, in every future advertisement and application form inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made.

(6) Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits issued after such waiver.

(7) Where a company had accepted deposits from small depositors and subsequent to such acceptance of deposits, obtains funds by taking a loan for the purposes of its working capital from any bank, it shall first utilise the funds so obtained for the repayment of any deposit or any part thereof or any interest thereupon before applying such funds for any other purpose.

(8) Every application form, issued by a company to a small depositor for accepting deposits from him, shall contain a statement to the effect that the applicant had been apprised of—

(a) every past default by the company in the repayment of deposit or interest thereon, if any, such default has occurred; and

(b) the waiver of interest under sub-section (6), if any, and reasons therefor.

(9) Whoever knowingly fails to comply with the provisions of this section or comply with any order of the [5][*Tribunal*] shall be punishable with imprisonment which may extend to three years and shall also be liable to fine for not less than five hundred rupees for every day during which such non-compliance continues.

(10) If a company or any other person contravenes any provision of this section, every person, who at the time the contravention was committed, was a director of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

(11) The provisions of section 58A shall, as far as may be, apply to the deposits made by a small depositor under this section.

Explanation.—For the purposes of this section, "a small depositor" means a depositor who has deposited in a financial year a sum not exceeding twenty thousand rupees in a company and includes his successors, nominees and legal representatives.]

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5. Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 10.

NOTES

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under sections 13, 18 and 19 shall become transferred to the Tribunal to be exercised by it in place of the Company Law Board. The Commentary and the procedure should be read keeping this change in mind.

Companies (Amendment) Act, 2000

This Section has been inserted by the Companies (Amendment) Act, 2000 to protect small depositors with deposits of a sum not exceeding Rs. 20,000 with the company in any financial year. As per clause (*iv*) of the Statement of Objects and Reasons appended to the Companies (Second Amendment) Bill, 1999, the Section requires companies to inform the Company Law Board within sixty days from the date of default if a company failed to make repayment of deposits on maturity to small deposit holders. The Company Law Board may make an order within thirty days from the date of receipt of intimation of the default calling upon the company to repay the deposit in question and the company shall be bound to comply with the order. The persons who are responsible for any default (both in respect of refund of deposits and compliance with CLB orders) shall be punishable with imprisonment which may extend to three years and shall also be liable to fine of not less than Rs. 500 per day during which such default continues.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The power of Company Law Board has been conferred on the Tribunal constituted under Para. 1B of this Act. Consequential changes have, accordingly, been made in sub-sections (1), (3) and (9) of this section Notes on Clauses of the Bill stated, thus:

Notes on clauses.—This clause seeks to amend section 58AA of the Companies Act, 1956. Under the existing provisions, every company may accept deposits from small depositors in accordance with the provisions contained in that section. The Company Law Board is conferred upon certain powers in the event of default in repayment of deposits to small depositors. It is now proposed to confer the same powers upon the Tribunal. This amendment is of consequential nature. (*Clause* 9 of the Companies (Amendment) Bill, 2001).

Deposits by small depositors

The provisions of Section 58A apply to deposits accepted by a company whether from small or other depositors. Special provisions have, however, been made in this Section in respect of deposits accepted from small depositors. As per *Explanation* to this section, a "small depositor" means a depositor who has invested in a financial year a sum not exceeding Rs. 20,000/- in a company, and includes his successor, nominee and legal representatives. "Financial Year" has been defined in Section 2 (17) to mean the period for which the audited accounts of a company are laid before its annual general meeting. Thus, for purposes of this Section, aggregate of all the deposits made by a small depositor from time to time in the same financial year shall be taken into account provided the total amount of deposits made in a particular financial year does not exceed Rs. 20.000, per depositor.

Intimation of default to Company Law Board [Sub-sections (1)/(2)]

Every company shall intimate to the Regional Bench of the Company Law Board (having jurisdiction over the registered office of the company) within 60 days from the first day of default in repayment of deposits or interest due thereon. The intimation shall also contain particulars of the names and addresses of all the small depositors, deposit amount in each case, reasons for non-payment or late payment and will send Annual Reports and Projection and Cash flow etc. etc. [*vide CLB Regulations, 1991, Form* I, *Annexure* II*]*. It is open to the company to submit a scheme for repayment of deposits to small depositors with full justification and projected cash-flow statement for consideration of CLB. This initimation is to be given on monthly basis. The intimation under sub-

section (1) shall be filed in Form No. 1 in Annexure II and in accordance with Annexure III to the CLB Regulations, 1991 [*Reg. 42A*].

It may be noted that a default is deemed to be made in case deposit/interest is not paid even to a single small depositor on the date of maturity. On receipt of intimation and particulars of small depositors, CLB shall take cognizance of the default made by the company and assume jurisdiction to pass appropriate orders for repayment thereof.

Applicability to NBFC.—Section 58AA applies to NBFCs. They are to report to CLB whenever they have defaulted in repayment of deposits to small depositors. [*RBI Circular No. DN BSC (PD) CC No. 18/02.01/2001-2002, dated 1-1-2002*].

Jurisdiction and powers of Company Law Board [Sub-section (3)]

On receipt of intimation of default in repayment of small depositors by a company alongwith the prescribed particulars, the Company Law Board may either pass appropriate orders within 30 days of the receipt of intimation without hearing the small depositors or may pass orders after 30 days after giving an opportunity of hearing to small depositors. It appears that notice of hearing to small depositors may be given by issuing individual notices or by publication of the notice of hearing in newspapers by the company, as may be deemed fit by CLB.

As provided in sub-section (11), the provisions of Section 58A shall, as far as may be, apply to the proceedings before CLB in respect of default in repayment to small depositors. Thus, CLB may proceed on the basis of application made by small depositors, even though the defaulting company has failed to give intimation under sub-section (1), and give an opportunity of hearing to the company also in pursuance of sub-section (9) of Section 58A. The Company Law Board may exercise *suo motu* powers to evolve a necessary order or may consider any scheme for repayment of deposits to small depositors presented by the company before passing appropriate orders, keeping in view the interest of the company, the interest of small depositors and public interest. In essence, the CLB may exercise its powers under Section 58A (9) while dealing with default in repayment of small depositors under this Section, with only this difference that CLB may pass orders expeditiously within the time limit prescribed in sub-section (3) to mitigate the sufferings of small depositors.

Prohibition against acceptance of fresh deposits [Sub-section (4)]

Sub-Section (4) prohibits the defaulting company to accept fresh deposits from small depositors. Similar provisions are also contained in Section 58A(2)(c) applicable to all types of deposits. Renewal of existing deposits tantamount to acceptance of fresh deposits. *Sujani Textiles Pvt. Ltd. v. Assistant ROC,* (1980) 50 Com Cases 276 (Mad). For the purposes of this sub-section, voluntary renewal of his deposit by a small depositor will not tantamount to default in repayment and, therefore, the prohibition against acceptance of further deposits does not come into play.

As per proviso (*b*), the prohibition also does not apply to deposits which could not be repaid due to the death of a small depositor or where repayment has been stayed by any court.

Advertisement for inviting deposits and application form [Sub-section (5)/(6)/(8)]

Sub-section (5) requires disclosure of past defaults in the repayment of small deposits or interest thereon to *a small depositor*, in any advertisement and application form for mobilisation of fresh deposits *from the public.* The advertisement and the application form should disclose particulars in respect of every past default (i) the total number of small depositors, (ii) the amount due to them, in respect of which default was made. Sub-section (6) further requires that, where any interest accruing on deposits of small depositors has been waived, the fact of such waiver and reasons therefor must be indicated in the advertisement and the application form. The advertisement and application form issued to a small depositor should contain similar particulars [sub-section (8)]. Of course,

any advertisement inviting fresh deposits must also comply with the 'Form and particulars of advertisements'. For details of requirements refer to Rule 4 of the Companies (Acceptance of Deposits) Rules, 1973.

Applicability to private companies

It may be noted that clause (d) of section 3(1)(iii) does not prohibit any invitation or acceptance of deposits by a private company from its members, directors or their relatives. An advertisement inviting deposits from only these persons must, however, comply with the provisions of sub-sections (5), (6) and (8). A small depositor of a private company can approach the CLB in case of default by the company in refund of his deposits and interest accrued thereon.

Utilisation of working capital loan from banks [Sub-section (7)]

Sub-section (7) provides that if a company obtains loan from a bank to meet its working capital requirements after acceptance of deposits from small depositors, it is obligatory on the part of the company to utilise these funds, on priority basis, for repayment of subsisting matured deposits before applying such funds for any other purpose. This has been considered necessary because deposits accepted by a company are mainly for the purpose of its working capital needs and not for acquisition of assets. The intention of the legislature seems to be that the funds obtained earlier for working capital from small depositors are repaid to them if their deposits have become due for repayment, before the funds obtained subsequently from a bank are utilised for other purposes.

The provisions of sub-section (7) shall apply only in case of default in repayment of deposits accepted from small depositors before obtaining funds from the bank and not otherwise.

Penal Interest for default

Rule 8A prescribes 20% annually compounded interest to be paid to small deposit holders in case of default in repayment to them. [*GRS 873 (E), dt. 28-11-2001; (Third Amendment Rules, 2001)*].

Penalty for default [Sub-section (9)/(10)]

The defaulting company and directors thereof shall be deemed to be guilty of the offence under this section and punishable under sub-section (9). The directors are punishable with imprisonment upto 3 years and both the company and its directors, with fine of not less than Rs. 500/- for every day during which the non-compliances continues. The offence has been made cognizable under section 58AAA inserted by the Amendment Act, 2000.

Directors apart, whoever knowingly fails to comply with the order of the CLB is punishable similarly.

§ See also Notes under section 58AAA.

Compoundable offences.—The offence is not compoundable under Section 621A.

Relevant Rules & Regulations

Intimation of default in repayment of small deposits under sub-section (1) shall be made by the company to the CLB by way of petition alongwith the following particulars in terms of Company Law Board Regulations, 1991 [*Appendix* 3]—

(1) Names and addresses of the officers of the company;
(2) Full details of small depositors such as names, addresses, amount of deposits, rate of interest, dates of maturity and other terms and conditions of deposits;
(3) Reasons for non-payment or late payment;
(4) Annual Reports for the last three years.

A fee of Rs. 1000 is to be paid along with the petition (w.e.f. 22-7-2002) [vide *CLB (Fees on Application and Petitions) Rules, 2002 at Appendix* **6**]

The intimation is given under this section to the concerned Regional Bench of the Company Law Board in case of any default in repayment of principal amount of deposit or interest on the date of maturity to any small depositor within sixty days from the date of default and thereafter at the end of every month.

ICSI Guidance Note on Compliance Certificate (August 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of maintenance of registers. The relevant paragraph 1 of the Form prescribed under Rule 3 of the Companies (Compliance Certificate) Rules, 2001 states :

Paragraph 23 under Rule 3 relates to Borrowing by way of Deposits by NBNFCs NBFCs & Deposits from Small Depositors and reads as follows:

***Paragraph-23.*—The company has complied with the provisions of sections 58A and 58AA read with Companies (Acceptance of Deposit) Rules, 1975/the applicable directions issued by the Reserve Bank of India/any other authority in respect of deposits accepted including unsecured loans taken, amounting to Rs..... raised by the company during the year and the company has filed the copy of advertisement/statement in lieu of advertisement/necessary particulars as required with the Registrar of Companies..... on..... The company has also filed return of deposit with the Registrar of Companies/Reserve Bank of India/other authorities.**

Prescribed Check List

Deposits from Small Depositors

Where the company has accepted deposits from small depositors as defined under section 58AA and has made any default in repayment of any such deposits or part thereof or interest thereupon.

Check whether:

(i) the company has sent an intimation of default, if any, in repayment of deposit or part thereof or interest thereupon to the Company Law Board *within 60 days from the date of default on monthly basis;

(ii) the intimation includes the particulars in respect of names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon;

(iii) the company has complied with the order of the Company Law Board*, if any;

(iv) the company has paid a penal rate of interest of twenty per cent. for the overdue period in case of public deposits matured and claimed but remaining unpaid;

(v) the company has not accepted further deposits from small depositors unless each small depositor, whose deposit has matured has been paid the amount of deposit and the interest accrued thereupon. This condition shall not apply if deposit is renewed by the small depositor voluntarily or repayment thereof has become impracticable or been stayed by a competent court or authority;

(vi) the company has stated in every advertisement and application form inviting deposits from the public issued after the default, the total number of small depositors and amount due to them in respect of which such default had been made;

(vii) the company has mentioned in the advertisement and application form inviting deposits issued by it after the default the fact of waiver of interest accrued on deposits of the small depositors; if any;

Power transferred to the National Company Law Tribunal from the commencement of the Companies (Second Amendment) Act, 2002 (11 of 2003).

(viii) the company has after default taken a loan for the purpose of working capital from any bank, whether the company has first utilised the funds so obtained in repayment of any deposit or any part thereof or any interest thereupon to the small depositors before applying such funds for any other purpose;

(ix) the application form, issued by the company to small depositors for accepting deposits from them, contained a statement that the applicant had been apprised of—

— every past default

— the waiver of interest and reasons therefor.

[1][***S. 58-AAA. Default in acceptance of refund of deposits to be cognizable.***—*Notwithstanding anything contained in sections 621 and 624, every offence connected with or arising out of acceptance of deposits under section 58A or section 58AA shall be cognizable offence under the Code of Criminal Procedure, 1973 (2 of 1974)*

(2) No court shall take cognizance of any offence under sub-section (1) except on a complaint made by the Central Government or any officer authorised by it in this behalf.]

NOTES

Companies (Amendment) Act, 2000

This section has been inserted by the Companies (Amendment) Act, 2000 to provide that the offences under Sections 58A and 58AA connected with or arising out of acceptance of deposits shall be cognizable offence under Criminal Procedure Code, 1973. As per Section 2(*d*) of Cr. P.C., 1973, "cognizable offence" means an offence for which a police officer may, in accordance with the First Schedule, or under any other law for the time being in force, arrest without warrant.

Recommendations of Parliamentary Standing Committe*

Government's views.—Suggestion to modify Sec. 58AAA and make offence cognizable in respect of only Whole Time/Managing Director is not acceptable. Disclosing of defaults in advertisement and application form inviting deposits shall be required for all times, as it is in investors interest to know the fact of the default in printed words and not by word of mouth.

Committee's Recommendation.—Discussion took place in the Committee with regard to the aspect of cognizable offences as prescribed in the clause. The Secretary, Department of Company Affairs *inter alia* informed the Committee that the provision of this clause is based on the 143rd Report of the Law Commission, the Working Group Report and the views of the depositors. He further clarified that these provisions are meant to safeguard the interest of the small depositors and also to induce fear in the minds of some part-time directors who do not take interest in the affairs of the company. Through this clause the collective responsibility concept has been sought to be incorporated [*Para 16.22*]. During the course of discussion it was *inter alia* suggested that, since the power may be misused, a provision should be made that prosecution would be launched with the prior permission of the competent authority. This suggestion was agreed to by the Secretary, Department of Company Affairs. [*Para 16.23*]. The Committee, accordingly, recommends that explicit provision may be made in the rules/guidelines that prosecution in the case of cognisable offences would be taken up only after prior sanction of the competent authority. [*Para 16.24*].

The section as enacted gives effect to the above recommendations.

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1. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 19 (w.e.f. 13-12-2000).

* 64th Report on Companies (Second Amendment) Bill, 1999.

Cognizance of offence by court [sub-section (2)]

The court may take cognizance of the offence under section 58A or 58AA only on a complaint made by the Central Government or any officer authorised by it and not on a complaint made by a shareholder or Registrar.

Regional Director authorised to make complaint [sub-sec. (2)]

The Regional Director of the Department of Company Affairs shall be the authorised officer to make complaints under sub-section (2) of section 58AAA of the Act. [*Rule 11A*].

Offence not compoundable

The penal provisions contained in Sections 58A(6)/(10) and 58AA (9) provide for compulsory imprisonment and fine and the accused persons may be arrested by a police officer without warrant being issued by the Court. These offences are also not compoundable under section 621A.

[1][**S. 58-B. Provisions relating to prospectus to apply to advertisement.**—The provisions of this Act relating to a prospectus shall, so far as may be, apply to an advertisement referred to in section 58-A.]

NOTES

See Notes under section 58A.

S. 59. Penalty and interpretation.—(1) If any prospectus is issued in contravention of section 57 or 58, the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to [2][*fifty thousand rupees*].

(2) In sections 57 and 58, the expression "expert" includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him.

NOTES

Eng. Act, 1948 : Sec. 40(2). Previous Act : Sec. 92 (5).
Eng. Act, 1985 : Secs. 61 and 62.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5000 rupees to 50,000 rupees under sub-section (1).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

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1. Ins. by the Companies (Amendment) Act, XLI of 1974, s. 7 (w.e.f. 1-2-1975).
2. Subs. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 20 (w.e.f. 13-12-2000) for "five thousand rupees".

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Meaning of the term "expert" and his position

The term "expert" probably includes "any one who holds himself out to the public as specially qualified in any line by knowledge or skill". (PALMER COMPANY PRECEDENTS, 16th Edn., page 123).

"It is to be observed that the word used is 'profession' [in sub-section (2)] not 'business' or 'occupation'. The meaning of the word is stated in MURRAY'S ENGLISH DICTIONARY as 'The occupation which one professes to be skilled in and to follow'. In the context the meaning is not clear : However construed it must include surveyors, architects, lawyers, doctors. And it may include others such as a banker, a brewer, and any person whose occupation requires skill". PALMER COMPANY PRECEDENTS, 17th Edn., Part I, page 104.

The expert's consent must be endorsed on or attached to the registered copy of the prospectus. (Section 60(1)). By consenting to the issue of prospectus the expert does not undertake liability in respect of anything in the prospectus except his own statement. (Section 62(1)). As to the expert's right of indemnity, if the prospectus is issued without his consent, see section 62(4).

Penalty for default.—The offence is punishable with fine which may extend to Rs. 50,000.

Compoundable offences.—The offence is compoundable under section 621A.

Power of making complaints with SEBI

By virtue of the amendment made in section 621 by the Amendment Act, 2000, SEBI is statutorily vested with the power to file complaints as discussed earlier. Before the amendments in the section, 12 officers of SEBI have been authorised to make complaint for prosecution for offences under sub-section (1) [*Notification No. GSR 727(E) dt. 18-9-2000*].

S. 60. Registration of prospectus.—(1) No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless, on or before the date of its publication, there has been delivered to the Registrar for registration a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his agent authorised in writing, and having endorsed thereon or attached thereto—

(a) any consent to the issue of the prospectus required by section 58 from any person as an expert; and

(b) in the case of a prospectus issued generally, also—

(i) a copy of every contract required by clause 16 of Schedule II to be specified in the prospectus, or, in the case of a contract not reduced into writing, a memorandum giving full particulars thereof; and

(ii) where the persons making any report required by Part II of that Schedule have made therein, or have, without giving the reasons, indicated therein, any such adjustments as are mentioned in clause 32 of that Schedule, a written statement signed by those persons setting out the adjustments and giving the reasons therefor.

(2) Every prospectus to which sub-section (1) applies shall, on the face of it,—

(a) state that a copy has been delivered for registration as required by this section; and

(b) specify any documents required by this section to be endorsed on or attached to the copy so delivered, or refer to statements included in the prospectus which specify those documents.

[1][(3) The Registrar shall not register a prospectus unless the requirements of sections 55, 56, 57 and 58 and sub-sections (1) and (2) of this section have been complied with and the prospectus is accompanied by the consent in writing of the person, if any, named therein as the auditor, legal adviser, attorney, solicitor, banker or broker of the company or intended company, to act in that capacity.]

(4) No prospectus shall be issued more than ninety days after the date on which a copy thereof is delivered for registration; and if a prospectus is so issued, it shall be deemed to be a prospectus a copy of which has not been delivered under this section to the Registrar.

(5) If a prospectus is issued without a copy thereof being delivered under this section to the Registrar or without the copy so delivered having endorsed thereon or attached thereto the required consent or documents, the company, and every person who is knowingly a party to the issue of the prospectus, shall be punishable with fine which may extend to [2][*fifty thousand rupees*].

NOTES

Eng. Act, 1948 : Sec. 41. Previous Act : Sec. 92(2) to (5)
Eng. Act, 1985 : Secs. 64 and 65.

Companies Act, 1956

Need for registration of prospectus.—The need for recommending the adoption of the provisions of this section or the English Act is thus explained by the Company Law Committee: "This section deals with the registration of prospectus and follows section 41 of the English Act in important respects. We have also made certain additions by providing that where a prospectus names any person as auditor, attorney, solicitor, banker or broker of the company, the written consent of these persons should be filed at the time of registration. We would point out that the mere giving of this consent would not subject such persons to any liability unless any of them is acting as an expert. The need for the above provision arises out of the necessity for circumspection on the part of these persons before they permit their names to be cited in a prospectus. They should remember that the public attaches importance to the presence of well-known and respected names on the face of a prospectus and they should be careful not to allow themselves to be associated with enterprises about whose merits they have not made some serious enquiry. Sub-section (4) prohibits the issue of a prospectus more than 90 days after it had been filed with the Registrar. The English Act contains no such restriction, but we think it is desirable to insert such a provision. If the issue is too long delayed, conditions may alter and what appears in the prospectus when registered may no longer be valid at the end of such a long period". (*Report:* Para 60).

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1. Subs. by Act 65 of 1960, s. 17 for sub-section (3).
2. Subs. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 21 (w.e.f. 13-12-2000) for "five thousand rupees".

Companies (Amendment) Act, 1960

Sub-section (3) was substituted for the reasons explained thus: "Section 55 requires every prospectus to be dated and provides that the date should be presumed to be the date of the publication of the prospectus. Section 60 provides that no prospectus shall be issued unless, on or before the date of its publication, there has been delivered to the Registrar for registration a copy thereof signed by the persons named therein as directors or proposed directors of the company. The filing of the prospectus with the Registrar should precede its publication and the date of its publication is the date it bears. It may not always be possible for companies to file the prospectus with the Registrar on the same date as it bears. In practice, it appears that prospectuses are prepared and printed a few days previous to the date they bear. In other words, a prospectus is given a date posterior to the date when its form and contents are settled by the promoters or directors and the document is printed. This enables the prospectus to be filed with the Registrar before the date of its publication which would be the date it bears. There is nothing objectionable in a prospectus bearing a date posterior to its presentation for registration."

"It appears that in some cases Registrars have refused to register prospectuses on grounds other than those referred to in section 60(3)(*a*) and (*b*). There is no express provision requiring the Registrar to register a prospectus if the requirements of section 60(3)(*a*) and (*b*) are complied with, but that is the effect of section 60(3) by implication. In our opinion, it should not be within the province of the Registrar to refuse registration of a prospectus on the ground that the company is directly or indirectly contravening the policy of the Act or that its business is sought to be carried on in a manner contrary to Law though it will be in order for him to point out the defects in the documents on scrutiny." [*Report :* Para 40, Pages 35, 36].

Hitherto the practice was for the prospectus to specify a time and place where the material contracts referred to therein might be inspected. Any members of the public may, now, have inspection of all the documents at the office of the Registrar.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5000 rupees to 50,000 rupees under sub-section (6).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Object of the section

The object of the section generally is (i) to preserve an authentic record of the terms on which the public have been invited to subscribe and (ii) to secure that the directors accept responsibility for the statements in the prospectus.

As to the period of time during which such inspection can be had, see section 610(1), *proviso*.

It would be sufficient compliance of this section if either the original director or the alternate director signs the prospectus. (*Department's Letter No.* 5(59)-CL-VI/ 65, dated 1-12-1965).

Registration is condition precedent [Sub-section (1)]

The words "No prospectus should be issued unless..." make compliance with the section a condition precedent to the issue of a prospectus. If a prospectus is issued before it has been registered, the issue is illegal and those who make it, may be summarily held liable, *R. v. Tyler,* (1891) 2 QB 588 : (1891-4) All ER Rep 1088 (CA). Moreover, anyone who subscribes on the faith of a prospectus so issued may be held entitled to repudiate his contract, for no company can keep a contract obtained on the faith of an illegal prospectus.

In view of the changes made in section 55A by the Amendment Act of 2000, the prospectus shall be filed with SEBI to ensure compliance of the provisions of this section.

SEBI Requirements for Issue of Prospectus

Section I, Chapter VI of SEBI Guidelines, 2000 deals with requirements for Issue of Prospectus which have to be complied with in addition to the requirements laid down under the Companies Act, 1956. Compliance with SEBI requirements does not absolve the company from its liabilities under sections 63-68 of the Companies Act.

§ For full text of SEBI Guidelines, 2000 refer *Appendix* 162 and also refer Notes under s. 56.

SEBI Guidelnies, 2000—Filing of offer document

§ SEBI Guidelines, 2000 deal with, requirements as to Public Issue. "For the requirements as to 'filing of offer document', refer SEBI Guidelines, 2000 in *Appendix* 162 and also refer to Notes under section 56.

Material contracts [Sub-section (1)(b)]

Under section 60(1)(b)(i), a copy of every contract required by clause 16 of Schedule II has to be disclosed. Under the amended Schedule, with effect from 1-11-1991, the earlier clauses 16(1)(b) is to be found in clause 11(ii) in Part II to Schedule II. While under sub-clause (a) thereof, every contract appointing or fixing remuneration of managing director or manager is required to be disclosed, sub-clause (b) thereof requires disclosure of every other "material contract", not being a contract entered into during the ordinary course of business carried on or intended to be carried on by the company or a contract entered into more than 2 years before the date of prospectus.

The phrase "material contract" appears in clause 11(ii) of Part II of Schedule II to the Act, but is not defined anywhere in the Act. Every contract, the knowledge of which may have an effect upon a reasonable subscriber for shares in persuading him to give or withhold faith in the promoter, director or trustee issuing the prospectus will be a "material contract". See *Broome v. Speak,* (1903) 1 Ch 586, 619, 627 **affirmed** in *Shepheard v. Broome,* (1904) AC 342 : (1904-7) All ER Rep Ext 1526 (HL). Hence, contracts with directors or promoters must be disclosed, irrespective of their value. With regard to other contracts with third parties where directors or promoters are in no way concerned, the question whether such contracts are material contracts, will be determined on the facts of each case. Where the value of the contract is only 5% or less of the capital issue, it may reasonably be considered that such a contract is not a material contract unless it is a contract required to be disclosed under Sch. II, clause 11(ii).

Executed as well as executory contracts, if they are material, have to be disclosed, and if the contract not disclosed was material, it would be no defence that the director was advised that it was not material and he honestly believed the same. *Broome v. Speak, (Supra).* The person concerned may not have been guilty of any moral obliquity, he would still be liable if the requirements of the section have not been complied with. *Watts v. Bucknall,* (1903) 1 Ch 766.

A verbal contract is as much within the rule as a contract in writing. *Capel & Co. v. Sims Ships Composition Co.,* (1888) WN 97. Where a contract has been rescinded by another contract, it would perhaps be necessary to disclose both the contracts. *London and Northern Bank, Re, Haddock's* case, (1902) 2 Ch 73.

The following are examples of contracts which were held to be material:

(1) rescinding a contract with a promoter with a provision that his claim to remuneration would be honourably paid; *Broome v. Speak,* (1903) 1 Ch 586; **affirmed** *Shepheard v. Broome,* (1904) AC 342 : (1904-7) All ER Rep Ext 1526 (HL);

(2) by promoters to transfer to the company certain fully paid shares in another company as consideration for a block of fully paid shares in the company; *McConnell v. Wright,* (1903) 1 Ch 546; *Macleay v. Tait,* (1906) AC 24;

(3) by promoter to buy route permit and subsequently to resell them to the company;

(4) by the above-mentioned promoter to give to another promoter remuneration for assisting in the promotion of the company; *Twycross v. Grant,* (1877) 2 CPD 469;

(5) by company with its promoter for payment of a large sum to him for securing a deposit and other services;

(6) contract with promoters under which a firm was to be commercial agent of the company, to receive 10,000 fully paid shares, and a partner in the firm to be a director; *Cackett v. Keswick,* (1902) 2 Ch 456; *Nash v. Calithorpe,* (1905) 2 Ch 237; *Macleay v. Tait,* (1906) AC 24.

(7) under which the promoter was to receive from the vendors to the company a part of the proceeds of sale; *Greenwood v. Leather Shod Wheel Co.,* (1900) 1 Ch 421 (CA);

(8) between promoters and the future chairman of the company, whereby the firm of which chairman was a member was to receive a block of vendors' shares as commission for underwriting and for the use of the firm's name; *Cackett v. Keswick,* (1902) 2 Ch 456.

It is a question of fact whether a particular contract has been entered into in the ordinary course of business carried on, or intended to be carried on, by the company.

Pre-incorporation contracts of the company (*e.g.*, by the vendors) may, in a proper case, be regarded as contracts entered into in the ordinary course of the business "intended to be carried on by the company".

Revision of prospectus

Any change proposed to be made in the prospectus delivered to the Registrar for registration will require approval of the Board of directors on the authority of all the directors, who have signed the prospectus. In case the prospectus has been registered, no correction can be made and in that event, the company may file revised prospectus after complying with the provisions of section 60, *de novo.*

Inspection of copies of contracts

The copies of contracts required by clauses (10), (11) & (15) of Schedule II to be disclosed should be available for inspection at the registered office of the company until the date of closing of the subscription list. These documents are also available for inspection in the office of the Registrar only during the 14 days beginning with the date of publication of the prospectus. Inspection of these documents thereafter requires permission of the Central Government (Section 610).

Practical hints

It is necessary to submit the draft prospectus to SEBI as per the Guidelines laid down by it well before it is submitted for registration to ROC. Agreements with financial institutions and some-times debenture trust deeds provide that the prospectus should be approved by the institutions or the debentures trustees. Their approval should, therefore, also be obtained to the prospectus in the draft form. The prospectus is required to be signed by *every director* or his attorney. To take care of a situation where some directors may be out of town at the time the prospectus is filed, a power of attorney should be

taken from every director in favour of some senior officer. It must also be ensured that the various documents mentioned in the prospectus are kept handy at the registered office for inspection.

Signature by original or alternate director

Department's Clarification.—The provisions of section 60 should be read with provision of section 313 in respect of alternate directors. Because when the original directors sign, it will be assumed that they are in the State in which the meetings of the board are ordinarily held, in which event the alternate directors will have no *locus standi* to act for the original directors. Thus, it would be sufficient compliance if either the original directors or the alternate directors sign the prospectus depending on the circumstances of each case. (*Letter No.* F. 5(59)-CL-VI/65, dated 1-12-1965).

New Capital Issues—supply of copies of prospectus to RBI

Department's Circular.—The Reserve Bank of India conducts regularly periodical survey of public response to capital Issues. The material for these companies when entering the capital market for new issues and also from the circulars issued by the companies to the shareholders while making rights issues. However, in some cases, copies of prospectuses or of the circular letters are not furnished. I am, therefore, to request that companies filing copies of prospectus with you may be advised to furnish a copy of the prospectus or of circular for right issue, as the case may be, to the Director, Division of Monetary Economics, Economics Department, Reserve Bank of India, P.B. No. 1036. Bombay-1. (*Circular No.* 17/75, dated the 31st July 1975 on *File No.* 5/8/75-CL-VI.)

Alterations, deletions or additions made in prospectus at instance of Registrar

Department's Clarification.—The existing practice as regards filing of prospectus is that the company files the prospectus for registration and simultaneously proceeds to make the announcement in the press and circulate the copies of prospectus. Many a time, it so happens that prospectus delivered for registration is not in conformity with the Law or does not furnish adequate information and, as such, on being called upon to make such corrections, additions, *etc.*, necessary corrections, alterations are made. It is, however, observed that such alterations, deletions or additions are not incorporated in the copies of prospectus which have actually been circulated and published in papers. Thus, it is apparent that the copies of prospectus issued or circulared are not the exact copies of prospectuses registered with the Registrar. (*5th Conference of Regional Directors and Registrars of Companies.*)

Rectification of defects

Department's Clarification.—The question of rectification of the defects in the prospectuses delivered to the Registrars under section 60 was considered at length. The Registrars pointed out that though the Companies concerned made good the deficiencies in the prospectuses filed with them, there was no means of ensuring that the said deficiencies were also made good in the copies of the prospectus as circulated among the public. The main point at issue was whether in such cases, the company concerned should be forced, on threat of prosecution, to publish in the newspapers any or all the alterations pointed out by the Registrar so that the public would get full picture. As, however, the complete prospectus was not, in most cases, published in newspapers and the Press announcements usually contain only certain important excerpts from the prospectus, Secretary stated that no useful purpose would be served by insisting on the publication in the press of all the alterations made at the instance of the Registrar. Where, however, the announcement in the press contained any statement which was patently false, the Registrar should, as soon as it was detected by him before registering the prospectus ask the company, on threat of prosecution, to publish immediately in the newspapers a suitable corrigendum to the earlier announcement. But, where the Registrar on a scrutiny of the prospectus, had reason to believe that there was deliberate suppression of facts, or that patently false, deceptive or misleading statements were included in the prospectus as circulated to the public, he should not hesitate to launch proceedings against the person concerned under section 68 of the Act.

The general view of the Conference was that the best remedy would be to impose a statutory obligation on every company to deliver the prospectus to the Registrar well in advance of its publication and to ensure that no prospectus would be issued to the public except in the form in which it was registered by the Registrar. Till such time as section 60 of the Act was amended in this regard, it was decided that each Registrar should persuade company promoters and managements under his jurisdiction to furnish to him for scrutiny a copy of the draft prospectus proposed to be published, at least a month before the date fixed for its publication, so that any alterations necessary to bring it in full conformity with the provisions of the Act could be pointed out by the Registrar and effected by the company before the final prospectus was delivered to the Registrar in terms of section 60. All the Registrars were advised to issue a suitable Press Note bringing the informal arrangement for scrutiny of the draft prospectus by the Registrars to the notice of all concerned.

The Registrars were also enjoined to exercise greater vigilance in granting certificates for commencement of business after filing Statement in lieu of prospectus and in appropriate cases, to ascertain the full implications of such requests. (*5th Conference of Regional Directors and Registrars of Companies.*)

Penalty for default [Sub-section (6)].—If a prospectus is issued without a copy thereof being delivered under section 60 to the Registrar or without the copy so delivered having endorsed thereon or attached thereto the required consent or documents, the company and every person who is knowingly a party to the issue is punishable with fine which may extend to fifty thousand rupees.

Compoundable offence.—The offence is compoundable under section 621A.

In a prosecution for violation of the prospectus requirements under sections 56 and 60, the persons accused contended that they had issued the shares through the mechanism of private placement and, therefore, there was no question of fulfilling the requirements of a public issue. They wanted the complaint to be rejected for that reason. The court refused to quash the proceedings and said that whether the allotment was by public issue or private placement could be decided at the trial itself. *TPG Nambiar v. ROC,* (1998) 92 Com Cases 564 : (1998) 30 CLA 83 (Kant).

Secretarial Practice Notes : Registration of Prospectus

(a) On or before the date of its publication, whether a copy of the prospectus was delivered to the Registrar and SEBI as per the Guidelines laid down by it, in the following manner?

(b) A copy of the prospectus was signed by every person who is named therein as a director or proposed director or by his duly authorised agent and having endorsed thereon or attached thereto:

(i) consent of expert;

(ii) a copy of every contract required by clause 10/11 of Schedule II/memorandum of particulars thereof when contract was not in writing;

(iii) statement signed by persons making adjustments, if any, as mentioned in clause 20 of Part III of Schedule II, giving reasons therefor;

(iv) consent in writing of auditor, legal adviser, attorney, solicitor, banker, or broker to act in such capacity.

(c) Whether such prospectus:

(i) states that a copy was delivered for registration?

(ii) specifies documents attached thereto?

(d) Whether prospectus was issued within 90 days after the date on which a copy thereof was delivered for registration?

§ See also Practice Notes under section 56.

[1][*S. 60A. Shelf prospectus.—(1) Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a shelf prospectus.*

(2) A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus.

(3) A company filing a shelf prospectus shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within such time as may be

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1. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 22 (w.e.f. 13-12-2000).

prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.*

(4) An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities under that prospectus:

Provided that where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Explanation.—For the purpose of this section,—

(a) "financing" means making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructural financing or, such other company as the Central Government may notify in this behalf;

(b) 'shelf prospectus" means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus].

NOTES

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Notes on clause 51 of the Companies Bill, 1997 (which was not enacted) which contained analogous provisions stated :

"Clause 51 is a new provision which defines 'shelf prospectus'. The shelf prospectus will have a validity period of 365 days subject to updating on material facts, material litigation and changes in financial position between the previous offering and the next one which is presently proposed to be allowed to public financial institution, public sector banks and scheduled banks."

Applicability

This section is applicable to public financial institutions, public sector banks and scheduled banks, whose main object is to make loans to, or subscribe for securities of private industrial enterprises engaged in infrastructural financing or such other company as may be notified by the Central Government.

Shelf Prospectus

Recommendations of Working Group.—"It was observed by the Group that public financial institutions have sometimes accessed the capital market more than once in the course of a 365-day period. As India's infrastructural financing takes off, there may be more such instances. Under the Act, a company must issue a full-fledged prospectus each

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* '3 months' is prescribed *vide* 4CCA of the Companies (Central Government) General Rules & Forms, 1956 *vide* GSR 96(E), dt. 14-2-2001.

time it accesses the capital market. While this is good in principle, it certainly leads to needless repetition—more so when a company takes recourse to capital markets more than once in a given year. A way out is through a "shelf prospectus" for a specified time period. Such a prospectus has a limited life during which it remains on the "shelf", and is up-dated for any changes that have occurred between two successive offerings. The Group recommends that:

The concept of a shelf prospectus should be incorporated in the new Act. It should have a validity of 365-days, subject to updates on material facts, material litigation and changes in financial position between the previous offering and the next one.

In the first instance, this shelf prospectus facility could be limited to public sector banks and financial institutions and those companies specialising in infrastructure finance. If the procedure succeeds and demonstrates that the interest of investors are protected, then the facility may be gradually extended by SEBI to other sections of corporate India." (*Para 3.17 of the Report*).

Section 60A gives effect to the above recommendations."

Shelf prospectus enables PFIs and banks to raise capital from the public more than once without issue of a fresh prospectus every time. This facility is available when the public money is to be mobilised for providing financial assistance by way of loan to or capital participation in private industrial enterprises engaged in infrastructural financing. The facility under shelf prospectus may be extended for providing finance to private sector companies other than those engaged in infrastructural financing, by the Central Government.

Validity of shelf prospectus.—Shelf prospectus is valid for a period of one year from the date of opening of the first issue under it.

Subsequent issues under shelf prospectus and 'Information Memorandum'

For raising further capital by subsequent issues under the shelf prospectus within its validity period of one year, the issuer is required to issue an 'information memorandum' indicating the changes that have occurred during the intervening period within the time prescribed under sub-section (3).

DCA fixes time limit for filing information on securities [Sub-section (3)]

Press Release, dt. 13-2-2001.—The Department of Company Affairs has issued a notification prescribing a time limit of three months for filing information memorandum between the first offer of securities, previous offer of securities and the succeeding offer of securities [*vide* Rule 4CCA]. Accordingly, the Companies (Central Government's) General Rules and Forms (Fourth Amendment) Rules, 2001, has been promulgated. § See Rule 4CCA of the Companies (Central Governments') General Rules & Forms, 1956, in *Appendix* 1 inserted by GSR 96(E), dt. 14-2-2001. [*PIB Press Release, dt. 13-3-2001.*]

Supply of copies to the public

The information memorandum should be supplied to the public along with the shelf prospectus at the time of initial as well as subsequent issues.

Filing with Registrar of Companies

The shelf prospectus together with the information memorandum should be filed with the Registrar of Companies, prior to the making of an issue.

SEBI Guidelines, 2000

Sub-section (3A) of section 67 inserted by the Amendment Act, 2000 empowers SEBI to specify guidelines, in consultation with RBI, in respect of offer or invitation made to the public by a public financial institution specified under section 4A or Non-banking Financial Company referred to in clause (f) of section 45-I of the Reserve Bank of India Act, 1934.

Chapter XII of SEBI Guidelines, 2000 contains 'Guidelines for Issue of Capital by Designated Financial Institutions' which expression includes Public Financial Institutions included in and notified under sec. 4A of the Companies Act, 1956 [*vide* clause 1.2.1 (x) of SEBI Guidelines, 2000]

§ See also Notes under section 56 and section 67.

American Concepts

Preliminary prospectus.—A prospectus for a stock issue that has been filed but not yet approved by the SEC. The SEC requires such a prospectus to contain a notice—printed in distinctive red lettering—that the document is not complete or final. That notice, which is stamped or printed in red ink, typically reads as follows: "The information here given is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission: These securities cannot be sold — and offers to buy cannot be accepted — until the registration statement becomes effective. This prospectus does not constitute an offer to buy. And these securities cannot be sold in any state where the offer, solicitation, or sale would be unlawful before registration or qualification under the securities laws of that state."—Also termed *red-herring prospectus; red herring.* BLACK'S LAW DICTIONARY [7th Ed., 1999] p. 1238.

Shelf registration.—Registration with the SEC of securities to be sold over time, the purpose being to avoid the delays and market uncertainties of individual registration.

"It is generally contemplated that the entire allotment of securities covered by a registered offering will be made available for purchase on the effective date. This is not always the case, however. For example, insiders, promoters or underwriters might receive securities directly from the issuer with an intent to resell at a later date. ....[I]t may be desirable to get a debt offering all ready to go but wait for a propitious moment to release it. These and other delayed offerings have led to what is known as shelf registration. In a shelf registration the registration statement is filed but the securities are put on the shelf until the manner and date of the offering are determined." Thomas Lee Hazen, THE LAW OF SECURITIES REGULATION § 3.8, at 119 (2d ed. 1994). BLACK'S LAW DICTIONARY p. 1288 [7th Ed., 1999].

Shelf issue.—An issue of securities that were previously registered but not released at the time of registration. BLACK'S LAW DICTIONARY p. 836 [7th Ed., 1999].

Relevant Rules

Rule 4CCCA of the companies (Central Government's) General Rules and Form, 1956 is the prescribed rule relevant to this section.

§ For the text of the Rule 4 CCCA, see *Appendix* 1.

[1]*[S. 60B. Information memorandum.—(1) A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.*

(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 not 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.

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1. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 22 (w.e.f. 13-12-2000).

(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 stockinvest 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 the 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 subscription moneys or cancellation of its application, as if the said application had never been made and the applicants are entitled to receive back their original application and interest at the rate of fifteen per cent. from the date of encashment till payment of realisation.

(9) Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised, whether 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 case with the Registrar only.]

NOTES

Companies (Amendment) Act, 2000.

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

"Red-herring Prospectus".—"Information memorandum", "Book Building"

This section inserted by the Amendment Act, 2000 provides for new concepts of 'information memorandum' and 'red-herring prospectus'. Clause 52 of the Working Draft of Companies Bill, 1997 (which was not enacted) contained analogous provisions with the 'marginal note' reading 'Book-building and information memorandum'. Clause 2(1)(9) of that Bill defined 'book-building'. The definition of 'information memorandum in sec.

2(19B) inserted by the Amendment Act, 2000 is substantially on the same lines as that of book-building. Conceptually 'book-building' appears to be synonymous with 'information memorandum'.

"Book Building" and "Information Memorandum".—The Working Group on Companies Act, 1956 recommended:

"Book-building is an international practice which refers to collecting orders from investment bankers and larger investors based on an indicative price range. In capital markets with sufficient width and depth, such a pre-issue exercise often allows the issuer to get a better idea of the demand and the final offer price of an Initial Public Offering (IPO).

The merits and de-merits of book-building – especially in thin or shallow capital markets – requires intensive examination. However, this is not the appropriate forum to evaluate its pros and cons. Irrespective of its merits, there is an issue regarding book-building that needs attention. The invitation and the building up of the book and receiving of advance payments by the book-runner (or book-builder) has connotations that impinge upon his liability *vis-a-vis* the prospectus definition and prohibitions contained in the Act. Thus, the Group recommends that :

An amendment be made to the definition of 'prospectus' in Section 2(36) of the Act which would

(a) exclude the information memorandum that is issued prior to the prospectus at the time of book-building, but

(b) require that, after formal closure of book-building, such a memorandum be submitted with the formal prospectus to the Registrar of Companies. [*Para 3.18 and 3.19 of the report*].

Notes on Clause 52 of the 1997 Bill stated thus:

> "This Section provides for the concepts of 'book building' and 'information memorandum'. This is an international practice and refers to collecting orders from investment bankers and large investors based on an indicative price range. This is essentially a pre-issue exercise which will facilitate the issuers to get a better idea of demand and the final offer price. The directors of the Company, however, will not be permitted to resort to underwriting on book building."

Scope and object of Section

With a view to explore the demand for securities and price at which securities may be offered to the public, a public company may, before issuing prospectus, circulate information memorandum and red-herring prospectus to the public. Red-herring prospectus does not contain particulars of pricing and quantum of securities being offered to the public. Any variation between information memorandum and red-herring prospectus shall be highlighted by the issuer company. The issuer company may negotiate with large investors, investment bankers, brokers and underwriters regarding the demand and offer price of securities of the company.

Filing of Red-Herring Prospectus

Information memorandum can be circulated prior to the filing of prospectus.

The *red-herring* prospectus is to be filed with ROC by unlisted public company, and with SEBI by listed public company, at least 3 days prior to the *opening* of the offer.

The *final* prospectus shall be similarly filed with ROC/SEBI on closure of the offer of securities indicating, *inter alia,* the total capital raised, closing price and other details as were not complete in the red-herring prospectus.

"Book-Building"

SEBI Guidelines, 2000.—Clause 1.2.1 (v) of SEBI (DIP) Guidelines, 2000 defines 'book-building' as follows:

> (v) *"Book Building"* means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the

price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document.

§ For 'Guidelines for Book-building', see Chapter XI of SEBI Guidelines, 2000 at *Appendix.* 162.

Red-herring prospectus

Where a company proposes to issue capital to the public through book building process, the relevant red-herring prospectus shall contain particulars as specified in paragraph 11.3.1 (viii-a) and (viii-b) of Chapter XI of the Guidelines.

Green shoe Option.—In case an issuer company is making an initial public offer of equity shares through the book building mechanism, the company can avail of the Green Shoe Option (GSO) for stabilizing the post listing price of its shares, subject to the provisions of Chapter VIIIA of SEBI Guidelines, 2000. Green Shoe Option means an option of allocating shares in excess of the shares included in the public issue. It is extensively used in international IPOs as stabilization tool for post listing price of the newly issued shares. It is being introduced in the Indian Capital Market in the initial public offerings using book building method. It is expected to boost investors' confidence by arresting the speculative forces which work immediately after the listing and thus results in short-term volatility in post listing price. [*vide SEBI Circular No. 11, dt. 14-8-2003*].

The disclosures to be made in the red-herring are contained in paragraphs 8A.4 to 8A.6 of Chapter VIII-A:

8A.4 The details of the agreements mentioned in clause 8A.2 and 8A.3 shall be disclosed in the draft Red Herring prospectus, Red Herring prospectus and the final prospectus. The agreements shall also be included as material documents for public inspection in terms of clause 6.19.15. ['Contents of Prospectus'].

8A.5 The Lead Book Runner, in consultation with the SA (Stabilizing Agent), shall determine the amount of shares to be overallotted with the public issue, subject to the maximum number specified in clause 8A.3.

8A.6 The draft Red Herring prospectus, the Red Herring prospectus and the final prospectus shall contain the following additional disclosures:

(a) Name of the SA

(b) The maximum number of shares (as also the percentage *vis a vis* the proposed issue size) proposed to be over-allotted by the company

(c) The period, for which the company proposes to avail of the stabilization mechanism,

(d) The maximum increase in the capital of the company and the shareholding pattern post issue, in case the company is required to allot further shares to the extent of over-allotment in the issue.

(e) The maximum amount of funds to be received by the company in case of further allotment and the use of these additional funds, in final document to be filed with RoC

(f) Details of the agreement/ arrangement entered in to by SA with the promoters to borrow shares from the latter which *inter-alia* shall include name of the promoters, their existing shareholding, number & percentage of shares to be lent by them and other important terms and conditions including the rights and obligations of each party.

(g) The final prospectus shall additionally disclose the exact number of shares to be allotted pursuant to the public issue, stating separately therein the number of shares to be borrowed from the promoters and overallotted by the SA, and the percentage of such shares in relation to the total issue size.

§ For full text, see *Appendix* 162.

§ See also Notes under section 60A.

S. 61. Terms of contract mentioned in prospectus or statement in lieu of prospectus, not to be varied.—A company shall not, at any time, vary the terms of a contract referred to in the prospectus or statement in lieu of prospectus, except subject to the approval of, or except on authority given by, the company in general meeting.

NOTES

Eng. Act, 1948 : Sec. 42. Previous Act : Sec. 99.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

SEBI Guidelines, 2000

Monitoring of issue proceeds.—Now there is a clear SEBI Guidelines on monitoring of issue proceeds, the contents of which are as follows:

(a) Actual expenditure incurred on the project (in cases of companies raising capital for a project) upto a date not earlier than 2 months from the date of filing the prospectus with Registrar of Companies.

(b) Means and source of financing including details of "bridge loan" or other financial arrangement, which may be repaid from the proceeds of the issue.

(c) Year-wise break up of the expenditure proposed to be incurred on the said project.

(d) Investment avenues in which the management proposes to deploy issue proceeds pending its utilisation in the proposed project [*Clause 6.6.5*].

Name of monitoring agency, if applicable, to be disclosed. [*Clause 6.6.6.*]

Requirement of Monitoring Agency.—In case of issues exceeding Rs. 500 crores, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by one of the financial institutions [*Clause 8.17.1*]

A copy of the monitoring report as per the format specified at Schedule-XIX to SEBI Guidelines, 2000, shall be filed with the Board by the said monitoring agency, on a half yearly basis, till the completion of project, for the purposes of record [*Clause 8.17.2*].

Alteration in prospectus giving authority of general meeting

The following statement of law appears in a SAT decisions, *M.P. Mehrotra v. SEBI*, (2003) 53 CLA 298 [SAT] : Variation of the terms of a contract referred to in a prospectus for public issue of shares is possible on the authority conferred for this purpose by the general body of shareholders on the Board of directors. As observed by the Supreme Court in *Bishundeo Narain v. Seogeni Rai*, AIR 1951 SC 280, parties pleading fraud, undue influence and coercion "must set forth full particulars and the case can only be decided on the particulars so laid. "There can be no departure from them in evidence. General allegations are insufficient even to amount to an averment of fraud of which any

court ought to take notice, however strong the language in which they are couched may be, and the same applies to undue influence and coercion.

Deployment of Issue Proceeds

For general effect of this section, see *N. Parthasarthy v. CCI,* (1991) 72 Com Cases 651 : AIR 1991 SC 1420. From this judgment two things are distinctly clear: *First,* there is no prohibition against variation of the terms of contracts contained in a prospectus pursuant to sub-section (1)(b) of section 60; *secondly,* the Supreme Court would seem to have regarded the "size" of the issue and its "objects" as stated in the prospectus falling within the mischief of section 61 and, therefore, requiring its compliance for variation thereof.

In *Madan Gopal Jajoo v. Union of India,* AIR 1992 Del 253 : (1996) 85 Com Cases 153, the Delhi High Court held that a change in the scheme of deployment of the issue proceeds as mentioned in the prospectus is a variation in the terms of a contract referred to in the prospectus, pursuant to section 61. But on facts the CCI (*now abolished*) had only revised its consent order so as to change the terms of conversion of debentures into shares and no change was made in the deployment of the proceeds of the issue. There was no need for the court to interfere in the CCI (*now abolished*) order. D P WADHWA J. cited with **approval** a passage from WADE, TREATISE ON THE ADMINISTRATIVE LAW, 709 (6th Edn) showing as to when the court may refuse to intervene even if it finds some act to be unlawful.

Where the letters of offer for allotment of shares stated that the money collected from the issue was to be used for the specified purposes, it was held that the shareholders could by a resolution permit the use of money for different purposes. *Kothari Industrial Corpn. Ltd. v. Maxwell Dyes and Chemicals P. Ltd.,* (1996) 85 Com Cases 79 (Mad). This decision of the single judge was **affirmed** by the Division Bench in *Maxwell Dyes and Chemicals P. Ltd. v. Kothari Industrial Corpn. Ltd.,* (1996) 85 Com Cases 111 (Mad—DB). The change over in the deployment of issue proceeds was permitted by all financial and lead institutions and Governmental authorities. The preferential allotment was at much higher price than the market price and, therefore, beneficial to the company.

Shifting Registered Office to place other than that stated in prospectus

Shifting the registered office of the company to another place from that stated in the prospectus even before allotment, when there were only two shareholders who resolved to do so at an emergent meeting was held by the CLB as coming within the scope of s. 61 in its spirit though not in its letter. The Board accordingly ordered that this fact should be brought to the notice of DCA and SEBI. *Pal-Peugeot Ltd., Re,* (1997) 89 Com Cases 808, 812 : (1997) 3 Comp LJ 334 (CLB—N. Delhi).

Accounting treatment of unutilised proceeds.—Part I of Schedule VI, which prescribes the form of balance-sheet, requires that all unutilised monies out of the issue proceeds must be separately disclosed in the balance-sheet of the company indicating the form in which such un-utilised funds have been invested under the head "Investment" and/or sub-item 7-B "Bank Balances".

§ See also Notes under section 56.

Jurisdiction

Matters relating to the violation of this section do not fall within the jurisdiction of a company court. They can be the subject matter of a regular suit before an ordinary Civil Court. *Poonam Chand Kothari v. Rajasthan Tubes Mfg. Co. Ltd.,* (1996) 87 Com Cases 842 (Raj).

Secretarial Practice Notes

Whether terms of contract mentioned in prospectus varied? If so, check whether:

(i) it was authorised by the company in general meeting? or

(ii) it was varied subject to approval of company and whether approval of general meeting obtained subsequently?

S. 62. Civil liability for misstatements in prospectus.—(1) Subject to the provisions of this section, where a prospectus invites persons to subscribe for shares in or debentures of a company, the following persons shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue statement included therein, that is to say,—

(a) every person who is a director of the company at the time of the issue of the prospectus;

(b) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time;

(c) every person who is a promoter of the company; and

(d) every person who has authorised the issue of the prospectus:

Provided that where, under section 58, the consent of a person is required to the issue of a prospectus and he has given that consent, or where, under [1][* * * *] sub-section (3) of section 60, the consent of a person named in a prospectus is required and he has given that consent, he shall not, by reason of having given such consent, be liable under this sub-section as a person who has authorised the issue of the prospectus except in respect of an untrue statement, if any, purporting to be made by him as an expert.

(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;

(b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent;

(c) that, after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and of the reason therefor; or

(d) that—

(i) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe, that the statement was true; and

(ii) as regards every untrue statement purporting to be a statement 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

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1. The words, brackets and letter "clause (b) of" omitted by Act 65 of 1960, s. 18.

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 that person had given the consent required by section 58 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder; and

(iii) as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or a correct copy of, or a correct and fair extract from, the document:

Provided that this sub-section shall not apply in the case of a person liable, by reason of his having given a consent required of him by section 58, as a person who has authorised the issue of the prospectus in respect of an untrue statement, purporting to be made by him as an expert.

(3) A person who, apart from this sub-section, would, under sub-section (1), be liable by reason of his having given a consent required of him by section 58 as a person who has authorised the issue of a prospectus in respect of an untrue statement purporting to be made by him as an expert, shall not be so liable, if he proves—

(a) that, having given his consent under section 58 to the issue of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration;

(b) that, after delivery of a copy of the prospectus for registration and before allotment thereunder, he, on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reason therefor; or

(c) that he was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, believe, that the statement was true.

(4) where,—

(a) the prospectus specifies the name of a person as a director of the company, or as having agreed to become a director thereof, and he has not consented to become a director, or has withdrawn his consent before the issue of the prospectus, and has not authorised or consented to the issue thereof; or

(b) the consent of a person is required under section 58 to the issue of the prospectus and he either has not given that consent or has withdrawn it before the issue of the prospectus;

the directors of the company excluding those without whose knowledge or consent the prospectus was issued, and every other person who authorised the issue thereof, shall be liable to indemnify the person referred to in clause (a) or clause (b), as the case may be, against all damages, costs and expenses to which he may be made liable by reason of his name having been inserted in the prospectus or of

the inclusion therein of a statement purporting to be made by him as an expert, as the case may be, or in defending himself against any suit or legal proceeding brought against him in respect thereof:

Provided that a person shall not be deemed for the purposes of this sub-section to have authorised the issue of a prospectus by reason only of his having given the consent required by section 58 to the inclusion therein of a statement purporting to be made by him as an expert.

(5) Every person who, becomes liable to make any payment by virtue of this section, may recover contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment, unless the former person was, and the latter person was not, guilty of fraudulent misrepresentation.

(6) For the purposes of this section—

(a) the expression "promoter" means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company; and

(b) the expression "expert" has the same meaning as in section 58.

NOTES

Eng. Act, 1948 : Sec. 43. Previous Act : Sec. 100.
Eng. Act, 1985 : Secs. 67, 68 and 69.

Companies Act, 1956

Recommendation of Company Law Committee.—The amendments made in this section are explained by the Company Law Committee, thus: "This follows English section 43 and seeks to amend section 100 of our Act. Two principal amendments may be noted. Under sub-clause (ii) of clause (d) to sub-section (2), the onus of proving that there was reasonable ground to believe that the expert was competent to make the statement contained in the prospectus has now been shifted from the plaintiff to the defendant. This gives effect to an important recommendation made in paragraph 43 of the *Cohen report*. The other amendment is contained in sub-section (3) which regulates the expert's liability. Under this sub-section, the expert is liable as a person authorising the issue of a prospectus, unless he can establish his *bona fides* under any of the pleas available to him under the sub-section". (*Report :* Para 61).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Who are promoters

The expression 'promoter' has not been defined in the Act. The definition in sub-section (6) of this section is restricted to and is meant for the purposes of prospectus only.

The term is not one of law but familiar to the business world. It points to a person who forms a company and gets it going. It indicates 'a person who originates the scheme for the formation of the company, has the Memorandum and Articles prepared, executed and registered, and finds the first directors, settles the term of the preliminary contracts and prospectus (if any) and makes arrangement for advertising and circulating the prospectus and placing the capital, is emphatically a promoter in the fullest sense'. He controls the formation and future of the company, and it is this control which lies at the root of the fiduciary relation of the promoter to the company. Nor is he the less a promoter if all or most of these activities are performed nominally by a company which he controls.

"But a person who has done much less than this—takes a much less prominent part—may bring himself within the meaning of the term and may be held liable as a promoter". (PALMER, COMPANY PRECEDENTS, 17th Edn., page 24); quoted with approval in *Official Liquidator v. Velu Mudaliar,* (1938) 8 Com Cases 7, 10 : AIR 1938 Mad 192. See also *Official Receiver and Liquidator, Jubilee Cotton Mills Ltd. v. Lewis,* (1924) AC 958 (HL).

BOWEN LJ observed that the word "promoter" is not a term of law but of business, usefully summing up in a single word a number of business operations, familiar to the commercial world by which a company is generally brought into existence. *Whaley Bridge Printing Co. v. Green,* (1880) 5 QBD 109. Also see *Vali Pattabhi Rama Rao v. Sri Ramanuja Ginning and Rice Factory Pvt. Ltd.*, (1986) 60 Com Cases 568 (AP).

In U.S.A., the S.E.C. (Security Exchange Commission) Rule 405(a) defines a 'promoter' 'as a person who, acting alone or in conjunction with other persons, directly or indirectly takes the initiative in founding or organizing a business enterprise'.

'Promoting' involves the idea of some exertion for the purpose of getting up and starting, or, as it is commonly called "floating" a company, and it also involves the idea of some duty towards the company arising out of the position which the person engaged in promoting it assumes towards it.

In this country the promoter or promoters or the principal of them are usually persons who, in forming the company, secure for themselves the management of the company in forming, or persons who convert their own private business into a limited company, public or private, and secure for themselves more or less a sinecure position and/or controlling interest in the company's management.

Promoter is the person who either by himslef or alongwith others does all or some of the following matters associated with promotion:

(i) planning the scheme for formation of a company;
(ii) preparation and registration of documents;
(iii) negotiation of preliminary contracts;
(iv) dealing with drafting, printing, registration and circulation of any prospectus.

Emma Silver Mining Co. v. Grant, (1879) 11 Ch D 918; *In re Olympiad Ltd.*, [1898] 2 Ch 153 (CA); *In re Leeds & Hanley Theatres of Varieties Ltd.*, (1902) 2 Ch 809.

A person who does not take a prominent part may also have so acted in the formation of a company so as to bring himself under the term 'promoter'. See *Official Liquidator v. Velu Mudaliar,* (1938) 8 Com Cases 7 : AIR 1938 Mad 192. A company can be held liable as a promoter *Re, Leeds and Hanley Theatre of Varieties Ltd.,* (1902) 2 Ch 809. A

promoter, even though he may only act as an agent or trustee, is personally liable where the contract is made on behalf of an intended company. *Newborne v. Sensolid (Great Britain) Ltd.*, (1953) 1 All ER 708 : (1954) 24 Com Cases 159; *Phonogram Ltd. v. Lane*, (1981) 3 All ER 182 (CA). The question whether a person is or is not a promoter is a question of fact, depending upon what he really did in connection with the formation of the company. *Lydney and Wigpool Iron Ore Co. v. Bird*, (1886) 33 Ch D 85. A person who, as principal, does anything in procuring the incorporation of a company cannot escape liability by acting through an agent. *Phosphate Sewage Co. v. Hartmont*, (1877) 5 Ch D 394; *Official Receiver and Liquidator Jubilee Cotton Mills Ltd. v. Lewis*, (1924) AC 958 (HL).

A person cannot become a promoter merely because he signed the memorandum as a subscriber for one or more shares. *Official Liquidator v. Velu Mudaliar* case, (*Supra*). A person may be a promoter though he has taken a comparatively minor part in the promotion proceedings. *Jubilee Cotton Mills, (Supra)* case. Anyone who assists in the promotion, *e.g.* by obtaining a director, or agreeing to place shares, or negotiating an agreement, or merely by putting a vendor in touch with persons who may form a company to exploit or purchase his goods, may find himself to be a promoter of any company which is consequently formed.

But persons who act in a professional capacity such as counsel, solicitors, accountants, engineers or other technicians, will not become promoters by reason of so acting, unless they exceed their professional function and do anything or take any interest in promoting the company. In *Great Wheal Poolgooth Co. Ltd., Re*, (1883) 53 LJ Ch 42, it was held that a person who merely acts in a professional capacity on behalf of a promoter, such as a solicitor who draws up an agreement or articles of association or an accountant or valuer who prepares figures or a valuation on behalf of a promoter, and who is paid by the person for whom he acts whether or not a company comes into being as a result, will not find himself to be a promoter. If, however, he goes further than this as by putting his client in touch with a person who may be interested in taking shares in the new company, he is liable to find himself regarded as a promoter. It has been held in *A Pleader, Re*, (1943) 13 Com Cases 189, 191 (Mad) that an advocate should not act as a promoter of a trading company. For comments on promoters' contracts and pre-incorporation contracts, see notes under section 46.

SEBI Guidelines as to definition of Promoters and Promoters' Group

SEBI Guidelines 2000.—The terms "promoter" and "promoter group" have been defined in Chapter VI of SEBI Guidelines, 2000 [*Explanations I to III to clause 6.4.2(k)*].

Meaning of 'promoter'

The term 'promoter' shall include—

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the person or persons named in the prospectus as promoter(s) :

But, a director/officer of the issuer company or person, acting as such merely in his professional capacity shall not be included in the Explanation [*Explanation I to clause (k)*].

Meaning of Promoter group

'Promoter Group' shall include—

(a) the promoter;

(b) an immediate relative of the promoter (i.e. any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

(c) in case promoter is a company—

(i) a subsidiary or holding company of that company;

(ii) any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter;

(iii) any company in which a group of individuals or companies or combinations thereof who holds 20% or more of the equity capital in that company also holds 20% or more of the equity capital of the issuer company; and

(d) in case the promoter is an individual,—

(i) any company in which 10% or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the 'promoter' or any one or more of his immediate relative is a member;

(ii) any company in which a company specified in (i) above holds 10% or more of the share capital;

(iii) any HUF or firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than 10% of the total share capital, and

(e) all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus "shareholding of the promoter group" [*Explanation II to Clause (k)*].

The Financial Institution, Scheduled Banks, Foreign Institutional Investors (FIIs) and Mutual Funds shall not be deemed to be a promoter or promoter group merely by virtue of the fact that 10% or more of the equity of the issuer company is held by such institution.

Provided that the Financial Institutions, Scheduled banks, Foreign Institutional Investors, shall be treated as promoters or promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them. [*Explanation III to clause (k)*]

Meaning of "Promoter" under SEBI (Substantial Acquisition of Shares & Take-overs) Regulations, 1997

§ See clause (h) of Reg. 2(1) of the above Regulations for the definition of "promoter". For text refer *Appendix* 177.

Position of promoters

In *Weavers Mills Ltd. v. Balkis Ammal,* AIR 1969 Mad 462, Madras High Court held as follows: "As to the exact legal status of promoters, the statutory provisions, both in England and in this country, are silent in most part except for a couple of sections in the Specific Relief Act, both old and new one. It appears that a promoter is neither an agent nor a trustee of the company under incorporation but certain fiduciary duties have been imposed on him both under the English Companies Act, 1948 (now 1985) and the Indian Companies Act, 1956. He is not an agent because there is no principal and he is not a trustee as there is no *cestui-que-trust.* It is on this ground that the doctrine of ratification by the company was regarded as inapplicable to the actual promoter *vis-a-vis* the company under incorporation." See also *Omnium Electric Palaces Ltd. v. Baines,* (1914) 1 Ch 332 (CA).

When promotion begins and ends

It is a question of fact in each case at what time a person begins or ceases to be a promoter. See *Glukstein* case, (1900) AC 240 (HL).

The relationship between the promoter and the company that he has floated must be deemed to be a fiduciary relationship from the day the work of floating the company started *CIT v. Bijli Cotton Mills Ltd.,* (1953) 23 Com Cases 114, 120 : AIR 1953 All 232 and continued upto the time that the directors take into their hands what remains to be done in the way of forming the company, *Twycross v. Grant,* (1877) 2 CPD 469, 541 (CA) and when there is no question open between the promoter and the company. *Eden v. Rids Dales Rly. Lamp & Lighting Co. Ltd.,* (1889) 23 QBD 368 (CA).

The date upon which a person becomes a promoter can be a matter of great importance to him and to the company, because once the relationship has arisen the promoter is in a fiduciary relationship towards the company, and once the company has come into existence it will be able to take the necessary measures to secure its position *vis-a-vis* the promoter.

The status of a promoter is generally terminated when the Board of directors has been formed and they start governing the company.

Ratification of promoters' contracts

The view taken in *Kelner v. Baxter,* (1866) LR 2 CP 174 was that the company could not ratify contract made by a promoter before its incorporation. The Specific Relief Act, 1963, however, provides that specific performance of a contract may be enforced against a company in respect of contracts entered into by promoters on behalf of the company, if such a contract is warranted by the terms of incorporation and the company has accepted the contract and communicated the acceptance to the other party.

As long as the company does not ratify, as required by the Specific Relief Act 1963, the position remains the same as under the common law. A promoter is personally liable to third parties upon all contracts made on behalf of the intended company, until with their consent, the company takes over this liability. The mere fact that it has been constituted and registered does not discharge the promoter. *D.R. Patel v. A.S. Dimllow,* AIR 1961 MP 4 at 5.

If the company accepts what the promoters have done on its behalf, it has a right to claim from the promoters the entire income of the property since its purchase or the entire income for the period during which the business was carried on for the benefit of the company. *CIT v. Bijli Cotton Mills Ltd., (supra).*

Some hints for promoters

(1) See that the memorandum and articles do not contain anything tricky or unfair to the company or subscribers; [*Omnium Electric Palaces v. Baines,* (1914) 1 Ch 332 (CA)];

(2) Before taking steps to promote the company, take particular care to see that contracts with vendors are already completed and not merely left at the negotiation stage;

(3) Let the Board of directors consist of persons who will win the confidence of those who would go in for shares in the company;

(4) Take particular care to see that the prospectus or statement in lieu of prospectus is thoroughly honest and accurate on facts;

(5) Be careful to comply with the provisions of section 69 and/or 70 as the case may require.

A promoter may be made liable in a suit by an aggrieved shareholder or debentureholder for damages for deceit besides being liable for compensation as provided in the section.

Duty to disclose personal profits

Promoters who purchase property and then create a company to purchase that property, stand in a fiduciary position towards the company. They must make a faithful disclosure to the company of all relevant facts which might affect the willingness of the company to purchase the property, including any profits made. *Erlanger v. New Sombrero Phosphate Co.,* (1878) 3 App Cas 1218 (HL). In the following cases the promoters were compelled to account for and pay back secret profits. *Emma Silver Mining Co. v. Grant,* (1879) 11 Ch D 918; *Mann v. Edinburgh Northern Tram Ways Co.,* (1893) AC 69 (HL).

Where the company is of such a nature that it does not have an independent Board of directors, as for example, in a small company, a disclosure must be made to the whole body of shareholders and not to do so would be again a breach of duty and the company will be entitled to recover the promoters' profits. *Gluckstein v. Barnes,* (1900) AC 240 (HL). The Act now provides that promoters' profits must be disclosed in the prospectus itself. See also *Darby Re, ex p Bougham* (1911) 1 KB 95, where also the promoter who was the real beneficiary of the sale made in the name of the company was held liable to account for his secret profit when the company floated by him failed.

Rescission and other remedies against promoters

Where a promoter makes some profits in connection with a transaction to which the company is a party and does not make a full disclosure of his profits, the company has the right to affirm the contract and to claim that the promoter should handover his profits to the company, *Gluckstein v. Barnes,* (1900) AC 240 (HL). The estate of a deceased promoter who has made illegitimate profits by promoting a company remains liable in an action by the company for deceit or breach of trust if the estate has benefited by the fraud or breach of trust. *Zamskill v. Edwards,* (1886) 31 Ch D 100; *Phillips v. Homfray,* (1883) 24 Ch D 439; *Bagnall v. Carlton,* (1877) 6 Ch D 371 (CA); *New Sombrero Phosphate Co., Erlanger,* (1877) 5 Ch D 73; *Concha v. Murrietta,* (1889) 40 Ch D 543, 553 (CA).

The company's claim is also provable in the promoter's insolvency, *Darby, ex p. Brougham* (1911) 1 KB 95. The company may choose to rescind the contract and to recover the price paid by it for purchasing the promoter's property.

Where a person acquires property or rights on his own account before he becomes a promoter, he is at liberty to resell at a profit to the company he promotes provided due disclosure is made. Otherwise, the company may rescind the contract or compel him to pay damages for his breach of duty. *Burland v. Earle,* (1902) AC 83 (PC); *Tyrrell v. The Bank of London,* (1862) 10 HLC 26; *Ladywell Mining Co. v. Brookes,* (1887) 35 Ch D 400 (CA). Once the promoter has commenced the promotion, he must give to the company the benefit of any subsequent contract for the acquisition of property which the company when formed buys.

A promoter must use his position and powers fairly and reasonably and in the interest of the company and must abstain from exercising undue influence and fraud. *Erlanger v. New Sombrero Phosphate Co.,* (1873) 3 App Cas 1218 (HL), *Gluckstein v. Barnes,* (1900) AC 240 (HL).

The company may affirm the contract instead of avoiding it. Sometimes rescission may not even be available as a possible remedy. In both these situations the company may sue the promoter for damages for breach of duty or, as the case may be, for fraud or misrepresentation. [Indian Contract Act Sections 19 and 75]. The amount of compensation would depend upon the nature and extent of loss suffered by the company. *Cavendish Bentinck v. Fenn,* (1887) 12 App Cas 652 at 658, 662 664 (HL); *Re Leeds and Hanley Theatres of Varieties Ltd.* (1902) 2 Ch 809 at 826, 830 (CA); see also *Jacobus Marler Estates Ltd. v. Marler,* (1913) 85 LJPC 167n.

A person who spends time and money in bringing a company into existence may not be able to recover anything from the company by way of his professional charges or remuneration, the company being not bound by any pre-incorporation arrangements. A provision in the company's memorandum or articles to pay the promoter would also not help because the promoter cannot enforce it in his capacity as promoter. *Rotherman Alum and Chemical Co.,* (1883) 25 Ch D 103; *English and Colonial Produce Co. Ltd.,* (1906) 2 Ch 435 (CA) **overruling** *Hereford and Southwales Waggon and Eng. Co.,* (1876) 2 Ch D 621 (CA). Even so a provision of this kind is useful because the company may of its own accord implement it. Generally promoters constitute the company's first board of directors.

Whether promoters are entitled to remuneration and an indemnity on equitable grounds, apart from contract, is extremely doubtful. The best provision they can usually make is to include a power in the company's article for the directors to pay them the value of their promotion services and to reimburse them for the expenses incurred by them in connection with the promotion (See CA, 1956 Schedule I Table A Art. 67). This imposes no legal obligations on the company towards the promoters, but as they or their nominees will usually be the first directors of the company, there is little risk of the power not being exercised in their favour. If the company contracts to pay promoter's remuneration or to indemnify them against expenses in connection with services they render before the company's incorporation or before the contract is entered into, the contract is enforceable only if made under the company's common seal or as a deed, because

the services and expenditure are then past consideration for the company's promise, and are therefore insufficient to support a simple contract. PENNINGTON'S COMPANY LAW, 530 (6th Edn., 1990). Where a promoter procures a company to be formed by fraudulent means and by fraud induces shareholders to join it, he cannnot recover expenses which he otherwise would have recovered. *Hereford* case *(supra).* It is a question of fact that whether there is a fresh contract between the company and the promoters after incorporation. *English and Colonial Produce Co. Ltd., Re, (supra).*

Liability of promoter under this section for misstatements in prospectus

Besides the statutory civil liability contained in this section and the criminal liability provided by section 63, there is a liability imposed by section 56 and there is also a liability under the general law enforceable by suit for recovery of damages on the ground of fraud, *etc.* [*Cf.* sub-section (6) of section 56].

The liability under this section is enforced by sub-section (1)(e) by specifically enumerating the promoter among the category of persons who are made liable under this section. Thus, his liability is uniform with all others in all respects.

Promoters may, if the prospectus omits to give the information or makes any untrue statement, be held liable to compensate subscribers and purchasers of shares *etc.*, for any damage sustained by them.

Persons liable and remedies for untrue statements or omissions in prospectus

The position is thus summarised in PALMER'S COMPANY GUIDE (pages 29-30).

"The following are some of the remedies available to the subscriber who is deceived—

(1) He may in some cases repudiate the contract and require repayment of his money with interest, and in default may take proceedings against the company to enforce rescission of contract and repayment. See *Oakes v. Turquand and Harding : Peek v. The Same,* (1867) LR 2 HL 325; *Houldsworth v. City of Glasgow Bank,* (1880) 5 App Cas 317 (HL).

(2) He may, in respect of any untrue statement in the prospectus, bring an action against the directors and promoters for the recovery of compensation under section 43 (corresponding to section 62 of the Indian Act).

(3) He may, when the prospectus fails to disclose the matters required to be disclosed, bring an action for damages against the directors and other persons responsible.

(4) He may, in respect of any untrue statement made fraudulently, bring an action of deceit against those who are responsible for the prospectus."

In addition to directors and promoters the liability under the section also attaches to persons who have authorised the issue of the prospectus. The words cannot reasonably be held to apply to such persons as bankers, brokers, accountants, solicitors and engineers who merely consent to their names appearing as such in the prospectus. The word 'issue' means that the initial putting forth of the prospectus and not its subsequent distribution. Therefore, clerks, servants, who distribute the prospectus do not fall within sub-section (1)(d).

Representation as to future events.—A mere representation that something will be done or will happen in future is not a representation of fact. It may be only a promise or a forecast. Thus, there must be a misstatement as to an existing fact. A calculation of future profits is not a statement of fact. *Bentley v. Black,* (1893) 9 TLR 580 (CA). But a misstatement as to purposes for which the money to be raised by the prospectus is to be applied is a misrepresentation of a present fact. *Edgington v. Fitzmaurice,* (1885) 29 Ch D 459 : (1881-5) All ER Rep 59 (CA). Representations as to future earnings do not avoid the contract. *Pioneer Tractors Co. Ltd. v. Peebles,* (1914) DLR 477 (Canada).

Names of directors.—A misstatement of the names of the directors in the prospectus is an important misrepresentation. *In Re, Metropolitan Coal Consumer's Association Ltd., Karberg's* case, (1892) 3 Ch 1 (CA).

Representation true only at time of issue.—Sometimes representations which were true when the prospectus was issued become false before the allotment is made. In such cases, the fact ought to be communicated to the appplicant otherwise the applicant will be able to rescind the contract. A director who knows that a statement has become false is under a duty to disclose the truth and if he abstains, he may be guilty of fraud. *Brownlie v. Campbell,* (1880) 5 App Cas 925; *Rajagopala Iyer v. The South Indian Rubber Works,* AIR 1942 Mad 656 : (1942) 12 Com Cases 203; *Venkataramaiya v. Indian Industrial Bank,* AIR 1930 Mad 325.

Some instances of misleading statements.—In *R. v. Kylsant,* (1932) 1 KB 442; it was held in a prosecution for misrepresentation in prospectus that a prospectus in which all statements were literally true but which failed to disclose that the dividend stated in it as paid was not paid out of trading profits but was, in fact, paid out of realised capital profits was false in a material particular. The following statements which were untrue, have, in their respective contexts, been held to be material statements of fact:

(1) that more than one-half of the first issue of shares had already been subscribed for, *Ross v. Estates Investment Co.,* (1868) LR 3 Ch 682; *Kent v. Freehold Land Co.,* (1868) LR 3 Ch 493; *Henderson v. Lacon,* (1867) LR 5 Eq 249; *Shiromani Sugar Mills Ltd. v. Debi Prasad,* AIR 1950 All 508 : (1950) 20 Com Cases 296 (All) promoters, their friends and directors promised to subscribe for shares upto a certain amount, but subscribed for much less,

(2) that the surplus assets as shown in the last balance sheet were more than £10,000 in value; *Re, London and Staffordshire Fire Insurance Co.,* (1883) 24 Ch D 149,

(3) representation as to the working capacity of a mine and the scale of operation, *Reese River, etc., Co. v. Smith,* (1869) LR 4 HL 64, or that it was as good as the adjacent mine, which was not true, *Mount Morgan, etc., Ltd., Re,* (1887) 56 LT 622,

(4) statement that orders have already been received, whereas some specimen were only sent for trial, *Greenwood v. Leather Shod Wheel Co.,* (1900) 1 Ch 421,

(5) statement that the person from whom the company bought the property would pay all the preliminary expenses, *Re, Liberian Government Concessions, etc., Co.,* (1892) 9 TLR 136,

(6) that the company was the sole manufacturer of asbestos and had a practical monopoly, *Hyde v. New Asbestos Co.,* (1891) 8 TLR 121,

(7) that the company's process was a commercial success, *Stirling v. Passburg Grains, etc., Ltd.,* (1891) 8 TLR 71,

(8) statement that nothing would be paid to promoters, *Lodwick v. Earl of Perth,* (1884) 1 TLR 76,

(9) statement that the company would be entitled to use a certain part of the water arranged by the vendors of property to the company, *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate,* (1899) 2 Ch 392, 397, 429.

A statement in a prospectus as to the persons who are to be directors is a material statement, and, if it is untrue, a person subscribing on the faith of it is *prima facie* entitled to rescind. *Re, Scottish Petroleum Co.,* (1883) 23 Ch D 413 : (1881-5) All ER Rep Ext 1536 (CA); *Anderson's* case, (1881) 17 Ch D 373; *Smith v. Chadwick,* (1882) 20 Ch D 27 : (1881-5) All ER Rep 242 (Ch D); *Exp. Whinwright,* (1890) 62 LT 30; *Re, Kent County Gas, etc., Co.,* (1906) 95 LT (CA) 756; *Metropolitan Coal Consumers' Assn., Re, Karberg's* case, (1892) 3 Ch 1; *Raja Gopala Iyer v. South Indian Rubber Works,* AIR 1942 Mad 656. A shareholder who knew that directors named in the prospectus had withdrawn

or would have known it with ordinary diligence would not be allowed to avoid the allotment, *Mohan Lal v. Sri Gangaji Cotton Mills Co.,* (1900) 4 Cal WN 369; *Chambers v. Edinburgh and Glasgow Aerated Bread Co.,* (1881) 18 R 1039.

The statement in a prospectus that share capital has been "subscribed" does not necessarily mean that it has been "subscribed in cash"; it is sufficient if shares have been allotted for a valuable consideration, *i.e.* a consideration which is money's worth. Such a statement is not a misrepresentation *Akerhielm v. De Mare,* (1959) 3 All ER 485 (PC). **Disapproving** *Arnison v. Smith,* (1889) 41 Ch D 348 and, *impliciter, Governments Stock and Other Securities Investment Co. Ltd. v. Christopher,* (1956) 1 All ER 490; *Hallows v. Fernie,* (1868) 3 Ch App 467, where the statement that the company would commence business with a certain number of ships was held to be not a misrepresentation. It would be a misrepresentation to state that the company has contracted for the purchase of a property when, in fact, there has been only negotiation, *Ross v. Estates Investment Co.,* (1868) LR 3 Ch 682.

"Normally the applicant has no relief when the misrepresentation is an innocent omission of information which should have been given in the prospectus and concerned merely unimportant matters. Grandiloquent statements which are substantially true are not misrepresentations", *City of Edinburgh Brewery Co. v. Gibson's Trustees, supra, Cf.*

Representation of facts, not merely of belief or opinion.—The statement that something will be done is not a statement of an existing fact so as to amount to as a contract or promise unless it implies the existence of a fact which does not exist, *Karberg's* case, (1892) 3 Ch 1; *Beattie v. Ebury,* (1874) LR 7 Ch 777, 804; *Alderson v. Maddison,* (1883) 3 App Cas 467; *Bellairs v. Tucker,* (1884) 13 QBD 562. A representation of belief, expectation or intention may be a representation of fact. This is so because "the state of a man's mind is as much a matter of fact as the state of his digestion", *Per* BOWEN LJ in *Edgington v. Fitzamurice,* (1885) 29 Ch D 459, 483.

Statements of ambiguous nature.—An ambiguous statement which carries double meaning and an applicant who reasonably puts one meaning and is misled would be entitled to relief and the maker of the statement would not be heard to say that some other meaning should have been put upon his words, *R. v. Kylsant,* (1932) 1 KB 442; *Hallows v. Fernie,* (1868) LR 3 Ch 467, 476; *Arkwright v. Newbold,* (1881) 17 Ch D 301, 322 (CA); *Smith v. Chadwick,* (1884) 9 App Cas 187 : (1881-5) All ER Rep 242 (HL).

Reliance on statement.—If a prospectus contains statements of fact, the recipient is entitled to rely upon them. He need not verify them. If the prospectus states the effect or terms of a document, and offers it for inspection, he is not bound to inspect it. He is entitled to assume that the prospectus is true: "One of the most familiar instances ... is where men issue a prospectus in which they make false statements of the contracts made before the formation of the company, and then say that the contracts themselves may be inspected at the offices of the solicitors. It has always been held that those who accepted those false statements as true were not deprived of their remedy merely because they neglected to go and look at the contracts." *Per* JESSEL M.R. in *Redgrave v. Hurd,* (1881) 20 Ch D 1, 14 : (1881-5) All ER Rep 77 (CA); *Smith v. Chadwick,* (1882) 20 Ch D 27, 57 : (1881-5) All ER Rep 242 (HL); *Re, Mount Morgan West Gold Mine Co.,* (1887) 56 LT 622.

The answer is: "You put me off my guard" *Venezuela Central Rly. Co. v. Kisch,* (1867) LR 2 HL 99. as explained by LORD HALSBURY L.C. in *Aaron's Reefs Ltd. v. Twiss,* (1896) AC 273 (HL). In this case LORD WATSON said: "It was argued for the company that, inasmuch as its contracts for the purchase of the concession are generally referred to towards the end of the prospectus, the respondent must be held to have had notice of their contents. This appears to me to be one of the most audacious pleas that ever was put forward in answer to a charge of fraudulent misrepresentation. When analysed it means simply that a person who has induced another to act upon a statement made with intent to

deceive must be relieved from the consequences of his deceit if he has given his victim constructive notice of a document, the perusal of which would expose the fraud."

Variation between prospectus and memorandum of association.—Rescission of the contract was ordered in the following cases since the objects of the company as stated in the prospectus were different from those stated in the memorandum. *Re, Russian (Vyksounsky) Iron Works Co., Stewart's* case, (1866) 1 Ch App 574; *Downes v. Ship,* (1868) LR 3 HL 343. Also see *Re, Frank Harris Granite Co. Ltd. (No. 2),* 32 NZLR 837 (New Zealand) where other clauses (other than the objects clause) were at variance with the prospectus.

Misreading of prospectus.—Where the statements in the prospectus are clear but an applicant happens to take a wrong meaning by misreading them he cannot complain so as to get rid of the allotment, *Bansidhar Durga Dutt v. Tata Power Co. Ltd.,* AIR 1925 Bom 272; *Baron Unocarl Samual Akerhielm v. Rolf Demare,* (1960) 30 Com Cases 1 (PC). Where, however, the statement is capable of bearing two meanings one right and the other wrong and the applicant happens to go by the wrong meaning, the directors will not be heard to say that he should have put the other meaning. *Smith v. Chadwick,* (1882) 20 Ch D 27 : (1881-5) All ER Rep 242 (HL).

Misrepresentation of law.—A misrepresentation of law is not a misrepresentation of fact. Also, a statement of fact does not become a representation of law merely because it involves an element of law also.

To obtain compensation under section 62, it is not necessary to prove that the directors knew that the statements were untrue. It is enough to prove that the statements were, in fact, untrue and that in relying upon them the subscriber suffered damage. The untrue statement must, therefore, be material one.

Any variation or modification of the terms and conditions of the issued prospectus and the prospectus approved by CCI would have the effect of misrepresentation. *N. Parthasarathy v. CCI,* (1991) 72 Com Cases 651 : AIR 1991 SC 1420.

Special defences under the section [Sub-section (2)]

A director sued for compensation may escape liability by proving—

(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 awere of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(c) That after the issue of the prospectus and before allotment he, on becoming aware of the untrue statement, withdrew his consent thereto and gave reasonable public notice of the withdrawal and of the reason therefor; a repudiation in a statement of defence in court is not reasonable public notice. *Mc Connell v. Wright,* (1903) 1 Ch 546 : (1900-3) All ER Rep Ext 1114 (CA); *Watts v. Bucknall,* (1902) 2 Ch 628; *Drincqbier v. Wood,* (1899) 1 Ch 393. A notice advertised in some of the principal newspapers in which the prospectus was advertised would be reasonable public notice. A statement contained in a defence to an action based on the section cannot be a 'public notice'. *Drincqbier v. Wood,* (1899) 1 Ch 393. Public notice must be given before the commencement of the legal proceedings, *Gerson v. Simpson,* (1903) 2 KB 197;

(d) That he believed, and had reasonable grounds to believe, that the statements were true. The director must disclose the reasonable grounds for his belief that the statements were true. *Alman v. Oppert,* (1901) 2 KB 576 : (1900-3) All ER Rep 281 (CA), [Approved in (1969) 3 All ER 1541]. In an action for fraudulent misrepresentation, it was held by the Privy Council that it would be a good defence that the director concerned honestly believed the statement to be true in the sense (being a sense in which it might reasonably be understood) in which he understood it *albeit* erroneously. *Akerhielm v. De Mare,* 1959 AC 789 : (1959) 3 All ER 485 (PC). The uncorroborated statements of a promoter-cum-vendor of a company afford no "reasonable ground" to the directors for believing such statements in a prospectus issued by them to be true, so as to relieve the directors from liability. *Adams v. Thrift,* (1915) 2 Ch 21 (CA).

(e) That the statement was a correct copy or extract from a report or valuation of an expert, whom he had reasonable grounds to believe and did believe, was competent to make it and that the prospectus was issued with the expert's consent in writing. Directors, promoters and others who authorise the issue of a

prospectus are not liable to pay compensation for loss or damage to subscribers if untrue statements in a prospectus, are extracts from reports or valuations by engineers, valuers, accountants or other experts, provided that they had reasonable grounds to believe, and did up to the time of the issue of the prospecuts believe, that the person making the statement was competent to make it, *Gray v. Central Finance Corp.*, (1903) 11 SLT 309 (Scot). A material misrepresentation as to the source from which the report of the expert was taken would give rise to liability. *Davidson v. Hamilton,* (1904) 12 SLT 353 (Scot).

(f) The statement was a correct copy or extract from an official document.

The defences allowed by section 62 will not absolve the responsible persons of civil liability (for misrepresentation or fraud under sections 17 and 18 of the Contract Act, 1872) and for this purpose it does not matter that the prospectus did not comply with section 56 of the Companies Act or that a copy was not filed with the Registrar. *Shanmugam Sundaram Chettiar v. A.A. Rangarama Naicker,* (1934) 4 Com Cases 367 : AIR 1934 Mad 641.

Effect of references to experts' opinion in prospectuses

Where the company and its officers issuing prospectus rely upon reports or expert statements they would be liable if the reports or statements turn out to be false. *Re, Reese River Silver Mining Co., Smith's* case, (1867) LR 2 Ch 604, 611; *Rawlins v. Wickham,* (1858) 3 De G&J 304; *Mair v. Rio Grande Rubber Estates,* (1913) AC 853 (HL). They can safeguard themselves from liability by clearly pointing out that they are not depending upon the official or expert version. A statement that profits have been calculated on the basis of the report would create liability if the report turns out to be not true. *Re, Pacaya Rubber Co.,* (1914) 1 Ch 542. But if the persons issuing a prospectus merely refer to the report, *e.g.* of a mine, as telling all they know, and propose to send out someone to test it, they will not be treated as guaranteeing its truth. *Re, British Burmah Lead Co.,* (1887) 56 LT 814.

Precautions to be taken by promoters and directors while drafting prospectus

1. *Reasonable ground to believe.*—Take care that statements are not made by directors or promoters unless such director or promoter believes and has reasonable ground to believe they are true. When it is desirable to state facts which the directors do not know to be true, let such facts be embodied in a report by some competent expert and then set out that report, or extracts therefrom, in the prospectus.
2. *Expert's statements.*—As regards every statement purporting to be a statement by an expert, take care that (a) it fairly represents the statement by the expert; (b) that there is evidence to show that the expert is competent to make it; and (c) that the expert gave the consent under section 58.
3. *Qualified statements.*—When a report of an expert cannot be obtained let the statement be qualified, *i.e.* "from the inquiries which the directors have made, they believe that".
4. *Statements by others.*—If it is desired to make use of a statement made by some person who is not an expert, *e.g.* by a vendor, let it be stated thus-"The vendor states that the supply of water is ample", rather than simply stating "the supply of water is ample".
5. *Prefer general expressions to specific.*—Generally, expressions such as, "the directors hope, anticipate, propose, or intend, *etc.*", are safer than blunt statements of facts.

The directors or promoters would do well to record in writing their grounds of reasonable belief of a fact at the time of preparation of the prospectus. This will be helpful in case the prospectus is challenged in future.

Joint action by shareholders

Where a number of shareholders join as plaintiffs in one action on the ground that they have subscribed on the faith of the same prospectus, each of them must prove separately

that he was induced to take shares by the untrue statements. *Arnison v. Smith,* (1889) 41 Ch D 338 : (1886-90) All ER Rep Ext 1332 (CA).

Measure of damages

For omissions in the prospectus the directors are liable to pay damages to persons who have suffered damage by reason of the omission.

The measure of damages for the loss suffered by reason of the untrue statement, omission *etc.*, is the difference between the value which the shares would have had but for such statement or omission and the true value of the shares at the time of allotment. See *McConnel v. Wright,* (1903) 1 Ch 546, *Cf. Clark v. Urquhart,* 1930 AC 28.

The measure of damages was held to be the difference between the price paid for the shares and their real value at the date of purchase. The real value need not necessarily be the market value. *Peek v. Derry,* (1887) 37 Ch D 541, **reversed** on other grounds in (1889) 14 App Cas 337.

If the market value was itself the result of the fraudulent misrepresentation, the intrinsic value of the share is taken as the measure of damages. The time in relation to which the loss must be measured is that when the fraud was discovered by the plaintiff. *S. Chatterjee v. Dr. K.L. Bhave,* (1962) 32 Com Cases 830, 843 : AIR 1960 MP 323. The measure of damages would be the actual loss suffered in consequence of the untrue statements; if there is no value for the shares, then the entire amount paid for them will be recoverable. *Arnison v. Smith,* (1889) 41 Ch D 348.

In applying the correct measure of damages to be awarded to compensate a person who has been fraudulently induced to purchase shares, the crucial criterion is the difference between the purchase price and their actual value. That value is not necessarily the current market value if that was distorted by the fraud. It may be appropriate to use the subsequent market price of the shares after the fraud has come to light and the market has settled. *Smith New Court Securities v. Scrimgeour Vickers (Asset Management) Ltd.,* (1992) BCLC 1104 (Ch D). The trial judge accordingly allowed by way of damages the difference between the purchase price and the price which the buyer subsequently realised on resale. The Court of Appeal reduced this amount by about ten times so as to correspond to the difference between the purchase price and the market price if the shares were resold immediately. *Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd.,* (1994) 2 BCLC 212 (CA). On appeal the House of Lords restored the amount awarded by the trial judge because there was justifiable reason for the buyer not being able to resell immediately after detecting the fraud, The buyer was thus entitled to the difference between the price which he paid for the shares and the price which he obtained on resale. *Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd.,* (1997) 1 BCLC 350 (HL).

Where a claimant has successfully established a civil claim in the tort of deceit, the amount of damages would not be reduced on the grounds of any alleged contributory negligence on the part of the claimant. *Standard Chartered Bank v. Pakistan National Shipping Corp (No. 2),* (2000) 1 Lloyds Reports 218 : (2000) 1 All ER (Comm) 1 (CA). On appeal to the House of Lords, in *Standard Chartered Bank v. Pakistan National Shipping Corpn.,* (2003) 1 All ER 173 (HL) : (2003) 1 BCLC 244 their Lordships added that there is no common law defence of contributory negligence in the case of fraudulent misrepresentation, and conduct by a claimant cannot be a fault within the meaning of the Law Reform (Contributory Negligence) Act, 1945, unless it gives rise to a defence of contributory negligence at common law. The Court **approved** *Alliance and Leicester Building Society v. Edgestop Ltd.,* (1994) 2 All ER 38 approved.

In cases of fraud damages can be awarded for foreseeable as well as unforeseeable consequences of the fraud. *Royscot Trust Ltd. v. Rogerson,* (1991) 3 WLR 57 (CA).

§ See also Notes under s. 291 under the heading "Liability for fraud."

Limitation for claiming compensation

A suit for damages by a shareholder against the directors on the ground of false representations in the prospectus is governed by Article 36 and not by Article 120 of the Limitation Act, 1908 the wrong complained of being entirely independent of contract. *Manavedan Tirumalpad (T.) v. Amirchand,* AIR 1944 Mad 431 : (1944) 14 Com Cases 125. **Affirmed** in *Amichand Doss Dwarakadoss v. T. Manavalan Tirumalpad,* (1945) 15 Com Cases 178 (Mad—DB). Note that both these Articles have been merged into Article 113 of Limitation Act, 1963 and period prescribed is 3 years.

Injunction against issue of prospectus

A person who is a complete stranger to the company cannot file a suit to restrain the company from issuing a prospectus on the alleged ground that the proposed prospectus contains misleading statements and that investing public might be thereby duped. This is so because Sec. 62 allows its remedy only to a person who has suffered loss or damage on the faith of the prospectus. *Kisan Mehta v. Universal Luggage Mfg. Co. Ltd., Bombay,* (1988) 63 Com Cases 398 (Bom).

Other laws not affected

The provisions of this Act do not omit or diminish any liability that any person may incur under general law or under other provisions. *Shanmugam Sundaram Chettiar v. Rangarama Naicker,* (1934) 4 Com Cases 367, 372 (Mad); *Amichand Doss Dwarka Doss v. Manavalan Tirumalpad,* (1945) 15 Com Cases 178, 179 (Mad).

If there are omissions on matters which the promoters are duty-bound to disclose, the omission is equivalent to a misstatement and the promoters would be liable to pay damages. *David v. Britannic Merthyr Coal Co.,* (1909) 2 KB 157. There must be some active misstatement of fact to support an action for *deceit. Peek v. Gurney,* (1873) 6 LR 377 (HL), *Derry v. Peek,* (1889) 14 AC 337.

Liability of company to misled investors

Under the common law the principal is liable for any fraud or misrepresentation committed by his agent within the scope of the agent's authority. Where a company is the principal it would also be liable for any fraud *etc.* of its officers. The liability of the company will depend upon the extent to which the fraudulent state of mind of an officer is attributable to the company. These principles are also applicable to the issue of a prospectus containing fraudulent or misleading statements. *Lynde v. Anglo-Italian Hemp Spinning Co.,* (1896) 1 Ch 178; *Collins v. Associated Greyhound Racecourses Ltd.,* (1930) 1 Ch 1. The company will be liable:

(a) where the misrepresentations are made by the directors or other general agents of the company entitled to act on behalf of the company and acting as such;

(b) where the misrepresentations are made by an agent who is specially authorised for the purpose;

(c) where the directors making the allotment were aware of the fact of misrepresentation and also knew that the applicants for shares were induced by the misrepresentation;

(d) where, to the knowledge of the company or its agents, the contract is made on the basis of a particular representations that later turn out to be untrue.

A subscriber to the memorandum was not allowed, as against the company to be relieved of the shares which he had taken as subscriber. His contention was that he subscribed to the memorandum because of the promoters fraud. The court said that such fraud could not be attributed to the company because the company came into existence after registration of the memorandum whereas the fraud was committed at the time of signatures to the memorandum. *Metal Constituents Ltd., Re,* (1902) 1 Ch 707 per LORD LURGAN.

Rescission of contract

The shareholder is entitled to rescind his contract of purchasing a company's shares and ask for repayment. The rescission can be on grounds of misrepresentation or an omission in the prospectus. But the misrepresentation must be of a material fact and the shareholder must have been induced by it and he must plead and prove the same. Similarly, mere omission of any particulars required to be disclosed under section 56-Schedule II will not *per se* entitle a shareholder to rescind the contract.

The right to rescind the contract to purchase shares is a remedy under the Contract Act, 1872 whereunder the contract is voidable, *inter alia*, on grounds of misrepresentation—see section 18 of that Act. Under the present section 62, the remedy is merely to claim compensation.

The relief of rescission can be claimed even after the shares have been forfeited for non-payment of calls. *Houldsworth v. City of Glasgow Bank,* (1880) 5 AC 317.

It should be noted that misrepresentation or fraud is not essential to a claim for rescission. A material change, *e.g.* change in the minimum subscription amount is sufficient. *T.S. Rajagopala Iyer v. South Indian Rubber Works Ltd.,* (1942) 12 Com Cases 203, 206 : AIR 1942 Mad 656. In a suit for rescission, the company is a necessary party. *S. Chatterjee v. Dr. K.L. Bhave, (supra).* Even where two directors mentioned in prospectus retire before allotment and the applicant is not put on notice of the same, he is entitled to repudiate the contract. *Venkatramayya v. Indian Industrial Bank Ltd.,* AIR 1930 Mad 325.

Nature of proceeding for setting aside allotment.—A proceeding for setting aside an allotment is a declaratory suit and not a regular suit for the purposes of court fees. *Laxmidas N. Madhvani v. Madhvani P. Ltd.,* (1968) 88 Bom LR 308 (Bom).

Right of rescission when lost.—The right to rescind the contract is lost unless it is exercised promptly on discovering the fact. It must be exercised before the commencement of winding-up. *Shiromani Sugar Mills Ltd. v. Debi Prasad,* (1950) 20 Com Cases 296 : AIR 1950 All 508; *Jagannath Prasad v. O.L.,* (1938) 8 Com Cases 123, 125 : AIR 1938 All 193. The right will also be lost if the allottee affirms the allotment after discovering the facts or where the rights of third parties have intervened *Tennent v. City of Glasgow Bank,* (1879) 4 App Cas 615 (HL).

Purchaser of shares in open market

A purchaser of shares in the open market has no remedy either against the company or any other person even if he purhased shares by being influenced by misrepresentation in the prospectus. *Peek v. Gurney,* (1861-73) All ER Rep 116 **followed** in *Al-Nakib Investments (Jersey) Ltd. v. Longcroft,* (1991) BCLC 7 (Ch D). But it is otherwise where the prospectus was addressed not merely to the first allottees but also to influencing subsequent transactions in the market. *Andrews v. Mockford,* (1896) 1 QB 372 (CA).

Where a prospectus is issued for a particular purpose and sent to a particular class of persons, the duty of care imposed upon directors in relation to the prospectus does not extend to those buying shares in the market. The directors of a company issued a prospectus inviting shareholders to subscribe to a rights issue. One of the shareholders, who took up his part of the shares, bought more shares in the market, allegedly relying upon the prospectus. He sued, alleging that the statements in the prospectus were misleading, claiming damages in relation to the shares issue and damages in negligence in relation to the shares bought in the market. It was held that the prospectus was prepared for the share issue to be communicated to a particular class of persons. There was no sufficient proximity for a duty to be owed to those buying shares in the market. *Al Nakib Investments (Jersey) v. Longcroft,* (1991) BCLC 7 (Ch D), **applying** the principle of *Capro Industries Plc. v. Dickman,* (1990) BCLC 273 HL.

The developments in the present century in this field have been noted in the decision in *Possfund Custodian Trustee Ltd. v. Diamond,* (1996) 2 BCLC 665 (Ch D); *Parr v. Diamond,* (1996) 2 BCLC 665 (Ch D). The defendant company issued a prospectus in connection with the flotation of its shares on the unlisted securities market. The prospectus specifically stated that, as part of the same exercise as allotment, the facility would be available for shares to be dealt with subsequently on the unlisted securities market. The majority of the plaintiffs were subscribers at the time of the placing of the shares; the others made subsequent purchases of shares in the unlisted securities market (the after-market purchases). The company subsequently went into receivership. Two of the plaintiffs commenced proceedings against the company, its directors at the time of the placing of shares, and its financial advisors and auditors, claiming, *inter alia*, damages for deceit and negligence in relation to material misrepresentations contained in the prospectus as to financial position which they had relied on and in consequence of which they had suffered financial loss. Subsequently, a second action was commenced against the defendants by a number of other plaintiffs. The defendants applied for striking out the plaintiffs' claims in respect of the after-market purchases as disclosing no cause of action, on the basis that the common law duty of care in respect of the issue of a company's prospectus was limited to the initial subscription and did not extend to subsequent purchasers of the company's shares in the unlisted market. The court said that it was arguable that persons responsible for the issue of a company's prospectus owed a duty of care to, and could be liable in damages at the instance of, subsequent purchasers of that company's shares on the unlisted securities market, provided that the purchaser could establish that he had reasonably relied on representations made in the prospectus and reasonably believed that the representor intended him to act on them, and that there existed a sufficient direct connection between the purchaser and the representor to render the imposition of such a duty fair, just and reasonable. If the plaintiffs in the instant case could establish that, at the date of preparation and circulation of the original share prospectus, the defendants intended to inform and encourage after-market purchasers, in addition to those investors who relied on the prospectus in making a decision whether to accept the allotment offer thereby made, it was at least arguable that the defendants had assumed and owed a duty of care to those investors who relied on the contents of the prospectus in making after-market purchases. The plaintiffs' claim therefore merited full consideration at trial. The applications for striking out the case were accordingly dismissed.

The court recaptured the position as it existed in the previous century [p. 673]: "In the nineteenth century when the issue of prospectuses first became a common feature of commercial life, the common law allowed a claim in damages to the investor who incurred a loss after investing in reliance on the contents of a false or misleading prospectus (in the absence of a breach of a fiduciary or contractual duty owed to the investor) only if he could establish the tort of deceit. *Derry v. Peek,* (1889) 14 App Cas 337 : (1886-90) All ER Rep 1. The prospectus was an invitation issued to the public to subscribe for shares, and not to purchase shares in the market, and without more the prospectus could only found liability if relied on for the purpose for which it was issued, namely making the decision whether to subscribe, and not if relied on for the purpose of deciding whether or not to make purchases in the market *Peek v. Gurney,* (1873) LR 6 HL 377 : (1861-73) All ER Rep 116. The principle was graphically expressed in the expression that the representations contained within the prospectus were exhausted upon the allotment being completed."

Intention to influence market.—Looking at the subsequent developments, the court found that in order to make an issuer liable in respect of market transactions there should be the intention to influence the market. For the purpose of the torts of deceit and negligent misrepresentation, it is necessary to establish a material misrepresentation intended to influence, and which did in fact influence the mind of the representee.

One of the questions was whether the required intention of the representor should be objectively ascertained, as the intention reasonably to be inferred from his words or action (or inaction), or whether the subjective intention of the representor to induce is suffi-

cient. The court said that the authorities and textbooks do not provide any clear guidance. For example, in 31 HALSBURY'S LAWS (4th edn.) para 1042 it is stated that the intention may be actual or presumptive. Whilst in CLERK AND LINDSELL ON TORTS (17th edn., 1995) para 7.65 it is categorically stated: 'The defendant's intention must be assessed objectively.' A footnote makes reference to a dictum of Lord GOFF in *Henderson v. Merrett Syndicates Ltd.*, (1994) 3 All ER 506 at 521 to the effect that in determining whether a party has 'assumed responsibility', an objective test of intention must be applied.

Such intent is objectively established if the representor expressly communicates intent to the representee. On the other hand, where it is not expressly communicated, the representee must establish that he reasonably relied on the representation and that he reasonably believed that the representor intended him to act upon it. Accordingly, if the subjective intention of the representor is not expressly communicated to him, the existence of a subjective intention alone is insufficient to found an action unless the existence of such an intention on the part of the representor was reasonably to be inferred by the representee: *i.e.*the objective test must be satisfied.

Proximity.—In reference to the requirement of proximity the court noted that the law has drawn a distinction between representations made to specific persons for specific purposes and representations to the public (or sections of the public *e.g.* investors). In the case of the former, in general it is sufficient to establish a duty on the part of the representor that he should reasonably have foreseen that the persons concerned would rely on his representation for the purposes in question. But in the latter, generally it is necessary to establish a proximity between the representor and representee beyond the mere foreseeability of reliance by the representee to render it fair, just and reasonable that such a duty be imposed in respect of the representation. It is at least well arguable that the necessary proximity in such a case is established if the reliance by the members of public for the purpose in question is intended by the representor. Intention, if not sufficient to establish the necessary proximity, is at the least a very important factor *Morgan Crucible Co. plc. v. Hill Samuel Bank Ltd.*, (1991) BCLC 178 at 191. The requirements for imposition of a duty of care of fairness, justice and reasonableness are to a large degree directed to protecting against potential far reaching foreseen, but unintended, consequences: where the consequences are intended, rarely can the representor on these grounds object to his being held responsible for the deliberate consequences of his words. *Galoo Ltd. (In liq.) v. Bright Grahame Murray*, (1994) 2 BCLC 492 at 513-514.

Negligence and prospectus.—Speaking on this point, the court said: In *Peek v. Gurney* the House of Lords held that (at common law) the object of a prospectus was to provide the necessary information to enable an investor to make an informed decision whether to accept the offer thereby made to take up shares on the proposed allotment, but not a decision whether to make after-market purchases. The 1986 Act recognises a wider object in the case of listing particulars in respect of listed securities: the object includes properly informing after-market purchasers and creates a corresponding duty of care. Parliament refrained from so widening the object of a prospectus in unlisted securities.

The starting point in determining the ambit of the duty of care in respect of a prospectus is the statutory purpose of the prospectus. In the same way the starting point in determining the ambit of the duty of auditors in respect of their audit and audit report is the limited statutory purpose of that statutory requirement, namely to enable shareholders to exercise their class rights in general meeting in an informed manner. *Caparo Industries plc. v. Dickman*, (1990) BCLC 273 at 291. The plaintiffs say the prospectus must be examined in the light of changed market practice and philosophy current at its date of preparation and circulation. The plaintiffs' claim that there has developed and been generally recognised an additional purpose, an additional perceived intention on the part of the issuer and other parties to a prospectus, namely to inform and encourage after-market purchasers, and that this is the basis for the pleaded purpose attributed by the plaintiffs to the prospectus. If this is established, then it does seem to me to be at least arguable that a duty of care is assumed and owned to those investors who (as intended) rely on the con-

tents of the prospectus in making such purchases. What is significant is that the courts have since 1873 (before any legislation) recognised a duty of care in case of prospectuses when there is a sufficient direct connection between those responsible for the prospectuses and the party acting in reliance.

How the intention is manifested, whether by sale of the prospectus to prospective aftermarket purchasers (as in *Scott v. Dixon,* (1859) 29 LJ Ex 62n), or by other means (as in *Andrews v. Mockford,* (1896) 1 QB 372), surely cannot be crucial. It is not self-evident that, if the issuers of a prospectus intend investors to rely on it, the issue of proximity should depend on whether the representation was fraudulent or negligent. In GOWER ON COMPANY LAW (5th edn., 1992) p. 498 the view is expressed that, once prospectuses specifically stated that one of their purposes was to lead to an admission to listing on The Exchange, the decision limiting the scope of the duty of care adopted in *Peek v. Gurney* seems outmoded and the decision in *Al-Nakib* should be reviewed by a higher court. This passage in this authoritative work supports the view that the plaintiffs' claim as to the purpose of the prospectus and the duty of care owed today in respect of the prospectus—a prospectus which specifically states that, as part of the same exercise as allotment, the facility will be available for shares in Diamond to be dealt with on the USM—sufficiently merits full consideration at trial.

SEBI Guidelines, 2000

Issuer's absolute responsibility.—Under SEBI Guidelines 2000, one of the disclosure requirements is incorporation of 'Issuer's Absolute Responsibility' clause in the prospectus as under :

"The issuer, having made all reasonable inquiries, accepts responsibility for and confirms that this offer document contains all information with regard to the issuer and the issue, which is material in the context of the issue, that the information contained in the offer document is true and correct in all material aspects and is not misleading in any material respect, that the opinions and intentions expressed herein are honestly held and that there are no other facts, the omission of which make this document as a whole or any of such information or the expression of any such opinions or intentions misleading in any material respect." [*See clause 6.2.1.2(vi) of Chapter VI*]

Simultaneously, the issuer company should include in the prospectus a disclaimer statement on the following lines:

Disclaimer Statement from the Issuer.—A statement to the effect that the issuer accepts no responsibility for statements made otherwise than in the prospectus or in the advertisement or any other material issued by or at the instance of the issuer and that anyone placing reliance on any other source of information would be doing so at his own risk should be incorporated [*Clause 6.3.4.1*] .

S. 63. Criminal liability for misstatement in prospectus.—(1) Where a prospectus issued after the commencement of this Act includes any untrue statement, every person who authorised the issue of the prospectus shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to [1][*fifty thousand rupees*], or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did, up to the time of the issue of the prospectus believe, that the statement was true.

(2) A person shall not be deemed for the purposes of this section, to have authorised the issue of a prospectus by reason only of his having given—

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1. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 23 (w.e.f. 13-12-2000).

(a) the consent required by section 58 to the inclusion therein of a statement purporting to be made by him as an expert, or

(b) the consent required by [2][* * * *] sub-section (3) of section 60.

NOTES

Eng. Act, 1948 : Sec. 44.
Eng. Act, 1985 : Sec. 70.

Companies Act, 1956

Recommendations of Company Law Committee.—This section is based on the recommendations of the Company Law Committee, reproduced below: "Under the provisions of this section, once the prosecution establishes the falsity of statement in a prospectus signed by a director, *etc.*, the onus is shifted to the defendant of proving either that the statement was immaterial or that he believed it to be true. An expert who has given the consent required by the proposed section 94 [section 58] will not be deemed to be *ipso facto* a person who authorised the issue of the prospectus. (*Company Law Committee Report,* para 62).

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5000 rupees to 50,000 rupees under sub-section (1).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Materiality of untrue statements

Presumably, a statement would be considered immaterial if it could be shown that, even if the true fact had been disclosed, a prudent investor would still have applied for the shares.

The words "untrue statement" have to be construed as explained in section 65(1)(a) which says that a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included. In a prosecution under the section it was found that everyone of the statements as to payment of dividends for the number of years specified was true but during some years preceding to the issue of the prospectus dividends were not paid out of current profits but out of other sources and, therefore, it was held that to the extent to which the prospectus created the impression that the company was in profits, whereas in fact it was in losses, the statements were not true in their context. *R. v. Kylsant,* (1932) 1 KB 442 : (1932) 2 Com Cases 225. See further *R. v. Bishirgian,* (1936) 1 All ER 586 (CCA). In another prosecution for failure to disclose material particulars in a prospectus, the accused who formed a company and issued a prospectus for taking over their own business were convicted for cheating under the Indian Penal Code, (s. 409) because they did not disclose the material particulars of

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2. The words, brackets and letter "clause (b) of" omitted by Act 65 of 1960, s. 19.

their business which they were going to hand over to the company. *M.K. Sreenivasan, Re,* (1944) 14 Com Cases 193 : AIR 1944 Mad 410.

In a proceeding under the section for false statement in prospectus, the complaint was that investments were invited through a document called "project overview" and huge sums of money were obtained from non-resident Indians but no shares were allotted to them in the proposed joint venture company. The moneys were siphoned off to off-shore companies controlled by the accused persons. The company was incorporated in India and had registered office in India. The allegations *prima facie* made out an offence. It was held that the questions whether the offences were committed in India and whether the accused persons were citizens of India at the relevant time would be determined by evidence at the trial. Prosecution was not to be quashed. *A.V. Mohan Rao v. M. Kishan Rao,* (2002) 111 Com Cases 390 : (2002) 49 CLA 299 : (2002) 39 SCL 413 : AIR 2002 SC 2653 : 2002 CLC 1169 : (2002) 4 Comp LJ 160 (SC). **Affirming** *A.V. Mohan Rao v. M. Kishan Rao,* (2000) 100 Com Cases 729 : (2001) 40 CLA 118 (AP).

A company's prospectus carried the statement that the company had the experience of two and a half decades. The experience was, however, that of the partners of a firm which was taken over by the company and not that of the company itself. Thus the statement was not precisely true. The directors apprehended prosecution by the ROC and sought relief against it under s. 633. Granting the relief, the court said that the statement was not made with the *mala fide* intention of luring people towards investment in the company and the management of the company being also very successful, the statement was not so materially false as to invite prosecution. *Progressive Aluminium Ltd. v. ROC,* (1997) 89 Com Cases 147 at 159 (AP).

Where a complaint disclosed an offence under the section and the persons charged were not able to show any ground for quashing the complaint without trial, the court asked the Magistrate not to insist upon the personal appearance of the persons concerned and allow their appearance through counsel. *Anil D. Ambani v. Santosh Tyagi,* (2000) 99 Com Cases 334 : (2000) 1 Comp LJ 243 (Raj).

Jurisdiction.—Where a company's prospectus intended to allot debentures but no debentures were sent to the applicant who applied from his place at Jaipur, it was held that a criminal prosecution could be launched at Jaipur. Earlier the Consumer Court at Jaipur had ordered the company and its directors to refund the application money to the petitioner. *Mohan P. Wag v. State of Rajasthan,* (1998) 94 Com Cases 507 : (1998) 1 Comp LJ 103 : (1998) 15 SCL 72 (Raj). In this case there was an alleged misstatement in the prospectus for which proceedings were launched before a Magistrate. The High Court was approached with a prayer for quashing of proceedings. The court said that it was not proper to do so. The persons charged must approach the Magistrate in the first place. The contention that the complaint was barred by time could also be examined by the Magistrate. Debentures were allotted to a Jaipur based person under a prospectus which stated that they would be converted into shares. But, instead, the company redeemed them by paying back the holder. Because of this action it could be deemed that the prospectus carried a misstatement. A prosecution under s. 63 for the misstatement was allowed to be launched at Jaipur. *Anil D. Ambani v. Santosh Tyagi,* (2000) 99 Com Cases 334 : (2000) 1 Comp LJ 243 (Raj).

The persons prosecuted under the section contended that they were foreigners/NRIs, that the prospectus was also issued in a foreign land, and that the Indian Court should have no jurisdiction. Refusing to quash the prosecution the Court said that it was a burden of the accused persons to show that they were not citizens of India, and that the Indian Law was not applicable to them. This could be known only by going into the facts. *A.V. Mohan Rao (Dr.) v. M. Kishan Rao,* (2000) 100 Com Cases 729 : 2000 CLC 2036 : (2000) 26 SCL 202 : (2001) 40 CLA 118 (AP). **Affirmed** by Supreme Court in *A.V. Mohan Rao v. M. Kishan Rao,* (2002) 111 Com Cases 390 : (2002) 49 CLA 299 : 92002) 39 SCL 413 : AIR 2002 SC 2653 : 2002 CLC 1169 : (2002) 4 Comp LJ 160.

Penalty for default.—Any untrue statement in the prospectus attracts penalty of imprisonment for a term up to two years or with fine up to Rs. 50,000/- or with both, unless the person authorised to issue the prospectus can show that at the time of the issue of the prospectus he believed that the statement so issued was true.

Compoundable offence.—The offence is compoundable under section 621A.

Power of making complaints lies with SEBI

By virtue of the amendment made in section 621 by the Amendment Act, 2000, SEBI has been statutorily vested with the power to file complaints as noted earlier.

Disclaimer clause under sec. 63—SEBI Guidelines, 2000.—Under the heading 'Disclaimer clause' to be incorporated in the prospectus, a statement, *inter alia,* on the following lines, is to be included:

The filing of offer document with SEBI does not, however, absolve the company from any liabilities under section 63 or 68 of the Companies Act, 1956 or from the requirement of obtaining such statutory or other clearances as may be required for the purpose of the proposed issue. SEBI further reserves the right to take up, at any point of time, with the lead merchant banker(s) any irregularities or lapses in offer document. [*Clause 6.3.3.1*]

S. 64. Document containing offer of shares or debentures for sale to be deemed prospectus.—(1) Where a company allots or agrees to allot any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company; and all enactments and rules of law as to the contents of prospectuses, and as to the liability in respect of statements in and omissions from prospectuses, or otherwise relating to prospectuses, shall apply with the modifications specified in sub-sections (3), (4) and (5), and have effect accordingly, as if the shares or debentures had been offered to the public for subscription and as if persons accepting the offer in respect of any shares or debentures were subscribers for those shares or debentures, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of misstatements contained in the document or otherwise in respect thereof.

(2) For the purposes of this Act, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, shares or debentures was made with a view to the shares or debentures being offered for sale to the public if it is shown—

(a) that an offer of the shares or debentures or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or

(b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

(3) Section 56 as applied by this section shall have effect as if it required a prospectus to state in addition to the matters required by that section to be stated in prospectus—

(a) the net amount of the consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and

(b) the place and time at which the contract under which the said shares or debentures have been or are to be allotted may be inspected.

(4) Section 60 as applied by this section shall have effect as if the persons making the offer were persons named in a prospectus as directors of a company.

(5) Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document referred to in sub-section (1) is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be; and any such director or partner may sign by his agent authorised in writing.

NOTES

Eng. Act, 1948 : Sec. 45. Previous Act : Sec. 98-A.
Eng. Act, 1985 : Secs. 58 and 64.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Scope of section

This section extends the right of action for compensation to persons accepting an offer of shares offered to the public for sale where the shares have been allotted with a view to their being offered for sale to the public. The section extends also to debentures so offered and accepted. The section covers cases where companies on their formation or afterwards allot shares to issuing houses and others with a view to such shares being offered for sale to the public. This section also comes into play when there is a public offer. As to the meaning of the expression "offer to the public" and other related matters see notes under Section 56.

Deemed prospectus

By section 64(1) where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered by the allotees for sale to the public, the document by which the offer for sale to the public is made is deemed to be a prospectus; and until the contrary is proved, an allotment or an agreement to allot shares or debentures is deemed to have been made with a view to them being offered for sale to public, if—

(a) the offer for sale is made within six months after the allotment or agreement to allot; and

(b) at the date when the offer for sale is made the company has not received the whole of the consideration it has agreed to receive for the shares or debentures.

SEBI Guidelines 2000.—Offer for sale

Unless otherwise stated, all provisions in the SEBI Guidelines applicable to public issue by unlisted company shall also apply to offers for sale to the public by unlisted companies.

Important Note.—The following Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" and "Public Issue by Unlisted Companies" as issued by SEBI Guidelines, 2000 discussed under section 56.

"Offer for sale" means offer of securities by existing shareholder(s) of a company to the public for subscription, through an offer document [*Clause 1.2.1(xxi)*].

Eligibility.—A company, whose equity shares or any security convertible at later date into equity shares are offered through an offer for sale, shall comply with the provisions of clause 2.2.1 (conditions for IPO by unlisted companies) or clause 2.2.2. (IPO through book-building process by unlisted companies which do not satisfy conditions of clause 2.2.1) [*Clause 2.2.3*].

§ See Notes under heading '*Initial Public Offerings by Unlisted Companies*' under sec. 56 *ante*.

Offer for sale can also be made if provisions of clause 2.2.2 are complied at the time of submission of offer document with SEBI [*Clause 2.2.4*].

Minimum number of allottees.—The prospective allottees shall not be less than one thousand (1000) in number [*Clause 2.2.2A*].

Offer for sale by listed company

The eligibility norms for offer for sale of its securities by a listed company are the same as are applicable to public issue by listed companies specified in clause 2.3 of SEBI Guidelines, 2000, see notes under section 56.

§ See Notes under the heading 'Public issue by Listed Companies' under sec. 56 *ante*.

Promoters' contribution

The promoters' shareholding after offer for sale shall not be less than 20% of the post-issue capital. [*Clause 4.2.1*].

Term of the issue

In an offer for sale, the entire amount payable on each instrument shall be brought at the time of the application [*Clause. 8.6.1(vii)*].

Minimum subscription

The requirement of minimum subscription shall not be applicable to offer for sale [*Clause 6.3.8.4.1*].

Book Building Process for Issue of Shares

§ See Notes under S. 81 under the same heading.

Secretarial Action Points for offer for sale of shares to public

1. Appoint the lead managers to the offer and decide on the premium (for companies with three year track record) in consultation with them.

2. Ensure that the provisions of section 56(1)(b) and section 64 of the Companies Act are complied with.

3. Ensure that the procedure for issue of shares to public are complied with, with the modifications outlined in sub-sections (3), (4) and (5) of the section.

4. In case of listed companies, ensure that the following compliances are made:—

(a) The offer should be made in a form approved by the concerned stock exchange and should comply with the listing guidelines and requirements of the stock exchanges and the relevant SEBI guidelines.

(b) The offer contains in bold types a statement on the following lines:—

(i) The offerers collectively and individually accept full responsibility for the accuracy of the information given in this offer for sale and confirm that to the best of their knowledge and belief there are no other facts the omission of which would make any statement in the Offer for Sale misleading and they, further confirm that they have made all reasonable inquiries to ascertain such facts;

(ii) The offerers hereby declare that the Stock Exchange to which an application for official quotation is proposed to be made does not accept any responsibility for the financial soundness of the offer, or the price at which the Offer for Sale is made, or for the correctness of the statements made or opinions expressed in this Offer for Sale. [*Stock Exchange Regulation* 11].

5. Complete the other post issue formalities as outlined in the procedure for issue of shares under s. 56.

S. 65. Interpretation of provisions relating to prospectuses.—(1) For the purposes of the foregoing provisions of this Part—

(a) a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and

(b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included.

(2) For the purposes of sections 61, 62 and 63 and clause (a) of sub-section (1) of this section, the expression "included" when used with reference to a prospectus, means, included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

NOTES

Eng. Act, 1948 : Sec. 46.
Eng. Act, 1985 : Sec. 71.

Companies Act, 1956

While clause (a) of sub-section (1) is adopted from section 46 of the English Act, clause (b) of sub-section (1) and sub-section (2) are new and are intended to give greater clarity to the meaning of the provisions interpreted.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of

account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Untrue statements by suppression of facts [Sub-section (1)]

Even where specified statements are literally true, the prospectus may nevertheless be false, if by suppression of other facts, it conveys a false impression. *R. v. Kylsant,* (1932) 1 KB 442 : (1932) 2 Com Cases 225. See also *R. v. Bishirgian,* (1936) 1 All ER 586 (CCA). See also *M.K. Sreenivasan, Re,* (1944) 14 Com Cases 193 : AIR 1944 Mad 410; where prosecution for cheating under Indian Penal Code, s. 409 by omission to disclose material particulars in prospectus resulted in conviction.

A bank issued a prospectus with the remark "India's highest profit making nationalised bank". The balance sheet showed a debit balance. The explanation offered by the bank was that the losses were due to revised accounting requirements of RBI and otherwise it had made an operating profit. The loss was set off against capital with Government permission. These facts were also mentioned in the offer document. The issue had been approved by SEBI, RBI and Stock Exchange. The Court said that the statement in question could not be regarded as deceptive or misleading. The Court further said that matters relating to accounting, fixation of premium, *etc.*, are specially within the domain of expert bodies like SEBI, RBI and Stock Exchange and therefore the Court cannot embark upon an inquiry into these issues. The Court further said that the usual disclaimer in the offer document that SEBI did not recommend or approve the securities nor guaranteed accuracy and adequacy of disclosures in offer documents was not a ground to hold that the issue was not approved. *Yugantar v. U.O.I.,* (1998) 94 Com Cases 621 : (1997) 14 SCL 145 : (1997) 27 Corpt LA 132 (Del).

§ See also Notes under sections 56, 62 and 63.

Statements included in prospectus [Sub-section (2)]

Penalties attaching to untrue statements in a prospectus also apply to the brochures *etc.* which may accompany a prospectus. Of late, the practice of sending small leaflets printed in manifold colours, *etc.* has become popular. These brochures sometimes make exaggerated claims about the company.

§ See also Notes under s. 62.

S. 66. Newspaper advertisement of prospectus.—Where any prospectus is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum or the signatories thereto, or the number of shares subscribed for by them.

NOTES

Previous Act : Sec. 93(2).

There is no corresponding provision in the English Act.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of

account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

SEBI Guidelines on Advertisement

SEBI has prescribed "Code of Advertisement" under Guidelines for Disclosure and Investor Protection [Chapter IX] with regard to announcement of issue of securities, which must be complied with.

"Advertisement" includes notices, brochures, pamphlets circulars, showcards, catalogues, hoardings, placards, posters, insertions in newspaper, pictures, films, cover pages of offer documents or any other print medium, radio, television programmes through any electronic medium. [*Clause 1.2.1 (iii)*].

The Lead Merchant Banker shall ensure compliance with the guidelines on Advertisement by the issuer company [*Clause 9.0*].

§ For text of the Guidelines, see *Appendix* 162.

S. 67. Construction of references to offering shares or debentures to the public, *etc.*—(1) Any reference in this Act or in the articles of a company to offering shares or debentures to the public shall, subject to any provision to the contrary contained in this Act and subject also to the provisions of sub-sections (3) and (4), be construed as including a reference to offering them to any section of the public, whether selected as members or debenture-holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.

(2) Any reference in this Act or in the articles of a company to invitations to the public to subscribe for shares or debentures shall, subject as aforesaid, be construed as including a reference to invitations to subscribe for them extended to any section of the public, whether selected as members or debenture-holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.

(3) No offer or invitation shall be treated as made to the public by virtue of sub-section (1) or sub-section (2), as the case may be, if the offer or invitation can properly be regarded, in all the circumstances—

(a) as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or

(b) otherwise as being a domestic concern of the persons making and receiving the offer or invitation:

[1][*Provided that nothing contained in this sub-section shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more:*

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1. The proviso inserted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 24 (w.e.f. 13-12-2000).

Provided further that nothing contained in the first proviso shall apply to the non-banking financial companies or public financial institutions specified in section 4A of the Companies Act, 1956.

[2][*(3A) Notwithstanding anyting contained in sub-section (3), the Securities and Exchange Board of India shall in consultation with the Reserve Bank of India, by notification in the Official Gazette, specify the guidelines in respect of offer or invitation made to the public by a public financial institution specified under section 4A or non-banking financial company referred to in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934)*].

(4) Without prejudice to the generality of sub-section (3), a provision in a company's articles prohibiting invitations to the public to subscribe for shares or debentures shall not be taken as prohibiting the making to members or debentureholders of an invitation which can properly be regarded in the manner set forth in that sub-section.

(5) The provisions of this Act relating to private companies shall be construed in accordance with the provisions contained in sub-sections (1) to (4).

NOTES

Eng. Act, 1948 : Sec. 55.
Eng. Act, 1985 : Secs. 59, 60.

Companies Act, 1956

Recommendation of Company Law Committee.—This Section is based on the report of Company Law Committee, reproduced below: "One of the methods by which savings are attracted from the public is through 'placing' by a broker's or issuing office or investing syndicates. While it will be hard to provide statutorily that every placing must be deemed to be an offer for sale, such placings as are to all intents and purposes 'offers to the public' should be brought indisputably within the provisions of the Act (*vide Recommendations of the Cohen Committee*). The object of this section is to cover such placings."

Companies (Amendment) Act, 2000

Sub-section (3) (First Proviso).—A proviso to sub-section (3) has been inserted by the Amendment Act, 2000. It provides that the circumstances stated in sub-section (3), which keep an issue outside the arena of public issues and make it a "domestic concern" of the issuer and the offeree, shall not apply in cases where the offer or invitation is made to fifty persons or more. The effect is that an issue will remain in the category of a "domestic concern" only when the offer is confined to less than fifty persons. An offer extending to fifty or more persons will tantamount to a public issue.

Sub-section (3) (Second Proviso).—The second proviso carves out an exception to the provisions of the first proviso. The effect of the second proviso is that an offer or invitation to subscribe to shares or debentures to 50 persons or more, by a NBFC or public financial institution will not be a public issue under this section.

Sub-section (3A).—Sub-section (3A) has been inserted by the Amendment Act, 2000 so as to take care of public issues by public financial institutions or non-banking financial companies. Public financial institutions are designated under section 4A of the Companies Act and Non-Banking Financial Companies are referred to in sec. 45-I(f) of the R.B.I. Act, 1934. The purpose of the new sub-section is to empower SEBI, in consultation with RBI, to prescribe Guidelines in respect of offers or invitations made by such

2. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000) s. 24 (w.e.f. 13-12-2000).

institutions and companies. The Guidelines shall be promulgated by Notification in the Official Gazette.

The object for the changes made in the section were explained, in the Statement of Objects and Reasons annexed to the Bill, 1999 as follows:

(x) to provide that any offer of shares or debentures to more than 50 persons shall be treated as public issue with suitable modification in the case of public financial institutions and non-banking financial companies.

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

"An offer to the public" [Sub-section (1)]

An offer of shares to the company's shareholders cannot be termed "an offer to the public". Sub-section (1) which states that an offer to the public shall include a reference to offering them to "any section of the public whether selected as members or debenture-holders of the company" is, as the sub-section itself states, to be read subject to the provisions of sub-sections (3) and (4). Sub-section (3) states that no offer shall be treated as made to the public if the offer or invitation can be regarded as "not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation provided the offer is made to less than 50 persons. An offer of rights shares, therefore, does not require to be accompanied by a prospectus or to be in the form of a prospectus.

These provisions which are by and large copied from the English section are somewhat difficult to construe in the abstract and each case will have to be decided on its own facts and circumstances.

The expression "offer to the public" is not a technical expression but has to be understood in its ordinary popular sense of indicating an approach to the general public by advertisement, circular or otherwise, as distinguished from an offer made privately such as to friends and relatives or a selected set of customers. In the latter case, it is always good to append a note that the shares are not offered to the public.

When shares or debentures do not provide any right of renunciation and such shares or debentures remain unsubscribed, or not taken up by shareholders or debenture-holders to whom they are offered and the same are offered by the brokers of the company to certain persons only without making a general offer to the public, the offer by the broker will not be deemed to be an offer or invitation to the public. Such an offer or invitation made by the brokers cannot, in view of the terms of S. 67(3), be regarded as an offer to the public because the under-subscribed shares or debentures will only be allotted to those persons to whom the brokers have made an invitation or offer.

If a prospectus addressed to the general public, or to a section of the public, is published, that no doubt constitutes an offer to the public, even though none of the public come in; but possibly if this offer is made without any intention to let the public take up any of the shares (*e.g.*, where all the shares were already taken from), it might be found as a fact that there was no real offer to the public. PALMER'S COMPANY PRECEDENTS, 59 (17th Edn., 1956).

§ See also Notes under S. 56 under the heading 'Issued', "Issued to the public".

What is public issue and what is not [Sub-section (3)]

Where an invitation is made by the management of a company to selected persons for subscription or purchase by less than fifty persons receiving the offer or invitation, the shares or debentures and such invitaion or offer is not calculated directly or indirectly to be availed of by other persons, such invitaion or offer shall not be treated as an offer or invitaion to the public.

Where in a private company, a resolution was passed enabling the directors to dispose of new issue of shares not taken by the existing shareholders, to any person or persons, it cannot be said to be an offer of shares to the public.

The word "calculated" in clause (a) suggests design, forethought or intention to accomplish a purpose. "Calculated" primarily means to compute mathematically, but when applied to a human action, it is used in the sense of 'to intend, to design, to plan or to adopt, to achieve a purpose'.

In *Nash v. Lynde,* (1929) AC 158 at 159, VISCOUNT SUMNER observed: The 'public' in the definition [section 285 of the English Act of 1908] is, of course, a general word. No particular numbers are prescribed. Anything from two to infinity may serve : perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to any one who brings his money and applies in due form whether the prospectus was addressed to him on behalf of the company or not.

The offer of shares to the kith and kin of a director is not an offer to the public. "Where a private company offers shares to selective persons it cannot be said to be extending an invitation to the public. In all cases the determination of the question of an offer being madetothe public depends upon the facts and language of the notice and the particular circumstances of each case." *Rattan Singh v. Moga Transport Co.,* (1959) 29 Com Cases 165 : AIR 1959 Punj 196.

But, generally, an offer to a select and small circle of friends, promoters, relations or customers cannot be said to be an 'offer to the public'.

An offer upon the reconstruction of a company of shares in the new company to members of the old company in respect of their shares in that company is not an offer to the public. *Booth v. New Afrikander Co. Ltd.,* (1903) 1 Ch 295 : (1900-3) All ER Rep Ext 1247 (CA).

The offer, to come within the section, need not be an offer by the company; for the section applies to any share capital offered to the public for subscription.

The test seems to be this—is there a sufficiently intimate subsisting connection between the company or the person making the offer and the persons to whom the offer is made as friends, customers, or otherwise to make the offer a domestic concern. And it is apprehended that the mere fact that an offer is made by circular addressed by name to a number of persons does not of itself take it out of the category of offer to the public.

An offer through issuing houses amount to offer to the public. See also, notes further under section 64.

§ For further Notes, see under s. 56.

'Private and confidential' offers

Where a syndicate had printed a prospectus marked "strictly private and confidential–not for publication" and some of the directors sent copies of it to their friends, it was not an offer to the public. *Sherwell v. Combined Incandecent Mantles,* (1907) 23 TLR 482. On the other hand, where a prospectus marked *private and confidential* was filed with the Registrar of Companies, and a number of copies not exceeding 3,000 were issued by the promoter to shareholders in certain gas companies in which he was interested, it was held to be an offer to the public. *South of England Natural Gas Co., Re,* (1911) 1 Ch 573.

§ For further Notes, see under s. 56

Option to acquire shares from company

Where an option given to a purchaser to acquire shares of the company carried no conditions, it was held that the option-holder was entitled to exercise his option unaffected by any subsequent reorganisation of the company's share capital. *Forsayth Oil and Gas NL v. Livic Pty. Ltd.*, (1985) BCLC 378 PC. The court went by the decision in *Hirsch & Co. v. Burns,* (1897) 77 LT 377 (HL) where it was pointed out that if the company had increased its capital and so diluted the potential rights of the option-holders, the latter would not have complained and so an option which was subject to no conditions would not be affected if the company reorganises capital in a manner which as against the option-holder disadvantages its shareholders.

Private placement of equity shares through brokers *etc.*

Department's Press Note.—It has come to the notice of Government that some companies utilise the services of brokers and other intermediaries for private placement of equity shares, out of promoters' quota or otherwise, insert advertisements in the print media and also mass-mail literature/material/ brochures superscribed by the caption "Confidential/For private circulation only". It is also noticed that the rights of renunciation are floated in the market by the companies themselves, charging unofficial premia from the investing public. Under Section 67(3) of the Act, no offer or invitation shall be treated as made to the public, only if the same can be regarded, in all the circumstances,—

(a) as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or

(b) otherwise as being a domestic concern of the persons making and receiving the offer or invitation.

In the context of the above provisions of law, such offers cannot be treated as private placement and provisions relating to prospectus under the Companies Act, 1956, are applicable. The companies concerned, their promoters and their intermediaries are hereby warned that making of so-called private placement of shares or collecting unofficial premia without recording the same in the books of account of the company, are serious contraventions of the Companies Act and will invite penal action under the Act by the Government. It may be noted that marketing of rights of renunciation by a private company is prohibited under Section 3(1)(iii)(c) of the Act, as it cannot make any invitation to the public to subscribe for its shares. (*Press Note No.* 17/6/92-CL-V, dated 6-7-1992).

Note : The Circular should now be read with the proviso added to s. 67(3) by the Amendment Act, 2000 which has the effect of saying that any such offer to more than fifty persons would be a public issue.

'Issue' as domestic concern [Sub-section (3)(b)]

In terms of sub-section (3)(b), an issue which can be regarded as being a domestic concern of the persons making and receiving the offer or invitation shall not be regarded as a public issue. If the following conditions are satisfied an issue can be regarded as a domestic concern:

(i) Offer made is made to less than 50 persons;

(ii) Each offer is made to a particular addressee and may only be accepted by the addressee;

(iii) Each addressee who takes up an offer warrants that he is acquiring the securities for his own account for long-term investment purposes and not with a view to resale, and it would be reasonable for the issuer in all circumstances to believe such a warranty from each addressee;

(iv) Non-renunciable documents of title are issued to successful applicants (*i.e.* distinctive share certificates); and

(v) The offer is not associated (either immediately or fairly soon after the issue) with an application for listing on the Stock Exchange or for some other facility for trading the securities offered. (TOLLEY'S COMPANY LAW, 1984 Edn., p. 615).

An invitation to subscribe for securities which is entirely a domestic concern of the persons making and receiving the offer, the invitation will not be a prospectus. A private placing where the company's directors approach a few likely investors with request that they or other individuals whom they may introduce should subscribe for the company's securities is again not a prospectus. Approach by a company through its brokers or a merchant banker or financier or recognised dealer acting on its behalf to a limited number of institutional or other investors inviting them to subscribe for the securities will not amount to a prospectus. But even an offer to a single person may be offer to public. Thus, a document addressed to the public even if it is in fact shown to one person only in the expectation that he will be willing to subscribe all the capital will be a prospectus and is deemed to be "issued" when it is shown to that person: *Nash v. Lynde,* 1929 AC 158.

Letter of offer with right of renunciation.—The issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require the issue or registration of prospectus. (*Letter No.* 8/81/56-PR, dated November 4, 1957 issued by Department of Company Law Administration). The offer of further shares with right of renunciation is a domestic concern of the persons receiving the offer and renouncing the offer and is not made by the company with intent to make a public offer and, therefore, the letter of offer to shareholder with right of renunciation does not require registration with the Registrar of Companies.

Guidelines specified by SEBI under sub-section (3A)

Notwithstanding anything contained in sub-section (3), SEBI is empowered under sub-section (3A) to specify guidelines for offers made by Public Financial Institutions specified in section 4A or NBFCs referred to in section 45-I(f) of Reserve Bank of India Act, 1934. These guidelines may be issued by SEBI after consultation with RBI.

SEBI Guidelines, 2000.—Issue of Capital by Designated Financial Institutions

"Designated Financial Institution" means the public financial institution included in or notified under section 4A of the Companies Act, Industrial Development Corporation established by State Governments and financial institutions approved under section 36(1)(viii) of Income Tax Act, 1961 [*Clause 1.2.1(x)*].

The guidelines shall be applicable to the Designated Financial Institutions (DFIs) approaching capital market for funds through an offer document. The requirements under the guidelines are under the following heads:

(1) Promtoers' Contribution [*Clause 12.1*]
(2) Reservation for Employees [*Clause 12.2*]
(3) Pricing of Issues (conditions for free pricing of issues and justification for premium) [*Clause 12.3*]
(4) Specific disclosures in offer document [*Clause 12.4*]
(5) Issue of debentures including bonds (matters relating to credit rating, premium amount, appointment of trustees, conversion option etc.) [*Clause 12.5*]
(6) Roll-over of debentures/bonds [*Clause 12.6*]
(7) Protection of interests of debenture/bond holders [*Clause 12.7*]
(8) Issue of new Financial Instruments by DFIs [*Clause 12.8*]
(9) Bonus Issue by DFIs [*Clause 12.9*]
(10) Other requirements [*Clause 12.10*]
(11) Utilisation of money before allotment (in public issue of debt instruments) [*Clause 12.11*]

§ For text of the SEBI Guidelines 2000 refer *Appendix* 162.

Default under sec. 274(1)(g) not to apply to Public Financial Institutions.—Default in complying with the provisions of sec. 274(1)(g) in respect of privately placed bonds/debentures/debt instruments by public financial institutions will not be considered

as default to disqualify directors under that section. [*General Circular No. 5 of 2003, dt. 14-1-2003 issued by Deptt. Of Company Affairs*].

Private placement of debt securities by listed companies.—For SEBI Circular No. SEBI/MRD/SE/AT/36/2003/30/09, dt. 30-9-2003 on this matter, see Notes under sec. 117.

RBI Guidelines on Investments by All India Financial Institutions in Non-Government Debt Securities.—See RBI Circular No. FID No. C-8/01.02.00/2003-04, dt. 4-11-2003 under sec. 117.

S. 68. Penalty for fraudulently inducing persons to invest money.—Any person who, either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into, or to offer to enter into—

(a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting shares or debentures; or

(b) any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuations in the value of shares or debentures;

shall be punishable with imprisonment for a term which may extend to five years, or with fine which may extend to [1][*one lakh rupees*], or with both.

NOTES

Companies Act, 1956

This section corresponds to section 12 of the British Prevention of Fraud (Investment) Act, 1939 (2 and 3 Geo. V. Chap. 16).

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 10,000 rupees to 1,00,000 rupees under this section.

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

These provisions are intended to apply not merely to company prospectuses but also to any proposal or offer for sale of shares by anybody whatsoever.

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1. The words "ten thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 25 (w.e.f. 13-12-2000).

This section is expected to serve "as a sufficient" deterrent to unscrupulous company promoters against making untrue and deceptive statements in prospectuses with a view to obtaining capital from the public. (*Company Law Committee Report :* Para 62).

An example of the type of situation contemplated by the section is to be found in *M. K. Sreenivasan, Re,* (1944) 14 Com Cases 193 : AIR 1944 Mad 410, where the accused persons were convicted for the offence of criminal conspiracy to cheat the public by selling them shares by means of an offer in a prospectus which suppressed vital information about the concerns to be transferred to the company.

A complaint under this section was quashed because it was not proved that the person in question who purchased rights of renunciation on the basis of which shares were allotted to him, had done so because of any fraudulant inducement. *Dilip S. Dahanukar v. Padam Kumar Khaitan,* 1996 Cr LJ 1569 (Raj).

Reckless

The term 'reckless' refers to basic intention. The mental element of the offence can be satisfied by proof either of intention or recklessness. The latter may mean proof either that the defendant knew the risk but consciously chose to go ahead and run that risk *R. v. Cunningham,* (1957) 2 QB 396 or that he failed even to consider the risk in circumstances where any reasonable person would have taken the risk into account. *Metropolitan Police Commissioner v. Caldwell,* (1982) AC 341. The word 'recklessly' must be left to bear its full meaning and be construed as covering also the case of a high degree of negligence without dishonesty. *R. v. Bates,* (1952) 2 All ER 842; see also *R. v. Russell,* (1953) 1 WLR 77.

§ For a discussion on the meaning of the word 'reckless', see Notes under s. 542, *post.*

SEBI Regulations for prohibition of fraudulant and unfair practices in securities markets

SEBI has issued "SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995. Under the Regulations the SEBI has powers to take measures to prohibit, unearth and deal with fraudulent and manipulative transactions to effectively protect the interests of investors. This is also necessary in order to promote healthy, fraud-free and manipulation-free development of securities market in the country so that effective measures are taken to check and prevent transactions which tend to affect and manipulate market conditions to the advantage of a few and to the detriment of general genuine investors. Therefore, no prohibition can be read in the provisions of section 11(2) of SEBI Act, 1992 for not giving effect to Regulation of 1995. Regulations of 1995 in no uncertain terms provide for an investigation in respect of the conduct and affairs of any person buying, selling or otherwise dealing in securities. Thus, necessary power to hold enquiry against buyer or seller and power to call the information from him exists. The fact that no reference has been made in summons to these regulations is immaterial. Such omission by itself does not invalidate the exercise of authority. Law in this regard is well-settled that if source of power exists, non-mentioning of it or wrong labelling of it would not invalidate exercise of such powers. *Karnavati Fincap Ltd. v. SEBI,* (1996) 23 CLA 113 at p. 118 (Guj).

§ For text of the "SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995", see *Appendix* 182.

Penalty for fraudulent inducement

A person who fraudulently induces persons to invest money is punishable with imprisonment for a term which may extend to five years, or with fine which may extend to one lakh rupees or with both.

Prosecution under Indian Penal Code

Two companies entered into sponsorship agreement for the purpose of raising finance by listing at Over the Counter Exchange of India (OTCEI). Investors made their sub-

scriptions for equity shares in the sponsored company on representations that shares would be arranged to be sold to public by a certain date. Subsequently the agreement was altered to the effect that the sponsor would specify the date for public sale. This alteration was not brought to the notice of the investors. The investors filed a complaint against the sponsor for cheating by false representations. The court refused to quash the complaint saying that magistrate could examine the question whether the complaint could be filed only by the Registrar of Companies. *Sundaram Finances Services Ltd. v. Grandtrust Finance Ltd.*, (2002) 112 Com Cases 361 (Mad).

Compoundable offence.—The offence is compoundable under section 621A.

Power of making complaint vested with SEBI

By virtue of the amendment made in section 621 by the Amendment Act, 2000. SEBI is statutorily vested with the power to file complaints as discussed earlier.

SEBI Guidelines, 2000.—Under the heading 'Disclaimer clause' to be incorporated in the prospectus, a statement, *inter alia*, on the following lines, is to be included:

The filing of offer document with SEBI does not, however, absolve the company from any liabilities under section 63 or 68 of the Companies Act, 1956 or from the requirement of obtaining such statutory or other clearances as may be required for the purpose of the proposed issue. SEBI further reserves the right to take up, at any point of time, with the lead merchant banker(s) any irregularities or lapses in offer document [*see Clause 6.3.3.1 of Chapter VI*].

§ For other details for disclaimer clause, see Notes under section 56.

[1][**S. 68-A. Personation for acquisition, *etc.*, of shares.**—(1) Any person who—

(a) makes in a fictitious name an application to a company for acquiring, or subscribing for, any shares therein, or

(b) otherwise induces a company to allot, or register any transfer of, shares therein to him, or any other person in a fictitious name,

shall be punishable with imprisonment for a term which may extend to five years.

(2) The provisions of sub-section (1) shall be prominently reproduced in every prospectus issued by the company and in every form of application for shares which is issued by the company to any person.]

NOTES

Companies (Amendment) Act, 1965

Object of section.—The section was inserted by section 8 of the Companies (Amendment Act (XXXI of 1965). The object of the section was thus stated in the Notes on clauses: "This clause is based on the recommendation contained in paragraph 11 of the Commission's Report. It seeks to make it an offence to make applications for shares in the name of or to induce the allotment of shares to fictitious persons." (*Clause 8*).

Genesis of section.—The Report of the Commission (Vivian Bose Commission) said as follows:—"An instance came to the notice of the Commission where shares of a public company to the extent of Rupees 16 lakhs were applied for on behalf of 114 non-existing shareholders. Although it cannot be stated that this practice is of widespread usage, still any instance of such practice should be dealt with severely. At one time the Commission thought that it might be possible to obtain application forms to be attested by a Magistrate or a Justice of the Peace or a Gazetted Officer of Government; but it was felt that this

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1. Ins. by Act 31 of 1965, s. 8 (w.e.f. 15-10-1965).

practice would result in inconvenience to genuine applicants and bring out particularly within the confines of a small community, the private affairs of individuals. However, in order to eradicate such a practice, even though fortunately not widespread, it is recommended that—

(i) A provision should be made in the Companies Act, whereby any person who, either makes an application to the company or otherwise induces the company to allot or transfer its shares in the names of fictitious or non-existent person, shall be punishable with imprisonment which may extend to five years.

(ii) The penal provision suggested in item (i) above shall be inserted at a prominent place—

(a) in every prospectus issued by a company; and

(b) in every form of application for shares that is issued to any person." [*Report* : Para (11)].

"The Commission has adverted to a case where shares to the extent of Rs. 16 lakhs in a public company were applied for on behalf of non-existing shareholders. Benami shareholding and shareholding in the names of fictitious or non-existing persons are common. The object is to avoid tax and defraud the revenue in cases where the super-tax limit is reached. A provision should be made in the Companies Act making it a punishable offence for a person to apply for or get an allotment of shares or get a transfer of shares registered in the names of fictitious or non-existing persons or benamidars and a clause to this effect should be inserted in every prospectus issued by the company and applications for shares or registration of transfer of shares". (*Daphtary-Sastri Committee's recommendation* : Para 11).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Scope of section

The section was not attracted to a case in which the applicants had not made any application in fictitious names and had applied in their own names. *Paresh M. Parekh v. SEBI,* 2003 CLC 62 (SAT).

Offences to be investigated by Delhi Police Establishment

As per *Notification No.* S.O. 3803, dated 8-11-1979 offences under this section are to be investigated by the Delhi Special Police Establishment. The text of the notification is reproduced below:

Text of Notification S.O. 3803, dated 8-11-1979.—"In exercise of the powers conferred by section 3 of the Delhi Special Police Establishment Act, 1946 (25 of 1946), the Central Government hereby specifies the following offences as the offences which are to be investigated by the Delhi Special Police Establishment, namely:—

(a) Offences punishable under section 68-A of the Companies Act, 1956 (1 of 1956); and

(b) Attempts, abetments and conspiracies in relation to, or in connection with, the offences mentioned in clause (a) or any other offence committed in the course of the same transaction arising out of the same facts."

Offences under SEBI Act : Investigation by Delhi Special Police Establishment

Notification No. S.O. 503, dated 13-2-1996.—In exercise of the powers conferred by section 3 of the Delhi Special Police Establishment Act, 1946 (Act No. 25 of 1946), the Central Government hereby specifies the following offences as offences which are to be investigated by the Delhi Special Police Establishment, namely:—

(a) Offence punishable under section 24 of the Securities and Exchange Board of India Act, 1992;

(b) Attempts, abetments, and conspiracies in relation to or in connection with one or more of the offences mentioned above and any other offence or offences committed in the course of the same transaction.

Elimination of Multiple/Fictitious Applications

§ SEBI has issued a Circular No. PR No. 21/2001, dt. 31-1-2001. See the text of Circular under section 73 *post.*

Penalty for personation of shareholder.—See Notes under section 116, *post.*

Penalty for default.—Acquisition of shares by a person by impersonation attracts imprisonment for a term up to five years.

Offence not compounable.—The offence is not compoundable under section 621A.

[1][***S. 68B. Initial offer of securities to be in dematerialised form in certain cases.***—*Notwithstanding anything contained in any other provisions of this Act, every listed public company, making initial public offer of any security for a sum of rupees ten crores or more, shall issue the same only in dematerialised form by complying with the requisite provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.*]

NOTES

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

This section has been inserted by the Amendment Act, 2000. It is mandatory for a listed company making its initial public offer of any security for a sum of Rs. 10 crore or more to be in demat form only in accordance with the provisions of the Depositories Act, 1996 and regulations made thereunder.

Scope of section

The mandatory requirement of issuing securities in demat form applies to an initial public offer of securities of not less than Rs. 10 crore by a listed company.

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1. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 26 (w.e.f. 13-12-2000).

Issue of securities in dematerialised form : SEBI Guidelines, 2000

§ See Notes under sec. 56.

Option to subscribe—Disclosure in offer document

(a) The details of option to subscribe for securities to be dealt with in a depository.

(b) The lead merchant banker shall incorporate a statement in the offer document and in the application form to the effect that the investor shall have an option either to receive the security in the form of physical certificates or to hold the securities in dematerialised form with a depository. [*Clauses 6.19.9 and 8.20*].

Issue of Certificates on IPO

SEBI has mandated that all the shares allotted under new initial public offerings (IPOs) will be traded in demat form only in all the exchanges. Investors, however, have the right to obtain and hold physical share certificate, though these will need to be dematerialised before sale of securities. Currently, the listing agreement provides that the physical share certificates are to be issued in market lots only. It has now been decided that in the case of IPOs the issuer company may issue a single share certificate to any investor who wishes to obtain physical share certificates unless otherwise specifically requested by him. [*SMDRP/Policy/Cir-12/01, dt. 28-2-2001, issued by SEBI*].

Allotment

S. 69. Prohibition of allotment unless minimum subscription received.—(1) No allotment shall be made of any share capital of a company offered to the public for subscription, unless the amount stated in the prospectus as the minimum amount which, in the opinion of the Board of Directors, must be raised by the issue of share capital in order to provide for the matters specified in clause 5 of Schedule II has been paid to and received by the company, whether in cash or by a cheque or other instrument which has been paid.

(2) The amount so stated in the prospectus shall be reckoned exclusively of any amount payable otherwise than in money, and is in this Act referred to as "minimum subscription".[1]

(3) The amount payable on application on each share shall not be less than five per cent of the nominal amount of the share.

[2][(4) All moneys received from applicants for shares shall be deposited and kept deposited in a Scheduled Bank—

(a) until the certificate to commence business is obtained under section 149, or

(b) where such certificate has already been obtained, until the entire amount payable on applications for shares in respect of the minimum subscription has been received by the company,

and where such amount has not been received by the company within the time on the expiry of which the moneys received from the applicants for shares are required to be repaid without interest under sub-section (5), all moneys received from applicants for shares shall be returned in accordance with the provisions of that sub-section.

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1. Ins. by the Companies (Amendment) Act, 2000, (53 of 2000) s. 24 (w.e.f. 13-12-2000).
2. Subs. by Act 31 of 1965, s. 9 for sub-section (4) (w.e.f. 15-10-1965).

In the event of any contravention of provisions of this sub-section, every promoter, director or other person who is knowingly responsible for such contravention shall be punishable with fine which may extend to [3][*fifty thousand rupees*].]

(5) If the conditions aforesaid have not been complied with on the expiry of one hundred and twenty days after the first issue of the prospectus, all moneys received from applicants for shares shall be forthwith repaid to them without interest; and if any such money is not so repaid within one hundred and thirty days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of six per cent per annum from the expiry of the one hundred and thirtieth day:

Provided that a director shall not be so liable if he proves that the default in the repayment of the money was not due to any misconduct or negligence on his part.

(6) Any condition purporting to require or bind any applicant for shares to waive compliance with any requirement of this section shall be void.

(7) This section, except sub-section (3) thereof, shall not apply in relation to any allotment of shares subsequent to the first allotment of shares offered to the public for subscription.

NOTES

Eng. Act, 1948 : Sec. 47.
Eng. Act, 1985 : Sec. 83.

Previous Act : Sec. 101.

Companies (Amendment) Act, 1965

The only important change in this section made by the Amendment Act of 1965 is in sub-section (5) and relates to the refund of monies to the applicants, which has to be done within 130 days of the issue of the prospectus if the conditions for allotment are not complied with within 120 days of such issue, and, on failure, the rate of interest chargeable is 6 per cent. Under the previous Act, the periods were 190 and 180 days respectively and the rate of interest was 7 per cent.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5,000 rupees to 50,000 rupees under sub-section (4).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

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3. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 27 (w.e.f. 13-12-2000).

Minimum subscription [sub-sections (1) and (2)]

'Minimum subscription' for the purposes of this section means the minimum amount which, in the opinion of the Board of Directors, must be raised by the issue of share capital in order to provide for the matters specified in clause 5 of Schedule II.

Clause 5 of Schedule II prior to the substitution of Schedule II read as follows:—

"5. Where shares are offered to the public for subscription, particulars as to—

(a) the minimum amount which, in the opinion of the directors or of the signatories of the memorandum arrived at after due inquiry, must be raised by the issue of those shares in order to provide the sums, or, if any part thereof is to be defrayed in any other manner, the balance of the sums required to be provided in respect of each of the following heads and distinguishing the amount required under each head:—

(i) the purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;

(ii) any preliminary expenses payable by the company, and any commission so payable to any person in consideration of his agreeing to subscribe for, or of his procuring or agreeing to procure subscriptions for, any shares in the company;

(iii) the repayment of any moneys borrowed by the company in respect of any of the foregoing matters;

(iv) working capital;

(v) any other expenditure, stating the nature and purpose thereof and the estimated amount in each case; and

(b) the amounts to be provided in respect of the matters aforesaid otherwise than out of the proceeds of the issue and the sources out of which those amounts are to be provided."

The present Schedule II does not contain any provision on the lines of clause 5 of erstwhile Schedule II. The reference to 'minimum subscription' in the present Schedule II is at two places. Clause (e) of Part I (I-General Information) requires a 'statement/declaration about refund of the issue if minimum subscription of 90% is not received within 90 days of the closure of the issue' to be incorporated in the prospectus. Part II-C which relates to disclosure of 'Statutory and other information' refers simply to 'minimum subscription' (Item 1).

Minimum subscription of 90% of the issued capital under Schedule II and in SEBI Guidelines, 2000 is bound to be more than the minimum subscription envisaged in sub-sections (1) and (2). The requirements of sub-sections (1) and (2) will thus be implicitly satisfied.

Application Money [Sub-section (3)]

The provisions of the section excepting sub-section (3), it must be noted, do not apply to any allotment subsequent to the first allotment.

It should be noted that the conditions laid down in section 69 apply only to shares and not to debentures whether convertible into shares or not. Further, except the condition which states that the minimum amount on application must be not less than 5%, conditions will not apply to any allotment of shares subsequent to the first allotment of shares offered to the public for subscription.

It follows that the 5% requirement is applicable to all allotments whether initial or subsequent, and an allotment without compliance with this requirement would be invalid. *Mutual Bank of India Ltd. v. Sohan Singh,* (1936) 6 Com Cases 195, 198 (Lah) and for a **contrary** view see, *Happy India Insurance Co. Ltd., Re,* (1940) 10 Com Cases 83, 86 : AIR 1940 Cal 164. In this case the court said that there was nothing in section 101 of the

Indian Companies Act, 1913, which forbade the directors of a company to allot shares to applicants who neglected to pay the application money in terms of the prospectus once the first allotment had been regularly made, although it might be that a prospectus empowering them to do so would be an infringement of the Act.

Mode of payment of application money [Sub-section (3)]

An application for allotment of shares accompanied with application money in cash of more than Rs. 20,000 was held to be rightly rejected. It was in violation of s. 40A(3) of the Income-tax Act, 1961. *Mohammed Rafeek v. SEBI,* (1999) 98 Com Cases 802 : (1999) 20 SCL 198 (Ker). The court further said that the subject-matter of the complaint could not be pursued under a writ remedy.

Protection of investors' money [Sub-section (4)]

The present sub-section (4) was substituted in the place of the previous provision, by section 9 of the Companies (Amendment) Act, 1965. The Notes on clauses stated: "This clause is based on the recommendation made by the Vivian Bose Commission and the Daphtary-Sastri Committee. This is intended to safeguard the amounts paid by the applicants for shares until such time as the minimum subscription is collected by the company. The proposed amendment to section 69(4) is on the lines indicated by the Daphtary-Sastri Committee". (*Clause 9*).

The recommendation of the Commission of the Inquiry was as follows:—"Under existing provisions of section 69 of the Companies Act, a company cannot allot any of its share capital offered to the public for subscription, unless the amount stated in the prospectus as minimum subscription, has been received by the company. Sub-section (4) of the same section provides that all moneys received from applicants for shares shall be deposited, and kept deposited, in a scheduled bank until either they are returned to the applicants or the certificate to commence business is obtained under section 149.

An instance came to the notice of the Commission where a company obtained its certificate to commence business by filing a statement in lieu of prospectus. Thereafter, further capital was offered to the public, and the moneys received from applicants were not deposited in a scheduled bank but were allowed to remain in the hand of a sister company, which had also acted as underwriters. The company was enabled to do this because under the provisions of section 101 (2-B) of the Indian Companies Act, 1913 analogous to section 69(4) of the Companies Act, 1956, the moneys received from applicants were required to be deposited in a scheduled bank until required to be returned to the applicants, or until the certificate to commence business was obtained. Since, in this instance, the company had already obtained the certificate to commence business after filing the statement in lieu of prospectus, it was not obliged to keep the moneys in a scheduled bank when these were received as a result of the prospectus, subsequently issued.

In view of this, we recommend that—The words 'until the certificate to commence business is obtained under section 149' be deleted from section 69(4) and instead the following words be added, "till the amount stated in the prospectus as the minimum subscription is raised." (*Report :* Paras 57, 58 and 59).

In the place of the words 'the entire amount of the minimum subscription' occurring in the original Bill, the words 'the entire amount payable on applications for shares in respect of the minimum subscription' were substituted by the Joint Committee as the Committee felt that the entire amount of the minimum subscription for shares is not invariably called for at one time and feel that the proposed new sub-section (4)(b) should apply only to the amount payable on applications in respect of the minimum subscription. (*Joint Committee Report :* Para 14).

The purpose of this provision is to curtail the promotion of mushroom or undercapitalised companies.

Penalty for default [Sub-section (4)]

Application money is to be deposited and kept deposited in a scheduled bank until the time specified in sub-section (4). For contravention of provisions of sub-section (4), every promoter, director or other person who is knowingly responsible for the contravention is punishable with fine which may extend to Rs. 50,000/-.

Compoundable offence.—The offence is compoundable under section 621A.

Prosecution under IPC for non-refund of subscription money

The Supreme Court has expressed the view that retention of subscription money in violation of S. 69(4) may amount to an offence on the part of directors and promoters under Ss. 405 & 409 of the Indian Penal Code provided *mens rea* is established. Since the factual question of the existence of *mens rea* could not be determined either by the Supreme Court or by the High Court, the prosecution was not quashed. *Radhey Shyam Khemka v. State of Bihar,* (1993) 77 Com Cases 356 (SC).

Requirement as to minimum subscription [Sub-sections (1) and (5)]

Section 69 prohibits a company from making allotments pursuant to a public issue of capital unless the amount stated in the prospectus as the minimum subscription has been subscribed and the money payable on application in respect of such shares constituting the minimum subscription has been received by the company within 120 days. Once this requirement is satisfied s. 69(5) will have no application. When the minimum subscription is received within the stipulated period, the ban imposed by section 69(5) disappears and the company is free to make allotment even after the expiry of 120 days subject to the other requirements of the Act.

SEBI Guidelines, 2000 as to minimum subscription

These Guidelines provide as follows in relation to minimum subscription :

1. For Non-underwritten Public Issues [Clause 6.3.8.1]
2. For Underwritten Public Issues [Clause 6.3.8.2]
3. For Non-underwritten Rights Issue [Clause 6.40.11].
4. For Underwritten Rights Issue [Clause 6.40.12].
5. Composite Issues [Clause 6.3.8.3].
6. Extension of period of subscription [Clause 7.4.1.2(a)]
7. Devolvement on underwriters [Clause 7.4.1.2(c)]

Offer for sale.—The requirement of minimum subscription shall not be applicable to offer for sale [*Clause 6.3.8.4.1*].

Public issue by infrastructure company.—The requirement of minimum subscription shall not be applicable to an eligible infrastructure company, provided disclosures regarding alternate source of funding is made in the offer documents [*Clause 6.3.8.5*].

§ For the text of the SEBI Guidelines, see *Appendix* 162 and also Notes under section 56 *ante*.

Minimum subscription on debenture issue on rights basis

A company made a fully convertible debenture issue on rights basis making the statutory declaration that it would refund the subscription money in case the issue does not materialise upto 90%. The issue failed and the company refunded the money to applicants. SEBI proceeded against the company on the ground that it should not have done so unilaterally and should have sought SEBI directions, and debarred the company from access to the capital market for ten years. The Calcutta High Court did not approve this line of action on the part of SEBI. The Court said that SEBI is a *quasi*-judicial authority. It is bound to observe principles of natural justice. It should not have debarred the com-

pany from access to the capital market without hearing the company. Furthermore, SEBI had no power under s. 11A of the SEBI Act to issue any direction to the company that it should not refund the application money even if the subscription was below 90%, the company being bound under the Companies Act to do so. Nor the Company was under any obligation to seek SEBI directions for refunding. *Jenson and Nicholson (India) Ltd. v. U.O.I.*, AIR 1997 Cal 308.

"Allotment"

The expression "allotment" is not defined. It means and implies a division of the share capital into definite shares of a particular value or of different classes and assignment of such shares to different persons. *Re, Calcutta Stock Exchange Association Ltd.*, (1957) 27 Com Cases 559 : AIR 1957 Cal 438. In other words, "allotment means the appropriation out of previously unappropriated capital of a certain number of shares to a person". *Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd.*, (1963) 33 Com Cases 862 : AIR 1964 SC 250, *Shri Gopal Paper Mills Co. Ltd. v. CIT*, AIR 1970 SC 1750. But it does not include a re-issue of forfeited shares and, therefore, a return of allotment of such shares to the Registrar under section 75 is not necessary. *Ibid.* See also, Notes under s. 75.

Department's Clarification.—Where a company issued two prospectuses in two successive years and raised this query before the department whether the allotment under the second prospectus would also have to satisfy the requirement of minimum subscription, the Department expressed the following opinion: "As shares had been allotted at the first allotment after the issue of the first prospectus in 1962 in compliance with the provisions of section 69 of the Companies Act, 1956; these requirements do not have to be complied with again at the second allotment after the issue of the second prospectus in 1963, *vide* sub-section (7) of sec. 69." (*Department's Clarification File No.* 5(16) CL/06).

Communication of allotment

The mere subscription to shares in a company does not constitute a subscriber a shareholder of the company; he acquires the status of shareholder and the right to demand shares and to exercise the rights of a shareholder only when shares are allotted to him and a communication of the allotment is made to him. Although an application for shares made upon a condition precedent does not become binding on the applicant until it has been complied with or its performance waived, a mere failure of consideration is not a ground for treating shares allotted as unpaid. *Associated Clothiers Ltd. v. Union of India*, (1958) 28 Com Cases 386 at 392 (P&H), **relying** on, In re, *Continental and Shipping Butter Co. Mege and Angier's* case, (1875) WN 208. An application for shares is an offer and like any other offer must not only be accepted but the acceptance must also be communiated to the person making the offer. The mere entry of a shareholder's name in the company's register is insufficient to establish that an allotment was in fact made. *Official Liquidator, Bellary Electric Supply Co. v. Kanni Ram Rawoothmal*, (1933) 3 Com Cases 45 : AIR 1933 Mad 320. There can be no proper allotment of shares unless the applicant has been informed of the allotment. *British and American Steam Navigation Co., Re*, (1870) LR 10 Eq 659. A formal allotment is not necessary. It is enough if the applicant is made aware of the allotment. *Universal Bkg. Corpn., Re Gunn's* case, (1867) 3 Ch App 40. A letter demanding payment may be a sufficient notification of acceptance. *Forget v. Cement Products Co. of Canada*, (1961) WN 259. If the acceptance is verbal, by telephone, telex, fax or by conduct, it is, in accordance with the general rules of the law of contract, effective when it is received by the applicant, unless there is a different intention of the parties. *Entores Ltd. v. Miles Far East Corporation*, (1955) 2 All ER 493; *Brinkibon Ltd. v. Stalag*, (1980) 2 Lloyd's Rep. 556 (effect of repudiation by telex); **affirmed** by HL (1982) 1 All ER 293. He has the right to revoke his offer to purchase his shares and ask for the return of the moneys paid, before he is informed of the allotment. *A. Sirkar v. Hosiery Mills Ltd.*, (1933) 3 Com Cases 454, 455 (Rang). A verbal withdrawal may be enough. *Natal Investment Co. Ltd., Re, Wilson's* case, (1869) 20 LT 962; *National Savings Bank Association, Re, Hebbs* case, (1867) LR 4 Eq 9.

Allotment by post

When communication is by post, the applicant becomes bound by the allotment when the letter is posted provided that this was done during reasonable time and the letter was properly addressed and stamped. The allottee cannot get rid of the allotment by showing that he did not receive the letter. He can ask for a copy but cannot say that is not bound, Indian Contract Act, Sections 4 and 5. *Household Fire Insurance Co. v. Grant,* (1879) 4 Ex D 216 (CA); *Re, London and Northern Bank, ex p., Jones,* (1900) 1 Ch 220; *Holwell Securities Ltd. v. Hughes,* (1974) 1 All ER 161.

Deemed delivery of letter of allotment.—The articles of a company provided that the letters of allotment when posted would be deemed to have been delivered to the addressees. The allotment was provisional. The allottee in question had to accept it within the specified period. He never received the letter which was sent to him by recorded delivery. The directors, thinking that the allotment was not accepted, allotted the shares to themselves. The allottee brought an action for rectification of the register of members by cancelling the allotment and restoring his allotment. The court allowed the relief. The letter of provisional allotment was also defective in itself inasmuch as it gave less than the statutory period for acceptance of an offer under pre-emptive rights. The purpose of the provision relating to deemed delivery is to deal with a case where there was uncertainty as to whether a document had been delivered, such a provision cannot be relied upon where it was established that the document was not delivered. The postman had testified that he had returned the letter to the company's office. Thus the directors knew that the letter had not been delivered and they also knew that the shareholder wanted to take-up the allotment. *Thundercrest Ltd., Re,* (1995) 1 BCLC 117 (Ch D).

Allotment by proper authority

The proper authority for allotment is the Board of directors. It is necessary that the Board should be duly constituted and should pass a valid resolution of allotment at a valid meeting. *Homer District Consolidated Gold Mines, Re,* (1888) 39 Ch D 546 (CA). But section 290 and the Rule in *Royal British Bank v. Turquand,* (1856) 6 E & B 327 : (1843-60) All ER Rep 435 may make an allotment valid even if some defect was there in the appointment of directors but which was subsequently discovered. An allotment by a Board irregularly constituted may be subsequently ratified by a regular Board. *Portuguese Consolidated Copper Mines,* (1889) 42 Ch D 160 (CA). A director who has joined in an allotment to himself will be estopped from alleging the invalidity of the allotment. *York Tramways Co. v. Willows,* (1882) 8 QBD 685 (CA).

***Ultra vires* allotment**

Where the directors have no authority under the company's memorandum to make an allotment, the allotment would be irregular and may be ratified by the company. But it would be void where the company itself has no power to make an allotment. At common law any subscription money was returnable to the allottee. *Waverly Hydropathic Co. v. Barrowman,* 1895, 23 R 136. If a member was admitted who was not duly qualified in terms of the articles, only the company, and not the member, could plead that his admission was *ultra vires: Aberdeen Master Masons Incorporation v. Smith,* 1908 SC 669; 15 SLT 953 (Scott).

Directors' duty in allotment

The directors are bound by the fiduciary duty to make an allotment in utmost good faith only in the best interest of the company *Re, London and Colonial Finance Corporation,* (1897) 13 TLR 576 (CA); *Shaw v. Holland,* (1900) 2 Ch 305 (CA); *Percival v. Wright,* (1902) 2 Ch 421; *Gething v. Kilner,* (1972) 1 All ER 1166. Where certain shares of the company which the auditors had certified to be of high market value were allotted at a meagre sum per share, it was held that the allottment was not in the interest of the company. Whilst it may be open to the directors to allot shares at such price and to such parties as they deem fit, there cannot be the slightest doubt that the action of the directors

must be in the interest of the company. *Shanta Geneieve Pommeret v. Sakal Papers Pvt. Ltd.*, (1990) 69 Com Cases 65, 76, 91 (Bom). Directors duty is to take into consideration the market value of their company's shares, except perhaps when they are offering shares on rights basis to the existing shareholders in which case they may charge less than the market price, the difference would be an element of bonus to the shareholders. *Hilder v. Dexter,* (1902) AC 474 (HL).

§ For further Notes as to the meaning of allotment see under s. 75 under the heading 'Allotment'.

"Offer to the public"

This section applies only where a prospectus is issued in the form of an offer to the public. *Model Bank Ltd. v. Janwi Narain,* (1932) 2 Com Cases 137, 142 (Lah).

"An offer to the public signifies an offer made by advertisement or circular to the general public or some section thereof, as distinguished from an offer made privately, that is, to a select and small circle of friends, customers or connections. Thus where a business is converted into a private company, shares offered by the vendors to their friends, relations or to selected customers, have not hitherto been regarded as having been offered to the public". (PALMER: COMPANY PRECEDENTS, 17th Edn., Part I, page 58).

§ See also, Notes under sections 56 and 67.

Money to be kept in separate bank account [Sub-section (4)]

It may be noted that this section does not require the application moneys to be kept in a separate bank account. It requires them only to be kept in a scheduled bank. However, under section 73, sub-section (3), where the shares or debentures are to be dealt with on the stock exchange, the application moneys must be kept in a separate bank account. This provision in section 73 applies to debentures in addition to shares. It is a condition precedent for permission that the shares should be allowed to be dealt with at the stock exchange that the application money was deposited as required by the section in a separate account to be opened with the bankers to the issue. The direction given by the Appellate Authority of SEBI for necessary compliance was held to be proper. *Universal Incast Ltd. v. AA, SEBI,* (2000) CLC 948 (P&H). To the same effect is *Goldline Financial Services Ltd. v. Hyderabad Stock Exchange,* (2001) 30 SCL 31 : (2001) CLC 489 (SAT—Mumbai), where the requirement of the section being a condition precedent to listing, a conditional permission that the company should transfer the application money to a separate bank account was held to be a refusal of permission.

***Stockinvest scheme.**—The Stockinvest Scheme is in conformity with the provisions of sections 69 and 73 of the Act. The share application money can be paid either in cash or by a cheque or by any other instrument. The scheme has been prescribed as a measure to avoid any complaint about non-payment/delay in refund of share application money in terms of this section from the investing public. For the text of the scheme and relevant Department Circulars, see notes under section 73(3) and *Appendix* 230.

Prescribed Form.—After the allotment has been made, a return of allotment must be filed in Form No. 2 of the Companies (Central Govt.'s) General Rules and Forms. (*Appendix* 1).

Procedure for share applications and application money

SEBI Guidelines, 2000.—See Notes under sec. 56.

For SEBI Guidelines on Basis of Allotment.—Procedure for proportionate allotment, see Notes under section 73.

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* **Stockinvest Scheme has been withdrawn w.e.f. 5-11-2003 [Vide *RBI Circular No. DBOD. No. FSC.BC.42/24.47.001/2003-04, dt. 5-11-2003*]. See *Appendix* 230.**

Secretarial Practice Notes : Prohibition unless minimum subscription received

In case of first allotment, check before allotment whether:

(i) the minimum subscription of 90% had been received?

(ii) the amount payable on application on each share, being not less than 5 per cent of the nominal amount of the share, received?

(iii) the same was deposited in a scheduled bank, until certificate to commence business has been obtained? [Separately accounted where securities are to be listed].

(iv) the above amount was received before the expiry of 120 days after the first issue of the prospectus? If not, whether the entire amount was repaid to applicants within 130 days after the issue of prospectus?

(v) in case of subsequent allotment, check that the amount payable on application on each share was not less than 5 per cent of the nominal amount of the shares?

Documents Involved: (1) Prospectus, (2) Application and Allotment Register, (3) Certificate to commence business, (4) Bank Statements.

S. 70. Prohibition of allotment in certain cases unless statement in lieu of prospectus delivered to Registrar.—(1) A company having a share capital, which does not issue a prospectus on or with reference to its formation, or which has issued such a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or debentures unless at least three days before the first allotment of either shares or debentures, there has been delivered to the Registrar for registration a statement in lieu of prospectus signed by every person who is named therein as a director or proposed director of the company or by his agent authorised in writing, in the form and containing the particulars set out in Part I of Schedule III and, in the cases mentioned in Part II of that Schedule, setting out the reports specified therein, and the said Parts I and II shall have effect subject to the provisions contained in Part III of that Schedule.

(2) Every statement in lieu of prospectus delivered under sub-section (1), shall, where the persons making any such report as aforesaid have made therein, or have without giving the reasons, indicated therein, any such adjustments as are mentioned in clause 5 of the Schedule III, have endorsed thereon or attached thereto a written statement signed by those persons, setting out the adjustments and giving the reasons thereof.

(3) This section shall not apply to a private company.

(4) If a company acts in contravention of sub-section (1) or (2), the company, and every director of the company who wilfully authorises or permits the contravention, shall be punishable with fine which may extend to [1][*ten thousand rupees*].

(5) Where a statement in lieu of prospectus delivered to the Registrar under sub-section (1) includes any untrue statement, any person who authorised the delivery of the statement in lieu of prospectus for registration shall be punishable with imprisonment for a term which may extend to two years or with fine which

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1. Subs. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 28 (w.e.f. 13-12-2000), for "one thousand rupees".

may extend to [2][*fifty thousand rupees*] or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of the delivery for registration of the statement in lieu of prospectus believe, that the statement was true.

(6) For the purposes of this section—

(a) a statement included in a statement in lieu of prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included; and

(b) where the omission from a statement in lieu of prospectus of any matter is calculated to mislead, the statement in lieu of prospectus shall be deemed, in respect of such omission, to be a statement in lieu of prospectus in which an untrue statement is included.

(7) For the purposes of sub-section (5) and clause (a) of sub-section (6), the expression "included", when used with reference to a statement in lieu of prospectus, means included in the statement in lieu of prospectus itself or contained in any report or memorandum appearing on the face thereon, or by reference incorporated therein, or issued therewith.

NOTES

Eng. Act, 1948 : Sec. 48. Previous Act : Sec. 98.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 1,000 rupees to 10,000 rupees under sub-section (4) and from 5,000 rupees to 50,000 in sub-section (5).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

It has to be noted that no allotment can be made by a public company until three days before the statement in lieu of prospectus has been filed. There was no such restriction under the previous Act.

As to the need to file a statement in lieu of prospectus where a private company ceases to be private company, see section 44.

Accuracy of statement

Filing of a statement with the Registrar which is complete on the face of it and the Registrar has certified it, entitles the company to proceed to allotment notwithstanding that the statement is insufficient and/or inaccurate. The allotment is not vitiated by any such insufficiency or inaccuracy. *Blair Open Hearth Furnace Co. Ltd. Re*, (1914) 1 Ch 390 (CA). The penalty provisions for any violation of the section may not affect the va-

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2. Subs. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 28 (w.e.f. 13-12-2000), for "five thousand rupees".

lidity of the contract of allotment between the company and the allottee. It has been held that this section does not, if infringed, make the contract between a shareholder and the company unlawful. *Mansukhlal Dhanji Vora v. Jupiter Airways Ltd.*, (1953) 23 Com Cases 124 : AIR 1953 Bom 112.

It should however be noted that if by reason of the violation of sections 69 and 70, the allotment becomes irregular, it would be voidable at the option of the allottee under section 71.

Conversion into public company

Section 44 requires a private company to file a statement in lieu of prospectus on its ceasing to be a public company. Once a statement in lieu of prospectus is filed under section 44 there is no need to file yet another statement in lieu of prospectus under this section.

Company cannot issue fully paid shares as donation/gift

Department's view.—A company limited by shares has no power to issue shares as fully paid-up as a gift or bonus to the shareholders although a contract to do so has been made *bona fide* and registered under the Companies Act, 1956; if there is no payment in money's worth for the shares the allotment would be *ultra vires*. Consequently, the allotment of shares as fully-paid up to a charitable trust by way of donation is not valid in Law. (*Letter No.* 8/50(77)/65-CL-V, dated 10-8-1965.)

Private Company [Sub-section (3)].—The section does not apply to any private company.

Penalty for default [sub-section (4).—If a company acts in contravention of sub-section (1) or (2), that is it fails to deliver statement in lieu of prospectus to the Registrar as required, the company and every officer of the company who wilfully authorises or permits the contravention are punishable with fine upto Rs. 10,000/- under sub-section (4).

Any person who authorises the delivery of the statement in lieu of prospectus containing any untrue statement for registration to the Registrar under sub-section (1) is punishable with imprisonment for a term up to two years or with fine up to Rs. 50,000/-, or with both, unless he proves either that the statement was immaterial or that at the time statement in lieu of prospectus was made and upto the time of its delivery, he believed that statement to be true, under sub-section (5).

Compoundable offence.—This offence is compoundable under section 621A.

Secretarial Practice Notes : Statement in lieu of prospectus

Check that a public company which had not proceeded to allot shares offered to public or which had not issued a prospectus had filed a statement in lieu of prospectus with the Registrar containing the required particulars for a prospectus along with relevant annexures, before 3 days of first allotment of shares or debentures.

Documents Involved: (1) Application and Allotment Register, if any, (2) Statement in lieu of Prospectus, (3) Minutes of Board/General Meeting.

S. 71. Effect of irregular allotment.—(1) An allotment made by a company to an applicant in contravention of the provisions of section 69 or 70 shall be voidable at the instance of the applicant—

(a) within two months after the holding of the statutory meeting of the company, and not later, or

(b) in any case where the company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, within two months after the date of the allotment, and not later.

(2) The allotment shall be voidable as aforesaid, notwithstanding that the company is in course of being wound up.

(3) If any director of a company knowingly contravenes or wilfully authorises or permits the contravention of, any of the provisions of section 69 or 70 with respect to allotment, he shall be liable to compensate the company and the allottee respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred thereby:

Provided that proceedings to recover any such loss, damages or costs shall not be commenced after the expiration of two years from the date of the allotment.

NOTES

Eng. Act, 1948 : Sec. 49.
Eng. Act, 1985 : Sec. 85.

Previous Act : Sec. 102.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Irregular allotments

Sections 69, 70 and 73 prescribe conditions of allotment but with different effects. Three cases have to be distinguished:

(1) Where the allotment is defective because it is made before the lapse of the third day after the publication of a prospectus issued generally, the allotment is valid, but the company and its officers in default are liable to a fine. (S. 70).

(2) Where the allotment is defective because no application to the stock exchange for listing permission is made or such application is refused, the allotment is void. (S. 73).

(3) Where the provisions relating to the minimum subscription or partial allotment or the application money have not been complied with (Ss. 83 and 84), the allotment is voidable at the instance of the allottee. (S. 69).

If an allotment is made without fulfilling the statutory requirement of payment of 5% of the value of the share along with the application, there is no concluded contract and the share money cannot be recovered. Failure to protest until demand for payment was made cannot be regarded as waiver. *Ram Lal Sao Gupta v. M.E.R. Malak,* (1939) 9 Com Cases 201 (Nag).

Remedy of applicant on irregular allotment

If an allotment is irregularly made, the applicant has two remedies open—one against the company and the other against the directors; as against the company within two months of the holding of the statutory meeting, or if none is held or is not required to be held or the allotment is made after the meeting, within two months of the allotment, and

as against the directors who knowingly contravened the legal requirements, within two years of the date of the allotment.

"Knowingly" in sub-section (3) means with knowledge of the facts upon which the contravention depends. But a director cannot escape liability by being ignorant of the law. *Burton v. Bevan,* (1908) 2 Ch 240.

An applicant who can avoid an irregular allotment can also accept it at his option and if does so he can still bring an action against the directors who have knowingly contravened section 69 or 70 to compel them to make good the loss caused to him by the irregular allotment. See PALMER'S COMPANY LAW, p. 405 (24th Edn., 1987). Unless an allotment is *ab inito* void, an allottee who wants to avoid an irregular allotment, must do so in the manner and within the time-limit provided by this section. If he does not take any steps in time and waits and after the expiry of the time or when winding up proceedings against the company are taken, he applies under this section or applies to the Court (now CLB) for rectification of the Register under section 155 (now s. 111(4)), the Court would not exercise its discretion in his favour. *Blanche Fonseca v. Jupiter Airways Ltd.,* (1953) 23 Com Cases 322 : AIR 1953 Bom 417.

Injunction against withdrawal of application money

The company is bound by virtue of section 69(4) not to withdraw the application money which has to be kept in a scheduled bank until the completion of allotment as per sections 69 and 70. This is necessary to protect the applicants in the matter of the refund of their application money. An injunction therefore may be granted to restrain directors from parting with or otherwise dealing with the application money provided that the proceedings are commenced in time. *Mears v. Western Canada Pulp & Paper Co. Ltd.,* (1905) 2 Ch 353 (CA).

Ratification by company of irregular allotment

An irregular allotment of shares made by the directors in excess of their powers may be subsequently ratified by the shareholders at a general meeting. *Bamford v. Bamford,* (1969) 39 Com Cases 369 : (1968) 2 All ER 655 (Ch D), **affirmed** in (1969) 1 All ER 969 : (1969) 39 Com Cases 838 (CA).

Lapse of application on undue delay in allotment

An application to take shares lapses if allotment is delayed unreasonably. See *Ramsgate Victoria Hotel Co. v. Montefiore,* (1866) LR 1 Ex 109 (C Ex). **Followed** in *ICN Trading Co. Ltd. v. Padamsey Premji,* (1934) 4 Com Cases 110, 114, 117 : AIR 1934 Bom 97. *Radhe Shiam Beopar Co. Ltd. v. Prabh Dayal Ram Dhan,* (1934) 4 Com Cases 287, 289 (Lah)—a year's delay was held to be fatal. *Murugappa Chettiar v. Pudukottai Ceramics Ltd.,* (1955) 25 Com Cases 78, 80 (Mad). If the allottee has acquiesced in the allotment, he cannot repudiate the allotment; *Ramlalsao Gupta v. M.E.R. Malak,* (1939) 9 Com Cases 201, 203 : AIR 1939 Nag 225.

Minimum subscription, when not necessary

The form of statement in lieu of prospectus set out in Schedule III contains no reference to minimum subscription; neither does section 149(2). These sections seem to contemplate that where there is no offer to the public, no minimum subscription need be specified.

Cases where applicant cannot avoid allotment

The applicant cannot avoid the allotment if he unequivocably affirms the allotment (1) by endeavouring to sell the shares. *Ex. P., Briggs,* (1866) LR I Eq 483, (2) by executing a transfer of the shares. *Crawley's* case, (1869) LR 4 Ch App 322, (3) by paying calls or receiving dividends, *Scholey v. Central Railway of Venezuela,* (1868) LR 9 Eq 266, (4) by attending and voting at a general meeting in person or by proxy. *Sharpley v. Louth Co.,* (1876) 2 Ch D 663 (CA).

Manner of avoiding allotment

In order to avoid the allotment, the applicant should notify the company and, if it is being wound up, also the liquidator, that he avoids the contract and demands repayment of his money and the removal of his name from the register of members. The company must be informed of the intent to avoid within the prescribed period. If the company refuses then legal proceedings must be taken. It is not necessary that the applicant should take legal proceedings within the prescribed period. *National Motor Mailcoach Co., Re,* (1908) 2 Ch 228.

Liability of directors to compensate [Sub-section (3)]

This is a heavy burden cast on the directors. The company's "loss, damages or costs" would include all the expenses by reason of the allotment having been made in contravention, but not damage occasioned by reason of the loss of membership. The loss and damages directly flowing from the breach of duty include the loss and damages occasioned by the carrying on of the business which never could have been commenced but for the improper allotment. The loss and damages would, therefore, appear to be the total losses of the company which include amounts due to creditors and shareholders. *Indian States Bank Ltd. v. Kunwar Sardar Singh,* (1934) 4 Com Cases 380, 401 : AIR 1934 All 855.

The allottee's loss, damages or costs will include all his legal expenses for enforcing the repudiation and obtaining repayment of the money paid by him with interest, but not damages for loss of the shares, if the allottee decides to affirm the contract and keep the shares or if the time for avoidance has expired.

Measure of damages

The measure of damages will be the difference between the price paid for the shares and their real value at the date of purchase. It is open to the applicant to recover damages from the directors even without avoiding the allotment. *Burton v. Bevan,* (1908) 2 Ch 240.

Estoppel of director

A director who has joined in an allotment to himself will be stopped from alleging the invalidity of the allotment. *York Tramways Co. v. Willows,* (1882) 8 QBD 685 (CA).

No allotment without application

The section in terms only applies to the case of applicants, *i.e.*, those who have made applications for shares. It does not affect the position of those to whom shares have been allotted surreptitiously or without their applying for them. For in such case any allotment made will be *ab initio* void, as there is no power to allot shares to persons who have not applied therefor. In this connection it may be noted that, unlike under the English Act, section 41(2) of this Act requires that an agreement in writing is necessary for any person becoming a member of a company, so that an allotment cannot be made on an oral request of application for shares.

Allotment in contravention of other laws

If shares are issued in a manner prohibited by foreign exchange regulations, the issue would be invalid and void and confer on the allottee no title whatsoever to the shares. *Re, Transatlantic Life Assurance Co. Ltd.*, (1979) 3 All ER 352.

Improper motive.—An allotment of shares made for any improper motive is bad and can be struck down. *Unit Trust of India v. Om Prakash Berlia,* (1983) 54 Com Cases 723, 726 (Bom—DB).

S. 72. Application for, and allotment of, shares and debentures.—(1)

(a) No allotment shall be made of any shares in or debentures of a company in pursuance of a prospectus issued generally, and no proceedings shall be taken on applications made in pursuance of a prospectus so issued, until the beginning of the fifth day after that on which the

prospectus is first so issued or such later time, if any, as may be specified in the prospectus:

Provided that where, after a prospectus is first issued generally, a public notice is given by some person responsible under section 62 for the prospectus, which has the effect of excluding, limiting or diminishing his responsibility, no allotment shall be made until that beginning of the fifth day after that on which such public notice is first given.

(b) Nothing in the foregoing proviso shall be deemed to exclude, limit or diminish any liability that might be incurred in the case referred to therein under the general law of this Act.

(c) The beginning of the fifth day or such later time as is mentioned in the first paragraph of clause (a) or the beginning of the fifth day mentioned in the second paragraph of that clause, as the case may be, is hereinafter in this Act referred to as "the time of the opening of the subscription lists".

(2) In sub-section (1), the reference to the day on which the prospectus is first issued generally shall be construed as referring to the day on which it is first so issued as a newspaper advertisement:

Provided that, if it is not so issued as a newspaper advertisement before the fifth day after that on which it is first so issued in any other manner, the said reference shall be construed as referring to the day on which it is first so issued in any manner.

(3) The validity of an allotment shall not be affected by any contravention of the foregoing provisions of this section; but, in the event of any such contravention, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [1][*fifty thousand rupees*].

(4) In the application of this section to a prospectus offering shares or debentures for sale, sub-sections (1) to (3) shall have effect with the substitution of references to sale for references to allotment, and with the substitution for the reference to the company and every officer of the company who is in default of a reference to any person by or through whom the offer is made and who is knowingly guilty of, or wilfully authorises or permits, the contravention.

(5) An application for shares in, or debentures of, a company, which is made in pursuance of a prospectus issued generally shall not be revocable until after the expiration of the fifth day after the time of the opening of the subscription lists, or the giving, before the expiry of the said fifth day by some person responsible under section 62 for the prospectus, of a public notice having the effect under that section of excluding, limiting or diminishing the responsibility of the person giving it.

NOTES

Eng. Act, 1948 : Sec. 50.
Eng. Act, 1985 : Secs. 82 and 86.

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1. Subs. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 29 (w.e.f. 13-12-2000), for 'five thousand rupees'.

Companies Act, 1956

Purpose of provisions relating to opening of subscription list.—The purpose underlying this section is thus explained by the Company Law Committee: "Under the existing law, a company is not required to keep its subscription list open for any period. An applicant for shares is also at liberty to withdraw his application before the allotment is made. The state of the law has set in motion two unhealthy tendencies to which our attention has been called by certain witnesses. It has been pointed out that in some cases the subscription list is closed on the very day it is opened; consequently, the public have no time to digest the contents of the prospectus, much less to obtain independent advice. Such precipitate action is evidently not in accord with the intentions of the Legislature which, by prescribing detailed particulars to be inserted in a prospectus, must be presumed to have expected the intending investor to consider the information contained in it before he risked his money in the particular venture. Further, a class of persons, colloquially known as 'stags' in the investment world, has arisen who prefer to make applications on a large scale with a view to reaping a quick profit on resale at a premium while the going is good, but who would be quick to withdraw the applications on the slightest prospect of the issue being found unpopular. Both these tendencies to which the Cohen Committee has also drawn attention in paragraphs 19 and 20 of its report are attributable to the present unsatisfactory state of the law and call for some action. A remedy is provided by the new section 50 of the English Act under which the subscription list is to be kept open for three days after publication of the prospectus. Having regard to distances in this country, in the section proposed by us, we have increased this period to five days. In the English section, a provision has been made preventing applicants from withdrawing their applications unless any person who is a party to the issue of the prospectus, *e.g.*, an expert, has withdrawn his consent by advertisement as provided by section 43 of the English Act, which corresponds to the proposed section 97 in item 20 of the Addendum to the Annexure of our Report. We have retained this provision in the section proposed by us. We have, however, suggested as addition to sub-section (7) to the effect that the closing of the subscription list should be announced by the company, and that the allotment should be made and the notice of allotment given not later than the tenth day after such closing. These additions appear to us desirable." (*Report* : Para 67).

It should be noted that the provisions of this section refer to allotment of both shares and debentures unlike section 69.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5,000 rupees to 50,000 rupees under sub-section (3).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Opening of subscription list [Sub-sections (1) and (2)]

The object of this provision is, as stated above by the Company Law Committee, to give applicants sufficient time to study the prospectus and to withdraw their offer to subscribe for shares in case they are not satisfied with the prospectus.

It must first be determined when the prospectus was first issued generally. If the first issue was by advertisement, time will be counted from the date of the advertisement. If there was any other kind of issue, it has to be determined as to whether such an issue would come, within the words "issued generally". [See definition in section 2(22)]. If it does so, time will be reckoned from the date of that issue. If there was also a newspaper advertisement in addition, time will run from the date of issue of advertisement.

SEBI Guidelines, 2000

Issue Opening Date.—An issue shall open within 3 months from the date of issuance of the observation letter by the Board, if any, or within 3 months from the 22nd day from the date of filing of the draft offer document with the Board, if no observation letter is issued [*Clause 8.21.1*].

Period of Subscription

Public Issues

(a) Subscription list for public issues shall be kept open for at least 3 working days and not more than 10 working days [*Clause 8.8.1(a)*].

(b) The public issue made by an infrastructure company, satisfying the requirements in Clause 2.4.1(iii) of Chapter II of SEBI Guidelines, 2000 (as to appraisal of the project and investment by the appraising agency) may be kept open for a maximum period of 21 working days [*Clause 8.8.1(b)*].

(c) The period of operation of subscription list of public issue shall be disclosed in the prospectus [*Clause 8.8.1(c)*].

Rights Issues

Rights issues shall be kept open for at least 30 days and not more than 60 days [*Clause 8.8.2.1*].

Basis of Allotment on Oversubscription

SEBI Guidelines, 2000.— § See Notes under s. 73.

Reservation for Firm/Preferential Allotment in Public Issue

SEBI Guidelines, 2000.— § See Notes under s. 81.

Allotment to minors

§ For the allotment of shares to minors, refer Notes under section 41, *ante*.

Agreement to allot shares, specifically enforceable

An agreement to allot shares or take and pay for shares is specifically enforceable. *Sri Lanka Omnibus Co. Ltd. v. Perera*, (1952) AC 76. "The legal possibility of a valid executory contract for allotment of shares is recognised, provided there was an offer to take up shares which was communicated to and was accepted by or on behalf of the company. An executory contract to take up shares may be brought into existence in the same manner and subject to the same principles as under the Contract Act. The communication of acceptance need not be in writing. It may be verbal or may be inferred from conduct." *Transport Company Ltd. v. Tirunelveli Motor Bus Co. Ltd.*, (1955) 2 Mad LJ 141 at 147. The Court continued to say that [at p. 147]: "A Court has jurisdiction to decree specific performance of a contract either to take shares or to allot shares subject to the same principles which govern suits for specific performance, as laid down in the Specific Relief Act. It has, therefore, to be seen, whether the evidence in the case establishes an executory contract of exchange of shares for the buses" accepted by the directors. The court cited with **approval** the observation of FRY LJ in *Portuguese Consolidated Copper Mines Ltd., Re*, LR (1889) 42 Ch D 160 to the effect that the company is entitled to the combined wisdom of directors but that the exercise of combined wisdom does not necessarily require directors' meeting. Though no proof was available to show that the directors actually met to approve the transaction but there was the endorsement by five out of seven

directors which shows that they consulted each other and the majority of them was of one mind and this was sufficient to signify their agreement on behalf of the company. The court **relied** upon *Bonellis Telegraph Co. (Collie's Claim),* (1871) LR 12 Eq 246, 258. See also *Bai Mangu v. Bharatkhand Cotton Mills Co.,* AIR 1930 PC 134 and *In re, Universal Banking Corporation (Gunn's* case), LR (1867) 3 Ch App 40.

Damages may also be recovered if the grant of such relief is justified by the circumstances of the case. The matter is one of judicial discretion.

Normally damages are considered to be an adequate remedy if the company's shares are readily available in the open market. *BTR Plc., Re,* (1987) 4 BCC 45. If before the action is brought, all the shares have been allotted to other persons, the only remedy would be an action for damages for breach of contract *Ferguson v. Wilson,* (1866) LR 2 Ch 77. A company may, by delay, disentitle itself from obtaining specific performance. *Nicol's* case, (1885) 29 Ch D 421. The company cannot, however, compel performance of an agreement to take shares to which it is not a party. *Myles v. City of Glasgow Bank,* (1879) 6 R 718.

Effect of allotment

An allotment by itself does not endow on the allottee the status of a member, as section 41 requires that the name of the person to whom any shares are allotted should be entered in the register of members, as a condition of his acquiring membership, unless he is a subscriber to the memorandum of association.

Oral application and allotment

In *Sree Ayyanar Spinning & Weaving Mills Ltd. v. V.V.V. Rajendran,* (1973) 43 Com Cases 225 (Mad) a learned Judge of the Madras High Court (RAMANUJAM, J.) expressed the view that the Companies Act, 1956, nowhere provides that there must be a written application for the allotment of shares of a company, allotment can be made on an oral application. He apparently ignored the provision of section 41(2) which requires, unlike the corresponding provision under the English Act, that an agreement in writing is necessary under this Act, for a person to become a member of a company. This means that, in the case of a company limited by shares, a person cannot become a shareholder unless he applies in writing for an allotment of shares or accept in writing an allotment of shares made to him. This is as regards the first allotment made after the formation of the company. In the case of subsequent allotments to persons who are already shareholders the procedure under section 81 will have to be followed, if such subsequent allotment comes within terms of that section. Perhaps, such an allotment made within two years after the formation of the company or within one year after the first allotment may be made orally as such allotment does not come within the scope of section 81.

Conditional application

Where a person applied for certain shares on the condition that he would be appointed cashier of a new branch of the company, it was held that he was not bound by the allotment made without fulfilling his condition and his name could not be put in the list of contributories. *Ramanbhai M. Nilkanth v. Ghashiram Ladliprasad,* (1918) 20 Bom LR 692: AIR 1918 Bom 153. This was a case of condition precedent. A condition subsequent would not have that effect. An application for shares was subject to the condition that the applicant would pay for the shares only when the company paid dividends. It was held that he became bound by the allotment even though the company had gone into liquidation before paying any dividend. *Motilal Chunilal v. Thakorelal,* (1912) 14 Bom LR 648. An allotment of this kind which is made without satisfying the applicant's conditions must be promptly rejected. If time is permitted to pass without rejection it would amount to acquiesence in the allotment and waiver of the condition. Where an applicant without rejecting the allotment pledged his shares, he was not allowed to say that the conditions in his application were not fulfilled before making the allotment to him. *Hargopal v. Peoples Bank of Northern India Ltd.,* AIR 1935 Lah 691.

Conditional applications and allotments are divided into two classes according as the condition is a condition precedent or a condition subsequent. Reference may be made to *Jackson v. Turquand*, LR 4 HL 305 and *Adam's* case, LR 13 Eq 474, as showing that where the company in dealing with the application for shares puts in a new term or condition then there is no valid agreement. Again where the allotment is made conditionally on the happening of some event, the applicant, although his name may have been registered, does not become a shareholder until the condition has been fulfilled. *Spitzel v. Chinese Corporation*, (1899) 80 LT 347; *Mutual Bank of India Ltd. v. Sohan Sing*, AIR 1936 Lah 790; *Indian Merchants Bank v. Anupchand*, AIR 1928 Lah 236.

Application by underwriters not necessary

An underwriting agreement has to be treated not merely as a guarantee but as an application for allotment of so many shares as would not be applied by the public, such shares can be allotted to them. A separate application for allotment is, therefore, not required. *Pioneer Company v. Kaithal Cotton & General Mills Ltd.*, (1970) 40 Com Cases 562, 564 (P&H).

Withdrawal of applications

An application for shares is a proposal to buy the shares and like all other proposals can be withdrawn before acceptance. See *Trueman's* case, (1894) 3 Ch D 272, where an oral revocation was held to be effective. But sub-section (5) of this section imposes a statutory restriction upon revocation. It says that an application shall not be revoked until after the expiration of the fifth day after the time of the opening of the subscription list or even earlier after some persons responsible under section 62 for statements in the prospectus has given a public notice excluding, limiting or diminishing his responsibility. This restriction is designed to prevent what are called stagging practices by speculators who apply for shares in large numbers for speculative purposes and subsequently finding that the prospectus does not seem to be successful, withdraw the applications at their sweet will See, *Govt. Stock & Other Securities Investment Co. Ltd. v. Christopher*, (1956) 1 All ER 490 : (1956) 26 Com Cases 210 (Ch D).

Lapse of application.—The lapse of an application is something different from its revocation. An application automatically lapses if the allotment is on different terms than those proposed in the prospectus giving the applicant the right to repudiate. *Imperial Flour Mills Co. v. Lamb*, (1888) ILR 12 Bom 647.

Repudiation of membership

Where a person takes an allotment in one company thinking it to be another, he may be allowed in exceptional circumstances to repudiate his membership if he acts promptly on discovering his mistake. Normally, however, such repudiation is not allowed. *Harrison & Jones Ltd. v. Burton & Lancaster Ltd.*, (1953) 1 All ER 903; *Neuchatel Asphalte Co. Ltd. v. Barnett*, (1957) 1 All ER 362.

Knowingly guilty of or wilfully authorises or permits [Sub-section 4]

The term 'knowingly' signifies knowledge of the facts on which the contravention depends, and 'wilfully' signifies that the person concerned realises that there is a contravention. *Burton v. Bevan*, (1908) 2 Ch 240.

Stamp Duty on letters of allotment

Being a State subject, the stamp duty varies from State to State. For Table of Stamp Duty to be affixed on letters of allotment of shares or debentures in different States, see *Appendix* 134-135.

§ Refer also K. KRISHNAMURTHY — Indian Stamp Act, 8th Edn., 2002.

Jurisdiction for Investor Guidance, Grievances and Complaints

Non receipt of letters of allotment.—A complaint lies before the new SEBI Forum. For the format of the complaint and address of the forum, see *Appendix* 234.

Penalty for default [Sub-section (3)]

Any allotment made in contravention of the provisions of section 72 though it does not effect the validity of the allotment, the company and every officer of the company who is in default are punishable with fine up to Rs. 50,000/- under sub-section (3).

Compoundable Offence.—The offence is compoundable under section 621A.

MUTUAL FUNDS

Mutual funds are investment vehicles which provide a means of participation in the securities market for investors who are not completely risk averse, and are willing to take a limited amount of risk by not seeking direct exposure to stock market. Of late, Mutual Funds have gained considerable importance in the stock market, and innumerable small investors, who are otherwise unable to effectively participate in the growing stock market, have been able to gain access to stock market through the medium of Mutual Funds.

A number of schemes have been offered by the mutual funds providing varied benefits. After making a decision as regards the scheme, the investors also have the advantage to know the value of the units of Mutual Funds held by them with the help of Net Asset Value (NAV) calculated by the Fund.

Open Ended and Close Ended Mutual Funds.—An open-ended scheme means a scheme of Mutual Funds which offers units for sale without specifying any duration for redemption. Under this scheme the units can be bought or sold on a continuous basis at prices which are based on the Net Asset Value (NAV) of the fund.

A close-ended scheme, on the other hand, is a scheme of a mutual fund in which the period of maturity of the scheme is specified. Thus, the units are offered for a limited period. They cannot be sold and are redeemed at the close of the pre-determined period. They are generally listed on the stock exchanges where trading takes place at market price.

Guidelines for Investment by Mutual Funds in Money Market Instruments

SEBI Mutual Funds Regulations, 1996 [w.e.f. 9-12-1996]

The Regulations strongly emphasize on the governance aspect of Mutual Funds in the interest of investors, increase the responsibilities of trustees of the Mutual Funds in overseeing that the AMC's function of the interest of investors, enhance the level of investor protection and bring about empowerment of investors, as also lay down a code of conduct for best practices for the mutual funds to follow. The Regulations require asset management companies to exercise due diligence and care in managing the assets of a scheme as would be exercised by other persons engaged in the same business.

Provision for portfolio disclosure, standardization of accounting policies, valuation norms for Net Asset Value, pricing as recommended by the NAV Committee have been incorporated in the revised Regulations. Additional disclosures are required in respect of transactions by the schemes of Mutual Funds, with associates of sponsors, AMC's and, trustees and also in respect of personal transactions of the key-personal of AMC's and trustees.

With the notification of the revised regulations the earlier Mutual Funds Regulations, 1993, have been repealed. Notwithstanding such repeal any action taken including registration or approval granted under the earlier regulations shall be deemed to have been done under the corresponding provision of the revised regulations. Similarly, any application made to SEBI under the earlier regulations and pending before it shall be deemed to have been made under the corresponding provision of these regulations and shall be dealt with accordingly. [*Issued by IIMARP Department vide Press Release No.* 126/96, dated 17-12-1996]

The RBI has withdrawn its guidelines on Money Market Mutual Funds (MMMF's) with effect from 7-3-2000. Amendments have been made in the SEBI (Mutual Funds) Regula-

tions, 1996 (*vide* Notification No. 235(E), dt. 14-3-2000) in this respect. Accordingly, all MMMF Schemes, like any other mutual fund schemes, would exclusively be governed by SEBI (Mutual Funds) Regulations, 1996. [*Circular No. MFD/Cir/1/189/2000, dt. 10-4-2000 issued by SEBI*].

§ For text of the SEBI Regulations, see *Appendix* 184.

SEBI Guidelines for advertisement by Mutual Funds

Sixth Schedule to SEBI (Mutual Funds) Regulations, 1996 specifies Advertisement Code in respect of every scheme. SEBI has issued guidelines supplementary to the code, dated 5-6-2000.

§ For text of the SEBI guidelines for Advertisements by Mutual Funds, see *Appendix* 185.

Standard Offer Document of Mutual Fund Schemes

Standard Offer Document format for Mutual Fund Schemes has been prescribed by SEBI *vide* F.No. IIMARP/MF/CIR/06/793/98, Dt. 31-3-1998. All offer documents of mutual fund schemes filed with SEBI on or after April 1, 1998, shall be in accordance with this new prescribed format.

All mutual funds are required to submit offer documents in soft copies also for the purpose of displaying them on SEBI website.

For the full text of the new prescribed Standard Offer Document and a copy by the memorandum containing key information for any scheme of mutual fund, see *Appendix* 186.

Updating offer document on continuous basis.—SEBI has issued guidelines on updating the offer document of open ended schemes on a continuous basis with a view to enabling the investors to get all material information before they take investment decisions and to avoiding complaints by them in this regard. [*SEBI Circulars No. MFD/CIR/10/039/2001, dt. 9-2-2001 and No. MFD/CIR/06/275/2001, dt. 9-7-2001, see Appendix* 185(13)].

Mutual Funds and Asset Management Companies

Independent directors on Boards of Trustee company and AMC.—Two-thirds of the directors of a trustee company and fifty percent of the directors of AMC shall be independent directors [*vide Regs. 16(5) and 21(d)*]. For clarifications issued in this regard by SEBI, see Circulars No. MFD/CIR/11/354/2001 dt. 20-12-2001 and No. MFD/CIR/17/21105/2002 dt. 28-10-2002 in *Appendix* 185.

§ For a complete text of the Regulations and the accompanying Press Note, see *Appendices* 184 and 191.

Guidelines for participation by mutual funds in securities lending scheme.—Mutual funds are permitted to lend securities in accordance with the stock lending scheme under sub-regulation (4) of regulation 44. The detailed guidelines for securities lending by mutual funds have been issued under regulation 77 of the 1996 Regulations *vide* Circular No. MFD/Cir/01/047/99, dated 10-2-1999 issued by SEBI. The mutual funds can lend securities through the intermediaries who are approved by the Securities and Exchange Board of India ('SEBI') for this purpose.

§ For the text of the Guidelines see *Appendix* 185.

Guidelines for participation by Mutual Funds in trading in derivative products.—The mutual funds shall be required to adhere to the guidelines for trading in derivatives. These Guidelines have been issued by SEBI *vide* MFD/CIR/011/061/2000, dated 1-02-2000. For text see *Appendix* 184(6).

Guidelines for valuation of securities for mutual funds for traded securities, thinly traded securities and non-traded securities.—SEBI has issued the requisite guidelines, *vide* MFD/Cir/8/92/2000, dt. 18-9-2000.

§ For text of the Guidelines, see *Appendix* 184(11).

Guidelines for valuation of unlisted equity shares for calculation of NAV of mutual funds.—See SEBI Circular No. MFD/CIR/03/526/2002, dt. 9-5-2002 (*Appendix* 185(27)).

Guidelines for calculation for sale and repurchase price and rounding off NAV.—See SEBI Circular No. MFD/CIR/08/514/2002, dt. 22-7-2002 at *Appendix* 185(31).

Guidelines for investment in foreign securities by mutual funds.—See SEBI Circular No. MFD/CIR/17/419/2002, dt. 30-3-2002 at *Appendix* 184.

Guidelines for identification and provisioning for non-performing assets (debt securities) for Mutual Funds.—For the Guidelines issued by SEBI (*vide* MFD/ Cir/8/92/2000, dt. 18-9-2000) see *Appendix* 184(11).

Code of Conduct for mutual funds intermediaries prescribed by AMFI.—For the Code of Conduct for mutual funds intermediaries as prescribed by AMFI, See SEBI Circular No. MFD/CIR/06/210/2002 dt. 26-6-2002 at *Appendix* 185(30).

Guidelines on and Format of Unaudited Half yearly results by mutual funds.—For the guidelines and format, see SEBI Circular No. MFD/CIR/1/200/2001, dt. 20-4-2001 at *Appendix* 185.

Guidelines on Updating of offer document on continuous basis, time frame for despatch of dividend warrants and reporting of securities transactions by directors of AMC.—For the guidelines, see SEBI Circular No. MFD/CIR/10/039/2001, dt. 9-2-2001 at *Appendix* 185(13).

Guidelines for launch of additional plans by mutual funds under existing schemes.—For the guidelines, see SEBI Circular No. MFD/CIR/12/175/01, dt. 15-2-2001, see Appendix 185(14).

Guidelines on disclosure of bench mark indices.—For the guidelines, see SEBI Circular No. MFD/CIR/16/400/2002, dt. 26-3-2002 at *Appendix* 185(25).

Investments by mutual funds in units of Venture Capital Funds or Shares of Venture Capital Companies.—According to clause 10 of the Seventh Schedule of the SEBI (Mutual Funds) Regulations, 1996, a mutual fund scheme can invest upto 10% of its NAV in the equity shares or equity related instruments of any company (with the exception for investments in index fund or sector or industry specific scheme) Further, clause 11 provides that a mutual fund scheme can invest upto 5% of its NAV in the unlisted equity shares or equity related instruments in case of open ended scheme and upto 10% of its NAV in case of close ended scheme. It is hereby clarified that within the above-mentioned limits, mutual fund schemes can also invest in the listed or unlisted securities of units of venture capital funds as the case may be.

Payment of Volatility margin by the Mutual Funds.—It is mandatory for all brokers to collect volatility margins on equity sales from the clients including institutional clients. Accordingly, all mutual funds are advised to pay applicable margins as directed by the stock exchanges. However, transactions for which early pay in are affected do not attract the requirement of margin payment. (*vide* Press Note MFD/CIR./9/230/2001, dated 14-8-2001, isued by SEBI).

Injunction against mutual fund issue

Where a trial judge stayed temporarily the issue of a mutual fund but fixed the date of hearing which went beyond the closing date of the issue, it was held that the order had the effect of a permanent injunction and would have rendered the issue infructuous. The court characterised the injunction as an improper exercise of jurisdiction and a miscar-

riage of justice. The injunction was running against the fact that the issue, its terms and the format of the proposed units had SEBI approval. *Morgan Stanley Fund v. Piyush Agarwal,* (1994) 80 Com Cases 283 (Delhi).

The Supreme Court has also emphasised that there should be no interference in the functioning of the Capital market by means of *ex parte* interim injunctions and that the consumer forums do not have jurisdiction over matters connected with issue of shares and applications for allotment of shares. *Arvind Gupta (Dr.) v. SEBI,* (1994) 14 CLA 162: (1994) 81 Com Cases 318 (SC); *Morgan Stanley Mutual Fund v. Kartick Das,* (1994) 81 Com Cases 318 : (1994) 3 Comp LJ 27 (SC).

VENTURE CAPITAL

Venture capital is the investment of long term equity capital in high risk projects with an expectation of high return from it. Such type of capital investment is more common in high technology industries in view of the possibility of high capital appreciation. Since the projects involve high risk and thereby an equally high return on investment, venture capital is sometimes known as 'risk capital'.

SEBI has notified the following regulations with regard to Venture Capital:

(1) Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 [see *Appendix* 195];

(2) Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000 [see *Appendix* 197];

Venture Capital Fund Regulations, 1996

Press Release, dated 17-12-1996.—The Board of SEBI in its meeting held on 18-11-1996, had approved regulations for Venture Capital Funds. The Regulations will allow Venture Capital Funds to be set up as companies or trusts, raise money only from institutional investors or high networth individuals, invest 80% of the resources raised to invest in the shares of unlisted companies, provide other types of assistance (*i.e.* give loans) to these companies, invest in sick or financially weak companies. There will be no restriction on the period within which the funds raised should be utilised. After a period of 3 years from the date of setting up Venture Capital Fund, a fund could be listed on the stock exchanges, subject to listing agreement and other appropriate regulations. [*Issued by IIMARP Department vide Press Release No.* 126/ 96, dated 17-12-1996]

SEBI (Portfolio Managers) Rules and Regulations, 1993

Rules for the regulation of the conduct of the financial services for their clients by portfolio managers have been issued. Under these Rules SEBI has issued Regulations on the same subject. For a complete text of the Rules and Regulations, see *Appendices* 225 and 226.

Guidelines for floatation of public sector bonds

Press Release, dated 6-1-1992.—The Government has formulated a scheme of guidelines for floatation of public sector bonds by existing as well as new corporate undertakings including Finance Corporations. For the text of the guidelines, see *Appendix* 277.

FOREIGN INVESTMENTS IN INDIA UNDER FEMA, 1999

The manner, extent and terms and conditions of permissible foreign investments have been specified under the various Regulations made under sec. 6(3) of FEMA, 1999. For the text of various regulations issued on the subject see relevant appendices.

RBI has made the following Regulations :

1. Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 [*Appendix* 105]
2. Foreign Exchange Management (Issue of Security in India by a Branch, Office or Agency of a Person Resident Outside India) Regulations, 2000 [*Appendix* 106]

3. Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 [*Appendix* 107]
4. Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000 [*Appendix* 109]
5. Foreign Exchange Management (Deposit) Regulations, 2000 [*Appendix* 110]
6. Foreign Exchange Management (Export and Import of Currency) Regulations, 2000 [*Appendix* 111]
7. Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2000 [*Appendix* 112]
8. Foreign Exchange Management (Guarantees) Regulations, 2000 [*Appendix* 113]
9. Foreign Exchange Management (Realisation, Repatriation and Surrender of Foreign Exchange) Regulations, 2000
10. Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000 [*Appendix* 114]
11. Foreign Exchange Management (Possession and Retention of Foreign Currency) Regulations, 2000
12. Foreign Exchange Management (Insurance) Regulations, 2000
13. Foreign Exchange Management (Remittance of Assets) Regulations, 2000 [*Appendix* 115]
14. Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000
15. Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 [*Appendix* 118]
16. Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 [*Appendix* 123]
17. Foreign Exchange Management (Establishment in India of Branch or Office or other place of Business) Regulations, 2000 [*Appendix* 124]
18. Foreign Exchange Management (Export of Goods and Services) Regulations, 2000
19. Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations, 2000
20. Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 [*Appendix* 125]
21. Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000 [*Appendix* 116]
22. Foreign Exchange Management (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs) Regulations, 2003 [*Appendix* 126]

Definitions under FEMA, 1999 and Regulations framed thereunder

'Non-Resident Indian (NRI)' means a person resident outside India who is a citizen of India or is a person of Indian origin. [*Reg. 2(vi) of FEM (Deposit) Regulations, 2000*]

'Person resident outside India' means a person who is not resident in India. [*Reg. 2(w) of FEMA, 1999*].*

'Person resident in India' means—

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than—

(a) for or on taking up employment in India, or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India. [*s. 2(v) of FEMA, 1999*]*

'Overseas Corporate Body (OCB)' means a company, partnership firm, society and other corporate body owned directly or indirectly to the extent of at least sixty per cent by Non-Resident Indians and includes overseas trust in which not less than sixty percent beneficial interest is held by Nonresident Indians directly or indirectly but irrevocably [*Reg. 2(xi) of FEM (Deposit) Regulations, 2000*]

'Person of Indian Origin' means a citizen of any country other than Bangladesh or Pakistan, if

(a) he at any time held Indian passport; or

(b) he or either of his parents or any of his grand-parents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

(c) the person is a spouse of an Indian citizen or a person referred to in sub-clause (a) or (b).

[*Reg. 2(xii) of FEM (Deposit) Regulations, 2000*]

AP (DIR Series) Circular No. 38, dt. 3-12-2003.—The RBI has given a summary of the regulatory provisions covering foreign investments in India. Relevant extracts are given below. For full text of the Circular, see *Appendix* 120.

1. Statutory Provisions

Foreign Investments in India are governed by the provisions of Section 6 of the Foreign Exchange Management Act (FEMA) 1999 and are subject to the Regulations issued by the Reserve Bank of India under FEMA 1999. The Regulations have been notified vide Notification No.FEMA 20/2000-RB dated May 3, 2000. [FEM (Transfer or Issue of Security by a person Resident Outside India) Regulations, 2000]. An Indian entity cannot issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person save as otherwise provided in the Act or the Rules or Regulations framed thereunder or with the specific permission of the Reserve Bank.

2. Foreign Direct Investment Policy

2.1 Foreign Investments in India are not permissible in the following cases [*Refer also Reg. 4(b) of FEM (Permissible Capital Account Transactions) Regulations, 2000*]:

(i) in the business of chit fund, or

(ii) Nidhi Company , or

(iii) in agricultural or plantation activities or

‡(iv) in real estate business, or construction of farm houses, or

†(v) In trading in Transferable Development Rights (TDRs).

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* For text of the Act, see *Appendix* 101.

‡ "Real estate business" shall not include development of townships, construction of residential/commercial premises, roads or bridges. [*Explanation under 4(b)*].

† 'Transferable Development Rights' means certificates issued in respect of category of land acquired for public purpose either by Central or State Government in consideration of surrender of land by the owner without monetary compensation, which are transferable in part or whole. [*Reg. 2(d)*].

2.2 In addition, the Government has also notified the following activities where Foreign Direct Investment is not permissible.

1. Retail Trading
2. Atomic Energy
3. Lottery Business
4. Gambling and Betting
5. Housing and Real Estate business
6. Agriculture (excluding Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisiculture and Cultivation of Vegetables, Mushrooms etc. under controlled conditions and services related to Agro and allied sectors) and Plantations(Other than Tea plantations).

2.3. In other cases, investments can be made either with the specific prior approval of the Government i.e the Secretariat for Industrial Assistance/Foreign Investment Promotion Board (SIA/FIPB) or under the Automatic Route. A list of the Activities requiring the approval of the Government is given in Annexure-A to Schedule 1 to FEMA Notification No 20 while details of the Industries which are covered under the Automatic Route are given as Annexure-B to the said Schedule. The Automatic Route is not open to those foreign investors who have/had a previous financial/technical/ trademark collaboration in an existing domestic company engaged in the same or allied activity. Also, if the activity of the issuer company requires an Industrial Licence under the provisions of the Industries (Development and Regulation) Act 1951 or under locational policy notified by Government of India under the Industrial Policy 1991, Automatic Route is not available.

2.4. Eligibility for Investment in India.—A person resident outside India (other than a citizen of Pakistan, Bangladesh, Sri Lanka) or an incorporated entity outside India (other than an entity in Bangladesh or Pakistan) has general permission to purchase shares or convertible debentures or preference shares of an Indian company subject to certain terms and conditions.

2.5. Nature of Investments.—2.5.1 The Indian companies have also got the general permission to issue partly convertible debentures/partly convertible preference shares provided the terms of issue are in accordance with the Schedule for convertible portion and in accordance with Regulation 5 of Notification No. FEMA 4/2000-RB dated May 3, 2000 for the non-convertible portion. Companies can issue NCDs only to NRIs and that too by means of a public Issue. The coupon rate on partly convertible preference shares/partly convertible debentures should not exceed State Bank of India's prime lending rate plus 300 basis points.

2.5.2 Trading is permitted under Automatic Route with FDI upto 51 % provided it is primarily towards export activities, and the undertaking is an export house/trading house/super trading house/star trading house. The Government also permits certain trading activities under FIPB route.

2.5.3. A company which is a small scale industrial unit and not engaged in any activity or in manufacture of items included in Annexure A to Notification No.20 may issue shares or convertible debentures to a non-resident , to the extent of 24% of its paid-up capital if,

(a) It has given up its small scale status;

(b) It is not engaged or does not propose to engage in manufacture of items reserved for small scale sector; and

(c) It complies with the ceilings specified in Annexure B to Notification No.20.

ANNEXURE A

(A) List of Activities for which Automatic Route of RBI for investment from person resident outside India is not available

1. Domestic Airlines
2. Petroleum Sector (except for private sector oil refining)
3. Investing companies in Infrastructure & Services Sector
4. Defence and Strategic Industries
5. Atomic Minerals
6. Print Media
7. Broadcasting
8. Postal services
9. Courier Services
10. Establishment and Operation of satellite
11. Development of Integrated Township
12. Tea Sector

Government approval for FDI in certain activities covered under Annexure A. [*Press Note No. 4 (2001 Series) dt. 21-5-2001, issued by Deptt. of Industrial Policy and Promotion*].

Defence industry.—The defence industry sector is opened up to 100 per cent. for Indian private sector participation with FDI permissible up to 26 per cent., both subject to licensing.

Courier Services.—FDI up to 100 per cent. is permitted in courier services subject to existing laws and exclusion of activity relating to distribution of letters. FDI in this sector would be permissible with prior Government approval.

Integrated townships.—FDI up to 100 per cent. is permitted for development of integrated townships, including housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems, and manufacture of building materials. Development of land and providing allied infrastructure will form an integral part of township's development, for which necessary guidelines/norms relating to minimum capitalisation, minimum land area, etc., will be notified separately by the Government. FDI in this sector would be permissible with prior Government approval.

Tea sector.—FDI up to 100 per cent. in tea sector, including tea plantations, will be allowed. Proposals for FDI in tea sector will require prior approval of the Central Government and would be subject to the following conditions:

(i) Compulsory divestment of 26 per cent. equity of the company in favour of an Indian partner/Indian public within a period of five years; and

(ii) Prior approval of the State Government concerned in the case of any future land use change.

The above dispensation would be applicable to all fresh investments (FDI) made in this sector from the date of this notification. [*Press Note No. 6/2002 series dt. 5-7-2002 [F. No. 5(9)/2000-FCI], issued by Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, SIA (FC Division)*]:

(B) List of activities or items for which FDI is prohibited.

1. Retail Trading
2. Atomic Energy
3. Lottery Business
4. Gambling and Betting
5. Housing and Real Estate business
6. Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisiculture and Cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations (Other than Tea plantations)

Annexure B

Sectoral cap on Investments by persons resident outside India

(1)	(2)	(3)
1. Private Sector Banking	49%	Subject to guidelines issued by RBI from time to time
2. Non-Banking Financial Companies	100%	FDI/NRI [1][* * *] investments allowed in the following 19 NBFC activities shall be as per the levels indicated below : (a) Activities covered : 1. Merchant Banking 2. Under writing 3. Portfolio Management Services 4. Investment Advisory Services 5. Financial Consultancy 6. Stock-broking 7. Asset Management 8. Venture Capital 9. Custodial Services 10. Factoring 11. Credit Reference Agencies 12. Credit Rating Agencies

1. The words "/OCB" omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.

(1)	(2)	(3)
		13. Leasing & Finance 14. Housing Finance 15. Forex-broking 16. Credit Card Business 17. Money-changing Business 18. Micro-credit 19. Rural credit (b) Minimum Capitalisation norms for fund based NBFCs: (i) For FDI upto 51%, US $ 0.5 million to be brought in upfront; (ii) If the FDI is above 51% and upto 75%, US $ 5 million to be brought upfront; (iii) If the FDI is above 75% and upto 100%, US $ 50 million out of which $ 7.5 million to be brought in upfront and the balance in 24 months. (c) Minimum Capitalisation norms for non-fund based activities; Minimum Capitalisation norm of US $0.5 million is applicable in respect of non-fund based NBFCs with foreign investment. (d) Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US $ 50 million as at b) (iii) above (without any restriction on number of operating subsidiaries without bringing in additional capital); (e) Joint Venture operating NBFCs that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e, (b)(i) and (b)(ii) above. (f) FDI in the NBFC sector is put on automatic route subject to compliance with guidelines of the Reserve Bank of India. RBI would issue appropriate guidelines in this regard.
3. Insurance	26%	FDI upto 26% in the Insurance sector is allowed on the automatic route subject to obtaining licence from Insurance Regulatory & Development Authority (IRDA)
4. Telecommunications	49%	(i) In basic, Cellular, Value Added Services, and Global Mobile Personal Communications by Satellite, FDI is limited to 49% subject to licencing and security requirements and adherence by the companies (who are investing and the companies in which the investment is being made) to the license conditions for foreign equity cap and lock-in period for transfer and addition of equity and other license provisions; (ii) ISPs with gateways, radio paging and end-to-end bandwidth, FDI is permitted upto 74% with FDI, beyond 49% requiring Government approval. These services would be subject to licensing and security requirements

(1)	(2)	(3)
		(iii) No equity cap is applicable to manufacturing activities.
		(iv) FDI upto 100% is allowed for the following activities in the telecom sector:
		(a) ISPs not providing gateways (both for satellite and submarine cables)
		(b) Infrastructure providers providing dark fibre (IP Category 1);
		(c) Electronic Mail; and
		(d) Voice Mail.
		The above would be subject to the following conditions;
		(a) FDI upto 100% is allowed subject to the condition that such companies would divest 26% of their equity in favour of Indian public in 5 years, if these companies are listed in other parts of the world.
		(b) The above services would be subject to licencing and security requirements, wherever required;
		(c) Proposal for FDI beyond 49% shall be considered by FIPB on case to case basis.
5. Petroleum refining (private sector)	100%	FDI permitted upto 100% in case of private Indian companies.
6. Housing and real estate	100%	Only NRIs [2][* * *] are allowed to invest upto 100% in the areas listed below :
		(a) Development of serviced plots and construction of built-up residential premises;
		(b) Investment in real estate covering construction of residential and commercial premises including business centres and offices;
		(c) Development of townships;
		(d) City and regional level urban infrastructure facilities, including both roads and bridges;
		(e) Investment in manufacture of building materials;
		(f) Investment in participatory ventures in (a) to (c) above;
		(g) Investment in Housing finance institutions which is also opened to FDI as an NBFC.
7. Coal & Lignite		(i) Private Indian companies setting up or operating power projects as well as coal and lignite mines for captive consumption are allowed FDI upto 100%;
		(ii) 100% FDI is allowed for setting up coal processing plants subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing;
		(iii) FDI upto 74% is allowed for exploration or

2. The words "/OCBs" omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.

(1)	(2)	(3)
		mining of coal or lignite for captive consumption;
		(iv) In all the above cases, FDI is allowed upto 50% under the automatic route subject to the condition that such investment shall not exceed 49% of the equity of a PSU.
8. Venture Capital Fund (VCF) and Venture Capital Company (VCC)		Offshore Venture Capital Funds/companies are allowed to invest in domestic venture capital undertaking as well as other companies through the automatic route, subject only to SEBI regulation and sector specific caps on FDI.
9. Trading		Trading is permitted under automatic route with FDI upto 51% provided it is primarily export activities, and the undertaking is an export house/trading house/ super trading house/star trading house. However, under the FIPB route: (i) 100% FDI is permitted in case of trading companies for the following activities: (a) exports; (b) bulk imports with export/expanded warehouse sales; (c) cash and carry wholesale trading; (d) other import of goods or services provided at least 75% is for procurement and sale of the same group and not for third party use or onward transfer/distribution/ sales. (ii) The following kinds of trading are also permitted , subject to provisions of Exim Policy: (a) Companies for providing after sales services (that is not trading *per se*); (b) Domestic trading of products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their Joint ventures in which they have equity participation in India; (c) Trading of hi-tech items/items requiring specialised after sales service; (d) Trading of items for social sector; (e) Trading of hi-tech, medical and diagnostic items; (f) Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name; (g) Domestic sourcing of products for exports; (h) Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities com-mence simultaneously with test marketing. (i) FDI upto 100% permitted for e-commerce activities subject to the condition that

(1)	(2)	(3)
		such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading.
10. Power	100%	FDI allowed upto 100% in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of foreign direct investment.
11. Drugs & Pharmaceuticals	100%	FDI permitted upto 100% for manufacture of drugs and pharmaceuticals provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology and specific cell/tissue targeted formulations. FDI proposals for the manufacture of licensable drugs and pharmaceuticals and bulk drugs produced by recombinant DNA technology and specific cell/tissue targeted formulations will require prior Govt. approval.
12. Road and highways, ports and harbours	100%	In projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbours.
13. Hotel & tourism	100%	The term hotels include restaurants, beach resorts and other tourist complexes providing accommodation and/or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports and health units for tourists and convention/seminar units and organisations. For foreign technology agreements, automatic approval is granted if : (i) Upto 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc.; (ii) Upto 3% of the net turnover is payable for franchising and marketing/publicity support fee, and Upto 10% of gross operating profit is payable for management fee, including incentive fee.
14. Mining	74% 100%	(i) For exploration and mining of diamonds and precious stones FDI is allowed upto 74 % under automatic route; (ii) For exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing FDI is allowed upto 100% under automatic route; (iii) Press Note 18 (1998 series) dated 14/12/98 would not be applicable for setting up 100% owned subsidiaries in so far as the mining sector is concerned, subject to a declaration from the applicant that he has no existing joint venture for the same area and/or the particular

(1)	(2)	(3)
		mineral.
15. Advertising	100%	Advertising Sector; FDI upto 100% allowed on the automatic route.
16. Films	100%	Film Sector; (Film production, exhibition and distribution including related services/products); FDI upto 100% allowed on the automatic route with no entry-level condition.
17. Airports	74%	Govt. approval required beyond 74%.
18. Mass Rapid Transport Systems	100%	FDI upto 100% is permitted on the automatic route in mass rapid transport system in all metros including associated real estate development.
19. Pollution Control & Management	100%	In both manufacture of pollution control equipment and consultancy for integration of pollution control systems is permitted on the automatic route.
20. Special Economic Zones	100%	All manufacturing activities except: (i) Arms and ammunition, explosives and allied items of defence equipment, defence aircrafts and warships; (ii) Atomic substances, narcotics and psychotropic substances and hazardous chemicals, (iii) Distillation and brewing of Alcoholic drinks and (iv) Cigarette/cigars and manufactured tobacco substitutes.

RBI Guidelines for FDI in the Banking Sector

Ref. DBOD. No. BP. BC. 68/21.01.055/2001-02, dt. 16-2- 2002.—The Reserve Bank of India (RBI) has received some enquiries regarding regulations pertaining to Foreign Direct Investment (FDI) in the Banking Sector. The position has been reviewed in the light of Government policy announced from time to time as well as guidelines laid down by RBI under various statutory provisions. The present position in this respect is clarified as under in a consolidated form.

1. Limit for FDI under automatic route in private sector banks.—(a) In terms of the Press Note No.4 (2001 Series) dated May 21, 2001 issued by Ministry of Commerce & Industry, Government of India, FDI upto 49 per cent from all sources will be permitted in private sector banks on the automatic route, subject to conformity with the guidelines issued by RBI from time to time.

(b) For the purpose of determining the above-mentioned ceiling of 49 per cent. FDI under the "automatic route" in respect of private sector banks, the following category of shares will be included:

(i) IPOs,

(ii) Private Placements,

(iii) ADRs/ GDRs, and

(iv) Acquisition of shares from existing shareholders [subject to (d) below].

(c) It may be clarified that as per Government of India guidelines, issue of fresh shares under automatic route is *not* available to those foreign investors who have a financial or technical collaboration in the same or allied field. This category of investors require FIPB approval.

(d) It may be further clarified that, as per Government of India guidelines, automatic route is *not* applicable to transfer of existing shares in a banking company from residents to non-residents. This category of investors requires approval of FIPB, followed by "in principle" approval by Exchange Control Department (ECD), RBI. The "fair price" for transfer of existing shares is determined by RBI, broadly on the basis of SEBI guidelines for listed shares and erstwhile CCI guidelines for unlisted shares. After receipt of "in principle" approval, the resident seller can receive funds and apply to ECD, RBI for obtaining final permission for transfer of shares.

(e) Under the Insurance Act, the maximum foreign investment in an insurance company has been fixed at 26%. Application for foreign investment in banks which have joint venture/subsidiary in insurance

sector should be made to RBI. Such applications will be considered by RBI in consultation with Insurance Regulatory and Development Authority (IRDA).

(f) Foreign banks having branch presence in India, are eligible for FDI in the private sector banks subject to the overall cap of 49% mentioned above with the approval of RBI.

2. Limit for FDI in public sector banks.—FDI and Portfolio Investment in nationalised banks are subject to overall statutory limits of 20 per cent as provided under Section 3 (2D) of the Banking Companies (Acquisition & Transfer of Undertakings) Acts, 1970/80. The same ceiling would also apply in respect of such investments in State Bank of India and its associate banks.

3. Voting rights of foreign investors.—In terms of the statutory provisions under the various banking acts, the voting rights, when exercised, have been stipulated which are indicated as under:

Private Sector Banks – [Section 12(2) of Banking Regulation Act,1949]	No person holding shares, in respect of any share held by him, shall exercise voting rights *on poll* in excess of ten percent of the total voting rights of all the shareholders.
Nationalised Banks – [Section 3(2E) of Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80]	No shareholder, other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of one percent of the total voting rights of all the shareholders of the nationalised bank.
State Bank of India (SBI) - (Section 11 of State Bank of India Act,1955)	No shareholder, other than **RBI,** shall be entitled to exercise voting rights in excess of ten percent of the issued capital, (Government, in consultation with RBI can raise the above voting right to more than ten percent).
SBI Associates - [Section 19(1) and (2) of SBI (Subsidiary Bank) Act, 1959]	No person shall be registered as a shareholder in respect of any shares held by him in excess of two hundred shares. No shareholder, other than SBI, shall be entitled to exercise voting rights in excess of one percent of the issued capital of the subsidiary bank concerned.

4. Approval of RBI and reporting requirements.—(i) Under extant instructions, transfer of shares of 5 per cent and more of the paid-up capital of a private sector banking company, requires prior acknowledgement of RBI. For FDI of 5 per cent and more of the paid-up capital, the private sector banking company has to apply in the prescribed form (Annexure I to this circular) to the Department of Banking Operations & Development in the Regional Office of RBI, where the bank's Head Office is located.

(ii) Under the provisions of FEMA 1999, any fresh issue of shares of a banking company, either through the automatic route or with the specific approval of FIPB, does not require further approval of Exchange Control Department (ECD) of RBI from the exchange control angle. The Indian banking company is only required to undertake 2-stage reporting to the ECD as follows:

(a) In the first stage, the Indian company has to submit a report within 30 days of the date of receipt of amount of consideration indicating the name and address of foreign investors, date of receipt of funds and their rupee equivalent, name of bank through whom funds were received and details of Government approval, if any.

(b) In the second stage, the Indian banking company is required to file within 30 days from the date of issue of shares, a report in Form FC-GPR (Annexure II) together with a Certificate from the Company Secretary of the concerned company certifying that various regulations have been complied with. The report will also be accompanied by a Certificate from a Chartered Accountant indicating the manner of arriving at the price of the shares issued.

5. Conformity with SEBI Regulations and Companies Act Provisions.—Wherever applicable, FDI in banking companies should conform to the provisions regarding shareholding and share transfer, etc. as stipulated by SEBI, Companies Act, etc.

6. Disinvestment by Foreign Investors.—In terms of Regulations 10 and 11 of RBI Notification No. FEMA 20/2000-RB dated May 3, 2000 issued under FEMA 1999, disinvestments by foreign investors would be governed by the following:

(i) Sale of shares by non-residents on a stock exchange and remittance of the proceeds thereof through an authorized dealer does *not* require RBI approval.

(ii) Sale of shares by private arrangement requires RBI's prior approval. The RBI grants permission for sale of shares at a price that is market related and is arrived at in terms of guidelines indicated in Regulation 10 above.

7. This circular supercedes the earlier instructions issued by RBI in regard to FDI in the banking sector.

8. All commercial banks which either have foreign investments or intending to have foreign investments are requested to observe the above guidelines.

FEMA 1999

Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulation, 2000†

Investment in India by persons resident outside India *i.e.*, issue of any security by an Indian entity to a person resident outside India and purchase or sale of Indian securities by a person resident outside India is regulated by FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 framed under FEMA, 1999.

For the purpose of these Regulations, investment in India by person resident outside India has been divided into six categories and the regulations applicable have been specified in respective Schedules, as under:—

Schedule 1 — Investment under Foreign Direct Investment Scheme.
Schedule 2 — Investment by Foreign Institutional Investors under Portfolio Investment Scheme.
Schedule 3 — Investment by NRIs/OCBs under Portfolio Investment Scheme.
Schedule 4 — Purchase and sale of shares by NRIs/OCBs on Non-repatriation basis.
Schedule 5 — Purchase and sale of securities other than shares or Convertible debentures of an Indian company by persons resident outside India.
Schedule 6 — Investment in an Indian Venture Capital Undertakings Funds by a registered Foreign Venture Capital Investor.

[See S. NO. 15 of *Annexure II to AD (MA Series) Circular No. 11, dt. 16-5-2000 issued by RBI.*]

Reg. 5(1) provides for permission for purchase of shares by certain persons residing outside India :

"5. (1) A person resident outside India (other than a citizen of Bangladesh or Pakistan or Sri Lanka) or an entity incorporated outside India, (other than an entity in Bangladesh or Pakistan) , may purchase shares or convertible debentures of an Indian company under Foreign Direct Investment Scheme, subject to the terms and conditions specified in Schedule 1."

"Entity incorporated outside India" means an entity incorporated/registered under the relevant statutes, laws of the host country. [Reg. 2(ii-a) *[Ins. by GSR 835(E), dt. 3-10-2003]*.

Foreign Direct Investment Scheme [Sch. I]

1. Purchase by a person resident outside India of equity/preference/convertible preference shares and convertible debentures issued by an Indian company

(1) A person resident outside India referred to in sub-regulation (1) of Regulation 5, may purchase shares or convertible debentures issued by an Indian company up to the extent and subject to the terms and conditions set out in this Schedule.

(2) If the person purchasing the shares under this Scheme proposes to be collaborator or proposes to acquire the entire share holding of a new Indian company, he should obtain a prior permission of Central Government if he has a previous venture or tie-up in India through investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company issuing the shares is engaged. The existing procedure to be followed by Indian Companies for entering into collaboration arrangments with overseas collaborators would continue.

2. Automatic Route of Reserve Bank for Issue of shares by an Indian company

(1) An Indian company which is not engaged in any activity, or in manufacturing of item included in *Annexure 'A'* to this Schedule*, may issue shares or convertible debentures to a person resident outside India, referred to in paragraph 1 upto the extent specified in *Annexure B*, subject to compliance with the provisions of the Industrial Policy and Procedures as notified by Secretariat for Industrial Assistance (SIA) in the Ministry of Commerce and Industry, Govt. of India, from time to time.

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† For the text of the Regulations, see *Appendix* 118.

* See *Annexure A(A)* to AP (DIR Series) Circular No. 38, dt. 3-12-2003, *ante*.

Provided that:

(i) the activity of the issuer company does not require an industrial licence under the provisions of the Industries (Development & Regulation) Act, 1951 or under the locational policy notified by Government of India under the Industrial Policy of 1991 as amended from time to time.

(ii) the shares or convertible debentures are not being issued by the Indian company with a view to acquiring existing shares of any Indian company.

Explanation:

A company which proposes to embark on expansion programme to undertake activities or manufacture items included in *Annexure B* to this Schedule† may issue shares or debentures out of fresh capital proposed to be issued by it for the purpose of financing expansion programme , upto the extent indicated in *Annexure B*, subject to compliance with the provisions of this paragraph.

(2) A trading company incorporated in India may issue shares or convertible debentures to the extent of 51 per cent of its capital, to persons resident outside India referred to paragraph 1, subject to the condition that remittance of dividend to the shareholders outside India is made only after the company has secured registration as an Export/Trading/Star Trading/Super Trading House from the Directorate General of Foreign Trade, Ministry of Commerce, Government of India, New Delhi.

(3) A company which is a small scale industrial unit and which is not engaged in any activity or in manufacture of items included in *Annexure A*, may issue shares or convertible debentures to a person referred to in paragraph 1, to the extent of 24% of its paid-up capital;

Provided that such a company may issue shares in excess of 24% of its paid up capital if

(a) it has given up its small scale status;

(b) it is not engaged or does not propose to engage in manufacture of items reserved for small scale sector, and

(c) it complies with the ceilings specified in *Annexure B*.

(4) Notwithstanding anything contained in clause (3) an Export Oriented Unit or a Unit in Free Trade Zone or in Export Processing Zone or in a Software Technology Park or in an Electronic Hardware Technology Park may issue shares or convertible debentures to a person resident outside India referred to in paragraph 1 in excess of 24 per cent provided it complies with the ceilings specified in *Annexure B*.

3. Issue of shares by a company requiring the Government approval

A company which is engaged or proposes to engage in any activity specified in *Annexure 'A'* or which proposes to issue shares to a person resident outside India beyond the sectoral limits stipulated in *Annexure 'B'* or which is otherwise not eligible to issue shares to a person resident outside India, may issue shares to a person resident outside India referred to in paragraph 1, provided it has secured prior approval of Secretariat for Industrial Assistance or, as the case may be of the Foreign Investment Promotion Board of the Government of India and the terms and conditions of such an approval are complied with.

$4. Issue of Shares by International offering through ADR and/or GDR

(1) An Indian company may issue its Rupee denominated shares to a person resident outside India being a depository for the purpose of issuing Global Depository Receipts (GDRs) and/or American Depository Receipts (ADRs),

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† See Annexure B *Ibid.*

$ *Retention of Proceeds of ADRs/GDRs abroad—*

A.P. (DIR Seires) Circular No. 69, dt. 13-1-2003.—In terms of Clause (4) of Regulation 4 of Schedule I, Indian companies issuing shares to overseas depository for the purpose of issuing ADRs/GDRs are permitted to invest funds abroad for a temporary period pending repatriation to India, subject to the conditions stipulated therein.

2. It has now been decided that Indian companies may retain abroad funds raised through ADRs/GDRs, for any period to meet their future forex requirements. Further, pending repatriation or utilisation of foreign resources raised, the Indian company may invest the foreign currency funds in:—

(i) deposits or Certificate of Deposit or other products offered by banks who have been rated not less than AA(-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's;

(ii) deposits with branch outside India of an authorised dealer in India; and

(iii) treasury bills and other monetary instruments of one year maturity having minimum rating as indicated at (i) above.

3. The corporates will be required to report (in soft copy form) the details of such funds raised and retained abroad within 30 days from the date of closure of the issue to the Chief General Manager, Exchange Control Department, Foreign Investment Division, Reserve Bank of India, Central Office, Mumbai-440 001.

4. The above relaxations, subject to review, shall be effective for a period upto June 30, 2003.

Provided the Indian company issuing such shares

(a) has an approval from the Ministry of Finance, Government of India to issue such ADRs and/or GDRs or is eligible to issue ADRs/GDRs in terms of the relevant scheme in force or notification issued by the Ministry of Finance, and

(b) is not otherwise ineligible to issue shares to persons resident outside India in terms of these Regulations, and

(c) the ADRs/GDRs are issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government thereunder from time to time.

(2) The Indian company issuing shares under sub-paragraph (1), shall furnish to the Reserve Bank, full details of such issue in the form specified in *Annexure 'C'**, within 30 days from the date of closing of the issue.

(3) The Indian company issuing shares against ADRs/GDRs shall furnish a quarterly return in the form specified in *Annexure 'D'** to Reserve Bank within fifteen days of the close of the calendar quarter.

(4) Pending repatriation or utilisation of foreign exchange resources raised in terms of clause (1) the Indian company may invest the foreign currency funds in -

(a) deposits with or Certificate of Deposits or other instruments of banks who have been rated not less than A1 by Standard and Poor or P1 by Moody's for short term obligations,

(b) deposits with branch outside India of an authorised dealer in India, and

(c) treasury bills and other monetary instruments with a maturity or un-expired maturity of the instrument of one year or less.

†[4A. A registered broker in India may purchase shares of an Indian company on behalf of a person resident outside India, for the purpose of converting the shares so purchased into ADRs/GDRs:

Provided that

(i) the shares are purchased on a recognized stock exchange;

(ii) the Indian company has issued ADRs/GDRs;

(iii) the shares are purchased with the permission of custodian of the ADRs/GDRs of the concerned Indian company and are deposited with the custodian;

(iv) the number of shares so purchased shall not exceed ADRs/GDRs converted into underlying shares and shall be subject to sectoral caps as applicable;

(v) the non-resident investor, broker, custodian and the overseas depository comply with the provisions of the scheme for the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, and guidelines issued thereunder by the Central Government from time to time.

(4B) (i) An Indian company may sponsor an issue of ADRs/GDRs with an overseas depository against shares held by its shareholders at a price to be determined by the lead manager.

(ii) The proceeds of the issue shall be repatriated to India within a period of one month.

(iii) The sponsoring company shall comply with the provisions of the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued thereunder by the Central Government from time to time;

(iv) the sponsoring company shall furnish full details of such issue in a form specified in Annexure C to the Foreign Investment Division, Exchange Control Department, Reserve Bank of India, Central Office, Mumbai, within 30 days from the date of closure of the issue.]"

5. Issue price

Price of shares issued to persons resident outside India under this Schedule, shall not be less than—

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* See *Appendix* 120.

† *Added by Notification No. FEMA 41/2001-RB, dt. 2-3-2001.*

(a) the price worked out in accordance with the SEBI guidelines as applicable, where the issuing company is listed on any recognised stock exchange in India, and

(b) fair valuation of shares done by a chartered accountant as per the guidelines issued by the erstwhile Controller of Capital Issues†, in all other cases.

5A. Issue price of ADRs/GDRs

Price of ADEs/GDRs to be issued to a person resident outside India may be decided by the Indian company—

(a) where the issue is on public offer basis, in consultation with the lead manager to the issue; and

(b) in other cases, as provided in paragraph 5 above.] [*Ins. by FEM (Transfer or Issue of Security by a Person Resident Outside India) (Second Amendment) Regulations, 2003, w.e.f. 18-6-2003] Or Ins. by GSR No. 588(E), dt. 18-6-2003.*

6. Dividend Balancing

Where a company is engaged in any of the industries in the consumer goods sector, specified in *Annexure E*‡, or in any other activity where the condition of dividend balancing has been stipulated in terms of the provisions of Industrial Policy and Procedures notified by Secretariat for Industrial Assistance, the cumulative outflow of foreign exchange on account of payment of dividend over a period of seven years from the date of commencement of commercial production to investors outside India shall not exceed cumulative amount of export earning of the company during those years.

Provided that

(a) the restriction under this paragraph shall not apply

(i) in respect of shares held in such a company by International Finance Corporation (IFC), the Deustche Entwicklungs Gescelschaft (DEG), the Commonwealth Development Corporation (CDC) and Asian Development Bank (ADB).

(ii) to a company that has completed a period of seven years from the date of commencement of commercial production,

[(iii) to obligations arising out of dividends declared/remitted after 14th July, 2000, *i.e.*, the date on which conditions of dividend balancing was withdrawn.] [*Added by GSR No. 558(E), dt. 18-6-2003*].

(b) * * * [Deleted by *Ibid*]

7. Rate of Dividend on Preference Shares

The rate of dividend on preference shares or convertible preference shares issued under these Regulations shall not exceed 300 basis points over the Prime Lending Rate of State Bank of India prevailing as on the date of the Board meeting of the company in which issue of such shares is recommended.

***8. Mode of payment for shares issued to persons resident outside India**

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† For text of the CCI Guidelines, see *Appendix* 275.

‡ Not included in this Note. Under Press Note No. 12 of 1992 series, it was decided to withdraw the condition of dividend balancing in all foreign investment approvals except for industries in the 22 specified consumer goods sector. On review of the eixsting policy on dividend balancing applicable to 22 specified consumer goods industries, and with a view to attracting FDI, it has been decided, with immediate effect, to remove the condition of dividend balancing on these 22 consumer goods industries. This decision will come into force from the date of issue of this Press Note and the export obligation and concomitant dividend balancing will remain applicable until the date of issue of this Press Note. [*Press Note No. 7 (2000 series) (F.No. 7(4)/2000-IP) dt. 14-7-2000, issued by Deptt. of Industrial Policy and Promotion*]. See sub-clause (iii).

* **Capitalisation of Lumpsum Fee/Royalty/ECB**

Attention of Authorised Dealers is invited to Regulation 5(1) of Notification No.FEMA.20/2000-RB dated May 3, 2000 and paragraph 8 of Schedule I thereto, in terms of which issue of shares or convertible debentures under Foreign Direct Investment Scheme by a company in India to a person resident outside India (other than a citizen of Bangladesh or Pakistan or Sri Lanka) is permitted only against inward remittance through normal banking channels or by debit to NRE/FCNR account of the person concerned maintained with an Authorised Dealer.

2. With a view to further liberalising the foreign investment policy, Government of India has issued Press Note No.3 (2003 Series) dated July 29, 2003 (copy enclosed), in terms of which issue of equity shares against Lump-sum fee, Royalty and External Commercial Borrowings (ECBs) in convertible foreign currency already due for payment/repayment has been permitted, subject to meeting all applicable tax liabilities and compliance with the procedures prescribed.

[Footnote mark * contd.]

A company in India issuing shares or convertible debentures under this Schedule to a person resident utside India shall receive the amount of consideration for such shares -

(i) by inward remittance through normal banking channels, or

(ii) by debit to NRE/FCNR account of the person concerned maintained with an authorised dealer/authorised bank.

. Report by the Indian company

(1) An Indian company issuing shares or convertible debentures in accordance with these Regulations shall submit to Reserve Bank,

(A) not later than 30 days from the date of receipt of the amount of consideration, a report indicating:

(i) Name and address of the foreign investors

(ii) Date of receipt of funds and their rupee equivalent

(iii) Name and address of the authorised dealer through whom the funds have been received, and

(iv) Details of the Government approval, if any.

(B) not later than 30 days from the date of issue of shares, a report in *Form FC-GPR* † together with,

(i) a certificate from the Company Secretary of the company accepting investment from persons resident outside India certifying that—

(a) all the requirements of the Companies Act, 1956 have been complied with;

(b) terms and conditions of the Government approval, if any, have been complied with;

(c) the company is eligible to issue shares under these Regulations; and

(d) the company has all original certificates issued by authorised dealers in India evidencing receipt of amount of consideration in accordance with paragraph 9;

(ii) a certificate from Statutory Auditors or Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

[Footnote mark * contd.]

3. The issue of shares against lump-sum technical know-how fee, royalty and ECB due for payment/repayment, whether under automatic route or SIA/FIPB route, is subject to the pricing guidelines of Reserve Bank/SEBI.

4. It has been clarified by the Government that the words 'import payables'‡ appearing in the Press Note refer only to payables towards import of technical know-how and other items mentioned under paragraph 2 above. Import dues by Indian companies, which are deemed as Trade (buyers'/ suppliers') Credit or ECBs in terms of Reserve Bank guidelines, are not permitted for conversion into equity shares.

5. Authorised Dealers may bring the contents of this circular to the notice of their constituents concerned.

6. Necessary amendments to the relevant Notifications are being issued separately.

7. The directions contained in this circular have been issued under Section 10(4) and Section 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999). [*A.P. (DIR Series) Circular No. 34, dt. 14-11-2003 issued by Reserve Bank of India*].

At present, issue of shares by a company in India to a person resident outside India is permitted only against inward remittance of convertible foreign exchange through normal banking channels or by debit to NRE / FCNR account of the person concerned maintained with an authorised foreign exchange dealer / bank.

2. As a part of the ongoing process of liberalisation, it has been decided to permit issue of equity shares against lumpsum fee, royalty and External Commercial Borrowings (ECBs) in convertible foreign currency already due for payment / repayment, subject to meeting all applicable tax liabilities and procedures. [*Press Note No. 3 (2003 Series), dt. 29-7-2003, issued by Deptt. of Industrial Policy & Promotion SIA (FC Division)*].

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‡ **This expression does not occur in the Press Note dt. 29-7-2003.**

† See *Appendix* 118.

10. Permission for retaining share subscription money received from persons resident outside India in a foreign currency account

Reserve Bank may, on an application made to it and on being satisfied that it is necessary so to do, permit an Indian company issuing shares to persons resident outside India under this Schedule, to retain the subscription amount in a foreign currency account, subject to such terms and conditions as it may stipulate.

Allotment of shares to existing non-resident shareholders within sectoral cap

The existing non-resident shareholders may apply for issue of additional shares, and the investee company may allot the same subject to the condition that the overall issue of shares to non-residents in the total paid up capital does not exceed the sectoral cap. [*Reg. 6(2)(ii) of FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000*].

Investment in shares and convertible debentures by FIIs under Portfolio Investment Scheme [Schedule 2]

§ See Notes under section 108.

Purchase and Sale of shares or convertible debentures by NRI on a stock exchange in India on repatriation/non-repatriation basis under Portfolio Investment Scheme [Schedule 3]

§ See Notes under section 108.

Investments by NRIs

In the case of NRIs it is to be ensured that the paid-up value of shares/ convertible debentures purchased by an NRI both on repatriation and non-repatriation basis does not exceed 5% of the paid-up capital/paid-up value of each series of debentures. The aggregate paid-up value of shares/ convertible debentures purchased by all NRIs should not exceed 10% of the paid-up capital of the company/paid-up value of series of debentures of the company provided that the NRI shall not purchase shares or convertible debentures of an Indian company which is engaged in Print Media. The aggregate ceiling of 10% can be raised to 24%, if the General Body of the Indian company concerned passes a special resolution to that effect. The NRI investor takes delivery of the shares purchased and gives delivery of shares sold. Payment for purchase of shares and/or debentures is made by inward remittance in foreign exchange through normal banking channels or out of funds held in NRE/FCNR account maintained in India if the shares are purchased on repatriation basis and by inward remittance or out of funds held in NRE/FCNR/NRO account of the NRI concerned, maintained in India where shares/debentures are purchased on non-repatriation basis. The link office of the designated branch of an AD shall furnish to the Chief General Manager, Reserve Bank of India, Exchange Control Department, Central Office, Mumbai a report on a daily basis on PIS transactions undertaken by it, such report to be furnished on-line or on a floppy or in a hard copy in a format supplied by RBI.

NRIs have also the general permission to purchase on repatriation basis Govt dated securities, Treasury bills, units of domestic Mutual funds bonds issued by public sector undertakings and shares in public sector enterprise being divested by the Govt of India (Schedule 5).

With effect from 29th November 2001, OCBs are not permitted to invest under the PIS in India. Further, the OCBs that have already made investments under the PIS, may continue to hold such shares/ convertible debentures till such time these are sold on the stock exchange. [See Para 7.3 of AP (DIR Series) Circular No. 38, dt. 3-12-2003]

§ For full text of the Circular, see *Appendix* 120 and *Appendix* 126.

A non-resident Indian (NRI) can invest on non-repatriation basis in the shares or convertible debentures of Indian companis which are not engaged in Chit Fund or Nidhi Company or in agricultural/plantation activities or real estate business or construction of

farm houses or dealing in Transferable Development rights and Print Media. There is no limit on NRI purchasing shares/convertible debentures issued by an Indian company whether by public issue or private placement. Amount of consideration for such purchase shall be paid by inward remittance through normal Banking channels from abroad or out of funds held in NRE/FCNR/NRO account maintained with the AD. In the case of NRIs resident in Nepal and Bhutan the amount of consideration for such purchase shall be paid only by way of inward remittance in foreign exchange through normal banking channels. The sale proceeds shall be credited to NRO account. The amount invested under the scheme and the capital appreciation thereon shall not be allowed to be repatriated abroad. [*Para 8 Ibid*].

Derecognition of OCBs as Investor class

(a) An unincorporated entity and OCB shall not make fresh investment under FDI Scheme (including Automatic Route). However, the unincorporated entities and OCBs may continue to hold shares and convertible debentures till they are sold/redeemed.

(b) OCBs shall not undertake purchase of shares/convertible debentures on non-repatriation basis. However, the OCBs may continue to hold the shares/convertible debentures purchased on non-repatriation basis till they are sold/redeemed. [*AP (DIR Series) Circular No. 14, dt. 16-9-2003*].

Purchase and Sale of Shares/Convertible Debentures by a Non-Resident Indian (NRI) or an Overseas Corporate Body (OCB), on Non-Repatriation basis* [Schedule 4]

SCHEDULE 4

[*See Regulation 5 (3) (ii)*]

PURCHASE AND SALE OF SHARES/ CONVERTIBLE DEBENTURES BY A NON-RESIDENT INDIAN (NRI) [1][* * *], ON NON-REPATRIATION BASIS

1. Prohibition on purchase of shares/convertible debentures of certain companies

No purchase of shares or convertible debentures of an Indian company shall be made under this Scheme if the company concerned is a Chit Fund or a Nidhi company or is engaged in agricultural/plantation activities or real estate business or construction of farm houses or dealing in Transfer of Development Rights.

Explanation : For the purpose of this paragraph, real estate business shall not include development of township, construction of residential/ commercial premises, roads, bridges, etc.

2. Permission to purchase and/or sell shares/convertible debentures of an Indian company

Subject to paragraph 1, a Non-resident Indian [1][* * *] may, without any limit, purchase on non-repatriation basis, shares or convertible debentures of an Indian company issued whether by public issue or private placement or right issue.

[2][*Provided that the person to whom the shares are being transferred, has obtained prior permission of Central Government to acquire the shares if he has previous venture or tie up in India through investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company whose shares are being transferred is engaged."*

Provided further that this restriction shall not apply to the transfer of shares to International Financial Institutions such as Asian Development Bank(ADB), International Finance Corporation(IFC), Commonwealth Development Corporation (CDC), Deutsche Entwicklungs Gescelsccha(DEG) and transfer of shares of an Indian company engaged in Information Technology sector.]

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* 1. NRIs and OCBs may purchase securities, other than shares and convertible debentures, subject to the terms and conditions specified in Schedule 5. [*Reg. 5(4)*].

2. There is no change in the existing procedures/regulations for purchase and sale of shares/convertible debentures by NRIs/OCBs on non-repatriation basis. [*vide S. No. 15 of Annexure II AD (MA Series) Circular No. 11 dt. 16-5-2000 issued by RBI*].

1. **The words "or an Overseas Corporate Body (OCB)" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.**

2. **The words "or OCB" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.**

3. Method of payment for purchase of shares/convertible debentures

The amount of consideration for purchase of shares or convertible debentures of an Indian company on non-repatriation basis, shall be paid by way of inward remittance through normal banking channels from abroad or out of funds held in NRE/FCNR /NRO/NRSR/NRNR account maintained with an authorised dealer or as the case may be with an authorised bank in India.

Provided that in the case of an NRI [3][* * *] resident in Nepal and Bhutan, the amount of consideration for purchase of shares or convertible debentures of an Indian company on non-repatriation basis, shall be paid only by way of inward remittance in foreign exchange through normal banking channels.

4. Sale/Maturity proceeds of shares or convertible debentures

(i) The sale/maturity proceeds (net of applicable taxes) of shares or convertible debentures purchased under this Scheme shall be credited only to NRSR account where the purchase consideration was paid out of funds held in NRSR account and to NRO or NRSR account at the option of the seller where the purchase consideration was paid out of inward remittance or funds held in NRE/FCNR/NRO/NRNR account.

(ii) The amount invested in shares or convertible debentures under this Scheme and the capital appreciation thereon shall not be allowed to be repatriated abroad.

Purchase of securities other than shares or convertible debentures

By Foreign Institutional Investors with reptriation benefits.—Foreign Institutional Investor can buy with repatriation benefits dated securities/ treasury bills, non-convertible debentures /bonds issued by Indian companies and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognised stock exchange in India. [*Para 8 of AP (DIR Series) Circular No. 38, dt. 3-12-2003*].

By NRIs on non-repatriation basis.—NRI can also, without any limit, purchase on non-repatriation basis dated Government securities, treasury bills, units of domestic mutual funds, units of Money Market Mutual Funds or National Plan/Savings certificates. [*Para 9 Ibid*]

Purchase and Sale of Securities other than Shares or Convertible Debentures of an Indian Company by a Person Resident outside India. [Schedule 5]

SCHEDULE 5

[*See Regulation 5 (4)*]

PURCHASE AND SALE OF SECURITIES OTHER THAN SHARES OR CONVERTIBLE DEBENTURES OF AN INDIAN COMPANY BY A PERSON RESIDENT OUTSIDE INDIA.

1. Permission to Foreign Institutional Investors for purchase of securities

A registered Foreign Institutional Investor may purchase, on repatriation basis, dated Government securities/treasury bills, non-convertible debentures/bonds issued by an Indian company and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognised stock exchange in India;

Provided that

(i) the FII shall restrict allocation of its total investment between equity and debt instruments (including dated Government Securities and Treasury Bills in the Indian capital market) in the ratio of 70:30, and

(ii) if the FII desires to invest upto 100 per cent in dated Government Securities including Treasury Bills, non-convertible debentures/bonds issued by an Indian company, it shall form a 100% debt fund and get such fund registered with SEBI.

2. Permission to Non-resident Indian [4][* * *] for purchase of securities

(1) A Non-resident Indian [5][* * *] may, without limit, purchase on repatriation basis,

(i) Government dated securities (other than bearer securities) or treasury bills or units of domestic mutual funds;

(ii) bonds issued by a public sector undertaking (PSU) in India;

(iii) shares in Public Sector Enterprises being dis-invested by the Government of India, provided the purchase is in accordance with the terms and conditions stipulated in the notice inviting bids.

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3. **The words "/OCB" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.**
4. **The words "and Overseas Corporate Body" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.**
5. **The words "or an Overseas Corporate Body" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.**

(2) A Non-resident Indian [6][* * *] may, without limit, purchase on non-repatriation basis, dated Government securities (other than bearer securities), treasury bills, units of domestic mutual funds, units of Money Market Mutual Funds in India, or National Plan/Savings Certificates.

[7][*(3) A Multilateral Development Bank which is specifically permitted by Government of India to float rupee bonds in India may purchase Government dated securities.*]

3. Method of payment of purchase consideration

(1) A registered Foreign Institutional Investor who purchases securities under the provisions of this Schedule shall make the payment for purchase of such securities either by inward remittance through normal banking channels or out of funds held in Foreign Currency Account or Non-resident Rupee Account maintained by the Foreign Institutional Investor with a designated branch of an authorised dealer with the approval of Reserve Bank in terms of *paragraph 2 of Schedule 2.*

(2) A Non-resident Indian [6][* * *] who purchases securities on repatriation basis, under sub-paragraph (1) of paragraph 2 of this Schedule, shall make payment either by inward remittance through normal banking channels or out of funds held in his/its NRE/FCNR account.

(3) A Non-resident Indian [6][* * *] who purchases securities on non-repatriation basis, under sub-paragraph (2) of paragraph 2 of this Schedule, shall make payment either by inward remittance through normal banking channels or out of funds held in his/its NRE/FCNR/ NRO/NRSR/NRNR account.

[7][*(4) A Multilateral Development Bank which purchases Government dated securities under this Schedule, shall make payment either by inward remittance through normal banking channels or out of funds held in the account opened with the specific approval of the RBI.*]

4. Permission for Sale of Securities

A person resident outside India who has purchased securities in accordance with this Schedule may (a) sell such securities through a registered stock broker on a recognised stock exchange or (b) tender units of mutual funds to the issuer for repurchase or for payment of maturity proceeds or (c) tender Government securities/treasury bills to the Reserve Bank for payment of maturity proceeds.

5. Remittance/credit of sale/maturity proceeds

(i) In the case of a registered Foreign Institutional Investor who has sold securities in accordance with paragraph 4, the designated branch of an authorised dealer referred to in sub-paragraph (1) of paragraph 3 may allow remittance of net sale/maturity proceeds (after payment of taxes) or credit the net amount of sale/maturity proceeds of such securities to the foreign currency account or Non-resident Rupee Account of the FII investor maintained in accordance with the provisions of *paragraph 2 of Schedule 2.*

(ii) In the case of a Non-resident Indian [6][* * *] who has sold securities in accordance with paragraph 4, the net sale/maturity proceeds (after payment of taxes) of such securities, may be

(a) credited only to NRSR account of the NRI investor where the payment for purchase of securities sold was made out of funds held in NRSR account, or

(b) credited, at the NRI [8][* * *] investor's option, to his/its NRO or NRSR account, where the payment for the purchase of the securities sold was made out of funds held in NRO account, or

(c) remitted abroad or at the NRI [8][* * *] investor's option, credited to his/its NRE/FCNR /NRO/NRSR/NRNR account, where the securities were purchased on repatriation basis in accordance with sub-paragraph (1) of paragraph 2 and the payment for purchase of the securities sold was made by inward remittance through normal banking channels or out of funds held in NRE/FCNR account.

[7][(iii) in the case of sale of Government dated securities by a Multilateral Development Bank, the net maturity proceeds (after payment of taxes) may be remitted abroad or credited to fund account opened with the prior permission of the Reserve Bank.]

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6. The words "or an Overseas Corporate Body" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.
7. Ins. by Fourth Amendment Regulations, 2003, *vide* Notfn. FEMA 106/2003-RB, (GSR 899(E)), dt. 27-10-2003.
8. The words "or OCB" omitted by Notification FEMA 101/2003-RB, dt. 3-10-2003.

VI. Investment by Foreign Venture Capital Investors in Indian Venture Capital Undertakings/Funds

A foreign venture capital investor‡ registered with SEBI may make investment in a venture capital fund† or an Indian venture capital undertaking@, in the manner and subject to the terms and conditions specified in Schedule 6.

Provided that the foreign venture capital investor shall not purchase shares or convertible debentures of an Indian company which is engaged in the print media sector. [*Reg. 5(5) and Schedule 6.*

INVESTMENT IN AN INDIAN VENTURE CAPITAL UNDERTAKING BY A REGISTERED FOREIGN VENTURE CAPITAL INVESTOR [SCHEDULE 6]

1. Investment by foreign venture capital investor.—(1) A registered Foreign Venture Capital Investor (FVCI) may, through the Securities and Exchange Board of India, apply to the Reserve Bank for permission to invest in Indian Venture Capital Undertaking (IVCU) or in a VCF or in a scheme floated by such VCFs. Permission may be granted by the Reserve Bank subject to such terms and conditions as may be considered necessary.

(2) The registered FVCI permitted by the Reserve Bank under sub-paragraph (1), may purchase equity/equity linked instruments/debt/debt instruments, debentures of a IVCU or of a VCF through initial public offer or private placement or in units of schemes/funds set up by a VCF.

(3) The amount of consideration for investment in VCFs/IVCUs shall be paid out of inward remittance from abroad through normal banking channels or out of funds held in an account maintained with the designated branch of an authorised dealer in India in accordance with para. 2.

2. Maintenance of account by the registered FVCI for investment in IVCUs/VCFs or schemes/funds set up by the VCFs.—The Reserve Bank may, on application, permit a FVCI which has received 'in principle' registration from SEBI to open a foreign currency account and/or a rupee account with a designated branch of an authorised dealer with the following permissible transactions:

(i) Crediting inward remittance received through normal banking channels or the sale proceeds (net of taxes) of investments.

(ii) making investment in accordance with the provisions of paragraph 1 above.

(iii) transferring funds from the foreign currency account of the FVCI to their own rupee account.

(iv) remitting funds from the foreign currency or rupee account subject to payment of applicable taxes.

(v) meeting local expenses of the FVCI.

3. Forward cover.—Authorised dealers may offer forward cover to FVCIs to the extent of total inward remittance. In case the FVCI has made any remittance by liquidating some investments, original cost of the investments will be deducted from the eligible cover.

4. Valuation of investments.—The FVCI may acquire by purchase or otherwise or sell shares/convertible debentures/units or any other investment held by it in the IVCUs or VCFs or schemes/funds set up by the VCFs at a price that is mutually acceptable to the buyer and the seller/issuer. The FVCI may also receive the proceeds arising out of the liquidation of VCFs or schemes/funds set up by the VCFs.

5. Adherence to SEBI Guidelines.—FVCIs shall abide by the relevant regulations/guidelines issued by the Securities and Exchange Board."

Trade/investment in exchange traded derivatives by FII and NRI

(i) A registered Foreign Institutional Investor (FII) having valid approval under FERA, 1973 or under FEMA, 1999 may trade in all exchange traded derivative contracts approved by SEBI from time to time subject to the limits prescribed by SEBI.

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‡ 'Foreign venture capital investor' means an investor incorporated and established, outside India which proposes to make investment in venture capital fund(s) or venture capital undertaking(s) in India and is registered with SEBI under the SEBI (Foreign Venture Capital Investors) Regulations, 2000;" [*Reg. 2(ii)a*]

†. 'Venture capital fund' means a fund established in the form of a trust, a company including a body corporate and registered under the Securities and Exchange Board of India (Venture Capital Fund) Regulations, 1996, which has a dedicated pool of capital raised in a manner specified under the said Regulations and which invests in venture capital undertakings in accordance with the said Regulations;" [*Reg. 2(xi)a*].

@ 'Indian venture capital undertaking' means a company incorporated in India whose shares are not listed on a recognized stock exchange in India and which is not engaged in an activity under the negative list specified by SEBI;" [*Reg. 2(va)*].

(ii) A Non-Resident Indian (NRI) may invest in exchange traded derivative contracts approved by SEBI from time to time out of INR funds held in India on non-repatriable basis subject to the limits prescribed by SEBI. Such investments will however not be eligible for repatriation benefits. [*Reg. 6 of FEM (Transfer or Issue of Securities by a Person Resident Outside India, Regulations, 2000*]

Policy and procedure for Foreign Investments

A Manual on Industrial Policy and Procedure has been issued by the Ministry of Commerce and Industry.

§ For text see *Appendix* 122.

Investment by Mutual Funds in ADRs/GDRs

SEBI Press Release, dated 3-9-1999.—The RBI, in its credit and monetary policy in October, 1997, had announced that all Fund Managers registered with SEBI including mutual funds would be permitted to invest in overseas markets. Subsequent to this decision, SEBI had constituted a working group to frame the guidelines for domestic funds to invest in overseas markets. The group submitted its report to SEBI on July 20, 1998 and recommended that initially Mutual Funds may be allowed to invest in overseas securities including ADRs/GDRs issued by Indian Companies.

SEBI had forwarded the recommendations of the working group to the Government and the RBI. The RBI, in consultation with the Government of India and SEBI has now decided to allow the mutual funds to invest in ADRs/GDRs issued by Indian companies.

Accordingly, all mutual funds will henceforth be permitted to invest in ADRs/GDRs initially within overall limit of US $ 500 mn. with a sub-ceiling for individual mutual fund which should not exceed 10% of the net assets managed by them as on the date of the last audited balance sheet, subject to a minimum of US $ 20 mn. and a maximum of US $ 50 mn. per mutual fund.

SEBI has advised all mutual funds in this regard. [*Press Release (Ref. No. PR 206/99), dated 3-9-1999, issued by Mutual Fund Department, SEBI*].

Allotment to NRIs, foreigners and to foreign companies

Allotment to non-residents, and foreigners (whether resident or non-resident or to companies with 51 per cent non-resident interest will not be legal without Reserve Bank's permission. See sections 19(1)(d) and 29(1)(b) of the Foreign Exchange Regulation Act, 1973 and the decision of the Supreme Court in *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 : AIR 1986 SC 1370.

Guidelines for Foreign Institutional Investors

Government has evolved a set of Guidelines for investments by FIIs to invest in all the securities traded in the primary and secondary markets on various Stock Exchanges in India *vide* its *Press Release*, dated 14-9-1992.

§ For the text of the Guidelines see *Appendix* 192.

SEBI (Foreign Institutional Investors) Regulations, 1995

§ SEBI has issued these regulations under *Notification* SO 918(E), dated 14-11-1995. For the text of these Regulations see *Appendix* 193.

Investment by FIIs in Debt Securities

§ See SEBI Press Release, dated 9-11-1996 in *Appendix* 192.

Modified Guidelines for Foreign Institutional Investors (Taxation Aspect)

Press Release, dated 24-3-1994.—The following modifications of FII Guidelines dated 14-9-92 in general, and paragraph 9(f) and paragraph 18 of those Guidelines in particular, are issued by way of clarification in the light of the enactment of section 115AD of the Income-tax Act through the Finance Act, 1993:

The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:

(i) The income received in respect of securities (other than units of offshore Funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;

(ii) Income by way of long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;

(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;

(iv) The rates if income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under section 28 to 44C.57 and Chapter VI-A of the Income-tax Act.

The expression "securities" referred to above shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956*. These include:

(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated or other body corporate:

(ii) Government securities; and

(iii) Rights or interests in securities.

On account of the concessional rate of income-tax on the capital gains, the provisions currently available to non-residents for protection from fluctuation of rupee value against foreign currency for computing capital gains arising from the transfer of shares in, or debentures of, an Indian company, will not apply to the Foreign Institutional Investors covered under section 115AD of the Income-tax Act. Further, the benefit of cost inflation indexation will also not be available to FIIs while computing long-term capital gains arising to them on transfer of securities.

Shares in a company shall have to be held for more than 12 months in order to qualify as a long-term capital asset. Other securities shall have to be held for more than 36 months in order to qualify as a long-term capital asset.

2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Income-tax Act to mean such investors as the Central Government may, by notification in the official gazette, specify in this behalf. The FIIs as are registered with Securities and Exchange Board of India will be automatically notified by the Central Government for the purposes of section 115AD.

3. Income of Foreign Institutional Investors from securities shall be subject to deduction of tax at source. However, no deduction of tax shall be made from any income by way of capital gains arising from the transfer of securities. In order that the tax on capital gains arising to FIIs can be realised, each FII, while applying for initial registration with Securities and Exchange Board of India, will have to specify an agent, including a person who is treated as an agent under section 163 of the Income-tax Act for the said purposes. [*F.No.* 5(13)/SE/91-FIV, *Ministry of Finance, Department of Economic Affairs (Investment Division)*, dated 24-3-1994].

FIIs investment limit raised to 40%—Press Release, dt. 1-3-2000.—Foreign Institutional Investors registered with SEBI are permitted to invest subject to an aggregate investment limit of 24 per cent. of the issued and paid-up capital of an Indian company. In terms of the Press Note dated 4th April, 1997. The Indian companies were permitted to enhance the normal aggregate portfolio investment limit from 24 per cent. to 30 per cent. under specified special procedure. The aggregate investment limits applicable to FIIs had also been segregated through a Press Note issued on 22nd June, 1998, from the portfolio investment limits for NRIs/PIOs/OCBs.

In his budget speech 2000-2001, the Finance Minister had announced an increase in the portfolio investment ceiling applicable to Foreign Institutional Investors (FIIs). Pursuant to the announcement, Indian companies would henceforth be permitted to raise the aggregate ceiling for FIIs portfolio investments from the normal level of 24 per cent. to 40 per cent. of the issued and paid-up capital of an Indian company subject to:

(a) Approval by the board of directors of the company to the enhanced limit up to 40 per cent. and

(b) A special resolution passed by the general body of the company approving the enhanced limit up to 40 per cent.

All other conditions applicable to FII portfolio investment would continue to be operative as before. [*Press Release F.No. 14/11/96-NRI, dated 1-3-2000, issued by Ministry of Finance, Department of Economic Affairs.*]

Writing off of securities held by Foreign Institutional Investors and sub-accounts and reporting to SEBI.

§ For procedure see SEBI Circular No. FITTC/FII/02/2002, dated 15-5-2002, *Appendix* 194(8).

Raising of foreign equity to 51% in existing companies through preferential allotments to NRIs and Guidelines for determining issue price

§ See Notes under s. 81 *post.*

Preferential Allotment by Listed Companies to Foreign Institutional Investors (FIIs)

§ See Notes under s. 81 *post.*

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* Refer amended definition of "Securities" in *Appendix* 246.

Preferential allotment of shares or warrants/FCDs/ PCDs to select group of persons under section 81(1A)

§ See Notes under s. 81 *post.*

SEBI Clarifications as to Preferential Allotment Norms

§ See Notes under s. 81 *post.*

Issue of shares to NRIs through preferential allotment—Revised guidelines for determining issue price

§ See Notes under section 81, *post.*

Book Building Processes for Issue of Shares

Book-building is an international practice which refers to collecting orders from investment bankers and larger investors based on indicated prices. SEBI has issued guidelines for making reservation in issues for bringing about firm allotment of a certain portion of the issue. The issuer company has an option of either reserving the securities for firm allotment or issuing the securities through book building process which is separately identified as 'placement portion category' in the prospectus.

§ For further detailed discussions see notes under s. 81. For the text of the SEBI Guidelines, 2000 on Book Building see Chapter 11 of *Appendix* 162.

Guidelines for Foreign Investment in Preference Shares

Guidelines dated 31-7-1997.— § For the Guidelines, see Notes under s. 81.

***[Investment in Air Taxi Operations**

(*i*) NRIs/OCBs are permitted to set up Indian companies with 100 per cent equity participation for carrying on Air Taxi Operations in terms of the guidelines issued by the Director General of Civil Aviation for Air Taxi Operations.

(*ii*) Reserve Bank, *vide* its Notification No. F.E.R.A. 197/99-RB dated 30th March 1999, has granted general permission under sections 19(1)(*d*), 19(1)(*a*) and 29(1)(*b*) of the Foreign Exchange Regulation Act, 1973 to Indian companies to issue and export shares/convertible debentures to NRI/OCB investors upto 100 per cent of paid-up capital as also to NRI/OCB investors to acquire shares/convertible debentures of the Indian companies. As a result of the general permission, Indian companies seeking investment from NRI/OCB investors under the scheme may issue shares/convertible debentures subject to the following conditions:—

(*i*) the company concerned should comply with the conditions stipulated by the Director General of Civil Aviation or the competent authority concerned in the letter of approval issued to the company for carrying on Air Taxi Operations in India;

(*ii*) in the case of issue of shares by an existing listed company the price of the issue is worked out according to SEBI guidelines and is duly certified by the company's statutory auditors and in the case of any other company, calculation of fair value of shares (as per erstwhile CCI guidelines) is made by an independent Chartered Accountant;

(*iii*) payment for the shares issued to NRIs/PIOs/OCBs is received by remittance from abroad through normal banking channels or out of funds held in the investor's NRE/FCNR account maintained with an authorised dealer in India;

(*iv*) the company should submit to Reserve Bank, not later than 30 days from the date of receipt of remittance, a report containing the following:

(*a*) Name of the investor;

(*b*) Country of residence;

(*c*) Date of receipt of remittance;

(*d*) Name and address of the authorised dealer in India through whom the remittance is received;

(*v*) the company issuing the shares should submit a report to Reserve Bank in Form ISD(R), not later than 30 days from the date of issue together with the documents specified in the Notification referred to above. [*RBI Exchange Control Manual, 1993, para 10C.14*]

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Notification No. FERA 197/99-RB, dated 30th March, 1999

Permission for issue of shares to NRIs/OCBs on repatriation basis by Air-Taxi Operating Company

In pursuance of clause (*a*) and clause (*d*) of sub-section (1) of section 19 read with clause (*b*) of sub-section (1) of section 29 of the Foreign Exchange Regulation Act, 1973 (46 of 1973), the Reserve Bank is pleased to permit a company incorporated in India holding a valid Air Taxi Operator's Permit granted by

* Subs. by AD (MA Series) Circular No. 21, dt. 18-6-1999.

the Competent Authority specified by the Government of India from time to time to issue shares or convertible debentures to the extent of 100% of its paid-up capital and subject to the conditions mentioned in paragraph 2, to non-residents of Indian nationality or origin (NRIs) or Overseas Corporate Bodies (OCBs) and to send such shares out of India to their place of residence or location, as the case may be.

2. The general permission granted herein to issue shares and/or convertible debentures is subject to following conditions:

(*i*) the company complies with the conditions of permit granted by the competent authority for carrying on Air-Taxi operations in India and any directions/instructions issued by it from time to time;

(*ii*) in the case of issue of shares by an existing listed company, the price for the issue is worked out according to SEBI guidelines and is duly certified by the Company's statutory auditors; and in the case of any other company, calculation of fair value of shares (as per erstwhile CCI guidelines) is made by an independent Chartered Accountant;

(*iii*) payment for the shares issued to NRIs/OCBs is received by remittance from abroad through normal banking channels or by transfer of funds held in the investor's NRE/FCNR account maintained with an authorised dealer in India.

(*iv*) approval, wherever necessary, from any authority, statutory or otherwise, is obtained by the company;

(*v*) the issuer company files with the Regional Office of Reserve Bank, not later than thirty days from the date of receipt of remittance, a report containing the following—

(*a*) Name of the non-resident investor;

(*b*) Country of residence or incorporation of the non-resident investor;

(*c*) Date of receipt of remittance and its rupee equivalent;

(*d*) Name and address of the authorised dealer in India through whom the remittance is received.

(*vi*) The issuer company files with Regional Office of Reserve Bank, not later than thirty days from the date of issue of shares/debentures, the following—

(*a*) One copy of Form ISD(R) duly completed.

(*b*) Original Foreign Inward Remittance Certificate (FIRC)/Bank Certificate evidencing receipt of funds, from abroad or from the NRE/FCNR account, as the case may be, of the NRI/OCB.

(*c*) Memorandum and Articles of Association of the issuer company.

(*d*) Original certificate from the Chartered Accountant containing particulars of shares issued, date of issue, number of shares issued and the issue price.

(*e*) Certified copy of Statutory Auditor's Certificate or the Chartered Accountant's calculation referred to in (*ii*) above.

(*f*) Certificate in Form OAC/OACI indicating that NRI shareholding is at least 60% either directly or indirectly in case of investment by OCB.

(*g*) Such other particulars and documents as may be required by or specified by Reserve Bank from time to time.

(*h*) An undertaking that the issuer company is not and shall not be engaged in agricultural/plantation activity, real estate business or as a Nidhi company.

Explanation:

I. A person (not being a citizen of Pakistan or Bangladesh or Sri Lanka) shall be deemed to be of 'Indian Origin', if—

(*i*) he, at any time, held Indian passport;

or

(*ii*) he or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955);

or

(*iii*) that person is the spouse of an Indian citizen or of a person of Indian origin (not being a citizen of Pakistan or Bangladesh or Sri Lanka).

II. "Overseas Corporate Body" means any overseas company, partnership firm, society and other corporate body predominantly owned directly or indirectly to the extent of at least sixty per cent by NRIs and includes overseas trust in which not less than sixty per cent beneficial interest is held by NRIs, directly/indirectly but irrevocably.

Investment in Non-Convertible Debentures by NRIs/OCBs

§ See Notes on section 117 under FEMA, 1999 and relevant Regulations framed under that Act.

Investment in Sick Industrial Units

[(i) NRIs/OCBs will be permitted by Reserve Bank to undertake revival of sick industrial units by making bulk investment in them either by way of purchase of equity shares from existing shareholders or in the form of subscription to new equity issues of the sick units on the following basis:

(a) The bulk investment can be made on private placement basis up to 100% of the equity capital of the sick company with full benefits of repatriation of capital invested and income earned thereon.

(b) Issue/transfer of equity shares should be approved by the existing shareholders of the company through a Special Resolution.

For the purpose of investment under the scheme, a company should be declared as sick or there should be a rehabilitation programme approved by the public financial institution/commercial bank or a consortium of banks or by the Board for Industrial and Financial Reconstruction (BIFR).

(ii) Applications for permission for issue/transfer of equity shares to non-residents should be made by the concerned Indian company in form RSU to the Central Office of Reserve Bank together with the particulars/documents specified in the application form. [*RBI Exchange Control Manual, 1993, para 10C.16*]

AD (MA Series) RBI Circular No. 22, dated 4-6-1997.—"**3.1** In terms of paragraph 10C.16 of ECM, NRIs/OCBs are permitted by Reserve Bank to undertake revival of sick industrial units by making bulk investment in them either by way of purchase of equity shares from existing shareholders or in the form of subscription to new equity issues of the sick units subject to the terms and conditions stated therein.

3.2 In order to encourage investment by NRIs/OCBs under the sick unit scheme and also to further simplify the norms prescribed under the scheme, it has been decided that henceforth NRI/OCBs will be permitted to invest upto 100 per cent of equity capital of a sick company either by purchase of equity shares from the existing shareholders or in the form of subscription to the new equity issue of the sick company subject only to the condition that the company should be declared as sick or there should be a rehabilitation programme approved by a public financial institution/a commercial bank or a consortium of banks or by Board for Industrial and Financial Reconstruction (BIFR). There will be no lock-in-period for repatriation of capital."

Export of Shares, bonds, debentures, *etc.*

In terms of section 19(1)(a) of FERA, 1973, export of any security (which includes shares, bonds, debentures, *etc.*) to any place outside India requires permission of Reserve Bank.

Unit Trust of India has been granted general permission by Reserve Bank to export certificates covering units purchased by non-resident investors from out of foreign exchange remittances to India or from their non-resident accounts in India.

At the time of granting permission for purchase/ issue of shares/bonds/debentures by/to non-residents, permission for export of the share/bond/debenture certificates is generally granted by Reserve Bank. Permission for export of shares/securities will, therefore, be required to be obtaind only in cases where such a permission has not been given. [*RBI Exchange Control Manual, 1993, para 10A.8*]

Issue and export of shares by Indian companies to NRI investors

Circular no. SMDRP/POLICY/CIR-28/98, dated 7-10-1998, issued by the SEBI.—This has reference to our Circular No. SMD/SED/CIR/94/6669 dated 31st October, 1994 requesting the exchanges to ensure that no listing or trading permission is granted unless

an unambiguous certificate is obtained from the company concerned that all the share certificates have been despatched.

Earlier, under the various schemes of NRI investments in Indian companies, the Reserve Bank of India ('the RBI') used to grant permission to eligible companies for issue of shares to NRI investors in two stages. In the first stage, after establishing the eligibility of the applicant Indian company, the RBI granted 'in-principle' approval. The final approval to issue and export share certificates to NRI investors was granted in the second stage after the company submitted the list of investors, foreign inward certificates/bank certificates, etc., evidencing funds from abroad. *Vide* Press Release dated 9th April, 1997 [copy annexed] titled "RBI simplifies procedure for issue and export of shares by India Companies", the RBI has provided that Indian companies will no longer have to approach the RBI twice for seeking permission for issue and export of shares to NRI investors and has decided to grant such permission to eligible companies in one stage in order to expedite the process of issue and export of shares to NRI investors as also to simplify the existing procedure.

The stock exchanges are advised to take note of change in the procedure by the RBI for issue and export of shares by Indian companies to NRI investors as provided in the referred Press Release and ensure compliance regarding obtaining certificate from the company that all share certificates including certificate to NRI investors have been despatched before listing or trading permission is granted.

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RBI Press Release dated 9-4-1997.—Indian companies will no longer have to approach the RBI twice for seeking permission for issue an export of shares to non-resident Indian and (NRI) investors. The RBI has decided to grant such permission to eligible companies in one stage in order to expedite the process of issue and export of shares to NRI investors as also to simplify the existing procedure.

Earlier, under the various schemes for NRI investments in Indian companies, the RBI used to grant permission to eligible companies for issue of shares to NRI investors in two stages. In the first stage, after establishing the eligibility of the applicant Indian company, the RBI granted 'in-principle' approval. The final approval to issue and export share certificates to NRI investors was granted in the second stage after the company submitted the list of investors, foreign inward remittance certificates/bank certificates, etc., evidencing receipt of funds from abroad.

The RBI has stated that after obtaining the one-stage RBI approval but before issuing and exporting the shares to NRI investors, Indian companies should ensure receipt of funds in foreign exchange by way of inward remittances or by debit to the non-resident (external)('NRE')/foreign currency non-resident ('FCNR') accounts of the investors as also obtain the necessary documentary evidence by way of foreign inward remittance certificates/bank certificates from the concerned banks. The RBI has also stated that the issuer-company should immediately report to the RBI along with a certificate by the authorised dealers that the remittances have been received.

Foreign Currency Convertible Bonds and Ordinary Shares (Through Global Depositary Receipt Mechanism) Scheme, 1993 (GDRs)

Notification, dated 12-11-1993.—Central Government has notified a new scheme for facilitating issue of Foreign Currency Convertible Bonds and Ordinary Shares through Global Depositary Mechanism by Indian Companies *vide* GSR No. 700(E), dated 12-11-1993. An issuing company desirous of raising foreign funds through Global Depositary Receipts is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Government of India.

§ For the text of the Scheme and eligibility for issue of convertible bonds or ordinary shares see *Appendix* 119.

FEM (Transfer or Issue of Any Foreign Security) Regulations, 2000.—An Indian company or a body corporate which has obtained necessary approval of Government of India, Ministry of Finance, Department of Economic Affairs has been permitted to issue Foreign Currency Convertible Bonds (FCCBs) to a person resident outside India. Such a company or body corporate is required to submit to Reserve Bank a report within 30 days from

issue of FCCBs as specified in Regulation No. 18(3) of FEM (Transfer or Issue of any Foreign Security) Regulations, 2000† framed under the Act*. Reg. 18 reads as follows:

"**Prohibition on issue of foreign security by a person resident in India**.

(1) Save as otherwise provided in the Act or in sub-regulation (2), no person resident in India shall issue or transfer a foreign security.

[(2) A person resident in India, being an Indian Company or a Body Corporate created by an Act of Parliament,

(i) may issue FCCBs not exceeding US$50 million, to a person resident outside India in accordance with and subject to the conditions stipulated in Schedule II;

(ii) where the issue exceeds US $50 million but does not exceed US $100 million, may apply to the Reserve Bank in Form ECB for permission to issue FCCBs;

(iii) where the issue exceeds US $100 million, may apply to the Government of India, Ministry of Finance, (Department of Economic Affairs) for approval".] [*Subs. by Fourth Amendment Regulations, 2002,* w.e.f. 7-3-2002].

(3) ‡[The company/body corporate referred to in clause (iii) of sub-regulation (2)], issuing the FCCBs shall, within 30 days from the date of issue, furnish a report to the Reserve Bank giving the details and documents as under:

(a) A copy of Government's approval for issue of FCCBs.

(b) Total amount for which FCCBs have been issued.

(c) Names of the investors resident outside India and number of FCCBs issued to each of them.

(d) The amount repatriated to India through normal banking channels and/or the amount received by debit to NRE/FCNR accounts in India of the investors (duly supported by bank certificate) [*Reg. 18*]

Automatic Route for issue of FCCBs

An Indian company or a body corporate created by an Act of Parliament may issue FCCBs not exceeding US $ 50 million in any one financial year to a person resident outside India under the automatic route without the approval from Government or Reserve Bank subject to the following conditions stipulated in Schedule II [*see Reg. 18(2) above*].

SCHEDULE II

AUTOMATIC ROUTE FOR ISSUE OF FOREIGN CURRENCY CONVERTIBLE BONDS (FCCBs)

(i) The FCCBs to be issued will have to conform to the Foreign Direct Investment Policy (including Sectoral Cap and Sectors where FDI is permissible) of the Government of India as announced from time to time and the Reserve Bank's Regulations/directions issued from time to time.

(ii) The issue of FCCBs shall be subject to a ceiling of U S $ 50 million in any one financial year.

(iii) Public issue of FCCBs shall be only through reputed lead managers in the international capital market. In case of private placement, the placement shall be with banks, or with multilateral and bilateral financial institutions, or foreign collaborators, or foreign equity holder having a minimum holding of 5% of the paid up equity capital of the issuing company. Private placement with unrecognised sources is prohibited.

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† For text of the Regulations, see *Appendix* 116.
See S. No. 14 of Annexure II to AD (MA Siries) Circular No. 11, dt. 16-5-2000.

* For text of the FEMA Act, 1999, see *Appendix* 96.

‡ Subs. for the words "referred to in sub-regulation (2)" by Fourth Amendment Regulation, 2002, *vide* Notification No. FEMA 55/2002-RB, dt. 7-3-2002.

(iv) The maturity of the FCCB shall not be less than 5 years. The call & put option, if any, shall not be exercisable prior to 5 years.

(v) Issue of FCCBs with attached warrants is not permitted.

(vi) The "all in cost" will be 100 basis points less than those prescribed for External Commercial Borrowing (ECB) schemes specified in the Schedule to Notification No: FEMA 3/2000-RB dated 3rd May 2000. The "all in cost" shall include coupon rate, redemption premium, default payments, commitment fees, and fronting fees, if any, but shall not include the issue related expenses such as legal fees, lead managers fees, out of pocket expenses.

(vii) The FCCB proceeds shall not be used for investment in Stock Market, and may be used for such purposes for which ECB proceeds are permitted to be utilised under the ECB schemes.

(viii) In case the FCCBs are issued for financing imports/foreign exchange capital expenditure, the proceeds can be retained abroad with the approval of the Reserve Bank of India. In all other cases, the proceeds shall be repatriated to India immediately on completion of issue process.

(ix) The issue related expenses shall not exceed 4% of issue size and in case of private placement, shall not exceed 2% of the issue size.

*(x) The issuing entity shall, within 30 days from the date of completion of the issue, furnish a report to the concerned Regional Office of the Reserve Bank of India through a designated branch of an Authorized Dealer giving the details and documents as under:

(a) The total amount of the FCCBs issued,

(b) Names of the investors resident outside India and number of FCCBs issued to each of them, and

(c) The amount repatriated to India through normal banking channels and/or, duly supported by bank certificates.

EURO ISSUES

An Euro equity issue is made by an instrument termed "Global Depository Receipts" (GDR). A GDR is a dollar denominated instrument tradeable on a stock exchange in Europe or USA.

Generally the following types of instruments are issued in the Euro market:

—Equity instruments

—Equity linked instruments

Equity Instruments

Equity instruments are classified into two types;

—GDR's

—GDR's with equity warrants

Equity Linked Instruments

Equity linked instruments are classified into four types;

(1) Ordinary Euro bonds

(2) Zero coupon bonds

(3) Euro convertible bonds

(4) Bonds with equity warrants.

Modalities of EURO Issue

(1) A GDR represents a certain number of equity shares. Though GDR is denominated in dollar terms, the equity shares comprised in each GDR are denominated in rupees. For

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* In terms of paragraph (x) of Schedule II the issue of FCCB is required to be reported to the Reserve Bank through the designated branch of an authorised dealer. Authorised dealers may forward the same to the concerned Regional Office of the Reserve Bank for obtaining a loan registration number. While forwarding the offer documents to Reserve Bank the authorised dealers shall ensure that the FCCBs are issued strictly in accordance with the notification. [*AP (DIR Series) Circular No. 29, dt. 11-3-2002 issued by RBI*]

example, a GDR of $30 may comprise two equity shares of $15 each equivalent to Rs. 450/- each, at the rate of exchange prevailing at the time of the issue.

(2) The securities are issued by the issuing company to an intermediary called 'depository'. The equity shares are registered in the name of the depository who subsequently issues the GDR to the investors. The issuers and the depository enter into a 'depository agreement' detailing the terms and conditions of the agreement between them.

(3) The equity shares are in physical possession of another intermediary called the 'custodian', who is an agent of the depository. The depository and the custodian shall enter into an agreement between themselves, known as the 'custodian agreement'.

(4) The GDR has a distinct identity and does not appear in the books of the issuing company.

Fungibility of GDR

Two way fungibility implies that not only is the GDR holder given the option to cancel his GDRs with the depository and recover the proceeds by selling the underlying shares, but the company is also given the option to convert the shares so released into GDRs for purchase by foreign investors and NRIs. This will result in a broad based market for GDR and remove volatility in prices owing to large cancellation of GDRs.

One way fungibility means that foreign investors have the option of cancellation of GDRs by withdrawing foreign exchange from the country without a corresponding inflow of foreign currency by fresh issue of GDRs by the company.

In India, fungibility is restricted to one-way fungibility since a company is not permitted to buy its own shares under the Companies Act. Hence, the arbitrage opportunities that may arise from two way fungibility of GDRs are not possible in the case of GDRs issued by Indian companies.

In order to ensure full fungibility of GDRs, free convertibility of GDRs without restricting it to the original issue size, listing of shares in major international stock exchanges and public issue of shares on the international stock exchanges are necessary.

Two-way fungibility of ADRs/GDRs

ADRs/GDRs have been provided with limited two way fungibility in terms of which converted domestic shares of Indian companies may be re-converted into ADRs/GDRs while being subject to sectoral caps wherever applicable. The "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993" dated the 12th November, 1993, notified by the Ministry of Finance, Department of Economic Affairs has been amended as under:—

(i) ADRs/GDRs redeemed and underlying shares sold in the domestic market shall be eligible for being reconverted as ADRs/GDRs to such extent.

(ii) Such re-conversion shall be governed by paragraph "4A" in Schedule I of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2001.

(iii) The domestic custodian will maintain details of ADRs/GDRs issued, cancelled, sold, re-converted and co-ordinate with the company/NSDL to ensure that total cap is not breached if there is a percentage cap on foreign investment or where there is a possibility of equity limits for automatic approval/FIPB approval being breached.

(iv) The Scheme would be governed by the operative guidelines issued by the Reserve Bank of India [See *Appendix* 119].

(v) The tax provision under Section 115AC of the Income Tax Act, 1961, which is applicable to non-resident investors investing in ADRs/GDRs offered against issue of fresh underlying shares would extend to non-resident investors investing in foreign exchange in ADRs/GDRs issued against existing shares under

these guidelines, in terms of the amendment to the Income-tax Act, 1961 which would come into force with effect from 01-04-2002. [*Press Release No. F. No. 15/7/99-NRI, dt. 13-2-2002; Issued by the Ministry of Finance, Department of Economic Affairs (Investment Division); AP (DIR Series) Circular No. 21, dt. 13-2-2002 issued by RBI*

Disinvestment of shares by the Indian companies in the Overseas market through issue of ADRs/GDRs

Notification No. 15/23/99-NRI, dt. 29-7-2002.—The Operative Guidelines for Disinvestment of shares by the Indian companies in the overseas market through issue of ADRs/GDRs as notified by Ministry of Finance. Divestment by shareholders of their holdings of Indian companies, in the overseas markets would be allowed through the mechanism of Sponsored ADR/GDR issue in respect of:-

(a) Divestment by shareholders of their holdings of Indian companies listed in India;

(b) Divestment by shareholders of their holdings of Indian companies not listed in India but which are listed overseas.

§ For the text of the Operative Guidelines, see *Appendix* 120(37).

Listing of Indian Companies in foreign stock exchanges

Indian companies have been permitted to list in foreign stock exchanges by sponsoring ADR/GDR issues against block share holding and that this facility would have to be offered to all categories of shareholders, and

The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993, notified by the Ministry of Finance, Department of Economic Affairs, has been amended as under:

(1) A listed Indian Company may sponsor an issue of ADRs/GDRs with an overseas depository against shares held by its shareholders.

(2) Such a facility would be available *pari-passu* to all categories of shareholders of the company whose shares are being sold in the ADR/GDR market overseas.

(3) Such issues would need to conform to the FDI policy and other mandatory statutory requirements. The provisions of paragraph (4B) of Schedule 1 to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 as notified by Reserve Bank of India vide Notification No. FEMA 41/2001-RB, dated March 2, 2001, would also need to be adhered to. [*Press Note No. F. No. 15/7/99-NRI dt. 16-4-2001, issued by Ministry of Finance, Deptt. of Economic Affairs (Investment Division)*].

SALIENT FEATURES OF EURO CONVERTIBLE BONDS

Euro convertible bonds are *quasi*-debt securities which are convertible into depository receipts or equity shares on the expiry of a minimum lock-in-period. They are issued to non-US investor. The exchange rate for the conversion and the conversion price are fixed. The conversion price shall undergo changes in case of mergers, issue of warrants with equity option, issue of bonus shares, etc. The salient features are as under:—

1. Conversion terms.—Each convertible bond is convertible into a fixed number of equity shares/depository receipts at the option of the investor at a predetermined price on the expiry of a minimum lock-in period. Generally, the bonds have a lock-in period of 60 days after which they are convertible at the option of the investor. The bonds are convertible into equity shares but in the Reliance Industries issue, the investors were given the option of conversion into GDRs. The exchange rate for the conversion price is also fixed and the investor is not subject to exchange fluctuation risk.

2. Interest rate.—The interest rate on the convertible bonds is lower than the interest payable on non-convertible bonds. In view of the prospectus of capital appreciation on

conversion of bonds, the issuer may offer a lower coupon rate on convertible bonds. Interest payments on ECBs are made annually.

3. Put Option.—Investors in convertible bond issue are given a put option which enables them to redeem their bonds before maturity. Put option are offered at par or at a premium - for example, 100 basis points over the US treasury rate at the time of the issue. for instance, SCICI offered a put option at 100 basis points over the five year US treasury of 4.65 percent, *i.e.* the put option rate was 5.65 per cent. The put option is normally exercisable after the expiry of a certain period, say, three years from the date of the issue. At the time of exercise of the put option, the investor is paid the principal amount and the difference between the agreed rate and the coupon rate that the investor has been paid till the date of exercise of the put option.

The put option at a premium enables the company to a negotiate a lower coupon rate on the bonds. For example, SCICI had offered a coupon rate of 3.5 per cent on the convertible bonds with a put option at 5.65 per cent. However, if the put option is at par, the issuer may have to offer a higher coupon rate on the bonds. Put options can be used to advantage to obtain a lower coupon rate by issuers who are confident that the conversion option will be exercised and the put option will not be exercised.

4. Call Option.—Call option denotes the right of the company to force redemption if the market price of the company's shares is at least a certain per cent of the dollar equivalent of the conversion price, say 140 per cent of the conversion price for at least 30 days. The call option may be exercised by the company by giving at least 30 days notice to the bond holders. Upon the expiry of the notice, the issuer shall redeem the bonds by payment of the principal and the accrued interest.

Upon receipt of the call notice the investor has an option to convert the bonds into shares. Since the call option can be exercised only when the shares are quoted at a premium, say, 130-140 per cent over the conversion price, the investor stands to gain by opting for conversion rather than compulsory redemption at the issue price.

5. Call option for taxation reasons.—The company may exercise the call option in the event of any change in the taxation laws or regulations of India.

6. Maturity.—The maturity period of the bond is generally fixed at 10 years.

7. Denomination.—Generally, Euro bonds are denominated in face value of US $5000.

8. Underwriting.—The bond issues are underwritten by the lead manager, the co-lead managers and other leading investment bankers.

9. Taxation.—All payment of principal and interest by the Company will be made without deduction of any taxes. Where the Company is required to pay Indian withholding tax at the rate of up to 10 per cent, the company will increase the amount of interest paid by it so that the interest received by the bond holder is not less than the coupon rate.

ADR ISSUES*

American depository receipt (ADR) as an investment instrument was devised by J.P. Morgan in 1907 to permit Amercian institutions to invest in securities overseas. The special features of ADRs are given below:—

1. ADR is denominated in dollars and dividends are also paid in dollars, insulating the investor from exchange risk. The instrument permits the foreign ivestor to access non-US markets for investment.

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* "American Depository Receipt" (ADR) means a security issued by a bank or a depository in United States of America (USA) against underlying rupees shares of a company incorporated in India [*Reg. 2(c) of FEMA (Transfer of issue of any Foreign Security) Regulations, 2000.*

2. ADRs are listed on the New York Stock Exchange or the Over the Counter Exchange in the USA. ADRs attract a much wider investor base than the GDR, since pension funds and individual investors in the USA are permitted to invest in them.

3. The size of the ADR issue can expand or contract according to demand as depository banks can issue or withdraw corresponding shares in the local market. GDR is a one time issue and can contract in size only if investor decide to redeem.

4. ADR issue is more expensive than a GDR issue as the spread for the underwriter on an ADR issue is 7-8 per cent as compared to 5-6 per cent for a GDR issue.

5. ADR issue requires drawing up the accounting statements in accordance with the stringent requirements of the Securities and Exchange Commission and US GAAP.

ADR is a tradeable instrument, equivalent to a fixed number of shares, which is floated on overseas markets. ADR issues can be made at four levels depending on the preference of the company. The norms for each level differ and are based on the specific criteria to be satisfied by the issuer.

The four levels of ADR issues are as follows:—

(1) Level I is the most basic route under which the company issues depository receipts which are traded on the OTC exchanges abroad. Under this programme the company gives a mandate to a depository house, which provides information about the company to investment institutions, brokers, equity analysts and other investors. The company executives interact with the investors and analysts to provide the relevant particulars about the company. Once the investors are convinced, the investors place their orders through an overseas investment banker who contracts an Indian broker. The local broker purchases the shares on behalf of the depository, which in turn issues DRs against these shares in a pre-determined ratio. The DRs so issued are traded on the OTC exchanges overseas. A level I programme offers the following advantages to the issuer:—

(a) The company is not required to conform to US Accounting Standards and other SEC norms necessary for listing on the New York Stock Exchanges.

(b) The shares of the company are available to all categories of investors unlike Euro issues where only qualified institutional buyers are permitted to invest. Even in direct investment by FIIs many of the pension funds are not permitted to invest in non-dollar denominated securities.

(c) Two-way fungibility is permitted in ADR issues. If a foreign investor sells the DR and the DR is converted into the underlying share denominated in Indian rupees, a reconversion into DR is allowed.

(d) The level I DR issue, also known as a secondary market DR issue, permits a company to broaden its investor base before making a Euro issue and opens up a large market for the company's shares.

(e) The cost of floatation of an ADR issue is quite low compared to a GDR issue—a one time cost of about $30,000 and a recurring cost of $10,000.

2. In a Level II ADR programme listing of the DR is mandatory. The company proposing a Level II ADR issue has to conform to US accounting practices and SEC norms and satisfy certain financial and listing criteria. A non-US company should have at least 5,000 shareholders and a market value of public shares of at least $100 million.

3. The Level III ADR programme, also known as the non-soponsored level is for companies which have already made DR issues and the DRs are listed on one of the US exchanges. This issue is targeted at American investors.

4. The Level IV ADR programme, also known as the Restricted Area DR programme, is similar to the level III route. In this issue, the DRs known as GDRs are offered only to qualified institutional buyers. This route for raising resources was adopted by Reliance Industries Ltd. and Grasim Industries Ltd.

Issue structure of GDRs

1. A GDR may be issued for one or more underlying shares or bonds held with the Domestic Custodian Bank.

   The Domestic Custodian Bank is a banking company which acts as a custodian for the equity shares or FCCBs of an Indian Company which are issued by it against GDRs or certificates.
2. The FCCBs or GDRs may be denominated in freely convertible foreign currency.
3. The ordinary shares underlying the GDRs and the shares issued on conversion of FCCBs shall be denominated in Indian currency.

Listing of GDRs

The GDRs may be listed on any of the following exchanges:

1. Any overseas exchange, or
2. Over the Counter Exchange, or
3. Through Book Entry Transfer Systems prevalent abroad.

The GDRs may be purchased and possessed and are freely transferable by any person who is non-resident within the meaning of section 2(*v*) of FERA subject to the provisions of FERA.

Transfer and Redemption

A non-resident holder of GDRs may transfer the GDRs or may request the Overseas Depository Bank to redeem those receipts. The procedure for redemption is as under:

1. The Overseas Depository Bank shall request the Domestic Custodian Bank to arrange for release of the underlying shares in favour of the non-resident investor, either for sale on behalf of the investor or for transfer in the books of the issuing company in the name of the non-resident.

   In case of redemption, the Overseas Depository Bank shall send a copy of the request to the issuing company for information or record.
2. On redemption, the cost of acquisition of the shares underlying the Global Depository Receipts shall be reckoned as the cost on the date on which the Overseas Depository Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.
3. For the purpose of conversion of Foreign Currency Convertible Bonds, the cost of acquisition in the hands of the non-resident investors would be the conversion price determined on the basis of the price of the shares at the Bombay Stock Exchange, or the National Stock Exchange, on the date of conversion of Foreign Currency Convertible Bonds into shares.

Taxation of Foreign Currency Bonds

1. Interest payments on the bonds till conversion shall be subject to a tax deduction at source of 10 per cent.
2. Dividend payments on the equity shares after conversion shall be subject to a TDS of 10 per cent.
3. Conversion of FCCBs into shares is exempt from capital gais tax in India.
4. Transfer of FCCBs made outside India by a non-resident to another non-resident is not subject to capital gains tax in India.

Taxation of Shares issued under GDR Mechanism

1. Dividend income is taxed at the rate of 10 per cent which is deducted at source and the net dividend is transferred to the Overseas Depository Bank who in turn distributes them to the non-resident holders in proportion to their holdings of GDRs.
2. Transaction in GDRs outside India among non-resident investors is not subject to tax in India.
3. The capital gains arising on the transfer of the said shares in India to the non-resident investors shall be computed as under:
   (a) If the shares are held by the non-resident investor for a period of more than 12 months from the date of advice of their redemption by the Overseas Depository Bank, the capital gains arising on the sale thereof is treated as long term capital gains subject to tax at 10 per cent under section 115AC of the Income Tax Act, 1962.
   (b) If the shares are held by the investor for a period of less than 12 months from the aforesaid date, the capital gains in the sale thereof are treated as short term capital gains.

   The rate of income-tax applicable to short term capital gains shall be the normal rate of income-tax applicable to non-residents under the I.T. Act.
   (c) Dividends received by the investors on the shares issued on redemption of GDRs will continue to be taxed at the rate of 10 per cent.
   (d) Upon sale of the redeemed shares in Indian Stock Exchanges against payment in rupees, these shares go out of the purview of section 115AC of the Income-tax Act and will not be eligible for concessional tax treatment on dividends and capital gains.
   (e) Deduction of tax at source on capital gains accruing on transfer of shares shall be in accordance with section 195 and 196C of Income-tax Act.
4. During the period the shares are held by the Overseas Depository Bank, the provisions of Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the Overseas Depository Bank will be applicable in the matter of income of dividends from shares and interest on FCCBs.
5. During the period the redeemed ordinary shares are held by the non-resident investor upon redemption till sale to resident investor, the provisions of Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the non-resident investor will be applicable to dividends from shares/interest on FCCBs/Capital gains arising on transfer of the shares.
6. The holding of GDRs in the hands of non-resident investors and the underlying shares by Overseas Depository Bank and the transfer of GDRs between the non-resident investors and the Overseas Depository Bank shall be exempt from Wealth Tax Act, 1957 and Gift Tax Act, 1958.

Procedure for Issue of GDRs/FCCBs

The procedure to be followed for issue of GDRs/FCCBs is as under:

(1) Approval of Board of Director

A company desirous of making a Euro Issue is required to hold a meeting of Board of Directors to approve the following matters:

(a) the issue of the proposed securities from the Euro market by issue of GDRs/FCCBs subject to necessary approvals;

(b) the quantum of issue and the tentative terms and conditions;

(c) purpose of the issue;

(d) authorise the directors/officers of the company to make applications for Government approvals and sign all necessary documents in relation to the Euro issue;

(e) authorise the directors to finalise the terms of the issue in consultation with the lead manager and make application to the Government for final approval after receipt of in-principle approval;

(f) convene and extra ordinary general meeting of the shareholders to approve the following matters:

—increase in authorised capital, if applicable,

—issue of the proposed securities subject to necessary approvals of the appropriate authorities.

(2) Approval of the shareholders

Approval of the shareholders of the company for the Euro issue under section 81(1A) of the Act and also under section 81(3)(b) in case of optionally Euro convertible bonds and filing of the special resolutions with the ROC in Form 23.

(3) Approval of the Government

Approval of the following agencies is required for making the Euro issues:

—Ministry of Finance

—Department of Company Affairs

—Reserve Bank of India

—SEBI

—Stock Exchanges

(4) Approval of the Department of Company Affairs

The issuer company has to obtain the approval of the Department of Company Affairs to ensure compliance regarding the following:

(a) the approval of the Government for issue of optionally convertible bonds under section 81(3)(b) of the Companies Act;

(b) application of section 108 for transfer of shares issued abroad;

(c) exemption from provisions relating to prospectus to the offer document.

(5) RBI Approval

The issuer company has to apply and obtain the following approvals:

1. Repatriation of benefits in foreign currency accruing to GDR holders.
2. Execute various agreements and make payment of underwriting commission, management and selling commissions under the different agreements.
3. Appointment and payment of fees to the lead manager, depositary, transfer agents, custodians, legal advisors, listing agents.

(6) SEBI and Stock Exchange Approvals

No approval is required from SEBI but a copy of the prospectus is to be filed with SEBI for record.

(7) Stock Exchange Approvals

The issuer company is required to complete the following formalities with the stock exchanges:

Listing of EURO Issues

The GDR and FCCB issues are generally listed on the Luxembourg Stock Exchange and the London Stock Exchange. The requirements for listing on the Luxembourg Stock

Exchange are less stringent than on the other stock exchanges like London and New York Stock Exchanges.

The shares underlying the GDRs are listed on the Indian stock exchanges where the shares of the company are listed.

Guidelines for Euro-Issues—issued by Ministry of Finance

Government of India have been permitting Indian companies to issue Equity and Equity related instruments to international investors in the form of Global Depository Receipts (GDRs) and Convertible Bonds. Government has recently issued fresh Guidelines on EURO issue in supersession of all previous guidelines on the subject.

Salient Features of the Euro Issue Guidelines

Vide Notification dated 12th November, 1993, issued by Ministry of Finance, Department of Economic Affairs, the Government of India has issued detailed guidelines of Euro issue. Several amendments and modifications have been made to these guidelines. The salient features of these guidelines are as under—

Terminology used in the Euro Issue Guidelines

"Global Depository Receipts (GDRs)" means any instrument in the form of a depository receipt or certificate created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares on foreign currency convertible bonds of issuing company.

"Foreign currency convertible bonds' (FCCBs)" means bonds issued in accordance with the government guidelines and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company either wholly or partly, on the basis of any equity linked warrants attached to debt instrument.

"Overseas Depository Bank" means any bank authorised by the issuing company to issue GDRs against issue of FCCBs or ordinary shares of the issuing company.

"Issuing company" means an Indian company permitted to issue FCCBs or ordinary shares of that company against GDRs.

Words and expressions used but not defined in the Scheme but defined in Companies Act, IT Act, SEBI Act or the Rules and Regulations made thereunder shall have the meaning respectively assigned to them in these Acts and Rules.

Definitions in FEMA (Transfer or Issue of any Foreign Security) Regulations, 2000 framed under FEMA, 1999:

"Foreign Currency Convertible Bond" (FCCB) means a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency. [*Reg. 2(g)*]

"Global Depository Receipt" (GDR) means a security issued by a bank or a depository outside India against underlying rupee shares of a company incorporated in India. [*Reg. 2(i)*].

Eligibility for issue of Euro Convertible Bonds or Ordinary Shares

A company seeking to raise foreign funds is required to obtain the prior approval of Department of Economic Affairs, Ministry of Finance. An issuing company seeking permission for Euro issues should have a consistent track record of good performance, financial or otherwise, for a minimum period of three years. For this purpose, the company is required to give following details along with the application:

1. Liabilities side of the Balance sheet as at the end of the last 3 financial year.
2. Fixed assets as at the end of the last 3 financial years.
3. Key profit & loss parameters for the last 3 financial years.
4. Capacity utilisation of its products for the last 3 years.
5. Profitability and Management ratios for the last 3 years.

6. Statutory liabilities (disputed and otherwise) and defaults.
7. Defaults in respect of interest/instalment to loans from Banks/financial institutions.
8. Exports and imports.

Besides the financials for the last 3 years, the company is required to provide the following information in the application for permission to float global issues:

1. Existing business.
2. Profile on proposed expansion/diversification with break up requirements of rupee and foreign currency.
3. Salient features of the prospective corporate plans and diversification proposals with special reference to foreign exchange requirements.

Vide Press Note dated 11-5-1994 issued by the Ministry of Finance, it was clarified that for the purpose of ensuring that as many companies as possible avail of this scheme, only one issue per company in a financial year will be permitted with a minimum gap of 12 months between two issues by the same company and not more than two issues will be permitted for any group of companies in a financial year.

Vide Press Note dated 28-10-1994 issued by Ministry of Finance, the issue of warrants along with Euro issues has been prohibited.

Final approval from Government of India

Upon receipt of in-principle approval from Government of India, the issuer should finalise the appointments of lead managers and finalise the issue structure in consultation with them. On completion of finalisation of issue structure, the issuer company shall obtain the final approval of Government of India. *Vide* Press Note dated 11-5-1994, the validity period of the final approval was stipulated as 6 months from the date of its issue.

In principle approval of Government of India

On the basis of the application, the Director (Foreign Investment), Government of India issues in principle approval for mobilisation of foreign currency resources upto a certain amount through issue of GDRs/ADRs/IDRs to meet the foreign currency needs of the project and other corporate purposes.

Limits to Euro Issues

The issue of shares against GDRs and FCCBs are treated as foreign direct investment in the issuing company. The aggregate of foreign investment made directly or indirectly (through GDR mechanism) shall not exceed 51 per cent of the issued and subscribed capital of the issuing company. However, the following investments shall not be included in computing the aforesaid issue of 51%.

—Investment made through offshore funds.

—Investments made by FIIs.

Vide Press Note dated 11-5-1994, it was again clarified that Euro Issues will be treated as direct foreign investments. Accordingly, a company covered by Annexure III of the New Industrial Policy of 1991 whose direct foreign investment after a proposed Euro Issue is likely to exceed 51 per cent, or which is implementing projects not predominantly contained in Annexure III, would need to obtain prior FIPB clearance before final approval for the Euro Issue is given by the Finance Ministry.

§ For the text of the Guidelines, see *Appendix* 119.

RBI Exchange Control Manual

Reserve Bank of India had covered this subject in Exchange Control Manual under para 10B.10 which is reproduced hereunder:

Euro Issues by Indian Companies

(i) In terms of the Guidelines issued by the Government of India, vide Ministry of Finance Notification No.S-II(25)CCI-II/89/NRI dated 12 November 1993 (as amended), Indian companies are permitted to raise foreign currency resources through issue of Foreign Currency Convertible Bonds (FCCBs) and/or issue of ordinary equity shares through Global Depository Receipts (GDRs)/American Depository Receipts (ADRs) to foreign investors i.e. institutional investors or individuals (including NRIs) residing abroad. Applications for necessary permission should be made to the Government of India, Ministry of Finance, Department of Economic Affairs, New Delhi. After obtaining the necessary approval from the Government, the Indian company should submit an application to the General Manager, Foreign Investment Division, Exchange Control Department, Reserve Bank of India, Central Office, Mumbai - 400 001 enclosing a copy of the application made to the Government and the in-principle/final approval granted by the Government, for necessary permission under FERA 1973 for issue/acquisition of shares to/by non-residents, remittance of issue expenses, opening of foreign currency accounts, etc.

(ii) The FCCBs/GDRs/ADRs issued by Indian companies to non-residents have free convertibility outside India. As regards transfer of shares (on conversion of GDRs/ADRs into shares) in favour of residents, the non-resident holder of GDRs/ADRs should approach the Overseas Depository bank with a request to the Domestic Custodian bank to get the corresponding underlying shares released in favour of the non-resident investor for being sold by the non-resident or for being transferred in the books of the issuing company in the name of the non-resident. Reserve Bank has granted general exemption vide its Notification No. F.E.R.A.185/98-RB dated 19th August 1998, permitting transfer of shares from non-residents to residents, provided (a) such shares were released by the Indian custodian of a GDR/ADR issue against surrender of GDRs/ADRs by the non-resident concerned and (b) the sale is made on a stock exchange or the shares are offered for sale in terms of an offer made under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 1997. Authorised dealers may allow remittance of sale proceeds of such underlying shares on verification of the following documents:

(a) Release Order in original from the Domestic Custodian bank of the GDR/ADR issue.

(b) Sale note from a SEBI registered broker/merchant banker showing the number of shares transferred and the amount of sale proceeds.

(c) An undertaking/Accountant's certificate regarding payment of Income-tax (cf. paragraph 3B.10).

Authorised dealers may also allow the non-resident transferor to keep the above mentioned shares in their safe custody till the sale of the shares is effected and to open a non-resident non-interest bearing account to collect the sale proceeds of the shares. A statement giving details, such as the name of the company whose shares have been sold, number of shares sold and the amount remitted should be submitted to the General Manager, Foreign Investment Division, Exchange Control Department, Reserve Bank of India, Central Office, Mumbai 400 001 within a period of 7 days from the date of effecting the remittance.

NOTE : The above general permission will be applicable for transfer of shares underlying GDRs/ADRs through stock exchange or under an offer made under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997. All other cases including transfer of shares, on conversion of FCCBs into shares in favour of residents, will require approval of Reserve Bank.

(iiA) Reserve Bank has granted general exemption vide its Notification No. F.E.R.A.193/99-RB dated 16th March 1999 permitting, (a) the non-resident holders of ADRs/GDRs issued by a company registered in India to acquire the underlying shares against surrender of ADRs/GDRs held by them when such shares are released by the In-

dian Custodian of the ADR/GDR issue, and (b) the company/depository concerned to enter in its register or books an address outside India of the non-resident holder in respect of the underlying shares issued against surrender of ADRs/GDRs.

(iii) In terms of Government guidelines, issue proceeds are required to be kept in foreign currency and can be utilised only for certain purposes such as for meeting the cost of expansion/diversification/acquisition/import of new plants and machinery, repayment of foreign currency loans, etc. as approved by the Government. Pending deployment of funds for approved purposes, the Indian company is allowed to keep the foreign currency funds abroad with foreign banks (which are rated for short-term obligations as A1 + by Standard and Poor or P1 by Moody's) or with branches of Indian banks abroad as deposits, or to invest them abroad in treasury bills and other monetary instruments with maturity not exceeding one year. Funds raised through GDRs/ADRs, FCCBs and ECBs will also be allowed to be invested in rated certificates of deposit abroad. The issue proceeds can also be kept in foreign currency accounts with authorised dealers/public financial institutions in India authorised to deal in foreign exchange. It will accordingly be in order for authorised dealers/public financial institutions to accept foreign currency deposits from Indian companies out of Euro Issue proceeds subject to the following conditions :

(a) The foreign currency deposits would carry interest at a rate not exceeding LIBOR for the respective period for which the deposit is accepted.

(b) Authorised dealers/public financial institutions with whom the foreign currency deposits are kept should not swap the foreign currency for rupees but use the amounts for on-lending in foreign currency to eligible clients.

(c) Authorised dealers may also invest surplus foreign currency out of such Euro Issue proceeds as permitted in paragraph 5B.9 subject to the condition indicated in (b) above.

(d) Authorised dealers/public financial institutions accepting the foreign currency deposits would be eligible to charge interest at the rate not exceeding 2.5 per cent over six months LIBOR for lending out of such funds.

(e) Authorised dealers will have to comply with the requirements of CRR/SLR as laid down by Reserve Bank from time to time.

(f) The deposits can be converted into Indian rupees only as and when expenditure for approved end uses (including upto a maximum of 15% of the proceeds earmarked for general corporate restructuring) are incurred by the Indian company.

(g) Authorised dealers/public financial institutions accepting such deposits as also the Indian company, as the case may be, should comply with the conditions stipulated by Government of India in their approval letters for such issues. [*RBI Exchange Control Manual, 1993 para 10B.10*]

AD (MA Series) Circular no. 18 dated 19th May, 1999.—1. Attention of authorised dealers is invited to paragraph 10B.10 (*ii*) of the Exchange Control Manual regarding general exemption granted by the Reserve Bank of India ('the RBI') permitting transfer of underlying shares after conversion of GDRs/ADRs from non-residents to residents, provided (*a*) such shares were released by the Indian custodian of a GDR/ADR issue against surrender of GDRs/ADRs, by the non-resident concerned, and (*b*) the sale was made on a stock exchange or the shares were offered for sale in terms of an offer made under the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 1997. In such cases, the foreign investor, however, is required to obtain approval of RBI under section 29 of the Foreign Exchange Regulation Act, 1973 (FERA) for acquiring the shares of the company concerned against surrender of ADRs/GDRs. Similarly, the Indian company concerned would also need approval of the RBI under section 19 of FERA for registering the shares in the name of the foreign investor.

2. In order to simplify the procedure, the RBI has issued a Notification No. FERA 193/99-RB dated 16th March, 1999 (reproduced as annexure) granting (*a*) exemption from the operation of provisions of section 29(1)(*b*) of the FERA to non-resident holder to acquire the underlying shares released by the Indian custodian of ADRs/GDRs upon surrender of the ADRs/GDRs, and (*b*) general permission to the company/depository concerned under section 19(4) of the FERA for entering an address outside India in its register or books in respect of such shares.

ANNEXURE

Notification No. FERA 193/99, dated 16th March, 1999

Permission for acquisition/purchase of shares acquired on surrender of ADRs/ GDRs

In the exercise of the powers conferred by clause (*b*) of sub-section (1) of section 29 and the clause (*b*) of sub-section (4) of section 19 of the Foreign Exchange Regulation Act, 1973 (46 of 1973), the RBI hereby permits—

(*a*) a non-resident holder of ADRs/GDRs/issued by a company registered in India, to acquire, upon surrendering ADRs/GDRs, the underlying shares when such shares are released by the Indian custodian of the ADR/GDR issue, and

(*b*) the company whose shares are so released, or a depository defined in clause (2) of sub-section (1) of section 2 of the Depositories Act, 1996 to enter in its register or books, in which securities are registered or inscribed, an address outside India of the non-resident holder of shares.

For 'Issue of shares by international offering through ADR/GDR', see under 'Foreign Direct Investment Scheme [Schedule I], *post*.

Guidelines for Overseas Business Acquisition by Indian Software Companies through ADR/GDR realisations/stock swap dt. 27-12-1999

§ The Ministry of Finance, Department of Economic Affairs, has issued Guidelines on this subject. For the text of the Guidelines, see *Appendix* 120 (9 to 14).

Consideration of Foreign Direct Investment (FDI) proposals by Foreign Investment Promotion Board (FIPB)

The Government has issued Guidelines on this subject. These guidelines are being revised/amended from time to time. For the updated version of these guidelines see *Appendix* 121.

Secretarial Practice Notes : allotment of shares or debentures

(1) Allotment can be made only if the company receives minimum subscription of 90% of the issued amount.

(2) Allotment shall be made within 120 days from the date of opening the issue.

(3) If a prospectus was issued, check that no allotment was made until the beginning of the 5th day after that on which the prospectus was first so issued or such later time as specified in the prospectus.

(4) Where a public notice was given under section 62, check that no allotment was made until the beginning of the 5th day after such public notice.

Documents Involved: 1. Prospectus, 2. Application to stock exchange, 3. Approval of stock exchange, 4. Bank Schedules, 5. Application and Allotment Register, 6. Annual Report.

S. 73. Allotment of shares and debentures to be dealt in on stock exchange.—[1][(1) Every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for the

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1. Ins. by the Companies (Amendment) Act, 1988, s. 10(a) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988.

shares or debentures intending to be so offered to be dealt with in the stock exchange or each such stock exchange.[2]]

[2][(1A)] Where a prospectus, whether issued generally or not, states that an [3][application under sub-section (1) has been] made for permission for the shares or debentures offered thereby to be dealt in one or more recognized stock exchanges, such prospectus shall state the name of the stock exchange or, as the case may be, each such stock exchange, and any allotment made on an application in pursuance of such prospectus shall, whenever made, be void [4][* * * * *] if the permission has not been granted by the stock exchange or each such stock exchange, as the case may be, before the expiry of ten weeks from the date of the closing of the subscription lists.

Provided that where an appeal against the decision of any recognized stock exchange refusing permission for the shares or debentures to be dealt in on that stock exchange has been preferred under section 22 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), such allotment shall not be void until the dismissal of the appeal.]

(2) Where the permission has not been [5][applied for under sub-section (1)] [6][or, such permission having been applied for, has not been granted as aforesaid], the company shall forthwith repay without interest all moneys received from applicants in pursuance of the prospectus, and, if any such money is not repaid within eight days after the company becomes liable to repay it, [7][the company and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at such rate, not less than four per cent and not more than fifteen per cent., as may be prescribed[8], having regard to the length of the period of delay in making the repayment of such money.]

Provided [9][* * * * *].

[10][(2-A) Where permission has been granted by the recognised stock exchange or stock exchanges for dealing in any shares or debentures in such stock ex-

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2. Original sub-section (1) renumbered as sub-section (1-A), by the Companies (Amendment) Act, 1988, s. 10(b) w.e.f. 15-6-1988 *vide* GSR No. 559(E), dt. 10-6-1988.
3. Subs. by the Companies (Amendment) Act, 1988, for the words "application has been, or will be", s. 10(b)(i) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988.
4. Omitted by the Companies (Amendment) Act, 1988, w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988, the words "if the permission has not been applied for before the tenth day after the first issue of the prospectus, or, where such permission has been applied for before that day", s. 10(b)(ii).
5. Subs. by the Companies (Amendment) Act, 1988, for the words "applied for as aforesaid", s. 10(c)(i) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988.
6. Subs. by the Companies (Amendment) Act (XLI of 1974) s. 8 for 'or has not been granted as aforesaid' (w.e.f. 1-2-1975).
7. Subs. by the Companies (Amendment) Act, 1988, s. 10(c)(ii) & 10(d)(i) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988, for the words "the directors of the Company shall be jointly and severally liable to repay the money with interest at the rate of twelve per cent per annum from the expiry of the said eighth day:"
8. The new rates of interest are prescribed *vide* new Rule 4D of Companies (Central Govt.) General Rules & Forms, 1956 inserted *vide* GSR No. 312(E), dated 6-3-1992 (w.e.f. 21-2-1992) as below—
   4D. Section 73.—The rates of interest, for the purposes of sub-sections (2) and (2A) of section 73, shall be 15 per cent per annum.
9. Omitted by the Companies (Amendment) Act, 1988, s. 10(c)(iii) & 10(d)(ii) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988, the proviso namely, "Provided that a director shall not be liable if he proves that the default in the repayment of the money was not due to any misconduct or negligence on his part".
10. Ins. by the Companies (Amendment) Act (XLI of 1974), s. 8 (w.e.f. 1-2-1975).

change or each such stock exchange and the moneys received from applicants for shares or debentures are in excess of the aggregate of the application moneys relating to the shares or debentures in respect of which allotments have been made, the company shall repay the moneys to the extent of such excess forthwith without interest, and if such money is not repaid within eight days, from the day the company becomes liable to pay it, [11][the company and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at such rate, not less than four per cent. and not more than fifteen per cent., as may be prescribed[12], having regard to the length of the period of delay in making the repayment of such money.]

Provided [13][* * * * *].

(2-B) If default is made in complying with the provisions of sub-section (2A), the company and every officer of the company who is in default shall be punishable with fine which may extend to [14][*fifty thousand rupees*], and where repayment is not made within six months from the expiry of the eighth day, also with imprisonment for a term which may extend to one year.]

(3) All moneys received as aforesaid shall be kept in a separate bank account maintained with a scheduled bank [15][until the permission has been granted, or where an appeal has been preferred against the refusal to grant such permission, until the disposal of the appeal[16], and the money standing in such separate account shall, where the permission has not been applied for as aforesaid or has not been granted, be repaid within the time and in the manner specified in sub-section (2)]; and if default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [14][*fifty thousand rupees*].

[17][(3-A) Moneys standing to the credit of the separate bank account referred to in sub-section (3) shall not be utilised for any purpose other than the following purposes, namely:—

(a) adjustment against allotment of shares, where the shares have been permitted to be dealt in on the stock exchange or each stock exchange specified in the prospectus; or

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11. Subs. by the Companies (Amendment) Act, 1988, s. 10(c)(ii) & 10(d)(i) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988, for the words "the directors of the Company shall be jointly and severally liable to repay the money with interest at the rate of twelve per cent per annum from the expiry of the said eighth day:"
12. The new rates of interest are prescribed *vide* new Rule 4D of Companies (Central Govt.) General Rules & Forms, 1956 inserted *vide* GSR No. 312(E), dated 6-3-1992 (w.e.f. 21-2-1992) as below—
4D. Section 73.—The rates of interest, for the purposes of sub-sections (2) and (2A) of section 73, shall be 15 per cent per annum.
13. Omitted by the Companies (Amendment) Act, 1988, s. 10(c)(iii) & 10(d)(ii) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dt. 10-6-1988, the proviso namely, "Provided that a director shall not be liable if he proves that the default in the repayment of the money was not due to any misconduct or negligence on his part".
14. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 30 (w.e.f. 13-12-2000).
15. Subs. by s. 8, Companies Amendment Act (XLI of 1974), for 'certain words' (w.e.f. 1-2-1975).
16. Made to Securities Appellate Tribunal in the format prescribed under Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000. For text see *Appendix* 248.
17. Ins. by the Companies (Amendment) Act (XLI of 1974), s. 8 (w.e.f. 1-2-1975).

(b) repayment of moneys received from applicants in pursuance of the prospectus, where shares have not been permitted to be dealt in on the stock exchange or each stock exchange specified in the prospectus, as the case may be, or, where the company is for any other reason unable to make the allotment of shares.]

(4) Any condition purporting to require or bind any applicant for shares or debentures to waive compliance with any of the requirements of this section shall be void.

[18][(5) For the purposes of this section, it shall be deemed that permission has not been granted if the application for permission, where made, has not been disposed of within the time specified in sub-section (1).]

(6) This section shall have effect—

(a) in relation to any shares or debentures agreed to be taken by a person underwriting an offer thereof by a prospectus, as if he had applied therefor in pursuance of the prospectus; and

(b) in relation to a prospectus offering shares for sale, with the following modifications, namely—

(i) references to sale shall be substituted for references to allotment;

(ii) the persons by whom the offer is made, and not the company, shall be liable under sub-section (2) to repay money received from applicants, and references to the company's liability under that sub-section shall be construed accordingly; and

(iii) for the reference in sub-section (3) to the company and every officer of the company who is in default, there shall be substituted a reference to any person by or through whom the offer is made and who is knowingly guilty of, or wilfully authorises or permits, the default.

(7) No prospectus shall state that application has been made for permission for the shares or debentures offered thereby to be dealt in on any stock exchange, unless it is a recognised stock exchange.

NOTES

Eng. Act, 1948 : Sec. 51.

Companies Act, 1956

Recommendation of Company Law Committee.—This section is based on section 51 of the English Act and the recommendation of the Company Law Committee which was as follows: "It is usual for a company to state prominently on the face of the prospectus that an application has been made or will be made to a stock exchange for quotation of the shares or debentures offered for subscription. The object underlying this statement is to give an assurance to the intending investor that his shares will become marketable and to induce him to subscribe for them on that basis. Although there is no guarantee that the application for quotation will be granted by the stock exchange

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18. Subs. by the Companies (Amendment) Act (XLI of 1974), s. 8 (w.e.f. 1-2-1975).

authorities, the public assumes that permission is likely to be granted and is thereby encouraged to subscribe. Our attention has been drawn to the facts that in many cases in spite of this statement contained in the prospectus the necessary permission is not sought or sought only after considerable delay. The Cohen Committee has dealt with this problem in paragraphs 23 and 24 of its report. We have tried to follow section 51 of the English Act, which has been specially enacted to meet the above situation. Under this section, where a statement of the kind referred to above is made in a prospectus, the company concerned has to make an application to the stock exchange for "permission to deal" before the third day after the first issue of the prospectus, failing which the allotment made would be rendered void. It further provides that if the application is refused by the stock exchange before the expiration of three weeks from the date of the closing of the subscription list or such longer period not exceeding six weeks as may, within the said three weeks, be notified to the applicant, the allotment would be void. In either of these events i.e., where the application has not been made or where the permission has been refused the company has to repay the moneys to the applicants. We have followed these and other incidental provisions in the section proposed by us subject to extension of the period for making the application from three to ten days" (*Report*: Para 68).

Companies (Amendment) Act, 1974

The notes on clauses give the following reason for the amendment of sub-sections (1), (2) and (5) by the Companies Amendment Act, 1974:

"Section 73 prescribes certain time-limit for enlistment with the stock exchanges. It also contemplates that enlistment has to be done in all the stock exchanges mentioned in the prospectus and in case of failure to do so, the money received in respect of allotment of shares on the basis of the prospectus should be refunded within a specified time. In *Union of India v. Allied International Products Limited*, (1971) 41 Com Cases 127 : AIR 1971 SC 251, the Supreme Court has held that if the stock exchange had intimated that it would give further consideration to an application the time-limit contemplated by the section will not operate. It has also held that if any of the stock exchanges mentioned in the prospectus approved the application for enlistment, it would mean sufficient compliance with the provisions of section 73 and the allotment made in pursuance of that prospectus would be valid.

It has been felt that the decision of the Supreme Court referred to above is likely to lead to complications inasmuch as the investing public as well as underwriting institutions are likely to lose the protection hitherto enjoyed by them. Hence section 73 is being amended suitably.

The amendment of sub-sections (2) and (5) proposed herein is a clarificatory provision, connected with the amendment proposed in sub-section (1)."

Sub-sections (2-A) and (2-B) have been inserted in order to discourage the retaining of moneys of applicants for shares for an unreasonably long time, while sub-section (3-A) is intended to provide against misuse of the moneys for other purposes.

Companies (Amendment) Act, 1988

This section has again been amended with effect from 15-6-1988 by the Amendment Act of 1988 to provide for compulsory listing of public issues and to make the company, in addition to the directors, liable for failure to repay application money or the excess application money, along with interest as may be prescribed. *Notes on the clauses* read as under:

"*Clause* 10 provides for compulsory listing of all public issues with recognised stock exchanges. Presently, listing of public issues is not compulsory. Further as per the existing provisions, only the directors are made liable for failure to repay application money or the excess application money within the specified time, if the company fails to pay. It

is proposed to make the company, in addition to the directors who commit the default, liable to repay the application money or the excess application money, along with interest at a rate between 4 per cent and 15 per cent depending upon the period of delay. With a view to ensuring that, ordinary directors like nominees of Government/Financial Institutions do not attract the penal provisions, it is further proposed that only the director, who is an 'officer in default' should be liable for prosecution."

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5,000 rupees to 50,000 rupees under sub-sections (2B) and (3).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

Every public company is required before issuing shares or debentures for public subscription by issue of a prospectus, to make an application for listing the security in one or more recognised stock exchanges. In case permission is not granted by any stock exchange, before the expiry of 10 weeks from the date of closing the subscription list, no allotment can be made. In case no application is made, or permission has not been granted, the company shall forthwith repay all moneys received from the applicants. The company is also required to repay the moneys received in excess of the allotment made. Failure to repay the moneys within 8 days will make the company and its officers liable to repay that money with interest. The company is also required to keep the money in a separate Bank account until the permission is granted, failure to do which is a punishable offence. It may be noted that the Act does not require the prospectus to fix any time to close the subscription list and there is nothing to prevent the company to keep the subscription list open until an issue is fully subscribed, though the common practice is to state in the prospectus that the list will be closed on or before a particular date or an earlier date when the issue is fully subscribed. The subscription list is, however, required to be kept open for at least 3 days.

Two pre-conditions for valid allotment are (i) minimum subscription (section 69) and (ii) listing permission (section 73). *Rich Paints Ltd. v. Vadodara Stock Exchange Ltd.*, (1998) 15 SCL 128 (Guj).

Refusal of listing by single stock exchange

What is clearly provided in the Act has found an example to the effect that if a single stock exchange, out of the stock exchanges applied for, refuses to grant permission, the entire allotment becomes void unless, of course, the refusal of the stock exchange is set aside on appeal. *Rishyashringa Jewellery Ltd. v. Stock Exchange, Bombay*, (1996) 85 Com Cases 479 : AIR 1996 SC 480; *Rich Paints Ltd. v. Vadodara Stock Exchange Ltd.*, (1998) 15 SCL 128 (Guj).

The case of *Rishyashringa Jewellery Ltd.* was followed in *Jaltrang Motels Ltd. v. Union of India*, (1999) 95 Com Cases 339: (1999) 1 Comp LJ 70 : (1999) 32 CLA 223(Guj). In this case the company instead of refunding the amount as ordered, spent it in purchasing land. The company's appeal against the refund order was allowed to be entertained on the conditions that the land should be attached in favour of SEBI and fifty lakh rupees deposited with SEBI and the managing director should give a personal undertaking to

refund the amounts to the applicants in case the decision went against the company. The order of the single judge for depositing fifty lakh rupees was questioned in appeal before the Division Bench in *Jaltrang Motels Ltd. v. Union of India,* (1999) 96 Com Cases 442 (Guj) : (1999) 1 Com LJ 70 : (1999) 39 CLA 223 : (1999) 18 SCL 371. The Division Bench **affirmed** the order of the single judge and said that the sum of fifty lakh rupees was neither arbitrary nor unreasonable.

Failure of Stock Exchange to dispose off application.—Where the stock exchange failed to dispose off the company's application and the company appealed to the Central Government, it was held that the order of the Central Government directing the stock exchange to grant the listing would save the issue from becoming void *Urmila Bharuka (Smt.) v. Coventry Spring and Engineering Co. Ltd.,* (1997) 88 Com Cases 197 (Cal–DB). Another litigation arising out of the same episode is *Urmila Bharuka v. Union of India,* (1999) 97 Com Cases 97 (Cal). When the company's appeal was pending before the Central Government, an applicant for 100 shares filed a suit questioning the validity of the issue and obtained an order that the Central Government should hear him on the matter. It was held that the Central Government was not bound to hear him. The only parties entitled to be heard are the stock exchange and the company. The relief claimed could not be granted to him. He did not have any substantial interest in the matter. An issue of rupees nine crores was not to be restrained at the instance of an applicant for 100 shares.

Listing permission : Disclaimer Clause

Disclaimer Clause of Stock Exchange(s).—Where a stock exchange has given permission "to use the exchange's name in the offer document", a disclaimer clause is to be incorporated in the offer document.

§ See Notes under sec. 56.

In-principle approval for listing of further issue of capital

A listed company is required to obtain 'in principle' approval for listing from the stock exchange before issuing further shares or securities. [*SMDRP/Policy/Cir-15/01, dt. 8-3-2001, issued by SEBI*].

SEBI Circular No. MRD/Policy/Cir – 35 /2003/29/09, September 29, 2003.—1. SEBI had, vide its circular No. SMDRP/Policy/Cir-15 /2001 dated March 08, 2001 mandated, *inter alia*, that a listed company shall be required to obtain 'in-principle' approval for listing from the stock exchanges before issuing further shares or securities.

2. The Government of India vide circular No.F.No.1/9/SE/2003 dated April 23, 2003 has, *inter alia*, withdrawn the requirement relating to compulsory listing by companies on regional stock exchange. Keeping in view the letter and spirit of the said circular, it has been decided that if a company is listed on any stock exchange which is having nationwide trading terminals, it would be a sufficient compliance of the aforesaid SEBI circular, if it obtains 'in-principle' approval from such stock exchange(s) for further issue of shares or securities. Where the company is not so listed on any stock exchange having nationwide trading terminals, it shall continue to obtain 'in-principle' approval from all the exchanges where it is listed as was provided in the aforesaid Circular dated March 08, 2001.

3. This shall come into force with immediate effect.

4. The stock exchanges are directed to:

4.1 amend the listing agreement by substituting the relevant clause with the following:

"The company agrees to obtain 'in-principle' approval for listing from the exchanges having nationwide trading terminals where it is listed, before issuing further shares or securities. Where the company is not listed on any exchange having nationwide trading terminals, it agrees to obtain such 'in-principle' ap-

proval from all the exchanges in which it is listed before issuing further shares or securities."

4.2 bring the provisions of this circular to the notice of the member brokers/clearing members/listed companies of the Exchange and also to disseminate the same on the website for easy access to the investors; and

4.3 communicate to SEBI, the status of the implementation of the provisions of this circular in Section II, item no. 13 of the Monthly Development Report for the month of October 2003.

5. This circular is being issued in exercise of powers conferred by section 11 (1) of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Rate of interest [Sub-sections (2) and (2A)]

The rate of interest, for the purposes of sub-sections (2) and (2A), is 15 per cent per annum. [*vide* Rule 4D of the Companies (Central Government's) General Rules and Forms, 1956].

The liability to pay back application money with interest arises only when applications for shares are invited from general public. The right to interest in cases of private placements would depend upon the terms of the letter of offer. *J.S. Sodhi (Dr.) v. CT Scan Research Centre P. Ltd.*, (1995) 83 Com Cases 762 (P&H) **following** *Pritam Singh Batra v. Deol Agro Oil Ltd.*, (1995) 82 Com Cases 685, 687 (P&H).

Computing the date of refund of excess amount and liability to pay interest

The Supreme Court in *Raymond Synthetics Ltd. v. Union of India*, (1992) 73 Com Cases 762: AIR 1992 SC 847 has held that the ten week formula should be of universal application irrespective of the date of allotment. This construction is just and reasonable from the point of view of both the investor and the company and has the advantage of certainty, uniformity and easy application. T.K. THOMMEN J. concluded his judgment [at p. 781] by saying: The liability of the company to pay the excess money under s. 73(2A) arises on the expiry of ten weeks from the date of the closure of the subscription lists, and the interest begins to accrue thereon at the end of eight days therefrom. The Court opined that even in the cases of non application for, or refusal of listing, liability to pay interest will be governed by the same time formula as in the case of refund of excess money. Explaining the meaning of the word "forthwith" [at p. 775] the court said that the expression does not necessarily and always mean "instantaneous". Another valuable contribution of the decision is the emphasis by the Supreme Court that where provisions are of ambiguous nature, the interpretation put on them by administrative agencies who have to enforce them should be taken to be as of convenience. The Court was referring to the construction put on the provisions by the Union of India and SEBI. On appeal from the decision of the Bombay High Court *Raymond Synthetics Ltd. v. UOI*, (1992) 73 Com Cases 1 (Bom-DB), the Supreme Court **not accepting** the view of the Bombay High Court as to the time at which liability to pay interest begins.

Default, continuing offence [Sub-section (2-B)]

A default in complying with the requirements of sub-section (2A) is a continuing offence so that a fresh period of limitation begins on every day that the default is continued. The period of limitation could not have any application in this respect. [Section 472 of Cr.P.C., 1973]. *Baush & Lomb India Ltd. v. ROC*, (2000) 38 CLA 13, 16 (Del).

Jurisdiction for filing refund suit

It has been held that a company court has no jurisdiction under s. 10 to entertain cases for refund of subscription money. The jurisdiction is with the ordinary civil courts. *Poonam Chand Kothari v. Rajasthan Tubes Mfg. Co. Ltd.*, (1996) 87 Com Cases 842 (Raj).

Complaint under the Companies Act for default in refund

A prosecution under this section was not allowed where as soon as the company discovered that the already dispatched refund orders were not received by the applicants, new refund orders were sent to them and thus the default was made good. *Herdillia Unimers Ltd. v. Arun Bansal,* (1999) 96 Com Cases 521 (Raj).

Prosecution under IPC on failure to refund subscription money

The Supreme Court has laid down in *Radhey Shyam Khemka v. State of Bihar,* (1993) 77 Com Cases 356 (SC) that investors in companies are not to be confined to their remedies under the Companies Act and that if a *prima facie* case is made out and proof of *mens rea* is there, a prosecution under the Indian Penal Code would also be permissible, but that the High Court and Supreme Court could not go into the factual question whether the accused would be likely to be punished. The facts were that a stock exchange had refused permission for listing of the shares and debentures of the company on the basis of its prospectus and it was a fact found by the CBI inquiry that the subscribers' money was not refunded and was transferred to another account.

STOCKINVEST : Stockinvest Scheme has been withdrawn w.e.f. 5-11-2003 (vide *RBI Circular No. DBOD. No. FSC. BC. 42/24.47.001/2003-04, dt. 5-11-2003* in *Appendix* 230).

Non-applicability of section to rights and further issue

The opening words of sub-section (1) of the section "where a prospectus....." and language used in other sub-sections of the section lead to the conclusion that the section applies only to cases in which a company issues prospectus inviting the public to subscribe for its shares and it is represented in that prospectus that application has been made to one or more recognised stock exchanges for enlistment. The section may not apply to the right as well as further issues made by a company, otherwise than through a prospectus.

Conditional permission [Sub-section (1A)]

In *Deccan Farms & Distilleries Ltd. v. Velabai Laxmidas Bhanji,* (1979) 49 Com Cases 321 (Bom) (DB), it was held that the grant of conditional permission did not amount to sanction or permission for the shares to be dealt with on the Stock Exchange as contemplated under s. 73(1). The provision contemplates an unqualified permission. A qualified permission is as good as refusal and the application should be construed as not disposed of within the time prescribed by sub-section (1). The ruling in *Deccan Farms* case was applied in *Goldline Financial Services Ltd. v. Hyderabad Stock Exchange,* (2001) 30 SCL 31 : (2001) CLC 489 (SAT—Mumbai) so as to hold that a conditional permission is equal to refusal. The time for filing appeal ran from the date of conditional permission because it tantamounted to refusal. The Securities Appellate Tribunal (SAT) has no power to condone delay. There was, therefore, no question of entertaining an appeal filed after the expiry of the period.

SEBI Circular: dt. 22-5-2001.—It has been brought to our notice that some stock exchanges have been granting conditional listing permission to the companies. Section 73 of the Companies Act, 1956 does not envisage and qualified conditional listing permission. Section 73 envisages a final decision of granting/refusing to grant listing permission. The stock exchanges are, therefore, advised to desist from the practice of granting conditional listing to the companies. [*SEBI Circular : SMDRP/POLICY/CIR/29/01, dated 22-5-2001*]

Effect of refusal

One of the effects of refusal is that the Stock Exchange can order the company to delete its name from the prospectus. *Lunkad Media & Entertainment Ltd. v. Stock Exchange, Mumbai,* (2000) 39 CLA 267 (SAT).

Appeal against refusal by stock exchange

As per the proviso to sub-section (1A), appeal may be preferred under section 22 of the Securities Contracts (Regulation) Act, 1956 both against the decision of a Stock Ex-

change refusing permission and its failure to dispose of the application for permission within ten weeks from the date of closing of the subscription lists, as such failure has to be presumed to be tantamount to not granting permission [sub-section (5).]

Sub-section (1A) mentions "the date of the closing of the subscription list to" be the crucial date for determining the expiry of the period of ten weeks for grant of permission by a stock exchange, and for calculating the time for preferring appeal against refusal of permission, but neither in this section nor elsewhere is there any provision requiring the mentioning of a date for closing the subscription lists. In the absence of such a provision, the actual date of closing will have to be determined on the facts of each case. Note that an allotment in contravention of this section is void and not voidable.

An appeal against the refusal by a Stock Exchange was not allowed where it appeared that the decision was based upon a report prepared by an independent chartered accountant who examined the records of the company and came to the conclusion that there was no genuine fund-flow as against the allotment. The SAT said that the Stock Exchange is under a duty to protect the interests of the market and investors. The decision was arrived at the materials available to the stock exchange. The decision was not to be disturbed in the absence of adequate evidence to prove that the decision was not proper in the circumstnaces. *Parekh Platinum Ltd. v. Stock Exchange*, (2002) 39 SCL 340 : (2002) 51 CLA 155 (SAT—Mum.]

§ For definition of "Recognised Stock Exchange" see section 2(39).

Procedure for Listing of securities on a stock exchange under SEBI (Central Listing Authority) Regulations, 2003 [w.e.f. 13-2-2003]

The SEBI (Central Listing Authority) Regulations, 2003 lay down the procedure for obtaining letter of recommendation precedent to listing of securities on a stock exchange. The securities of a body corporate, mutual fund or collective investment scheme will be listed by a stock exchange only on the recommendation of the Central Listing Authority constituted by SEBI under Regs. 3 and 4 of the Regulations. SEBI Press Release No. 45/2003, dt. 19-2-2000 explains the features of the Regulations.

SEBI Press Release, 19-2-2003, PR No. 45/2003 read with Notification No. S.O. 954(E), dt. 21-8-2003.—The SEBI (Central Listing Authority) Regulations, 2003 were notified in the Official Gazette on 13th February, 2003 vide S.O. No. 171 (E) and thereafter were repealed and replaced by Notification No. S.O. 954(E), dated 21st August, 2003.. The important features of these Regulations are as follows:

- A Central Listing Authority (CLA) will be constituted by the SEBI.
- The CLA shall have the functions of issuing or rejecting the application made by any body corporate, mutual fund or collective investment scheme for letter of recommendation for listing, of making recommendations as to listing conditions and of discharging such other functions as may be specified by SEBI from time to time.
- Before making an application for listing to any stock exchange, a body corporate, mutual fund or collective investment scheme shall obtain a letter of recommendation for listing from the CLA on an application made in that behalf.
- Any exchange shall not consider any listing application made by any body corporate, mutual fund or collective investment scheme, unless it is accompanied by a letter of recommendation issued by the CLA.
- Where the CLA refuses to issue a letter of recommendation in accordance with the procedure laid down in the Regulations, the aggrieved party may approach SEBI, which may if satisfied, direct the CLA to issue a letter of recommendation.

- If the exchange refuses listing to the body corporate, mutual fund or collective investment scheme, it may prefer an appeal to the Securities Appellate Tribunal as provided in the Securities Contracts (Regulation) Act, 1956.

The CLA Regulations are available on the SEBI website: www.sebi.gov.in

§ For text of the CLA Regulations, see *Appendix* 166.

Appeal under section 22A of SCRA to Securities Appellate Tribunal

An appeal against refusal of stock exchanges to list securities of public companies is to be preferred to the Securities Appellate Tribunal (SAT) under section 22A.

Section 22A of SCR Act, 1956 reads as follows:

"22A. Right of appeal to Securities Appellate Tribunal against refusal of stock exchange to list securities of public companies.—(1) Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,—

(a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or

(b) where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1A) of section 73 of the Companies Act, 1956 (1 of 1956) (hereafter in this section referred to as the "specified time"), the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow,

appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be, and thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,—

(i) vary or set aside the decision of the stock exchange, or

(ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission, and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

(2) Every appeal under sub-section (1) shall be in such form and be accompanied by such fee as may be prescribed.

(3) The Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal.

(4) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Appeal against SAT Order.—An appeal against any order or decision of SAT lies with the High Court in terms of section 22F of the SCR Act, 1956.

The appellate authority must satisfy itself that the mandatory requirement of minimum subscription has been complied with. *Rich Paints Ltd. v. Vadodara Stock Exchange Ltd.*, (1998) 15 SCL 128 (Guj).

Securities Appellate Tribunal Rules, 2000.—The Central Government has framed the Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000, prescribing the procedure for preferring appeal to SAT under section 22A. For text of the Rules, see *Appendix* 248.

Appeal by investors when listing cancelled

Where a company has been listed but the listing is subsequently cancelled, the question whether the affected shareholders would have the standing to question the decision of the Stock Exchange was answered by the Court of Appeal in the negative in *R. v. International Stock Exchange of the United Kingdom and the Republic of Ireland*, (1993) BCLC 834 (QBD and CA); *Else, Ex parte*, (1993) BCLC 834 (QBD and CA); *Thomas, ex parte*, (1993) BCLC 834 : (1993) 1 All ER 420 : (1994) 3 Comp LJ 550 (QBD and CA). The Council Directive (EEC) expressly recognises the responsibility of competent listing

authorities for protecting the interest of investors, which is always to be the overriding concern of a competent authority when exercising the power of dealing with conditions imposed and obligations undertaken by companies whose securities are admitted to listing, the primary purpose of the directive is to co-ordinate the listing practice of competent authorities in member States with a view to establishing a common market in securities and not in any direct way to provide additional protection for investors. The directive is concerned with the relations between the competent authorities and companies and issuers and the right to apply to the courts is conferred on a company or issuer alone. It was held that although the investors are liable to suffer prejudice if the public listing of a company is cancelled and although they cannot successfully resist a potentially damaging cancellation unless they are given notice of an impending decision and the grounds of cancellation and an opportunity to make representations, the directive does not confer any enforceable rights on investors to have recourse to the courts.

The decision in *Chapmans Ltd. v. Australian Stock Exchanges Ltd.*, (1994) 12 ACLC 512 (Aust) is to the same effect. In this case the company failed to keep the market fully informed and also failed to maintain the required level of net tangible assets. The Stock Exchange removed the securities of the company from the official list. In other words the trading was suspended pending clarification of certain matters. The issue before the court was whether the decision to delist was made 'under an enactment' within the meaning of section 3(1) of the 1977 Act (Australia). BEAUMONT J held that as the listing rules derive their force and effect from the law of contract rather than from the relevant legislation, they were not made under an 'enactment'. Therefore, it was held that the decisions made by the Australian Stock Exchange under the stock exchange listing rules were not subject to review under the 1977 Act. The decision was upheld on appeal by the Full Federal Court in *Chapmans Ltd. v. Australian Stock Exchange Ltd.*, (1996) 14 ACLC 1297). (Aust). In criticism of this decision it has been said that the listing rules are at least the equivalent of an instrument (including rules, regulations or by-laws) made under statute. Though the listing rules gain their effect from the listing contract, their authority to bind is contractual and statutory. The listing rules impose contractual requirements, but they also impose important statutory obligations outside the contract.

§ For further study see PAUL LATIMER, *Legal Enforcement of Stock Exchange Rules : Part II* (1996) 8 Bond Law Review 210 (USA) and *Legal Enforcement of Stock Exchange Rules*, (1995) 7 Bond Law Review 1 (USA).

Money to be kept in separate bank account [Sub-section (3)]

The object of this sub-section is to provide a protection for persons who pay the money on the faith of a promise to refund the money in case certain conditions are not fulfilled, to erect by statute a kind of trust for applicants in such cases. The application monies do not form part of the assets of the company. *Re, Nanwa Gold Mines Ltd.*, (1955) 3 All ER 219 : (1955) 25 Com Cases 443 (Ch D).

The statutory requirement is that the share application money received may be kept in a separate account in any Scheduled Bank. But in *Rich Paints Ltd. v. Vadodara Stock Exchange Ltd.*, (1998) 92 Com Cases 282 : (1998) 3 Comp LJ 309 : (1998) 28 CLA 276 : (1998) 15 SCL 128 (Guj), it has been held that the application money should be deposited only with the Scheduled Bank(s) which are bankers to the issue. It is only the bankers to the issue who are subject to the statutory control of SEBI under SEBI (Bankers to an Issue) Rules, 1994 and Regulations 1994. The whole allotment was void because the application money was not received in full amount in respect of the bogus applications and also not through the prescribed Rules and also because where bogus applications were excluded, there was no subscription upto 90%. See also *Universal Incast Ltd. v. AA, SEBI*, 2000 CLC 948 : (2000) 38 CLA 332 (P&H—DB), where the direction to the company to keep the money in a separate account was held to be proper.

The requirement that application moneys received in response to a public issue should be kept in a separate bank account in a Scheduled Bank until permission for listing is

granted by a Stock Exchange, is not applicable to moneys received towards share applications on private placements. In such a case until the allotment is made by the company, the relationship is one of debtor and creditor and only on allotment is the amount received transferred to share capital. There is no prohibition against the company utilising such moneys; in the event of allotment not being made, the amount will have to be refunded.

Subscription money in the nature of trust money

The money received by a company's banker to the issue for issue of shares or debentures is bound to be maintained by the banker for only those purposes which are permitted by the section. It cannot be appropriated to any other purpose. It cannot be used by the bank for the purposes of its lien. It also does not become a part of the bank's general assets for the purposes of the winding up of the bank. The money is in the nature of a trust fund. The court can direct the bank to reimburse the company. *Reserve Bank of India v. Bank of Credit and Commerce International (Overseas) Ltd.*, (1993) 78 Com Cases 230 (Bom). The court **followed** its own earlier decision in *RBI v. BCCI (Overseas) Ltd. (No. 1)*, (1993) 78 Com Cases 207 (Bom) and *Ballantyne v. Nanwa Gold Mines Ltd.*, (1955) 25 Com Cases 443 (Ch D).

Where the issue became void by reason of refusal of listing by one of the stock exchanges necessitating the refund of application money, the release of the subscription money by the bank to the company even before listing refusal was received was held to be a breach of trust. The SAT rejected the plea that listing approval by the regional stock exchange should have been considered as sufficient for releasing the money. *Bank of Baroda v. SEBI*, (2001) CLC 714 : (2000) 26 SCL 532 (SAT).

SEBI Guidelines, 2000—Release of application money by bankers to the issue.— The post-issue Lead Merchant Banker shall ensure that moneys received pursuant to the issue and kept in a separate bank (i.e. Bankers to an Issue), as per the provisions of section 73(3) of the Companies Act 1956, is released by the said bank only after the listing permission under the said section has been obtained from all the stock exchanges where the securities were proposed to be listed as per the offer document. [*Clause 7.4.1.3*]

Restriction on use of application money [Sub-section (3A)]

The provisions of this section are very clear. The application money can be used only for the purposes mentioned and for no other purpose. *Deccan Farms & Distilleries Ltd. v. Velabai Laxmidas Bhanji*, (1979) 49 Com Cases 321 (Bom—DB). An injunction may be granted to an applicant so as to restrain directors from parting with or otherwise dealing with the application money till such time that it becomes an absolute money of the company by compliance with the requirement of section 69 or 73. *Mears v. Western Canada Pulp & Paper Co. Ltd.*, (1905) 2 Ch 353 (CA).

Where utilisation of the issue proceeds was stayed on the ground that the name of the company was allegedly violative of the copyright of the product name of another company, the Court vacated the stay, it being argueable whether violation was there or not and ordered only this that till the decision in the matter, the company should state in its advertisement, *etc.*, that the product in question is in no way connected with the product of any established company. *Panjon Ltd. v. Swad Industries & Leasing Ltd.*, (1994) 81 Com Cases 437 (MRTP).

Where several cases were filed against the company at different places to prevent it from going ahead with its issue, the Supreme Court ordered that all such cases be transferred to the file of a single court at one place and that court should consider all the relevant aspects including jurisdiction, cause of action and interim injunction. The Supreme Court condemned the adventurism of some of the respondents whose action was calculated to harm the company's interest and directed each of them to pay Rs. 10,000/- to the company as a token of its disapproval. *Bloom Dekor Ltd. v. Subhash Himmatlal Desai*, (1995) 82 Com Cases 591 (SC).

SEBI Guidelines, 2000 on the deployment of issue proceeds.—See Notes under sec. 61.

Requirement of Monitoring Agency.—See Notes under sec. 61.

Refund of application monies against issue

A civil action lies for a refund order. Where a company did not allot the shares applied for and instead sent to the applicant transfer forms for transfer of shares from the original allottees, the court held that the applicant was entitled to refund of his money. *Shanti Vijay v. Lan Exda Industry Ltd.*, (1998) 1 Comp LJ 113 : (1998) 92 Com Cases 116 (Raj).

Vide Circular No. F 1/63/SE/87, dated 8-1-1988 issued by the Ministry of Finance, Stock Exchange Division, Companies have been advised to ensure despatch of refund orders to the applicants within 10 weeks from the date of closure of subscription list. *Vide Circular No.* 8/ 15/SE/86B, dated 3-6-1986, companies had been directed to send refund orders by registered post only. SEBI, *vide its Circular No.* PMD/CIR 5050/92, dated 26-6-1992 has directed all merchant bankers and registrars to ensure compliance with the above circular.

However, *vide Circular No.* 17/8/89-CL-V: 1/ 93, dated 16-3-1993, issued by the Department of Company Affairs, the requirement of sending refund orders by registered post has been partly relaxed by the Department of Company Affairs. The department has directed that refund orders of amounts exceeding Rs. 1,500 per refund order need only be sent by registered post.

Following are the texts of relevant circulars on the subject:

Department's circular.—The following Departmental Circular may be noted:

1. Your attention to the provisions of section 73 of the Companies Act, 1956, is invited, which make it obligatory upon companies to refund application monies to the applicants, after public issue, within 10 weeks from the close of the subscription list and to enclose herewith a copy each of *Circular No.* F. 1/63/SE/87, dated 8-1-1988, and *Press Note*, dated 8-1-1988, issued by the Ministry of Finance, Department of Economic Affairs (Stock Exchange Division), for information.

2. In order to safeguard the interests of the investors, you are requested to get in touch with the concerned Stock Exchange(s) to ensure that the complaints regarding non-refund of monies are promptly attended to and the delinquent companies are called upon to repay the money with interest at the rate of 12 per cent per annum from the expiry of the 8th day after 10 weeks from the close of the subscription list. In case the companies fail to pay interest, in terms of the provisions of section 73, in appropriate cases, you may file prosecution, after issuing a show-cause notice to the Directors concerned. In this regard, you may consider the report sent by Stock Exchanges to you, in terms of paragraph 6 of the *Circular*, dated 8-1-1988 issued by the Ministry of Finance to Stock Exchanges. If necessary, you may cause inspection of the records of the company to ensure that the company concerned has duly complied with the provisions of section 73 of the Act. Needless to say, this requires your personal attention, when you receive complaints from the investing public, after the prospectus is filed with you.

3. You may send a report to this Department after three months of the close of the subscription list in respect of prospectus filed by a company in your office, indicating, *inter alia*, the nature of complaints/number of complaints received by you relating to the contravention of section 73 and the action taken by you in the matter. [*Circular No.* 4, dated 8-2-1988 : (1988) 64 Com Cases 68 (St)].

Delay in transfer of shares, issue of allotment letters, refund, *etc.*

Press Note No. 17/8/89-CL-V, dated 11-1-1991.—"Government has been receiving a number of complaints, from time to time, from shareholders/debenture-holders/investors regarding delay in transfer of shares, delay in issue of allotment letters and share/debenture certificates or refund of share/debenture application money to unsuccessful applicants of public issue.

2. Attention of companies is invited to the following provisions of the Companies Act, 1956, as also the Listing Guidelines, *etc.* issued in this regard:

(a) Under section 113 of the Companies Act, 1956, every company shall, within 3 months, after allotment of any shares/debentures and within 2 months after the application for registration of transfer of such shares/debentures, deliver the certificates of all shares/debentures allotted or transferred. Any default in compliance of these provisions of law is punishable.

(b) As per the Listing Guidelines which are applicable to companies listed on Stock Exchanges, allotment letters or share certificates must be issued to the allottees immediately after the al-

lotment of shares is made, but not later than 2 months from the date of the closure of the subscription list. Letters of regret, together with the refund order, will also be issued simultaneously.

(c) As per Listing Agreements entered into by listed companies with Stock Exchanges, a company is required to issue share certificate within one month of the date of lodgement of transfer of shares.

(d) Under section 111 of the Companies Act, 1956, if a company refuses to register any transfer of shares, it shall, within 2 months, send notice of refusal to the transferee and the transferor and it is open to the aggrieved transferee/ transferor to file an appeal before the Company Law Board.

*(e) Under section 22A of the Securities Contracts (Regulation) Act, 1956, in case of a company whose shares are listed on a stock exchange, the company may refuse to register the transfer of shares on one or more of the following grounds:—

(i) that the instrument of transfer is not proper or has not been duly stamped and executed or that the certificate relating to the security has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with;

(ii) that the transfer of the security is in contravention of any law;

(iii) that the transfer of the security is likely to result in such change in the composition of the Board of Directors as would be prejudicial to the interests of the company or to the public interest; and

(iv) that the transfer of the security is prohibited by any order of any court, tribunal or other authority under any law for the time being in force.

However, before communicating refusal to transfer shares on the grounds specified at (ii), (iii) and (iv) above, the company has to make a reference to the Company Law Board for confirmation, within 60 days of the lodgement of the instrument of transfer.

(f) Section 73 of the Companies Act, 1956, and the Listing Guidelines which are applicable to companies listed on Stock Exchanges provide for a maximum time-limit of 10 weeks from the close of the subscription list for public issue, for despatch of allotment letters/certificates as to shares and debentures and refunds to unsuccessful applicants. Companies entering the capital market are required to pay to the unsuccessful applicants, interests up to a maximum rate of 15 per cent p.a. for delayed period beyond 10 weeks from the date of close of the subscription list.

(g) As per *Circular No.* 8/15/SE/86-B, dated 3-6-1986, issued by the Ministry of Finance, Department of Economic Affairs, (Stock Exchange Division), North Block, New Delhi, all companies listed/seeking enrolment on stock exchanges, shall issue refund orders, allotment letters/certificates only by registered post.

3. Complaints have also been received against non-payment and delay in payment of interest on debentures or on redemption of debentures. Such complainants may approach the trustees of the debenture trust fund, in whose favour the assets of the company are mortgaged, for enforcing the security created for the purpose.

4. In regard to non-compliance of the provisions of the Companies Act, 1956 [and section 22A of the Securities Contracts (Regulation) Act, 1956]*, shareholder can take up the matter with the concerned Registrar of Companies and in regard to non-compliance of Listing Guidelines/Listing Agreement/Circular issued by Department of Economic Affairs, a reference may be made to the concerned Stock Exchange(s)/Department of Economic Affairs. Section 621 of the Companies Act, 1956 also authorises a shareholder to file prosecution against the company and its officers. The companies concerned are advised to ensure that delays and non-compliance of provisions of the Companies Act, Listing Guidelines, *etc.* are avoided, failing which proceedings will be initiated against them in accordance with law."

RBI Circular.—The following *Circular* issued by RBI may be noted under the section:—"Section 73 of the Companies Act, 1956, requires every company offering shares or debentures to the public to complete its listing formalities including allotment of shares and obtain permission from the stock exchanges specified in the prospectus for the shares or debentures offered to be dealt within the stock exchange(s), within 10 weeks from the date of closing of subscription lists. However, many companies are unable to

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* Sec. 22A of SCRA was omitted by the Depositories Act, 1996 w.e.f. 20-9-1995. Sec. 22A inserted by the Securities Laws (Second Amendment) Act, 1999 relates to 'Right of appeal to Securities Appel- against refusal of stock exchange to list securities of public companies'.

complete listing formalities within the specified time limit. One of the main reasons for delay in the allotment of shares and completion of listing formalities is attributable to the delay in receiving the details of applications from the bankers to the issue. All the scheduled commercial banks have already been impressed by *RBI Circular* dated 5-4-1988 to extend the necessary co-operation in enabling the issuing companies to adhere to the stipulated time schedule of 10 weeks by suitably amending or strengthening the existing systems and procedures of banks for the collection of application money and proper despatch of the refund orders. For this purpose a time schedule was also suggested to be observed by banks to ensure that the particulars together with application forms collected by their various authorised branches are forwarded to the designated branches for the issue within 2 weeks of the closure of the subscription lists, so that the designated branches can consolidate the particulars received from the branches and send the final lists to the managers to the issue within a week. It appears that the time-schedule has not been adhered to by the banks.

"As the banks' contribution to the delay in submission of the necessary particulars to the issuing companies for the purpose of allotments and refunds will have an adverse impact on the confidence of the investing public besides giving rise to avoidable customer dissatisfaction particularly when the capital markets have shown signs of growing maturity and increasing activity with the widening of the market, the RBI once again urged all the commercial banks vide this *Circular* (2 pages) to initiate strengthening the existing systems and procedures for collection of the application money and proper despatch of the refund order by strictly adhering to the time schedule prescribed in the earlier circular of 5-4-1988." [*Issued by the Reserve Bank of India, vide* DBOD, BP. BC. 67/C. 469(W)—90, dated 18-1-1990].

SEBI Guidelines on Extension of time limit for refund of moneys

It is observed that in many of the prospectuses, under the heading "refund/allotment", a statement is incorporated *inter alia* to the effect that allotment letters/certificates or refund orders or bank drafts, if any, would be despatched by registered post within 10 weeks of the closing of subscription list or within such period as may be extended by the Stock Exchange in case of unforeseen circumstances. The scope of a similar provision came up for consideration before the Hon'ble Bombay High Court, in the writ petition filed by Raymond Synthetics Ltd. In the course of the judgment, the Hon'ble High Court observed that the obligation to pay interest under section 73 of the Companies Act in respect of delayed refunds is absolute and a provision contrary to this obligation would be void in view of provisions contained in section 73(4) of the Companies Act. Therefore, you are requested to ensure that any prospectus the design or preparation of which is your function in terms of *inter se* allocation of responsibilities of lead managers, clearly brings out the legal position that extension if any granted by the Regional Stock Exchange would be without prejudice to company's liability to pay interest under section 73 of the Companies Act in respect of delayed refunds.

Accordingly, for total amount of each issue aggregating less than Rs. 50 crores the number of lead managers will not exceed two; for total amount of each issue aggregating Rs. 50 crores and above but less than Rs. 100 crores the number of lead managers may go up to three; for total amount of each issue aggregating Rs. 100 crores and above but less than Rs. 200 crores the number may go up, to a maximum of four. In case of total amount of issue aggregating Rs. 200 crores and above but upto Rs. 400 crores, the number of lead managers may go up to maximum of five. For issues aggregating above Rs. 400 crores, the number of lead managers in excess of five will be prescribed by SEBI on the merits of each case. [*SEBI's Circular No. 8(115)/MB/91, dated 6-8-1991*].

Issue of refund orders, allotment letters/certificates, letters of offer by Regd. post

Circular dated 16th March, 1993.—I am directed to invite your attention to this Department's Circular No. 6 of 1992 (No. 17/8/89-CL-V), dated 3rd September, 1992 (1992) 75 Com Cases (St) 217*, on the above subject, and to say that your constituent member-companies were advised to ensure issue of refund orders only by registered post. The matter has been considered further, keeping in view the constraints faced by the companies in issuing the refund orders by registered post, as the Postal Department is not able to cope up with the work involved. It has, accordingly, been decided that it will be in order for the companies to issue refund orders for amounts exceeding Rs. 1,500 per refund order only by registered post and the refund orders below that amount be issued under certificate of posting. In case of delay in refund, interest for the delayed period be calculated at 15 per cent. per annum and paid along with the

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* **Departments' Circular.**—"The Government has been receiving complaints from the investing public regarding non-receipt of refund orders, allotment letters, share certificates, rights of offer and dividend warrants. In this connection, it may be stated that the Ministry of Finance, Department of Economic Affairs, *vide* their circular letter No. 8/15/SE/86-B, dated 3rd June, 1986, addressed to all stock exchanges, informed that the Government has decided that henceforth all companies listed or seeking enlistment on stock exchanges, shall issue refund orders, allotment letters/certificates only by registered post. It has now been considered necessary that with a view to protect the interests of investors, the letters of offer for rights issue be also issued to the shareholders by registered post, in future." [*Circular No.* 6 of 1992, dated 3-9-1992]

refund order or while issuing the duplicate refund order, as the case may be, up to the date of actual despatch. In this regard, attention is also invited to the penal provisions contained in section 73(2B) of the Companies Act, 1956. [*Circular No.* 1 of 1993, dated 16-3-1993].

Press Release, dated 23-6-1993.—Share certificates, debenture certificates, dividend warrants and refund orders will have to be compulsorily registered under the Post Office Rules with effect from July 1, 1993. Post Office Rules require postal articles of certain description to be compulsorily registered for transmission by post. Postal articles containing postage or other stamps or labels, cheque, hundi, bank note, and bill of exchange are among them. This requirement is intended to ensure the security of the contents which are valuable. The existing condition that registration is compulsory only if the content is superscribed on the cover or is known or is manifest to the officer of the post office owing to the transparency, insecurity or insufficiency of the cover or to any other cause, continues. Any postal article coming within the scope of this rule, but not registered, will become due for double the registration fee, when delivered. [*PIB Press Release, by P&T Department*, dated 23-6-1993.]

Press Release, dated 22-7-1993.—A Government notification was issued on May 18, 1993, by which, with effect from July 1, 1993, registration was made compulsory for mail containing dividend warrant, refund order, share certificate and debenture certificate, if they are sent by post. It has now been decided that the notification will have effect only from September 1, 1993. It is also clarified that the registration is compulsory only if these items are enclosed in envelopes with nature of contents superscribed on them or the nature of enclosures are clearly manifest to the post office by the use of "window" envelopes or the like. [*PIB Press Release, by P&T Department*, dated 22-7-1993.]

Refund of subscription to NRIs/OCBs

†[Where NRIs/OCBs intended to subscribe to new issues of Indian companies, authorised dealers may allow payment of subscription (application money) from the applicants' NRE/FCNR accounts or NRO accounts, as the case may be. If the subscription or any portion thereof (inclusive of interest on delayed refunds of share application money) is to be refunded by the company, authorised dealers may recredit the amount to the same account of the applicant from which it was drawn earlier. In cases where subscriptions to new issues of shares/securities were made by remittance from abroad or by debit to the investor's NRE/FCNR account, he will have the option of having the excess subscription refunded to him either by remittance of the amount abroad or by credit to his NRE/FCNR account. Remittance of funds abroad or credit thereof to the applicant's NRE/FCNR account may be allowed only if the relative refund order is accompanied by a certificate from the collecting bankers or the investee company's bankers indicating that the original subscription was received by way of remittance from abroad or by debit to the applicants' NRE/FCNR account. Authorised dealers may also ensure that the payment of interest in respect of delayed refund of share subscription is in accordance with the provisions indicated in the prospectus of the company in its public issue as vetted by Securities and Exchange Board of India (SEBI)]. [*RBI Exchange Control Manual, 1993, para 10C.18*].

For FEMA, 1999 provisions see *Appendix* 101.

Measures to prevent theft of Refund Orders

SEBI Press Release, dated 6-5-1994.—It may be recalled that the Securities and Exchange Board of India (SEBI) instituted additional feature last year for enabling investors in the primary market to indicate details of their bank account and bank branch. This was intended to reduce the malpractice of theft of refund orders. It has been found that the response from the investors has been very good. Considering the recurring thefts of dividend warrants/refund orders/interest warrants, the Securities and Exchange Board of India has required the companies to institute a procedure of requesting the shareholder to indicate his account number and bank branch so that the cheques/drafts/warrants sent to the shareholder include the details of his account number and the designated bank branch. A letter in this regard has been issued by Chairman, SEBI to the various Associations such as FCCI, ASSOCHAM, CII requesting them to urge their members to institute such procedure in the interest of the investors. [*Issued by Secondary Market Department of SEBI vide Press Release*, dated 6-5-1994].

SEBI Guidelines, 2000

Despatch of Refund Orders.—The following clause shall be incorporated in the prospectus:

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† Subs. *vide* AD (MA Series) Circular No. 8/96, dated 8-6-1996.

"The company shall ensure despatch of refund orders of value over Rs.1500/- and share/debenture certificates by Registered Post only and adequate funds for the purpose shall be made available to the Registrars by the issuer company" [*Clause 6.5.5.1*].

Issuer's Undertaking.—The offer document should state that the funds required for despatch of refund orders/allotment letters/certificates by registered post shall be made available to the Registrar to the Issue by the issuer company [*Clause 6.5.6.1(d)*].

Instruction to investors.—Provision must be made in the application form for inserting particulars relating to savings bank/current account number and the name of the bank with whom such account is held, to enable the Registrars to print the said details in the refund orders after the names of the payees [*Clause 6.23.2.1*].

Closure of Bank Account

After obtaining permission from the Stock Exchange(s) and issuing refund warrants the separate bank account need not be continued. In contrast, the unpaid dividend account under section 205A has to be continued as stipulated therein.

Before the amendment of 1974 Amendment Act, the obligation on the part of the company to maintain the bank account continued so long as the company might become liable to repay the subscription money. However, after the 1974 amendment the company's obligation to maintain the bank account continues only until the permission for listing has been granted or until the disposal of the appeal against refusal to grant permission for listing.

Non-compliance, ground for order of investigation

Where there was statement from the side of the Government that general meetings of the company were not properly held, excess application money received in response to public issue was not refunded to applicants, the bank in which the refundable portion of the money was placed was not listed as a banker to the issue in the prospectus and subscription moneys were not deployed for the purpose mentioned in the propsectus, it was held that a ground for an order of investigation was made out. The court refused to interfere in the discretion exercised by the judge on the basis of the materials placed before him. *Premier Plantations Ltd. v. M. Ebrahim Kutty,* (2002) 110 Com Cases 721 : (2002) 37 SCL 804 : (2002) CLC 776 : (2002) 49 CLA 341 (Ker).

Transfer of unpaid/unclaimed amount to Investor Education Protection Fund

The amount which became refundable to the applicants but remained unpaid or unclaimed has to be transferred to the Investor Education and Protection Fund constituted under s. 205C. The transfer has to take place in case the amount remained unclaimed for 7 years.

Check list of activities for refund of application money

1. Make arrangements with a banker for handling the refund of application money and payment of refund orders at par at all centres where application money was accepted.
2. Arrange printing of the refund register and refund pay orders.
3. Arrange instructions from the controlling branch for payment of refund orders by all the centres where refund orders are payable at par.
4. Arrange for printing of the refund orders by the registrars.
5. Where the Board resolution specifies that refund orders of a certain amount and above require autographic signature, the autographic signatures should be obtained on the relevant refund orders.
6. Take necessary steps for despatch of the refund orders by registered post/ under certificate of posting, as the case may be.

7. After the validity period of refund orders expires, arrange for reconciliation of the refund orders paid with the refund orders issued and prepare a list of unpaid refund orders.

Seizure of refund orders.—A restraint order was issued under section 132(3) of the Income-tax Act. 1961 prohibiting a company from refunding subscription money for shares as a result of oversubscription to the public issue. The restraint order was later converted into a deemed seizure under section 132(1) of the I.T. Act. As a result of the deemed seizure the company is deemed to have made a refund of the moneys to the persons in respect of whom the seizure is made and the company will be absolved of its liability which may be attached under any law other than the Income-tax Act. *Maharaja International Ltd. v. Union of India*, (1992) 75 Com Cases 651 (Del).

Jurisdiction for Investor Guidance, Grievances and Complaints

SEBI FORUM has the jurisdiction on the following matters:

(1) *Delay in and non receipt of refund orders*

(2) *Non listing of securities on Stock Exchange*

A complaint lies before the SEBI Forum. For the format of the complaint and address of the forum, see *Appendix* 234.

Penalty for default.—Default in repayment of application moneys and interest is publishable [*vide* s. 73(2-B)] with fine upto Rs. 5,000/- and when repayment is not made within 6 months from the expiry of the 8th day, also with imprisonment for a term upto 1 year. The offence is compoundable by the Regional Director under section 621A only when the delay does not exceed 6 months.

If default is made in complying with section 73(3) and all application moneys are not deposited in a separate bank account maintained with a scheduled bank, until the permission for listing is granted, or until disposal of appeal against refusal, the company and every officer of the company who is in default are punishable with fine up to Rs. 5,000/- .

Compoundable offence.—This offence is also compoundable under section 621A.

Writ Jurisdiction for proceeding against manipulation

The company had its registered office at Chennai. A complaint was filed by the Calcutta Stock Exchange and the Stockholding Corporation of India against the promoters of the company at Calcutta. The complaint alleged that the promoter was guilty of the offences of causing wrongful loss to the Stock Exchange and public investors by artificially inflating the price of shares and circular trading. It was held that the cause of action had arisen wholly within jurisdiction of the Calcutta High Court. The writ petition in the Madras High Court to have the prosecution quashed was held to be not maintainable. The fact that the communication was addressed to the promoter at the company's registered office at Madras was considered to be not material. *Dinesh Dalmia v. Commissioner of Police*, (2003) 114 Com Cases 530 (Mad).

Power of making complaint with SEBI

By virtue of the amendment made in section 621 by the Amendment Act, 2000. SEBI is statutorily vested with the power to file complaints as discussed earlier. Before the amendments in the section, Notification read as under:

Notification GSR 94(E), dated 26-2-1997.—Under Notification No. GSR 94(E), dated 26-2-1997, in supersession of the earlier Notifications on this subject, 14 officers of the SEBI named therein have been authorised to make complaint for prosecution for offences under this section.

GSR No. 97(E), dated 15-2-1994.—Central Government has authorised SEBI to deal in respect of offences punishable under sub-section (1) *vide Notification, GSR No.* 97(E), dated 15-2-1994 superseded by *Notification No.* GSR 69(E), dated 15-2-1995.

Subscriber's *locus standi* to file criminal complaint

An applicant for shares or debentures does not have the standing to file a criminal complaint against an officer in default within the meaning of s. 5. The complaint here was under s. 73 for non-payment of interest on delayed refund of application money to a person whose application for debentures could not be accepted. The court also added that an ordinary director could not be prosecuted where the company had a managing or whole-time director. *S.C. Bhatia v. P.C. Wadhwa,* (1998) 92 Com Cases 511 : (1995) 1 Comp LJ 529 (P&H). The Supreme Court held on appeal that the High Court was not **justified** in quashing the complaint. *P.C. Wadhwa v. S.C. Bhatia,* (1995) 4 Supp. SCC 244 (SC).

Transfer of application Money to Investor Protection and Education Fund.—Application moneys received for allotment of any securities due for refund and interest accrued thereon which have remained unclaimed and unpaid for a period of 7 (seven) years from the date they became due for payment are to be credited to the Investor Education and Protection Fund established under section 205-C of the Act.

Guidelines for eligibility for listing on a stock exchange

Eligibility on Bombay Stock Exchange (BSE).—I. The Governing Board of the Exchange has decided that with effect from 27th February, 1996:

Existing listed companies.—In respect of the existing listed companies, listed on any other stock exchanges and now seeking listing on the Stock Exchange, Mumbai, all the following criteria will have to be fulfilled:

(*a*) minimum issued equity capital of Rs. 5 crore,

(*b*) minimum book value of Rs. 10 crore (capital + free reserve), and

(*c*) minimum market capitalisation of Rs. 15 crore.

In respect of the existing listed companies on any other stock exchanges and whose listing applications are already received and pending with the listing department as on 26th February, 1996, the Governing Board will use its discretion for applying old limit for the purpose of listing permission.

Delisted companies seeking re-listing.—In respect of delisted companies seeking relisting on the Exchange, the limit for relisting will be issued equity capital of Rs. 10 crore.

[*Press Release*, dated 26th February, 1996 *issued by the Mumbai Stock Exchange*]

New Companies.—The Governing Board of the Exchange has decided that for new companies the threshold limit for listing on this Exchange will be as follows with immediate effect:

Category I (for companies with post-issue equity capital of Rs. 10 crore and above)

(i) Post-issue capital of Rs. 10 crore.

(ii) Post-issue networth of Rs. 20 crore.

(iii) The project/activity of the applicant must have been appraised by a financial institution as described in section 4A of the Companies Act, 1956 or State Finance Corporation or scheduled commercial bank with a paid-up capital of Rs. 50 crore or Category I Merchant Banker with a networth of Rs. 10 crore.

Category II (for companies with post-issue equity capital of Rs. 5 crore and above but less than Rs. 10 crore)

(i) Post-issue capital of Rs. 5 crore.

(ii) Post-issue networth of Rs. 20 crore.

(iii) The minimum market capitalisation should be of Rs. 50 crore. (The capitalisation will be calculated by multiplying post-issue subscribed number of equity shares with the issue price.)

(iv) The project/activity of the applicant must have been appraised by a financial institution as described in section 4A of the Companies Act, 1956 or State Finance Corporation or scheduled commercial bank with a paid-up capital of Rs. 50 crore or Category I merchant banker with a networth of Rs. 10 crore.

"At least 10% of each class or kind of securities issued by a company was offered to the public for subscription through advertisement in newspapers for a period not less that two days and that applications received in pursuance of such offer were allotted subject to the following conditions:

(a) minimum 20 lakh securities (excluding reservations, firm allotment and promoters contribution) was offered to the public;

(b) the size of the offer to the public i.e. the offer price multiplied by the number of securities offered to the public was minimum Rs. 100 crores; and

(c) the issue was made only through book building method with allocation of 60% of the issue size to the qualified institutional buyers as specified by the SEBI:

Provided that if a company does not fulfil the conditions, it shall offer at least 25% of each class or kind of securities to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted : Provided further that a recognised stock exchange may relax any of the conditions with the previous approval of the SEBI, in respect of a Government Company within the meaning of Section 617 of the Companies Act, 1956 (1 of 1956) and subject to such instructions as that Board may issue in this behalf from time to time.

Explanation : For the purpose of this clause, it is hereby clarified that where any part of the securities sought to be listed have been or are agreed to be taken up by the Central Government, a State Government, development or investment agency of a State Government, Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India Limited, Life Insurance Corporation of India, General Insurance Corporation of India and its subsidiaries, namely, the National Insurance Company Limited, the New India Assurance Company Limited, the oriental Fire and General Insurance Company Limited and the United Fire and General Insurance Company Limited or Unit Trust of India, the Total subscription to the securities, whether by one or more of such bodies, shall not form part of the ten per cent or twenty five per cent of the securities, as the case may be, to be offered to the public." [*Notification No. GSR 415(E), dt. 7-6-2001*]

*All the applications will continue to be scrutinised by the Listing Committee of the exchange. [*SEBI Circular dt. 4-3-2002*].

SEBI Guidelines 2000—Net offer to the public.—Clause 8.3 of Chapter VIII of the Guidelines provides for minimum net offer to the public in a public issue by a listed, unlisted and infrastructure company. See Notes under sec. 56.

Listing of shares of an unlisted company on reconstruction/amalgamation

SEBI Guidelines, 2000.—Unlisted companies which have allotted shares to holders of securities in a listed company pursuant to a scheme of reconstruction or amalgamation sanctioned by the appropriate High Court, have been approaching the Board for seeking exemption from making a public offer for listing their shares. Exemptions, subject to fulfillment of certain conditions are already being granted by way of communication to the stock exchanges. For the sake of greater transparency, the requirements in this regard are stated in this clause 8.3.5 of the SEBI (DIP) Guidelines 2000.

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* w.e.f. 13-2-2003 a company is required to obtain a letter of recommendation from the Central Listing Authority before making application for listing under SEBI (Central Listing Authority) Regulations, 2003.

8.3.5. Application to the Board for relaxation from applicability of clause (b) to sub-rule (2) of rule 19 of the Securities Contracts (Regulation) Rules, 1957 by an unlisted company:

8.3.5.1. An unlisted company may make an application to the Board for relaxation from applicability of clause (b) to sub-rule (2) of rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its shares without making an initial public offer, if it satisfies the following conditions:

(i) Shares have been allotted by the unlisted company (transferee company) to the holders of securities of a listed company (transferor company) pursuant to a scheme of reconstruction or amalgamation under the provision of the Companies Act, 1956 and such scheme has been sanctioned by the High Court/s of the Judicature.

(ii) The listing of the shares of the unlisted transferee company is in terms of scheme of arrangement sanctioned by the High Court/s of the Judicature.

(iii) At least 25% of the paid up share capital, post scheme, of the unlisted transferee company seeking listing comprises shares allotted to the public holders of shares in the listed transferor company.

(iv) The unlisted company has not issued/reissued any shares, not covered under the scheme.

(v) There are no outstanding warrants/instruments/ agreements which gives right to any person to take the shares in the unlisted transferee company at any future date. If there are such instruments in the scheme sanctioned by the Court, the percentage referred to in point (iii) above, shall be computed after giving effect to the consequent increase of capital on account of compulsory conversions outstanding as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

(vi) The share certificates have been despatched to the allottees pursuant to the scheme of arrangement or their names have been entered as beneficial owner in the records of the depositaries.

(vii) That the shares of the transferee company issued in lieu of the locked-in shares of the transferor company are subjected to the lock-in for the remaining period.

(viii) In addition to the requirements of clause (vii) above, the following conditions are also to be complied with:

(a) in case of a hiving off of a division of a listed company (say 'A') and its merger with a newly formed company or existing company (say 'B'), there would not be any additional lock-in, if the paid up share capital of company 'B' is only to the extent of requirement for incorporation purposes.

(b) in case of merger, where the paid-up share capital of the company seeking listing (company 'B') is more than the requirement for incorporation, the promoters' shares shall be locked in to the extent 20% of the post merger paid-up capital of the unlisted company, for a period of 3 years from the date of listing of the shares of the unlisted company. (The balance of the entire pre-merger capital of the unlisted company shall also be locked-in for a period of 3 years from the date of listing of the shares of the unlisted company.)

8.3.5.2 An application to the Board under clause 8.3.5.1 shall be made through the regional stock exchange of the listed company and the regional stock exchange may recommend the application giving the reason therefor.

8.3.5.3 The unlisted company shall take steps for listing, simultaneously on all stock exchanges where the shares of the (transferor) listed company are/were listed, within 30 days of the date of the final order of the High Court/s approving the scheme. The for-

malities for commencing of trading shall be completed within 45 days of the date of final order of the High Court/s.

8.3.5.4 Before commencement of trading the company shall give an advertisement in one English and one Hindi newspaper with nationwide circulation and one regional newspaper with wide circulation at the place where the registered office of the company is situated, giving details as specified in Schedule XXVIII. [*SEBI Cir No. 1 (2001-2002) RMB Compendium Series, dt. 17-7-2001*]

The eligibility criteria for listing of securities of a company on a stock exchange as laid down in rule 19(2)(b) of the Securities Contracts Regulation Rules, 1957 and various circulars issued by the Ministry of Finance, Stock Exchange Division are given in *Appendix* 251.

SEBI Guidelines, 2000.—OTCEI Issues

Any company making an initial public offer of equity share or any other security convertible at a later date into equity shares and proposing to list them on the Over The Counter Exchange of India (OTCEI) shall comply with all the requirements specified in Chapter 14 of SEBI (DIP) Guidelines [*Clause 14.0*].

Eligibility norms.—Any company making an initial public offer of equity share or any other security convertible at a later date into equity shares and proposing to list them on the OTCEI, is exempted from the eligibility norms specified in Clause 2.2 of Chapter II of SEBI Guidelines, 2000 subject to its fulfilling the following besides the listing criteria laid down by the OTCEI:

(i) it is sponsored by a member of the OTCEI; and

(ii) has appointed at least two market makers (one compulsory and one additional market maker) [*Clause 14.1.1*].

Any offer for sale of equity share or any other security convertible at a later date into equity shares resulting out of a Bought out Deal (BOD) registered with the OTCEI is exempted from the eligibility norms specified in Clause 2.2 of Chapter II of SEBI Guidelines, 2000* subject to the fulfilment of the listing criteria laid down by the OTCEI [*Clause 14.1.2*].

Provided that the issuer company which has made issue of capital under Clauses 14.1.1 & 14.1.2 above shall not delist its securities from OTCEI for a minimum period of three years from the date of admission to dealing of such securities on OTCEI [*Clause 14.1.2 Proviso*].

Pricing Norms.—Any offer for sale of equity share or any other security convertible at a later date into equity shares resulting out of a Bought out Deal (BOD) registered with OTCEI is exempted from the pricing norms specified in Clause 3.2 of Chapter III of SEBI Guidelines, 2000* subject to the following conditions:

(i) The promoters after such issue shall retain at least 20% of the total issued capital with the lock-in of three years from the date of the allotment of securities in the proposed issue; and

(ii) At least two market makers (One Compulsory and one additional market maker) are appointed in accordance with the Market Making guidelines stipulated by the OTCEI [*Clause 14.2.1*].

Projections.—In case of securities proposed to be listed on OTCEI , for the purpose of Clause 6.12.1 (Projection of profits) of Chapter VI of SEBI Guidelines, 2000*, projections based on the appraisal done by the sponsor who undertakes to do market making activity in the securities offered in the proposed issue can be included in the offer document subject to compliance with other conditions contained in the said clause [*Clause 14.3.1*].

§ For 'Guidelines for OTCEI Issues', see Ch. XIV of SEBI Guidelines, 2000 at *Appendix* 162.

Listing Guidelines of OTCEI for Investment, Leasing, Finance and Hire-Purchase Companies

§ For the text of the Guidelines, see *Appendix* 262.

Trade Mechanism, Bought out deals and Business Rules of OTCEI

§ For the text of the Rule, see *Appendix* 263.

Code of Conduct for members and dealers of OTCEI

§ For text of the Code, see *Appendix* 264.

Norms for Sale/Transfer/Surrender of Dealership/Membership

§ For the text of Norms, see *Appendix* 265.

Listing of Debt Instruments

SEBI had removed the restriction regarding prior listing of equity before listing of debt on the stock exchanges. [*Press Release issued by SEBI, vide ref.* No. PR 108/96, dated 29th October, 1996]

Listing of NCDs and DSCEs of an unlisted company—SEBI Guidelines, 2000

Clause 8.2 of Chapter VIII of SEBI (DIP) Guidelines, 2000 permits an unlisted company making public issue of non-convertible debt securities (NCDs) and debt securities convertible into equity after allotment (DSCEs) to get its NCDs and DSCEs listed on a stock exchange, without making a public issue of equity shares, subject to the following conditions:

Public issue of NCDs by unlisted company.—An unlisted company making a public issue of NCDs may, subject to other applicable provisions of these Guidelines, make a public issue and make an application for listing its NCDs in the stock exchange/s without making a prior public issue of equity and listing thereof, if the following conditions are fulfilled:

(a) *Credit rating.*—The NCDs shall carry a credit rating not below investment grade at-least from one credit rating agency registered with the Board. Where the issue size of the NCDs is Rs. 100 crores or more, such rating shall be obtained from at least two credit rating agencies.

[(b) *Promoter's contribution and lock-in-period.*—A contribution of atleast 20% of the project cost i.e., objects proposed to be *inter alia*, financed through the issue, shall be brought in the form of equity. Such equity participation may be brought by the promoter from his own funds or from other sources, subject to the condition that at least 20% of the issue size is brought by way of equity by the promoter from his own funds. In case, the project is to be implemented in stages, the promoters contribution as per these requirements shall be with respect to total equity participation till the respective stage *vis a vis* the debt raised or proposed to be raised through the issue.] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(c) *Disclosure requirements.*—The issuer company shall agree to comply with the requirements of continuing disclosures as specified under the listing agreement to be entered into with concerned stock exchanges as is applicable for listing of equity shares.

(d) *Consent by special resolution.*—The issuer company shall agree to obtain prior consent of the holders of the NCDs through special resolution to be passed at the general meeting of the NCDs holders for change in terms of issue, change in capital structure and change in shareholding pattern.

(e) *Shares to be fully paid up.*—There shall be no partly paid up shares/other securities at the time of filing of draft offer document with the Board.

(f) *Subsequent public issue.*—The issuer company may come out with a public issue of equity/security convertible into equity after allotment during the currency of the NCDs or thereafter, only after complying with the guidelines applicable for an initial public offering of such securities.

(g) *Listing of equity.*—The equity held by the promoters or others at the time of issue of NCDs may be listed only when an initial public offer of equity/securities convertible into equity after allotment is made after complying with the applicable provisions of these guidelines. [*Clause 8.2.1*]

Public issue of NCDs by Municipal Corporation

Municipal Corporation which has no share capital may, subject to the provisions of sub-clauses (a), (b) and (c) of clause 8.2.1, make a public issue of NCDs and list the same on the stock exchange/s. [*Clause 8.2.2*]

Public issue of DSCE by unlisted company

An unlisted company making a public issue of DSCE may, subject to other applicable provisions of these guidelines make a public issue and make an application for listing on the stock exchanges without making a prior public issue of its equity and listing thereof, if the following conditions are fulfilled:

(a) The provisions of clauses (a) to (e) of clause 8.2.1 shall be *mutatis mutandis* complied with.

(b) *Subsequent public issues.*—An issuer company making an initial public offer of DSCE may come out with a subsequent public issue of equity/security convertible into equity after allotment during the currency of the DSCE only after complying with the Guidelines applicable for an initial public offering of such securities:

Provided that the provisions of clause 2.6 shall not be applicable for an Initial Public Offer of such securities if the floor price for conversion of DSCE is determined and disclosed in the offer document for issue of DSCE.

(c) *Listing of equity.*—The equity held by the promoters and others may be listed along with the listing of equity in initial public offering of equity/security convertible into equity after allotment or at the time of listing of equity arising on conversion of the DSCE.

(d) *Listing on conversion of DSCE.*—If the equity shares held by the promoters is proposed to be listed on conversion of DSCE, it shall be ensured that the number of equity shares allotted to the public (after excluding the allotment of equity shares to holders of DSCE issued on firm allotment/reservation basis) as a percentage of the total paid up equity capital after conversion and listing of the promoters equity, is not less than the percentage specified in clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957. [*Clause 8.2.3*]

Pricing of NCDs/DSCEs

The lead merchant banker can mention a price band of 20% (cap in the coupon rate/price band should not be more than 20% of the floor coupon rate/price) in the offer document filed with the Board and the specific coupon rate/price can be determined by an issuer in consultation with the lead manager at a later date before filing of the offer document with the RoC/s. [*Clause 8.2.4*]

Issue through book building process

The issuer may subject to the provisions of Chapter XI of these guidelines, make the issue through book building process to ascertain and determine the coupon rate and price/conversion price of the NCDs/DSCE. [*Clause 8.2.5*]

[*SEBI Cir. No. 3(2001-2002) RMB Compendium Series, dt. 11-1-2002*]

Listing of shares of Public Sectors Enterprises

Press Release, dated 13-8-1992.—Please refer to this Ministry's letter of even number dated 6-2-1992, regarding the subject noted above.

2. It has been brought to the attention of this Ministry that some stock exchanges have listed only those shares of Public Sector Enterprises (PSEs) which have been disinvested by the Government and not their entire paid-up capital. Stock Exchanges are hereby advised that they may list the entire paid-up capital of PSEs, whose shares have been disinvested by the Government, subject to their compliance with the disclosure requirements laid down by the Securities and Exchange Board of India and other listing requirements. [*Issued by the Ministry of Finance, Deptt. of Economic Affairs, Stock Exchange Section, vide F. No.* 6/1/SE/92, dated 13-8-1992].

Listing of shares of State Public Sector Enterprises on disinvestment

Press Release, dated 12-4-1993.—In order to facilitate the disinvestment of shares held by State Governments in their Public Sector Enterprises (PSEs) and the listing of shares of such enterprises on Stock Exchanges, it has been decided by the Government, in exercise of the powers conferred by proviso to Rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957, that the shares of such enterprises may be listed on Stock Exchanges irrespective of the percentage of shares disinvested by the State Governments.

2. The listing of shares of State PSEs on Stock Exchanges as indicated in para above is subject to the condition that the disinvestment of shares is made in favour of the public through an offer document. Further, the State PSEs should submit the draft offer document to SEBI for vetting and satisfy other listing requirements. The State PSEs which are in the joint sector or have foreign collaboration should provide information relating to the share holding by the joint sector partner/foreign collaborator in the offer document/disclosure format. [*Issued by the Ministry of Finance, Department of Economic Affairs vide F. No.* 6/1/SE/ 92, dated 12-4-1993].

For Specimen Draft on public announcement to the shareholders of the company for disinvestment, refer to *Appendix* 251.

Listing fees payable by Companies to Stock Exchanges

From the point of view of competition and brand equity, stock exchanges are free to fix the quantum of listing fees. Without seeking SEBI's approval. [*SEBI Circular No. SEBI/SMD/SE/25/2003/19-06, dt. 19-6-2003*]. The stock exchanges are also free to determine the manner and periodicity of payment of the fees.

The listing fees specified by the Mumbai Stock Exchange are given below:

1.	INITIAL LISTING FEES	Rs. 7,500
2.	ANNUAL LISTING FEES	
	(i) Companies with paid-up share and/or debenture capital upto Rs. 10 crores	Rs. 20,500
	(ii) above Rs. 10 crores and upto Rs. 20 crores	Rs. 41,500
	(iii) above Rs. 20 crores and upto Rs. 50 crores	Rs. 62,000
	(iv) above Rs. 50 crores and upto Rs. 75 crores	Rs. 1,03,000
Companies which have a paid-up share and/or debenture capital of more than Rs. 75 crores will pay additional fee of Rs. 2,100/- for every increase of Rs. 5 crores or part thereof in the paid-up share and/or debenture capital. In case of annual listing fees, they will be reduced by 50% for companies which are non-regional for this Exchange.		

Clause 38 of the Mumbai Stock Exchange Standard Listing Agreement reads as follows:

"38. The Company agrees that as soon as its securities are listed on the Exchange, it will pay to the Stock Exchange an Initial Listing Fees as prescribed in Schedule II hereto annexed [*see Table above*] and made a part thereof, and that, thereafter, so long as the securities continue to be listed on the Stock Exchange, it will pay to the Exchange on or

before the 30th April, in each year an Annual Listing Fee computed on the basis of the capital of the Company as on 31st March and worked out as provided in Schedule II hereto annexed. The company also agrees that it shall pay the additional Annual Listing Fee, at the time of making application for listing of securities arising out of further issue, as is computed in terms of Schedule II annexed hereto for any addition in the capital after 31st March".

Collection of Stock Exchange Fees

By SEBI Circular No. SMDRP/CIR-14/98, dt. 29-4-1998, SEBI had directed that the stock exchanges shall collect three years listing fees upfront at the time of initial listing and subsequently once in every three years and the amount so collected was to be kept in an escrow account with the stock exchanges which may be drawn periodically by the stock exchanges to the extent of its yearly annual listing fees. As the exchanges have expressed difficulties in collecting the three year listing fees upfront, *the requirement of collection of three year listing fees up-front is being withdrawn and now the exchanges may collect the listing fees in a manner as they deem fit.* [*SMDRP/Policy/Cir-12/01 dt. 28-2-2001, issued by SEBI*]

1. The existing clauses 40A shall be substituted by following—

40A—Conditions for continued listing

(i) The company agrees that in the event of the application for listing being granted by the Exchange, the company shall maintain on a continuous basis, the minimum level of non-promoter holding at the level of public shareholding as required at the time of listing.

(ii) Where the non-promoter holding of an existing listed company as on April 01, 2001 is less than the limit of public shareholding as required at the time of initial listing, the company shall within one year raise the level of non-promoter holding to at least 10%, in case the company fails to do so, it shall buy back the public share holding in the manner provided in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(iii) The company agrees that it shall not make preferential allotment or an offer to buy back its securities, if such allotment or offer result in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (Disclosure and investor Protection) Guidelines as applicable at the time of initial listing or the limit specified in sub-clause (ii) for the existing listed company, as the case may be.

(iv) The conditions stipulated in sub-clauses (i), (ii) and (iii) shall not apply to the companies referred to BIFR.

(v) The company agrees that the following shall also be the condition for continued listing.

(a) When any person acquires or agrees to acquire 5% or more of the voting rights of any securities, the acquirer and the company shall comply with the relevant provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(b) When any person acquires or agrees to acquire any securities exceeding 15% of the voting rights in any company or if any person who holds securities which in aggregate carries less than 15% of the voting rights of the company and seeks to acquire the securities exceeding 15% of the voting rights, such person shall not acquire any securities exceeding 15% of the voting rights of the company without complying with the relevant provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997".

2. SEBI vide its circular No. SMD/RCG/JJ/1819/96 dated May 15, 1996 and circular No. SMDRP/POLICY/CIR-30/98 dated October 16, 1998 had introduced the requirement

of at least 5 public shareholders for every Rs. 1 lakh capital issued. This requirement is being withdrawn. [*Circular No. SMDRP/POLICY/CIR-44/01 dt. 31-8-2001 issued by SEBI Secondary Market Department*].

Listing Agreement Form

For the text of the Form see *Appendix* 252.

Compliance with corporate governance provisions on Listing of Initial Public Offerings

As per the schedule of implementation of corporate governance specified by SEBI Circular No. SMDRP/Policy/Cir-10/2000 dated 21st February, 2000, all the entities seeking listing for the first time are required to comply with the provisions of corporate governance at the time of listing. The stock exchanges shall ensure that these provisions have been complied with before granting any new listing. For this purpose, it will be satisfactory compliance if these companies have set up the Board and constituted the committees such as audit committee, shareholders/investors grievance committee, etc., before seeking listing. A reasonable time to comply with these conditions may be granted only where the stock exchange is satisfied that genuine legal issues exists which will delay such compliance. In such cases while granting listing, the stock exchanges shall obtain an undertaking from the company. In case of the companies failing to comply with this requirement without any genuine reason, the application money shall be kept in an escrow account till the conditions are complied with. [*SMDRP/Policy/ Cir. 03/01 dt. 22-1-2001, issued by SEBI, Secondary Market Department*].

Non-compliance of provisions of listing agreement—action on

It has been observed that in the cases where companies listed at the stock exchanges fail to comply with the various requirements of listing agreement, the exchanges do not initiate any action against the companies.

In this context, we would like to draw your attention to Section 21 of Securities Contracts (Regulation) Act, 1956, which stipulates where securities are listed on the application of any person in any recognized stock exchange, such person shall comply with the conditions of the listing agreement of that stock exchange. Further, Section 23(2) of Securities Contracts (R) Act, 1956, prescribed punishment for violation of Section 21 of the said enactment. Thus, exchanges are expected to take necessary action under Section 23(2) of the SC(R) Act, 1956, for any violation of Sec 21 of Securities Contracts (Regulation) Act, 1956, due to non-compliance of the provisions of listing agreement.

You are advised to take suitable action against companies under Sec 23(2) of SC(R) Act, 1956, for violation of section 21 of SC(R) Act, 1956, by the companies for non-compliance of the provisions of listing agreement. [*SEBI Circular No. SMD/Policy/ Listing/Cir-5/2003, Dt. 12-2-2003*].

Post-issue obligations of Lead Merchant Bankers under SEBI Guidelines, 2000

The post-issue activities will involve essential follow-up steps, which must include finalisation of basis of allotment/weeding out of multiple applications, listing of instruments and despatch of certificates and refunds, with the various agencies connected with the work such as registrars to the issue, bankers to the issue, and the bank handling refund business.

Even if many of these post-issue activities would be handled by other intermediaries, the designated Lead Merchant Banker shall be responsible for ensuring that these agencies fulfil their functions and enable him to discharge this responsibility through suitable agreements with the issuer company.

Ordinarily, one Lead Merchant Banker shall be responsible for post issue activities. [*Vide clauses (g), (h) and (i) of Inter se Allocation of Responsibilities' in Schedule II to SEBI Guidelines, 2000 at Appendix* 162]

Post-issue Lead merchant banker shall continue to be responsible for post issue activities till the subscribers have received the shares/debenture certificates or refund of application moneys and the listing agreement is entered into by the issuer company with the stock exchange and listing/trading permission is obtained. [*Clause 7.7.7*]

The Lead Merchant Banker is required to ensure compliance with, *inter alia,* the following post-issue obligations:

(1) Co-ordination with intermediaries.

(2) Basis of allotment.

(3) Despatch of refund orders, allotment letters, security certificates.

(4) Publication of post-issue advertisements.

(5) Submission of post-issue monitoring reports.

(6) Redressal of investors grievances.

(1) Co-ordination with Intermediaries

(i) The Post-issue lead merchant banker shall maintain close co-ordination with the Registrars to the Issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches, processing of the applications including those accompanied by stockinvest and other matters till the basis of allotment is finalised, despatch security certificates and refund orders completed and securities listed.

(ii) Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to SEBI (Board). [*Clause 7.4.1*]

Closure of issues

(i) If the issue is proposed to be closed at the earliest closing date, the lead Merchant Banker shall satisfy himself that the issue is fully subscribed before announcing closure of the issue.

(ii) In case there is no definite information about subscription figures, the issue shall be kept open for the required number of days to take care of the underwriters' interests and to avoid any dispute, at a later date, by the underwriters in respect of their liability. [*Clause 7.4.1.2(a)*].

Underwriters

In case there is a devolvement on underwriters, the lead Merchant Banker shall ensure that the underwriters honour their commitments within 60 days from the date of closure of the issue. [*Clause 7.4.1.2(b)*].

In case of undersubscribed issues, the lead merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvements to the Board in the format specified at Schedule - XVII to SEBI Guidelines, 2000. [*Clause 7.4.1.2(c)*].

Release of issue proceeds by Bankers to the issue.—The post-issue Lead Merchant Banker shall ensure that moneys received pursuant to the issue and kept in a separate bank (i.e. Bankers to an Issue), as per the provisions of section 73(3) of the Companies Act 1956, is released by the said bank only after the listing permission under the said section has been obtained from all the stock exchanges where the securities were proposed to be listed as per the offer document. [*Clause 7.4.1.3*].

(2) Basis of Allotment

Multiple and fictitious applications to be weeded out

SEBI Press Release No. 21/2001, dt. 31-1-2001 lays down the procedure for detecting and weeding out multiple or fictitious applications in the new issues.

Press Release, Dated 31-1-2001.—The working group on multiple applications set up by SEBI, held a meeting today under the Chairmanship of Prof. J R Verma, Member, SEBI. The group discussed about the problems associated with multiple/fictitious applications in the new issues, procedure relating to allotment in public issues etc.. The group deliberated at length the ways and means of detecting the multiple/ fictitious applications with a view to make the allotment process fair and transparent and to protect the interest of small investors. Accordingly, the group suggested the following recommendations:—

1. Multiple applications in an issue would mean two or more applications made in single and/or joint names wherein the first name of the applicant is one and the same. Such applicants would be required to make a declaration in the appellation form that they have made multiple applications and identify all such applications. All such applications of the applicant would be clubbed and will be considered in the highest category ie more than 10 market lots at the time of finalising the basis of allotment. Actual allocation of share to each applicant would be made on a pro-rata basis.

In case of wrong/false declaration by the applicant to this effect, all his applications would be compulsorily rejected and the applications monies wool be refunded. The group discussed at length the minimum uniform parameters to be adopted for identifying the multiple/fictitious applications with a view to ensure that only genuine multiple/ fictitious applications are weeded out in the process and genuine applications are not rejected

2. With regard to fictitious applications, the group recommended that all such fictitious applications should be detected based on the laid down parameters and procedures before finalisation of the basis of allotments. The allotments thereon would be completed and the dispatch of share certificates/ credit to demat account would be kept in abeyance till establishing the identity and genuineness of the applicant. Only after satisfactory verification on the genuineness of the applicant, the shares would be credited/ released to the allottees. In the intervening period, the investors would be given an option to sell the shares kept in abeyance if he so desires. However, the proceeds of such sale would remain frozen and would be released only after the completion of verification and identification of the applicants. Prosecutions under Section 68A of the Companies Act should also be initiated where appropriate.

3. Since the trading of securities in all new issues is compulsorily in electronic mode and also requirement of issue of shares in demat mode for issue size of more than Rs. 10 crores the group recommends for doing away with the requirement of allotment in the market lots. However, with a view to prevent fractional allotment and allotments of miniscule value, it is decided that the minimum allotment would be the higher of one share or smallest integral number of shares that have a value of Rs.1000 calculated on the basis of issue price

4. The group recommended that applications for new issues can be made available through alternative sources of supply such as through internet, newspaper, photocopies in addition to the present system of pre-printed applications. To enable this, the requirement of prenumbering of applications forms would be dispensed with and application numbers would be assigned by the collecting banker and/ or registrar [*Ref .No. PR 21/2001*].

In a public issue of securities, the Executive Director/Managing Director of the Designated Stock Exchange along with the post issue Lead Merchant Banker and the Registrars to the Issue shall be responsible to ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the following guidelines:

Provided, in the book building portion of a book built public issue notwithstanding the above clause, Clause 11.3.5 of Chapter XI of these Guidelines shall be applicable. [*Clause 7.6.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Proportionate Allotment Procedure

The allotment shall be subject to allotment in marketable lots, on a proportionate basis as explained below:

(a) Applicants shall be categorised according to the number of shares applied for.

(b) The total number of shares to be allotted to each category as a whole shall be arrived at on a proportionate basis i.e. the total number of shares applied for in

that category (number of applicants in the category x number of shares applied for) multiplied by the inverse of the oversubscription ratio as illustrated below:

Total number of applicants in category of 100s -	1,500
Total number of shares applied for -	1,50,000
Number of times oversubscribed -	3
Proportionate allotment to category -	1,50,000 × 1/3 = 50,000

(c) Number of the shares to be allotted to the successful allottees shall be arrived at on a proportionate basis i.e. total number of shares applied for by each applicant in that category multiplied by the inverse of the oversubscription ratio. Schedule XVIII to SEBI Guidelines, 2000 of basis of allotment procedure may be referred to.

Number of shares applied for by each applicant -	100
Number of times oversubscribed -	3
Proportionate allotment to each successful applicant -	100 × 1/3 = 33

(to be rounded off to 100)

(d) All the applications where the proportionate allotment works out to less than 100 shares per applicant, the allotment shall be made as follows:
   (i) Each successful applicant shall be allotted a minimum of 100 securities; and
   (ii) The successful applicants out of the total applicants for that category shall be determined by drawal of lots in such a manner that the total number of shares allotted in that category is equal to the number of shares worked out as per (ii) above.

(e) If the proportionate allotment to an applicant works out to a number that is more than 100 but is not a multiple of 100 (which is the marketable lot), the number in excess of the multiple of 100 shall be rounded off to the higher multiple of 100 if that number is 50 or higher.

(f) If that number is lower than 50, it shall be rounded off to the lower multiple of 100. As an illustration, if the proportionate allotment works out to 250, the applicant would be allotted 300 shares.

(g) If however the proportionate allotment works out to 240, the applicant shall be allotted 200 shares.

(h) All applicants in such categories shall be allotted shares arrived at after such rounding off.

(i) If the shares allocated on a proportionate basis to any category is more than the shares allotted to the applicants in that category, the balance available shares for allotment shall be first adjusted against any other category, where the allocated shares are not sufficient for proportionate allotment to the successful applicants in that category.

(j) The balance shares, if any, remaining after such adjustment shall be added to the category comprising applicants applying for minimum number of shares.

(k) As the process of rounding off to the nearer multiple of 100 may result in the actual allocation being higher than the shares offered, it may be necessary to allow a 10% margin i.e. the final allotment may be higher by 10% of the net offer to public. [*Clause 7.6.1.1*].

Since the trading of securities in all new issues is compulsorily in electronic mode and also requirement of issue of shares in demat mode for issue size of more than Rs. 10 crores the working group on multiple applications set up by SEBI has recommended for doing away with the requirement of allotment in the market lots. However, with a view to prevent fractional allotment and allotments of miniscule value, the minimum allotment

would be the higher of one share or smallest integral number of shares that have a value of Rs. 1,000 calculated on the basis of issue price. [*SEBI Press Release No. 21/2001, dt. 31-1-2001*].

[Reservation for Small Individual Applicants

The above proportionate allotments of securities in an issue that is oversubscribed shall be subject to the reservation for small individual applicants as described below:

(a) A minimum 50% of the net offer of securities to the public shall initially be made available for allotment to retail individual investors.*

(b) The balance net offer of securities to the public shall be made available for allotment to:

(i) individual applicants other than retail individual investors; and

(ii) other investors including corporate bodies/institutions irrespective of the number of shares, debentures, etc. applied for.

(c) The unsubscribed portion of the net offer to any one of the categories specified in (a) or (b) shall/may be made available for allotment to applicants in the other category, if so required.

Explanation

It is clarified that the words "a minimum of 50% of the public offer" used in sub-clause (a) above means that if the category of retail individual investors was to be entitled to get 70% of the public offer in accordance with proportionate formula, the category should get 70%. If the category is entitled to get only 30% of the public offer in accordance with the proportionate allotment formula, there should be a reservation of a minimum of 50% of the net public offer]. [*Clause 7.6.1.2.1*]. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Public representative's presence

The drawal of lots (where required) to finalise the basis of allotment shall be done in the presence of a public representative on the Governing Board of the Designated Stock Exchange. [*Clause 7.6.2*]

Certification of basis of allotment

The basis of allotment shall be signed as correct by the Executive Director/Managing Director of the designated stock exchange and the public representative (where applicable), in addition to the lead merchant banker responsible for post issue activities and the Registrar to the Issue. The designated stock exchange shall invite the public representative on a rotation basis from out of the various public representatives on its governing board [*Clause 7.6.3*].

(3) Despatch of refund orders/allotment letters/certificates

It is a mandatory obligation of Registrars to the Issue (RTI) to despatch allotment advice, share or debenture certificates, letters of allotment, refund orders and cancelled stockinvests.†

Refund orders of the value of Rs. 1500 and share or debenture certificates are to be sent by registered post only. The LMB must ensure that adequate funds have been made available by the company to the RTI for this purpose. [A disclosure to this effect should be made in the offer document] [*Clause 6.5.5.1*].

The lead merchant banker shall ensure that the despatch of share certificate/refund orders/cancelled stock invests and demat credit is completed and the allotment and listing documents submitted to the stock exchanges within 2 working days of finalisation of the basis of allotment [*Clause 7.7.1*]

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* Retail individual investor' means an investor who applies or bids for securities of or for a value of not more than Rs. 50,000/-. [*Clause 1.2.1 (xxiv-a)*].

† See Operational Guidelines/Instruction to RTI and STA issued by SEBI at *Appendix* 212.

The Post-issue Lead Merchant Banker shall ensure that the despatch of refund orders/ allotment letters/share certificates is done by way of registered post/certificate of posting as may be applicable. [*Clause 7.7.4*].

Lead Merchant Banker shall ensure payment of interest to the applicants for delayed dispatch of allotment letters, refund orders, etc. as prescribed in the offer document. [*Clause 7.7.3*].

Completion of listing formalities.—The post-issue lead manager shall ensure that all steps for completion of the necessary formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed are taken within 7 working days of finalistion of basis of allotment [*Clause 7.7.2*]]

(4) Publication of Post-issue Advertisements*

Post-issue Lead Merchant Banker shall ensure that in all issues, advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of applications received along with stockinvest, number, value and percentage of successful allottees who have applied through stockinvest, date of completion of despatch of refund orders, date of despatch of certificates and date of filing of listing application is released within 10 days from the date of completion of the various activities at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated. [*Clause 7.5.1., Clauses 7.7.5 and 7.7.6*].

Post-issue Lead Merchant Banker shall ensure that issuer company / advisors/brokers or any other agencies connected with the issue do not publish any advertisement stating that issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public. [*Clause 7.5.2*].

Advertisement stating that "the subscription to the issue has been closed" may be issued after the actual closure of the issue. [*Clause 7.5.3*].

For 'Advertisement for Post Rights issue' see under '**Right issue of shares**'.

(5) Submission of Post-issue Monitoring Reports

One of the post issue obligations of the lead manager is to submit 'monitoring reports' on the issue to SEBI.

Irrespective of the level of subscription, the post-issue Lead Merchant Banker shall ensure the submission of the post-issue monitoring reports as per formats specified in Schedule XVI SEBI Guidelines, 2000‡ These reports shall be submitted within 3 working days from the due dates. [*Clause 7.2*].

Due date for submitting post issue monitoring report in case of public issues by listed and unlisted companies—

(a) 3 day monitoring report in case of issue through book building route, for book built portion.

The due date of the report shall be 3rd day from the date of allocation in the book built portion or one day prior to the opening of the fixed price portion whichever is earlier.

(b) 3 day monitoring report in other cases, including fixed price portion of book built issue.

The due date for the report shall be the 3rd day from the date of closure of the issue.

(c) Final post issue monitoring report for all issues.

The due date for this report shall be the 3rd day from the date of listing or 78 days from the date of closure of the subscription of the issue, whichever is ear-

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* Advertisements must comply with 'Guidelines on Advertisement' in Chapter IX of SEBI (DIP) Guidelines, 2000.

‡ See *Appendix* 162.

lier]. [*Clause 7.2.1.1*]. [*Subs. by SEBI Circular No. 1 (2001-2002) RMB Compendium Series, dt. 17-7-2001*].

Due dates for submitting post-issue monitoring reports in case of rights issues

(a) ***3-Day Post-Issue Monitoring Report***

The due date for this report shall be the 3rd day from the date of closure of subscription of the issue.

(b) ***50-Day Post-Issue Monitoring Report***

The due date for this report shall be the 50th day from the date of closure of subscription of the issue. [*Clause 7.2.1.2*].

The concerned lead merchant banker shall submit, in duplicate, the Post Issue Monitoring Reports specified within 3 working days from the due dates either by registered post or deliver at respective regional offices/head office at the addresses given in Schedule XXII to SEBI Guidelines, 2000. [*Clause 16.2.3.1(a)*].

Where the offer document has been dealt with by any of the regional offices of SEBI, a copy of the report shall be sent to the Board's Head office, Mumbai. [*Clause 16.2.3.1(b)*].

The Lead Merchant Banker(s) shall inform SEBI on important developments about the particular issues being lead managed by them during the intervening period of the reports. [*Clause 16.2.3.2*].

(6) Redressal of Investor Grievances†

The Post-issue Lead Merchant Banker shall actively associate himself with post-issue activities namely, allotment, refund and despatch and shall regularly monitor redressal of investor grievances arising therefrom. [*Clauses 7.3.1 and 16.2.2.2*].

The merchant bankers shall assign high priority to investor grievances and take all preventive steps to minimise the number of complaints. [*Clause 16.2.2.1(a)*].

The lead merchant banker shall set up proper grievance monitoring and redressal system in co-ordination with the issuers and the Registrars to Issue, and take all necessary measures to resolve the grievances quickly. [*Clause 16.2.2.1(b)*].

Appointment of Compliance Officer by Intermediaries.—SEBI Regulations governing the activities of intermediaries require the intermediary concerned to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the Board or the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

Application for issue of No Objection Certificate by SEBI for release of deposit with stock exchange [*As subs. by SEBI Circular No. 11, dated 14-8-2003*]

As per the Listing Agreement of the Stock Exchanges,* the issuer companies shall deposit 1% of the amount of securities offered to the public and/or to the holders of the ex-

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† See *Appendix* 234 for Investor Complaint Format.

* Clause 42 of Mumbai Stock Exchange Listing Agreement reads as follows:

"42. The Company agrees that it shall be a condition precedent for issuance of new securities that it shall deposit before the opening of subscription lit the keep deposited with the Exchange (in cases where the securities are offered for subscription whether through a prospectus, letter of offer or otherwise) an amount calculated at the rate of 1% (one per cent) of the amount of securities offered for subscription tot he public and/or to the holders of existing securities of the company, as the case may be for ensuring compliance by the company, within the prescribed or stipulated period, of all prevailing requirements of law and all prevailing listing requirements and conditions as mentioned in, and refundable or forefeitable in the manner stated in the Rules, Bye-laws and Regulations of the Exchange for the time being in force.

50% (fifty per cent) of the above mentioned security deposit should be paid to the Exchange in cash. The balance amount can be provided for by way of a bank guarantee. The amount to be paid in cash is limited to Rs. 3 crores."

isting securities of the company, as the case may be, with the Designated Stock Exchange, which can be released by the concerned stock exchange only after obtaining an NOC from the SEBI. [*Clause 16.2.4.1(a)*]

An application for NOC shall be submitted by issuer company to SEBI in the format specified in Schedule XXIV to SEBI Guidelines, 2000. [*Clause 16.2.4.1(b)*]

Conditions for issue of NOC.—The following conditions shall be complied before submitting the application for issue of NOC:

(a) Completion of 4 months from the date of obtaining the listing permission from the concerned Designated Stock Exchange, or the last date when the listing permission was obtained from any of the other stock exchanges, where the securities are proposed to be listed, whichever is later.

(b) Satisfactory redressal of all complaints received at SEBI against the company.

(c) Certificate from the Designated Stock Exchange to the issuer company to the effect that underwriting/brokerage commission as well as Registrars/Lead merchant bankers fees have been duly paid by the company. [*Clause 16.2.4.2*]

Filing of application.—Applications for issue of NOC shall be filed by merchant bankers with the concerned designated office of SEBI under the jurisdiction to which the registered office of the issuer company falls, as specified in Schedule XXII [*Clause 16.2.4.3*].

NOC when not needed.—In cases where issues (i.e. public/rights/offer of sale or any other) fail and the investors monies are fully refunded, an NOC from SEBI may not be required and the concerned Designated Stock Exchange can refund the 1% security deposit after duly verifying that the refund orders have actually been despatched. [*Clause 16.2.4.4*].

Complaints from intermediaries

The complaints with respect to non-receipt of underwriting/brokerage commission and non-receipt of Registrars/Lead merchant bankers fees may be filed with the concerned Designated Stock Exchanges. [*Clause 16.2.4.5(a)*].

Responses against complaints forwarded by the SEBI (Board) to the concerned companies shall be submitted to the Board as per the proforma specified in Schedule XXV to SEBI Guidelines, 2000 for updation of records. [*Clause 16.2.4.5(b)*].

Secretarial Action Points for listing of securities

A company seeking enlistment is required to comply with the following listing formalities within a period of 8 weeks from the closing of subscription list:—

In order to facilitate compliance with the provisions of section 73 of the Companies Act, 1956 a company seeking enlistment is required to comply with the following listing formalities within a period of 8 weeks from the closing of subscription list:—

1. Forward a copy each of signed prospectus, newspaper announcement, memorandum and articles of association (in case of a new company) and all material contracts and documents to the stock exchange.
2. Prepare the basis of allotment in accordance with the Government guidelines from time to time and submit the following documents for approval of basis of allotment by the regional stock exchange:—
   (a) Basis of allotment
   (b) Statement of valid applications in each category
   (c) Statement of bank-wise collections in each category
   (d) A copy each of the bank certificates
   (e) Confirmation by the lead managers to the issue that the company has received at least 90% subscription in the issue.

3. Furnish the following to the stock exchanges where the securities are proposed to be listed within a period of 8 weeks of the closing of subscription list:—
   (a) Basis of allotment duly approved by the regional stock exchange (5 copies)
   (b) Analysis form of region-wise collections (Table 1A)
   (c) Analysis of issue offered to shareholders (Table 1B).
4. A copy each of the bank certificates.
5. File the following confirmations with the stock exchanges:—
   (a) arrangements have been made for acceptance of allotment/call money at all centres where applications were accepted,
   (b) collections from the issue have been kept in separate bank accounts,
   (c) the letters of allotment/share certificates would be issued in lots of 100 equity shares of Rs. 10/- each and 5 debentures of Rs. 100/- each or more, unless otherwise approved by the regional stock exchange,
   (d) the underwriters have taken up the unsubscribed amount of the issue in case of devolvements.
6. Intimate the last date for acceptance of allotment money.
7. Submit a copy of the advertisement published in two newspapers notifying the basis of allotment.
8. Submit certificates from the statutory auditors to the stock exchanges that:
   (a) the allotment has been made in accordance with the basis approved by the stock exchange;
   (b) the letters of allotment and/or share certificates with lock-in-period for promoters/preferential allotment to shareholders of promoters companies and employees of the company (to the extent applicable) have been inscribed with an endorsement that they cannot be sold/transferred/hypothecated for a period of ..... years from the date of allotment;
   (c) the company's expenditure on the public issue is within the overall ceiling prescribed by the Government Circular No. F-14/1/SE/85 dated 7th May, 1985.

Certificate mentioned in (a) and (b) above may also be obtained from a practising company secretary.

9. File confirmation with the stock exchanges on the following matters:
   (a) exact date of posting of underwriting commission and brokerage,
   (b) exact date of posting of refund orders and/or letters of allotment and/or share certificates to all applicants,
   (c) undertaking by the company, duly signed by the chief executive or the secretary confirming despatch of the refund orders and allotment letters/share certificates within 70 days of the closing of subscription list.
10. Forward specimen letter of allotment/share certificate/letter of allotment cum share certificate and refund order to the stock exchanges.
11. Submit the following listing documents, along with the listing fees:—
    (a) Detailed listing application in the prescribed format
    (b) Distribution schedule of the securities issued (in duplicate)
    (c) Listing agreement duly stamped (for an unlisted company).
12. Confirmation that the register of members/debentureholders is open for registering transfers of shares/debentures.
13. Confirmation that the listing formalities have been completed at all other stock exchanges where listing is sought.

Secretarial Action Points for issue and listing of shares on the OTC exchange

1. Check whether the issue of equity shares conforms to the guidelines for listing of securities on the OTC exchange.
2. For listing of companies with issued capital of less than Rs. 300 lacs, ensure that—
   (a) the minimum issued equity capital of the company is Rs. 30 lacs with a minimum public offer of equity shares of Rs. 20 lacs;
   (b) where the issued capital is more than Rs. 30 lacs but less than Rs. 300 lacs, the minimum public offer is 40% of the issued capital or shares of the face value of Rs. 20 lacs;
   (c) in case of closely held companies, the minimum public offer is 20% of the issued capital.
3. For listing of companies with issued equity capital of more than Rs. 300 lakhs, ensure that the listing requirements and guidelines applicable to other recognised stock exchanges are complied with.
4. Decide on the sponsor and appoint him after obtaining letter of consent from him.
5. Ensure that the sponsor identifies an additional market maker for compulsory market making of shares.
6. Appoint the additional market maker after obtaining letter of consent from him.
7. Execute an agreement with the sponsor outlining the terms of the placement or for the direct issue of shares to the public.
8. Arrange for the appraisal of the project by the sponsor and obtain a project report.
9. Obtain certificates from the sponsor—
   (a) as regards the eligibility of the sponsor to be listed on the OTC exchange,
   (b) that the shares to be traded on the OTC exchange have already been subscribed by licensed dealers/members of OTC exchange.
10. Ensure that the agreement with the sponsor provides for the following:—
    (a) that the sponsor will make necessary arrangements for full subscription of the public offer;
    (b) that in the event of undersubscription, the unsubscribed portion will be subscribed by the sponsor;
    (c) that the sponsor will ensure that the securities are offered and allotted to the public in a fair manner subject to the approval of the OTC exchange;
    (d) that the sponsor will offer two-way quotes for the securities for a period of 3 years from the commencement of trading.
11. Fix the price for offer of shares to public in consultation with the sponsor and ensure that the promoter retains 2% of the total issued capital after disinvestment.
12. For issue of prospectus, follow the procedure for drafting of prospectus given in under notes to section 56.
13. Appoint the members/licensed dealers of OTCE as managers to the issue.
14. Obtain the approval of the OTC exchange for all publicity materials relating to the public issue.
15. Apply to the OTC exchange for registration of, listing and permission to deal in equity shares along with the relevant annexures.

16. Pay the one time listing fees of Rs. 6,000 and annual listing fees of 0.01% of the paid up capital of the company (for listing of equity shares) and 0.01% of the gross amount of securities issued (for listing of other securities), with a minimum of Rs. 1,000.

SEBI Guidelines, 2000.—Registration of Merchant Bankers

Registration and renewal of registration of Merchant Bankers—[See clause 16.3.1.1]

Reporting requirements in respect of merchant banking activities—[See clause 16.3.2.1]

Registration with Association of Merchant Bankers of India (AMBI)—[See clause 16.4.1]

Issue of Penalty Points.—[See clause 16.5.1]

Directions by the Board in case of violation of these Guidelines.—[See clause 17.1]

Action against intermediaries.—[See clause 17.2]

Merchant Banking and SEBI Regulations

Merchant Bankers provide the services in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management. For the regulation of the conduct of such business, rules have been promulgated under the title:

(1) Securities and Exchange Board of India (Merchant Bankers) Rules, 1992:

(2) SEBI (Merchant Bankers) Regulations, 1992.

For the complete text of the amended Rules and Regulations see *Appendix* 206 and *Appendix* 207 respectively.

DERIVATIVES

[*For detailed Notes on Derivatives, See under Section 2 (12-B) ante.*]

Prohibition of forward trading in securities lifted

Press Release, dated 2-03-2000.—The Government has lifted a three-decade old prohibition on forward trading in securities. A notification No. S.O. 186(E) issued on March 1, 2000, to this effect says that this prohibition was imposed by the Government under section 16 of the Securities Contracts (Regulation) Act, 1956, by a notification No. S.O. 186(E) on 27th June, 1969, in order to curb certain unhealthy trends that had developed in the securities markets at that time and to prevent undesirable speculation. According to the notification, in the changed financial environment, the relevance of this prohibition has been greatly reduced. It says that there have been substantial improvements in the functioning of the securities market. Requirements of adequate capitalisation, margining and establishment of clearing corporations have reduced market and credit risks. The Securities Laws (Amendment) Act, 1999, and the repeal of the 1969 notification would permit development of the derivatives markets in accordance with the rules and guidelines of the relevant regulatory authorities.

In order to promote an orderly development of the market, the Government has issued another notification delineating the areas of responsibility between RBI and SEBI. In terms of this notification, the contracts for sale and purchase of Government securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities will be regulated by RBI. Such contracts, if executed on stock exchanges, will, however, be regulated by SEBI in a manner that is consistent with the guidelines issued by RBI. RBI and SEBI have also issued noti-

fications specifying the regulatory framework in their respective areas. [*PIB Press Release, New Delhi, dated 2nd March, 2000*].

Future Contracts.—Future contracts are standardised contracts, which are traded or recognised future markets or Exchange. In future contracts, profit and loss is paid every day at the end of the trading. it is called daily or marking to market systems.

Forward Contracts.—Forward Contracts are private deals between two individuals who can sign a mutually acceptable terms. Such contracts are settled on the date agreed upon between the two contracting Parties.

Difference between Future and Forward Contracts.—While the forward markets self regulatory, the future market is regulated under the bye-laws for Regulation and control of Derivative Trading and Settlement, by some Regulatory Authority, for example by the statutes like SEBI Act, SCRA, Depositories Act and the Companies Act.

Futures and options

Futures.—A futures contract involves an agreement between the parties involved to buy/sell the shares (or any other security) at a certain future time for a certain price. One of the parties assumes a long-term position and agrees to buy the shares (or security), while the other takes a short term position and agree to sell the same.

Option.—An option is the right, but not the obligation, to buy or sell a specified number of shares (or other security) at an agreed price on or before a specified date in future. An option may also relate to buy or sell of a specified number or future contracts.

There are two parties to an option contract; the long who buys the option and the short who sells, or writes it. The long enjoys the right (and no obligation) which is granted by the seller of the option for a price, called premium.

There are two types of options—calls and puts. A call option gives the holder the right to buy while a put option entails a right to sell for its holder. The purchaser of the option can exercise the option or invoke his right. It is CALL option when he either pays the agreed price (*i.e.* the strike price) and receives delivery of the shares (or security) or PUT option when he delivers the shares (or security) and receives the payment. The seller of the option, known as the writer of the option, is obligated to make or receive delivery depending upon whether he wrote a call option or put option. In either case the writer has no ability to determine whether or at what point of time the option will be exercised. This right vests only with the purchaser of the option. For this right the purchaser pays a onetime non-refundable fee called the premium to the writer or seller of the option and is not liable to pay anything extra as a result of his position.

Negotiated Deals

Press Release No. 202/99, dt. 1-9-1999.—The SEBI appointed Committee on Negotiated Deals, met on 1 September, 1999 to discuss further measures to bring transparency in such negotiated deals. A negotiated deal has been defined as any transaction which either has a value of Rs. 25 lakhs or volume not less than 10,000 shares and which has been executed at a price not formed through the stock exchange price and order matching mechanism. SEBI has also by an earlier circular prohibited deals below the aforementioned size to be treated as a negotiated deal. The current guidelines of SEBI to the stock exchanges permit negotiated deals as defined above. SEBI also requires the reporting of all such negotiated deals to the stock exchanges within 15 minutes of the trade being negotiated and information in respect of such trades is being disseminated by the stock exchanges. It is also required that all such negotiated deals should result in delivery. These guidelines were also applicable to cross deals.

Negotiated deals to the executed on screens of the Stock Exchanges.—1. Henceforth all negotiated deals (including cross deals) will no longer be permitted in the existing manner described above. This decision has been taken, because such deals avoid transparency requirements, do not contribute to price discovery and some investors do not have benefit of the

best possible price. Indeed, such deals militate against the basic concept of stock exchanges which are meant to bring together a large number of buyers and sellers in an open manner. Now, all negotiated deals will be permitted only if these are executed on the screens of the exchanges in the price and order matching mechanism of the exchanges just like any other normal trade.

2. Currently, trading in the debt market takes place largely over the telephone and through the mechanism of negotiated deals. The world over the trend is to move away from a telephone based debt market to a screen based trading system of the exchanges. This allows greater transparency, better price discovery, reduction in transaction cost and benefits to the investors. Accordingly, it was also decided today that negotiated deals in respect of listed corporate debt securities will not be permitted, and all such trades will have to be executed on the price and order matching mechanism of the stock exchanges as in the case of equities. As Government debt securities and money market instruments are under the regulatory jurisdiction of RBI and do not fall within the purview of SEBI, this decision does not apply to such securities.

The above decision will come into effect from the settlement subsequent to the date of the press release. [*Press Release Reference No. 202/99, issued by SEBI, dated 1st September, 1999*].

Delisting of Securities

SEBI (Delisting of Securities), 2003 Guidelines, dt. 17-2-2003

SEBI has issued SEBI (Delisting of Securities) Guidelines, 2003 for removal of the securities of a listed company from stock exchange. Delisting of securities may be of two types:

(1) Voluntary delisting

(2) Compulsory delisting

Voluntary delisting

'Voluntary delisting' means delisting of securities of a body corporate voluntarily by a promoter or an acquirer or any other person other than the stock exchange(s). [*Cl. 3.1(j)*].

Voluntary delisting can be sought by the promoters of a company [*Cl. 4.1(a)*] from all or some of the stock exchanges where its securities are listed [*Cl. 4.1(c)*].

A company may seek voluntary delisting if, on any acquisition of shares of the company (either by a promoter or by any other person) or scheme or arrangement, by whatever name referred to, the public share holding falls below the minimum limit specified in the listing conditions or listing agreement that may result in delisting of securities. [*Cl. 4.1(b)*].

Requisites for voluntary delisting.—(1) A company may delist from stock exchange where its securities are listed only if the securities of the company have been listed for a minimum period of 3 years on any stock exchange.

(2) An exit opportunity must be given to the investors for the purpose of which an exit price shall be determined in accordance with the "book building process" described in clauses 7-10 and 13 and 14 of these Guidelines.

(3) An exit opportunity need not be given in cases where securities continue to be listed in a stock exchange having nation wide trading terminals (*i.e.*, the Stock Exchange, Mumbai, the National Stock Exchange and any other stock exchange, which may be specified by SEBI] [*Clause* 5].

Procedure for Voluntary Delisting.—Any promoter or acquirer desirous of delisting securities of the company under the provisions of these Guidelines shall:—

(a) Obtain the prior approval of shareholders of the company by a special resolution passed at its general meeting;

(b) Make a public announcement in the manner provided in these Guidelines;

(c) Make an application to the delisting exchange in the form specified by the exchange, annexing therewith a copy of the special resolution passed under sub-clause (a); and;

(d) Comply with such other additional conditions as may be specified by the concerned stock exchanges from where securities are to be delisted. [*Cl. 6*].

The Guidelines further provide for the following matters relating to voluntary delisting:

(a) Public announcement for voluntary listing [*Cl. 7*]: Contents of the public announcement [*Sch. I*]

(b) Determination of exit price for voluntary delisting in accordance with book-building process [*Cl. 8 and Sch. II*]

(c) Right of promoter [*Cl. 9*]

(d) Public announcement of final price [*Cl. 10*]

(e) Delisting in one or more stock exchanges [*Cl. 11*]

(f) Minimum number of shares to be acquired [*Cl. 12*]

(g) Payment of consideration by promoter or acquirer [*Cl. 13*]

(h) Class of securities for delisting [*Cl. 14*].

Compulsory delisting

1. The Stock Exchanges may delist companies which have been suspended for a minimum period of six months for non-compliance with the Listing Agreement.

2. The Stock Exchanges may also delist companies as per the norms and procedure provided in Schedule III.

3. The Stock Exchange shall give adequate and wide public notice through news papers (including one English national daily of wide circulation) and through display of the notice on the notice board/Website/trading systems of the Exchange.

4. The stock exchange shall give a show cause notice to a company or adopt procedure provided under Part B of Schedule III for delisting under sub-clauses 15.1 and 15.2.

5. The exchange shall provide a time period of 15 days within which representation, may be made to the exchange by any person who may be aggrieved by the proposed delisting.

6. The stock exchange shall ensure that adequate and wide public notice is given through newspapers and on the notice boards/trading systems of the stock exchanges after the period of show cause is over.

7. The stock exchange shall display the name of such company on its website. [*Cl. 15*].

Procedure

1. The decision on delisting should be taken by a panel to be constituted by the Exchange comprising the following:

(a) Two directors/officers of the Exchange (one director to be a public representative),

(b) One representative of the investors,

(c) One representative from the Central Government (Department of Company Affairs)/Regional Director/Registrar of Companies,

(d) Executive Director/Secretary of the Exchange.

2. Due notice of delisting and intimation to the company as well as other Stock Exchanges where the company's securities are listed to be given.

3. Notice of termination of the Listing Agreement to be given.

4. An appeal against the order of compulsory delisting may be made to the SEBI. [*Part B of Schedule III*].

Reinstatement of Delisted Securities

Reinstatement of delisted securities should be permitted by the stock exchanges with a cooling period of 2 years. In other words, relisting of securities should be allowed only after 2 years of delisting of the securities. It would be based on the respective norms/ criteria for listing, at the time of making the application for listing and the application will be initially scrutinized by the Central Listing Authority. [*Cl. 18*].§

§ For text of the Guidelines, see *Appendix* 167.

Secretarial Practice Notes : Shares and Debentures to be quoted in Stock Exchange

(a) Check whether the prospectus contained a statement to the effect that an application had been made to one or more designated stock exchanges for listing?

(b) If so,—(i) the name(s) of the stock exchange(s) was/were specified in the prospectus? (ii) such application was made in accordance with the requirements of SEBI (Central Listing Authority) Regulations, 2003? (iii) permission was obtained from stock exchange(s) before the expiry of 10 weeks from the date of closing of subscription lists? (iv) any appeal was made again the refusal to list the shares? (v) the company has repaid the amount received from applicants within 8 days after the expiry of the prescribed period, if no application was made or permission was not obtained or the appeal was dismissed? (vi) the application money received in excess was repaid within 8 days of the company becoming liable to repay? (vii) the moneys received were kept in a separate bank account?

(c) Ensure such money was not used for purposes other than those mentioned in sub-section (3A).

S. 74. Manner of reckoning fifth, eighth and tenth days in sections 72 and 73.—In reckoning for the purposes of sections 72 and 73, the fifth day, [1][or the eighth day] after another day, any intervening day which is a public holiday under the Negotiable Instruments Act, 1881 (XXVI of 1881), shall be disregarded, and if the fifth, [2][or eighth day] (as so reckoned) is itself such a public holiday, there shall for the said purposes be substituted the first day thereafter which is not such a holiday.

NOTES

Eng. Act, 1948 : Sec. 50 (6).
Eng. Act, 1985 : Secs. 82 and 86.

Companies (Amendment) Act, 1988

Changes made by the Amendment Act of 1988 in this section are consequential to the amendment made in section 73 (clause 11 of notes on clauses).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of

1. Subs. by the Companies (Amendment) Act, 1988, s. 11, w.e.f. 15-6-1988 *vide* GSR No. 559(E) dated 30-6-1988, for the words "the eighth day, or the tenth day"
2. Subs. by the Companies (Amendment) Act, 1988, s. 11, w.e.f. 15-6-1988 *vide* GSR No. 559(E) dated 30-6-1988, for the words "the eighth day, or the tenth day".

account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Public Holiday: See definition in Section 2(38) and Notes thereunder.

S. 75. Return as to allotments.—(1) Whenever a company having a share capital makes any allotment of its shares, the company shall, within [1][thirty days] thereafter,—

(a) file with the Registrar a return of the allotments[2], stating the number and nominal amount of the shares comprised in the allotment, the names, addresses and occupations of the allottees, and the amount, if any, paid or due and payable on each share :

[3][*Provided* that the company shall not show in such return any shares as having been allotted for cash if cash has not actually been received in respect of such allotment;]

(b) in the case of shares (not being bonus shares) allotted as fully or partly paid-up otherwise than in cash, produce for the inspection and examination of the Registrar a contract in writing constituting the title of the allottee to the allotment together with any contract of sale, or a contract for services or other consideration in respect of which that allotment was made, such contracts being duly stamped, and filed with Registrar copies verified in the prescribed manner[4] of all such contracts and a return stating the number and nominal amount of shares so allotted, the extent to which they are to be treated as paid-up, and the consideration for which they have been allotted; and

[5][(c) file with the Registrar—

(i) in the case of bonus shares, a return stating the number and nominal amount of such shares comprised in the allotment and the names, addresses and occupations of the allottees and a copy of the resolution authorising the issue of such shares;

(ii) in the case of issue of shares at a discount, a copy of the resolution passed by the company authorising such issue together with a copy of the order of the [6][*Tribunal*] sanctioning issue and where the maximum

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1. The words "thirty days" were substitued for the words "one month" by s. 62 and Schedule to the Companies Amendment Act (XXXI of 1965) (w.e.f. 15-10-1965).
2. Form No. 2 of the Companies (Central Government) General Rules & Forms is the prescribed form for Return of Allotment.
3. The Proviso to sub-section (1) (a), the words within quotation marked in sub-section (3) and proviso after sub-section (4) which was substituted in the place of the previous proviso were all inserted by section 11 of the Companies (Amendment) Act (XXXI of 1965) (w.e.f. 15-10-1965).
4. Such contract should be verified by an affidavit of a responsible officer of the Company that they are true, *vide* Rule 5 of the Companies (Central Government) General Rules & Forms, 1956.
5. Subs. by Act 65 of 1960, s. 21 for Clause (c).
6. **Subs. for "Court" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 11. Earlier when in section 79 'Company Law Board' was subs. for 'Court' by the Amendment Act 40 of 1974, the word 'Court' here also ought to have been replaced by the words 'Company Law Board'. The omission is inadvertent. The 'Court' has no longer any jurisdiction to pass an order authorising the issue of shares at a discount. [See *Letter No.* 12/26/75-CL-V, dated 10-1-1976].**

rate of discount exceeds ten per cent, a copy of the order of the Central Government permitting the issue at the higher percentage.]

(2) Where a contract such as is mentioned in clause (b) of sub-section (1) is not reduced to writing, the company shall, within [7][thirty days] after the allotment, file with the Registrar the prescribed particulars of the contract[8] stamped with the same stamp duty as would have been payable if the contract had been reduced to writing; and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899 (II of 1899), and the Registrar may, as a condition of filing the particulars, require that the duty payable thereon be adjudicated under section 31 of that Act.

(3) If the Registrar is satisfied that in the circumstances of any particular case the period of [7][thirty days] specified in sub-sections (1) and (2) for compliance with the requirements of this section [9][is, or was inadequate, he may, on application made in that behalf by the company, whether before or after the expiry of the said period, extend that period as he thinks fit]; and if he does so, the provisions of sub-sections (1) and (2) shall have effect in that particular case as if for the said period of [7][thirty days] the extended period allowed by the Registrar were substituted.

(4) If default is made in complying with this section, every officer of the company who is in default shall be punishable with fine which may extend to [10][five thousand rupees] for every day during which the default continues :

[11][*Provided* that in case of contravention of the proviso to clause (a) of sub-section (1), every such officer, and every promoter of the company who is guilty of the contravention shall be punishable with fine which may extend to [12][fifty thousand rupees].]

(5) Nothing in this section shall apply to the issue and allotment by a company of shares which under the provisions of its articles were forfeited for non-payment of calls.

NOTES

Eng. Act, 1948 : Sec. 53. Previous Act : Sec. 104.
Eng. Act, 1985 : Secs. 97 and 98.

Companies (Amendment) Act, 1960

The amendment of clause (c) of sub-section (1) made by Act (LXV of 1960) is intended to make it clear that particulars in respect of bonus shares also should be filed with the Registrar.

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7. The words "thirty days" were substituted for the words "one month" by s. 62 and Schedule to the Companies (Amendment) Act (XXXI of 1965), (w.e.f. 15-10-1965).
8. Form No. 3 of the Companies (Central Government) General Rules & Forms, 1956 is the prescribed form for the particulars of Contract Relating to Shares.
9. Subs. by Act 31 of 1965, s. 11 (w.e.f. 15-10- 1965).
10. The words "five hundred rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 31 (w.e.f. 13-12-2000).
11. The proviso to sub-section (1)(a), the words within bracket marked in sub-section (3) and the proviso after sub-section (4) which was substituted in the place of the previous proviso were all inserted by section 11 of the Companies (Amendment) Act (XXXI of 1965), (w.e.f. 15-10-1965).
12. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 31 (w.e.f. 13-12-2000).

Companies (Amendment) Act, 1965

Share capital to reflect cash or other assets.—"The Notes on clauses stated as follows:—The amendment to clause (a) of sub-section (1), which is based on the recommendation of the Daphtary-Sastri Committee, seeks to impose a duty on the promoters and directors of a company to ensure that the share-capital reflects cash or other valuable assets and is not supported by merely book adjustments.

"The amendment to section 75 (3) empowers the Registrar of Companies to grant in appropriate cases, such extension of time, as he thinks fit, for filing the return of allotment even when the application for the extension is made after the expiry of one month specified in sub-sections (1) and (2). Simultaneously, it is also proposed to delete the existing proviso to sub-section (4) which gives power to the court to grant extension of time when the delay exceeds one month. The amendment is designed to save companies from the expenses involved in applying to a Court, and help them in obtaining extension of time speedily from the Registrars". (*Clause 11*)

The recommendation in this connection of the Daphtary-Sastri Committee was as follows:—"The share-capital of a company must be supported by and be reflective of the existence of cash or valuable assets and should not represent mere book adjustments based on promissory notes or the taking over by another of the liability to pay. Auditors must inquire, wherever it is stated that cash has been paid towards subscriptions to share-capital, whether cash has, in fact, passed, and if cash has not, in fact, so passed they should satisfy themselves that the position as stated in the account books and the balance-sheet is correct, regular and not misleading. Corresponding changes must be made in the form of the balance-sheet and the form of annual return.

Strict duties must be imposed on the promoters and directors not to show shares as having been allotted for cash, if cash has actually not been received and only book adjustments are made without there being any intention that cash should pass. Any breach of duty in this respect should be penalised by a heavy fine on the delinquent promoters or directors."

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 5,00 rupees to 5,000 rupees under sub-section (4).

The Amendment Act of 2000 has also enhanced the penalty amount from Rs. 5,000/- to Rs. 50,000/- under proviso to sub-section (4).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Companies (Second) Amendment Act, 2002 [11 of 2003]

The power of the court under this section has been conferred on the Tribunal constituted under Part 1B of the Act. Consequential change has, accordingly, been made in sub-section (1)(c)(ii) of this section. Notes on clauses of the Bill stated, thus:

Notes on clauses.—"This clause seeks to amend sub-section (1) of section 75 of the Companies Act, 1956 relating to returns as to allotments. The provisions contained in the existing section, *inter alia,* require a company to file return of allotment of issue of shares at discount with a copy of the order of the Court sanctioning such issue. It is proposed to confer this power of sanctioning the issue upon the Tribunal. This amendment is of consequential nature. (*Clause* 10 of the Companies (Amendment) Bill, 2001)."

Payment in "cash" or in kind

By payment in "cash" is meant *bona fide* transaction, between a company and an allottee of shares which, if the company were to bring an action against the allottee for calls, would support a plea of payment, constitutes payment in cash. "Cash" is actual money or instruments or claims which are generally used and accepted as money. Thus bank cheques, demand bills of exchange, bank drafts, letters of credit and other orders for payment of money on presentation may be rated as cash. Its characteristic feature is that it is immediately available for disbursement. If it cannot be so made available, it cannot be treated as cash. Thus marketable securities, deposits under restrictions and account not immediately collectible are not, in ordinary business transactions, considered as cash as they are not readily available for use. But there is no reason why the cancellation of a genuine debt by mutual consent cannot be treated as payment in cash. Whatever constitutes the cancellation of a genuine debt due by the company, and whatever payment is presently enforceable against the company, such as loan amount or consideration payable for property purchased, will constitute payment in cash. *Harmony & Montage Tin & Copper Mining Co., Spargo's* case, (1873) 8 Ch App 407; *Larocque v. Beauchemin,* 1897 AC 358; *North Sydney Investment and Tramway Co. Ltd. v. Higgins*, 1899 AC 253; *Chettiar Thodopuzha Rubber Co. Ltd. v. Registrar of Joint Stock Companies,* (1918) ILR 41 Mad 307 : 33 MLJ 474; *Chokkalingam v. Official Liquidator,* AIR 1944 Mad 87 : (1943) 13 Com Cases 263 allotment of shares against promissory notes, not valid.

Where the requisite formalities have been complied with the court will not interfere merely on the ground of inadequacy of consideration unless the contract is fraudulent or shows on the face of it that the consideration given to the company is illusory or clearly not equal to the nominal value of the shares. In such a case, the shares will be treated as not fully paid and the shareholder may be held liable to pay for them in full. *Alote Estate v. R.B. Seth Hiralal Kalyanmal Kasliwal*, (1970) 40 Com Cases 1116 : AIR 1971 SC 920; *Re, Wragg Ltd.,* (1897) 1 Ch 796 (CA); *Hong Kong and China Gas Co. Ltd. v. Glen,* (1914) 1 Ch 527; *Theatrical Trust Ltd., Chapman's* case, (1895) 1 Ch 771. See also, *Punjab Distilling Industries Ltd. v. Biermans Paper Coating Mills Ltd.,* (1973) 43 Com Cases 189 (Del—DB) where shares were allotted against out of date imported machinery and the court agreed that it could be a case of partial failure of consideration.

Where shares are issued as fully or partly paid-up in consideration of property thereafter to be sold to the company or services to be rendered to the company or in consideration of the release of a claim or by way of compromise, the issue is for consideration other than cash. (PALMER'S COMPANY PRECEDENTS, Part I, 17th Edn., page 152). But if the shares are allotted on a cash basis, though the amount is actually paid later, that will not come under clause (1) (b), as the amount is credited as paid in cash (*ibid*). See also, *Baglan Hall Colliery Co.*, (1870) 5 Ch App 346. The amounts agreed to be considered as paid must be entered in the Register of Members as per section 150(1)(b) and the particulars are to be stated in the annual return under Schedule V, Part II, item 3.

Department's Clarification.—I. If consideration for allotment of shares is actual cash, then only the allotment would be for cash. "Cash" is actual money or instruments *e.g.* cheques which are generally used and accepted as money. If consideration for allotment is not flow of cash but some other mode of payment *e.g.* cancellation of a genuine debt or outstanding bills, for goods sold and delivered, marketable securities, time deposits in banks, then allotment cannot be treated as for cash. (*Department's Letter No.* 8/4/69-CL-V, dated 18-11-1969).

Clarification—II. Further, clarification given by the Department of Company Affairs is as follows:—"I am directed to refer to this Department's *Circular Letter No.* 8/4/69, dated 18-11-1969 and to say that

the views conveyed therein have since been re-examined. The Department is now of the view that the allotment of shares by a company to a person in lieu of a *genuine debt* due to him is in perfect compliance of the provisions of section 75 (1). In this connection it is clarified that the act of handing over cash to the allottee of shares by a company in payment of the debt and the allottee in turn returning the same cash as payment for the shares allotted to him is not necessary for treating the shares as having been allotted for cash. What is required is to ensure that the genuine debt payable by a company is liquidated to the extent of the value of the shares. [*Circular* 8/32/(75) 77-CL-V, dated 13th March, 1978].

Copies to be filed with Registrar under clause (b) of sub-section (1) should be verified by an affidavit of a responsible officer of the company. [See Rule 5 in *Appendix* 1].

Allotment for consideration other than cash : Relief to allottee from liability

Under section 113 of the (English) Companies Act, 1985, the court is empowered to give relief to a person from any liability for not complying with the requirements of allotment of shares for any consideration other than cash. It has been laid down in *Ossory Estates plc., Re,* 1988 BCLC 213 (Ch D) that in considering whether to grant an exemption order the court is required to have regard to the overriding principle that a company which allots shares should receive money or money's worth at least equal in value to the aggregate of the nominal value of the shares and any premium. Where this requirement was satisfied and the valuation report obtained subsequently also showed that the overriding principle had been satisfied, the court relieved the vendor of any liability under the section. But no such relief was granted in a case where it was necessary to show the real value of the shares and debts assigned by the allottee to the Company and there was absolutely no evidence to show whether they were worth the amount of the shares. The Court observed that it was still an open question whether if the company repudiates the allotment, it would become void or whether the allottee could still show the real worth of the consideration to save his allotment. *System Control plc. v. Munro Corporate plc.*, 1990 BCLC 659 (Ch D). See also, *Asoka Tea Estate (P.) Ltd. v. ROC*, (1959) 29 Com Cases 244 : AIR 1959 Mad 384 (on notification for jurisdiction).

Reimbursing promoters for their expenses by share allotment.—In *Park Business Interiors Ltd. v. Park*, 1992 BCLC 1034 [CS (OH)] the Court of Session (Outer House) laid down that the directors of a company are entitled to allot shares for a consideration other than cash and the court would not investigate the adequacy of that consideration unless it is merely colourable or manifestly inadequate. A company may agree to reimburse promoters for expenses incurred in preparations for its business. There is no rule in Scots law, (same true under the Indian Contract Act) unlike English law, that past services to the company cannot constitute an adequate consideration for allotment of shares. In this case, in spite of the absence of any formal minute, the company openly agreed to accept the liability for the promoter's expenditure and there was nothing to suggest that he and his co-ordinator did not consider adequately the sufficiency of the consideration.

A subscriber to the memorandum of association is liable to pay for his shares in cash, even though he had entered into an arrangement with the promoter of the company that he should receive them for his legal services rendered in connection with the promotion of the company. *Kanduri Lakshmiah Chetty v. Adoni Electric Supply Co. Ltd.*, (1944) 14 Com Cases 63 at 66, 67 (Mad).

Transfer of partnership assets in consideration of allotment.—The court noted in *Bradford Investments plc. (No. 2), Re,* (1991) BCLC 688 (Ch D) that although the documents did not reflect it, the parties seemed always to have intended that the transfer of the partnership assets was to be the whole consideration for the shares and no outstanding obligation to pay for the shares would remain and this was subsequently reflected through the company's accounts. But under section 113 of the [English] 1985 Act an independent valuation was required and the same was not done. The purpose of the provision is to assure that the company should receive assets worth at least the nominal value of the allotted shares and any premium and this requirement was not affected by the fact that under the agreement share premium was contingently payable if the net value of the assets exceeded a fixed amount. The court said that although valuation is not an exact science and experts can provide only a partial guidance, it was clear that the company had re-

ceived no net value for its shares. The court accordingly dismissed the application for relief against the liability to pay the nominal value of the shares.

Department's Instructions.—"Where shares are allotted for consideration other than cash, the original contract together with a copy thereof duly verified by an affidavit should be sent along with the return of allotment to the Registrar. The affidavit has to be made on a general stamp paper by a responsible officer of the company stating that the copy is a true copy of the contract. Where in terms of a contract shares are allotted to nominees of the parties to the contract, a letter or letters from each such party should be obtained, addressed to the company to allot such shares to the nominees. Copies of such letters should be duly verified by an affidavit by a responsible officer of the company". (*Departmental Guide to Filling Forms and Making Applications, pages 4-5*).

Prescribed Form.—For Form of Return of Allotment and Form of Particulars of Contract see Forms Nos. 2 and 3 in *Appendix* 1.

Accounting and Auditing Practice

Allotment of shares for consideration other than cash.—The Institute of Chartered Accountants has considered the effect of the ruling in *Spargo's* case and its subsequent modifications in S. 227(1-A)(f) and has concluded that this new provision requires an auditor to see that where shares have been described to have been subscribed for in cash, whether actual cash has been received by the company or not. Accordingly whenever there is a mutual adjustment against a debt payable by the company, shares should not be taken to have been allotted for cash. See Compendium of Statements and Standards, 1986 pp. 367-377 and Paras 8.5—8.6 of the Statement on Auditing Practices.

A judicial observation pertinent to this point is to be found in *Park Business Interiors Ltd. v. Park,* 1992 BCLC 1034 (CS) (OH) [at p. 1041]: "In accountancy practice it is quite common for a company, particularly a small one, to adopt liability for pre-incorporation expenses although the amount chargeable in the company accounts might have to be agreed with the Inland Revenue. Their view appeared to be that if the company was happy that pre-incorporation expenditure should be re-imbursed, the auditors would accept that without looking for a formal minute."

Department's view.—However Company Law Department has taken a different view in its *Circular No.* 8/32/(75) 77-CL-V, dated 13-3-1978. For the text of Circular see under heading "Payment in Cash or in kind".

Return of allotment and stamp charges

An agreement to allot shares or an allotment of shares is not a transfer of property, as the company which allots the shares is not in any sense an owner of the shares which it creates. The agreement will, therefore, be not liable to stamp duty as a conveyance, *Madura Mills Company Ltd., Re,* (1937) 7 Com Cases 71, 75 (Mad); *Raj Sachdeve v. Board of Revenue,* AIR 1959 All 595; *Swadeshi Cotton Mills Co. Ltd., Re*, (1932) 2 Com Cases 411, 415 (All); *Bhola Ram and Sons Ltd. v. The Crown,* (1934) 4 Com Cases 159, 166 (Lah); **followed** in *Laxmi Iron and Steel Manufacturing Co. Ltd. v. Emperor*, (1934) 4 Com Cases 285 (Lah).

Stamp Duty.—For the schedule of Stamp duty see K. KRISHNAMURTHY INDIAN STAMP ACT, 8th Edition, 2002.

Allotment

The expression 'allotment' is not defined in the Act. It means a division of the entire share capital into definite shares, each of particular value, and also of different classes and an assignment, of such shares singly or numerously to different persons. The central core of the word 'allotment' is the notion of "lot". The true meaning of the word 'allotment' must, therefore, be first the creation of lots of shares and then the division of them into value and classes and lastly allocation of them to various persons. *Calcutta Stock Exchange Association Ltd., In re*, (1957) 27 Com Cases 559 : AIR 1957 Cal 438.

"What is termed "allotment" is generally neither more nor less than the acceptance by the company of the offer to take shares. To take the common case, the offer is to take a

certain number of shares or such a less number of shares as may be allotted. That offer is accepted by the allotment either of the total number mentioned in the offer or a less number, to be taken by the person who made the offer. This constitutes a binding contract to take that number according to the offer and acceptance. To my mind there is no magic whatever in the term "allotment" as used in these circumstances. It is said that the allotment is an appropriation of a specific number of shares. An allotment is an appropriation, not of specific shares, but of a certain number of shares." *Florence Land and Public Works Co., In re*, (1885) 29 Ch D 421 at 426, *quoted* in *Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association*, (1963) 33 Com Cases 862 : AIR 1964 SC 250.

In *Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association (supra)* the Supreme Court held that 'allotment' means the appropriation out of the previously unappropriated share capital of a company, of a certain number of shares to a person. Till such allotment the shares do not exist as such. It is on allotment in this sense that the shares come into existence."

When a block of shares is offered for sale to members, acceptance of a part of the block is not good. *Ocean Coal Co. v. Powell Duffryn Steam Coal Co.*, (1932) 2 Com Cases 454 (Ch D).

In *Golkonda Industries (P.) Ltd. v. Registrar of Companies*, (1968) 38 Com Cases 165 (FB) (Del) a Full Bench of the Delhi High Court has held that where a return of allotment is made and it is otherwise in order, the Registrar cannot inquire into the legal validity of the matters contained in the return, such as allotment made to minors, *etc.* The proper forum to determine whether or not a minor can be member is the Court and not the Registrar. See *Department's Letter No.* 9/9/(41)/64-PR, dated 30-8-1964.

The subscribers to the memorandum of association become entitled to and liable for the shares mentioned against their respective names in the memorandum, by virtue of the contract contained in the memorandum. Hence, there is no "allotments", and consequently, no necessity to file any return of allotment when such shares are issued to the subscribers.

§ For further notes on the requirements of a valid allotment see under s. 69 under the heading "Allotment".

Bonus shares

§ See Notes under section 81.

Company cannot issue fully paid share as donation/gift

§ For Notes, see under section 70 under the same heading.

Contract to be reduced to writing [Sub-section (2)]

Where the contract is not reduced to writing, the particulars filed in term of Form 3 (*Vide Appendix* 1) will constitute the contract and as such be liable to pay the same stamp duty as is payable on the contract if it was in writing. For a discussion of this subject, see, *Sudarsen Talkies v. Chief Controlling Revenue Authority*, (1978) 48 Com Cases 591 (FB) (Del) and *Raj Sachdeva v. Board of Revenue*, AIR 1959 All 595. It is no longer possible to escape from paying the full *ad valorem* duty as was the case in making allotments on the basis of agreements to sell or exchange property. The Form 3 is such as to net in all cases of sales and exchanges and make them liable to pay the full *ad valorem* duty on the transactions as which constitute the title of an allottee to the shares allotted.

Registrar's power of extension for filing return [Sub-section (3)]

The Registrar can now extend the period for filing the return, on application made whether before or after the expiry of the period of thirty days provided by the section. If the Registrar refuses, a remedy to apply to the Central Government is now provided by section 637-B, clause (b). The Government has the power under the section to condone delay.

Department's Clarifications.—Under section 75(3) of the Companies Act, a Registrar can grant extension of time for filing of a return of allotment only if an application for such extension is submitted to him before the expiry of the period of one month prescribed by sub-section (1) of the section (Letter dated 18th March, 1957 addressed to Field Officers). Where the Registrar has not extended the time for filing under sub-section (3) of section 75 and a return of allotment is filed with him after the expiry of the one month period specified in sub-section (1), he should take the documents on record on payment of additional fee, if any, imposed under section 611(2) without prejudice to any other liability of the company and its officer in default for such delay [*Company News and Notes*, dated 1st July, 1963].

Penalty for default in filing return [Sub-section (4)]

For default made in complying with the section, every officer of the company who is in default is punishable with fine which may extend to fifty thousand rupees for every day during which the default continues. In case of default of contravention of proviso to sub-section (1), namely showing in the return, showing shares have been allotted for cash, when such is not the case, every officer and every promoter of the company who is guilty of the contravention is punishable with fine which may extend to five thousand rupees. The offence is compoundable by the Central Government under section 621A.

This sub-section punishes every officer of the company who is guilty of default in filing return. Since neither the section as a whole nor this penalty provision talks about the validity of the allotment being affected by any failure to file a return, the Calcutta High Court expressed the opinion that 'non-filing of the return will not make the allotment of shares to be bad'. *Gobind Pritamdas Malkani v. Amarendra Nath Sircar*, (1980) 50 Com Cases 219, 236 (Cal).

Exception in favour of forfeiture [Sub-section (5)]

Note that there is no provision in the Act, giving power to forfeit shares. Such power has to be given only by the articles, and even the articles can confer it only in respect of non-payment of calls.

As regards the re-issue of forfeited shares, though the sub-section uses the word "allotment", there is no question of any allotment in such case. "Allotment" means the appropriation out of the previously unappropriated capital of a company, of a certain number of shares to a person. Till such allotment, the shares do not exist as such. When a share is forfeited and then re-issued it is not allotment in the above sense. The use of the word 'allotment' in sub-section (5) owes its origin to a confusion of ideas. It is probably used by way of caution "to prevent any argument being raised that a return has to be filed of the re-issued shares forfeited for non-payment of calls". *Sri Gopal Jalan v. Calcutta Stock Exchange Association*, (1963) 33 Com Cases 862 : AIR 1964 SC 250; *Calcutta Stock Exchange Assn. Ltd., Re*, (1957) 27 Com Cases 559 : AIR 1957 Cal 438. The duty to file the return as to allotment is not confined merely to the first allotment. It applies whenever any allotment of shares is made. (*Sri Gopal Jalan's* case) (*supra*).

Allotment of fractional shares

Department's Circular.—The holders of coupons for fractional shares cannot be said to be allottees of any shares by the strength of holding those coupons till they actually receive communication of the allotment of any share from the company in their favour in exchange of the said coupons. Any dividend declared in the meantime in respect of the "capital" represented by the coupons should not be treated as dividend declared in favour of any particular holder of a share as such, but as dividend kept earmarked for whoever may acquire full shares in exchange of the coupons. (*Department's F. No.* 8/31(75)63-PR, dated 27th March, 1963.)

Court means Company Law Board

Department's view.—The word "court" used in section 75(1)(c)(ii) should be read harmoniously with section 79 in which the word "court" has been replaced with the words "Company Law Board". Therefore, the order of the Company Law Board in this context should be taken as the order of the court within the meaning of section 75(1)(c)(ii). (*Letter No.* 12/26/75-CL-V, dated 10-1-1976.)

Documents Involved: 1. Application and Allotment Register, 2. Register of Members, 3. Forms 2 and 3, 4. Particulars of agreement, if any.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

Paragraph 2.—**The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Return of Allotment

Prescribed Check List

Check whether:

(i) the company has made any allotment of its shares. If so, the return of allotment in Form No.2 was filed with the Registrar within 30 days stating the number and nominal amount of the shares comprised in the allotment, the names, addresses, and occupations of the allottees, and the amount, if any, paid or due and payable on each share;

(ii) shares were allotted at a discount. If so, copy of the resolution authorising the issue of shares at a discount along with a copy of the order of the Company Law Board *was filed with the return;

(iii) shares were issued for consideration other than cash. If so, the original contract, along with a copy thereof, entered into with the persons to whom the shares were allotted for consideration other than cash was filed with the return;

(iv) the copy of the contract was verified by an affidavit by a director or the Secretary of the company;

(v) the contract for issue of shares for consideration other than cash was not reduced in writing. If so, whether particulars of the contract were filed in Form No.3 and the Form was duly stamped with stamp duty which would have been paid, had the contract been reduced to writing;

(vi) bonus shares were issued. If so, a return stating the number and nominal amount of the shares comprised in the allotment, the names, address and occupation of the allottees and a copy of the resolution authorising the issue of such shares was filed;

(vii) allotment has been made in pursuance of the order of the Court† under sections 391/394. If so, verify whether shares were allotted in the proportion stated in the order.

Notes :

1. The return of allotment is not required to be filed in case the allotment was of forfeited shares or the allotment was made to the subscriber to the Memorandum and Articles of Association.

2. The return of allotment is not required to be filed where debentures are allotted.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

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* **Power transferred to the Central Government and in respect of Sick Industrial Companies power vested with National Company Law Tribunal from the commencement of the Companies (Second Amendment) Act, 2002 (11 of 2003).**

† **Power transferred to the NCLT from the commencement of the Companies (Second Amendment) Act, 2002 (11 of 2003).**

For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Commissions and discounts

S. 76. Power to pay certain commissions and prohibition of payment of all other commissions, discounts, *etc.*—(1) A company may pay a commission to any person in consideration of—

(a) his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in, or debentures of, the company, or

(b) his procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in, or debentures of, the company,

if the following conditions are fulfilled, namely:—

(i) the payment of the commission is authorised by the articles;

(ii) the commission paid or agreed to be paid does not exceed in the case of shares, five per cent of the price at which the shares are issued or the amount or rate authorised by the articles, whichever is less, and in the case of debentures, two and a half per cent of the price at which the debentures are issued or the amount or rate authorised by the articles, whichever is less;

(iii) the amount or rate per cent of the commission paid or agreed to be paid is—

in the case of shares or debentures offered to the public for subscription disclosed in the prospectus; and

in the case of shares or debentures not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filed before the payment of the commission with the Registrar and, where a circular or notice, not being a prospectus inviting subscription for the shares or debentures, is issued, also disclosed in that circular or notice; [1][* * * *]

(iv) the number of shares, or debentures which persons have agreed for a commission to subscribe absolutely or conditionally is disclosed in the manner aforesaid; [2][and]

[2][(v) a copy of the contract[3] for the payment of the commission is delivered to the Registrar at the time of delivery of the prospectus or the statement in lieu of prospectus for registration.]

(2) Save as aforesaid and save as provided in section 79, no company shall allot any of its shares or debentures or apply [4][any of its moneys], either directly or

1. The word "and" omitted by Act 31 of 1965, s. 12 (w.e.f. 15-10-1965).
2. Ins. by Act 31 of 1965, s. 12 (w.e.f. 15-10-1965).
3. Form No. 4 of the Companies (Central Government) General Rules & Forms, 1956 is the prescribed form for the section.
4. Subs. by Act 65 of 1960, s. 22 for "any of its capital moneys".

indirectly; in payment of any commission, discount or allowance, to any person in consideration of—

(a) his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in, or debentures of, the company, or

(b) his procuring or agreeing to procure subscriptions, whether absolute or conditional for any shares in, or debentures of, the company, whether the shares, debentures or money be so allotted or applied by being added to the purchase money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase money or contract price, or otherwise.

(3) Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay.

(4) A vendor to, promoter of, or other person who receives payment in shares, debentures or money from, a company shall have and shall be deemed always to have had power to apply any part of the shares, debentures or money so received in payment of any commission the payment of which, if made directly by the company, would have been legal under this section.

[5][(4A) For the removal of doubts, it is hereby declared that no commission shall be paid under clause (a) of sub-section (1) to any person on shares or debentures which are not offered to the public for subscription:

Provided that where a person has subscribed or agreed to subscribe under clasue (a) of sub-section (1) for any shares in or debentures of, the company and before the issue of the prospectus or statement in lieu thereof any other person or persons has or have subscribed for any or all of those shares or debentures and that fact together with the aggregate amount of commission payable under this section in respect of such subscription is disclosed in such prospectus or statement, then, the company may pay commission to the first-mentioned person in respect of such subscription.]

(5) If default is made in complying with the provisions of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [6][*five thousand rupees*].

NOTES

Eng. Act, 1948 : Sec. 53.
Eng. Act, 1985 : Secs. 97 and 98.

Previous Act : Sec. 105.

Companies (Amendment) Act, 1965

Underwriting commission.—Sub-section (1), Clause (v) and sub-section (4-A) were inserted by section 12 of the Amendment Act (XXXI of 1965). The Notes on clauses stated : This clause is based on the recommendation contained in paragraph 10 of the Commission's Report, and seeks to make it clear that underwriting commission should not be paid except in respect of shares or debentures offered to the public. It also requires

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5. Ins. by Act 31 of 1965, s. 12 (w.e.f. 15-10-1965).
6. The words 'five hundred rupees' substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 32 (w.e.f. 13-12-2000).

that the company should file with the Registrar a copy of the contract for payment of the underwriting commission at the time of the delivery of the prospectus. (*Clause* 12).

In respect of this, the Commission of Inquiry had reported as follows : "The word 'underwriting' means that a person agrees to take up shares specified in the underwriting agreement if the public or other persons fail to subscribe for them. Consideration for this contract takes the form of payment of commission whether or not the underwriters are called upon to take up any shares. Underwriters are thus paid for the risk they expose themselves to in the placing of shares before the public"

* * * *

An instance which came to the notice of the Commission in the course of its investigation was that of a company which acted as underwriters of a public company and the directors of that public company had a major interest in the company which acted as underwriters for the issue of capital amounting to Rupees 310 lakhs. According to the disclosure made by the directors themselves in the prospectus, "applications with full amount for about three crores" had already been received. The persons in control thus made to themselves a gift of about Rupees 8 lakhs in the shape of underwriting commission at the cost of the investing public although the underwriter was not exposed to any risk in this instance.

It is, therefore, recommended that—

(i) the commission shall not be paid to any persons on such shares or debentures as are actually subscribed for at the time of the filing of the company's prospectus or statement in lieu of prospectus.

(ii) a copy of the contract or agreement, for the payment of commission shall be delivered to the Registrar simultaneously with the filing of the prospectus or the statement in lieu of prospectus (*Report* : paras 7, 9, and 10).

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 500 rupees to 5,000 rupees under sub-section (5).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

This section deals with the important subject of payment of commission to subscribers and others who procure capital for the company. It is usual in the case of public companies, when shares are offered to the public for subscription, to make certain of obtaining the necessary capital by having the issue underwritten.

Without an authority like the one provided by the section, it will not be lawful for a company to pay such commissions as are authorised therein, at any rate out of capital inasmuch as such payment will, in effect, amount to an unauthorised issue of shares at a discount.

Payment of underwriting commission

The word is not restricted to payment of money out of capital only: it includes payments from profits as well, *Madanlal Fakirchand Dudhediya v. Shree Changdeo Sugar Mills Ltd.*, AIR 1958 Bom 491 : (1958) 28 Com Cases 312 **affirmed** by the Supreme Court on appeal, *Madanlal Fakirchand Dudhediya v. Shree Changdeo Sugar Mills Ltd.*, (1962) 32 Com Cases 604 : AIR 1962 SC 1548. The fact that the agreement for the payment of commission mentioned other services of the company's promoters would not take the case out of the mischief of the section. The percentage commission of 5 per cent of the price in the case of shares, and 2½ per cent of the price in the case of debentures, fixed by the section only indicates the quantum, and not the source from which it is to be paid, which may be out of capital or profits. *Madanlal F. Dudhediya, (supra)* and out of share premium account also. *Hilder v. Dexter*, (1902) AC 474 (HL). By the words 'subscribing or agreeing to subscribe' is meant entering into an agreement to take shares by means of a formal application or in any other manner, under which there is a liability to pay for the shares, *Arnison v. Smith*, (1889) 41 Ch D 348.

Payment may be in cash or kind or in a lump sum or by way of percentage, but in no case should it go beyond the statutory prescription. *Booth v. New Africander Gold Mining Co.*, (1903) 1 Ch 295 (CA). If a director pays commission out of the company's money without disclosing it as required by the section, the company may recover the amount from him in an action. *Dominion of Canada General Trading Syndicate v. Brigstoke*, (1911) 2 KB 648; *South African Territories v. Wallington*, (1898) AC 309 (HL). A vendor or a promoter does not have a free hand to pay commission; he can pay only such commission as the company could have legally paid.

Underwriting commission by Banking Companies

In the case of banking companies, section 13 of the Banking Regulations Act provides: "Notwithstanding anything to the contrary contained in sections 76 and 79 of the Companies Act, 1956 (1 of 1956), no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it any amount exceeding in the aggregate two and one-half per cent of the paid-up value of the said shares".

What is underwriting

"To 'underwrite' as the expression is used in company matters, is a well-known business term signifying the entering into a contract by which a person (known as 'the underwriter') agrees (usually for a commission) that if the shares, debentures, or debenture stock about to be offered for subscription, or some specified proportion thereof, are not, within a specified time, taken up by the public, or by that section of the public to which they are to be offered, he will himself take them up and pay for what the public do not take up, or some specified proportion thereof. Sometimes the contract binds the underwriter either to take up the shares, *etc.*, or to find responsible persons to do so; it is nonetheless, in either case, called an underwriting contract. It is today though it was not always in the past the almost universal practice for one person, or firm, or company, to underwrite the whole issue, sometimes, however, with very big issues a consortium of bankers will share the underwriting between them in which case their arrangement will stipulate that the public subscriptions are to go in relief of all the underwriters' liability rateably in proportion to the amounts underwritten by them respectively." (PALMER: COMPANY PRECEDENTS, 17th Edn., Part I, Page 175).

"Underwriting is in the nature of an insurance against the possibility of inadequate subscription. A public company cannot proceed to allot shares offered to the public, unless the amount specified in the prospectus as the minimum subscription is raised by the issue of shares..... an underwriter is entitled to enter into subsidiary agreements with which the company is not concerned. They are not required to be disclosed in the prospectus..... The underwriting agreement being a contract that the underwriter will either himself purchase or procure purchasers for the shares underwritten by him, it is no concern of the

company as to how the underwriter procures the purchasers". *Naini Gopal Lahiri v. State of Uttar Pradesh,* (1965) 35 Com Cases 30 (SC).

There is no reason why a director should not participate in the purchase of shares (*ibid*). But he will have to comply with sections 297 and 299.

The advantage of underwriting is that the success of a proposed issue is ensured. It is in the nature of an insurance against risk.

Where there is contingent underwriting of any private placement to employees and business associates, the private placement which is unsubscribed or portion thereof, must be allotted to the contingent underwriter and cannot be added to the general pool.

Underwriting commission is payable only when a person subscribes or agrees to subscribe and not when he purchases the shares because in that case the company will be violating section 77 which prohibits financial assistance for the purchase of the company's shares; but where a person agreed to buy the shares of an old company which gave him the right to subscribe for shares in a new company and he agreed with the new company to exercise that right, this amounted to an agreement to subscribe for shares in the new company and the commission paid to him by the company was regarded as a valid payment. *Barrow v. Palinga Mines (1909) Ltd.,* (1909) 2 Ch 658. As to the meaning of the word 'subscribe' in relation to an exchange of shares for shares, see *Government Stock and Other Securities v. Christopher,* (1956) 1 All ER 490 (Ch D). Underwriting commission earned by an underwriter is income for tax purposes but not so when the underwriter himself has to purchase shares to the extent of public default. *CIT v. U.P. State Industrial Development Corpn.,* (1997) 25 Corpt LA 163 : AIR 1997 SC 2214 (SC).

Since the extent of the liability of an underwriter to a public issue of a company's equity shares can be ascertained only after receiving the public subscription position from the company, it is not a 'liquidated demand' within the meaning of the term in R. 2(1) (Bombay) of O. 37 of Civil Procedure Code so as to attract summary procedure. Neither can the ceiling or upper limit of the liability stipulated in the agreement be treated as 'liquidated demand'. *Dena Bank v. K. Motiram Vakil,* AIR 1989 Bom 264 at p. 266.

Application by underwriters not necessary

The underwriting agreement has to be treated not merely as a guarantee but as an application for allotment of so many shares as could not be applied for by the public. A separate application for allotment is therefore, not required. *Pioneer Company v. Kaithal Cotton & General Mills Ltd.,* (1970) 40 Com Cases 562, 564 (P&H).

Authority for applying for shares on behalf of underwriters.—Usually underwriting letters carry an authority to the other party to the agreement who may be either a promoter or a sub-underwriter that if the underwriter fails to apply for shares the other party will do so on his behalf. Such authority if properly conferred is effective and irrevocable. *Carter v. White,* (1883) 25 Ch D 666; *Hannan's Empress Mining Co., Carmichael's* case, (1896) 2 Ch 643 (CA); *Pole's* case, (1920) 2 Ch 34. In some cases the authority is of conditional nature in the sense that in the first place the underwriter will be called upon to apply for the shares and if he fails to do so an application will be made on his behalf. In such cases an allotment without calling upon him to subscribe will be ineffective. *Omerod's* case, (1894) 2 Ch 274; *Brussels Palace of Varities v. Prockter,* (1893) 10 TLR 72 (CA); *Sangster v. Netter,* (1893) 9 TLR 441. If the authority is properly exercised, not only the underwriter, his executors will also be bound by the underwriting agreements and the consequent allotment. *Warner Engineering Co. v. Brennan,* (1913) 30 TLR 191; *Pathe Freres,* (1914) 2 KB 299.

Ever since the decision of the Court of Appeal in *Crown Lease Proprietary Co., Re,* (1897) 14 TLR 47, it has become an accepted principle that no implied conditions would be imported into the agreement which are derogatory to its main terms. Where, the underwriter gave authority to the other party to apply on his behalf, he was held bound by an allotment though it had become impossible in the terms of the prospectus.

Underwriting by partnership firms

Where a partnership firm enters into an underwriting contract with a company and there is a devolvement, the firm shall be liable to take up the number of shares unsubscribed and cannot avoid its liability on the ground that a firm cannot be allotted shares under the Companies Act. The partners of the firm acting in the firm's name shall be liable to subscribe and be allotted the unsubscribed shares.

Withdrawal of underwriting letters

An underwriting letter is usually in the shape of an offer though it may carry a binding commitment without acceptance. If the letter is a mere offer it can be withdrawn at any time before acceptance and just by a word of mouth. *Truman's* case, (1894) 3 Ch 272. The offer must be accepted within the time specified and if no time is specified, within reasonable time. *Hindley's* case, (1896) 2 Ch 121, 134; *Crawley's* case, (1869) LR 4 Ch App 322. Acceptance should be communicated to the underwriter. Consort *etc., Mines, Re*, (1897) 1 Ch 575 (CA). An oral acceptance may suffice. *North Charterland Exploration Co. v. Riordan*, (1897) 13 TLR 281. Up to the time of communication of acceptance, underwriting letters can be withdrawn unless, of course, they carry a commitment that the underwriter will be bound without the formalities of acceptance. *Bultfontein Sun etc., Mines*, (1897) 75 LT 669 (CA); on appeal 13 TLR 156. If the underwriting is in the form of an application for shares, it cannot be withdrawn like other applications until the fifth day after the opening of the subscription list (Section 72). Where an allotment was made after the period specified in the underwriting letters was already over but the underwriter questioned it after two years, he was estopped from doing so. *Crown Lease Proprietary Co.*, (1897) 14 TLR 47. **Reversing** *Hindley's* case, *Hemp Cordage etc., Co.*, (1896) 2 Ch 121 (CA).

Firm underwriting

When an underwriter desires to take in a firm way the whole or a proportion of the number of shares he has underwritten, the effect will be that an allotment of that number would be made to him irrespective of whether the issue is over or undersubscribed. The underwriter who takes on firm basis a given number of shares will be so far as the rest of the shares are concerned in the same position as other underwriters.

Revocation of underwriting agreement

An underwriting letter generally authorises the company or persons acting for it, to apply in the name of the underwriter or sub-underwriter for the shares in case they fail to apply when called upon to do so. This letter is an authority coupled with interest and, therefore, after acceptance by the promoter is irrevocable. *Carmichael's* case, (1896) 2 Ch 643; *Olympic Fire and General Re-Insurance Co.*, (1920) 2 Ch 341.

Variation of terms of draft prospectus

An underwriting letter generally empowers the company to vary the terms of the draft listing particulars or any offer document on which it is based before the offer is issued. This does not entitle the company to alter the terms on which the shares are offered, in any way which materially increases the risk borne by the underwriter. Where a company altered its draft prospectus by stating that the company might pay for the business it was acquiring by instalments out of the proceeds of successive issues of shares instead of by a lump sum out of the proceeds of the first issue, as originally stated, it was held that the company had exceeded its rights under a power in the underwriting agreement to vary the terms of the draft prospectus, and so the underwriter was released from his obligations. *Warner International and Overseas Engineering Co. Ltd. v. Kilburn, Brown & Co.*, (1914) 84 LJ KB 365 (CA). The safest course when negotiating underwriting contracts is to specify the variations which may be made (*e.g.* enabling the company to fix the issue price within specified limits without having to obtain the underwriters' approval), or to

permit variations to be made only in order to correct or supplement the factual information, or more restrictively, to permit variations only with the consent of the underwriters.

Enforcement of Underwriting agreement against legal heirs

The underwriting agreements can be enforced even against the executors of the deceased underwriter, because it has been held that the duty imposed for finding capital is not such a personal contract as would come to an end with the life of the contractor. *Warner Engineering Co. v. Brenman*, (1913) 30 TLR 191; *In Re, Worthington Ex Parte, Pathe Freres*, (1914) 2 KB 299 (CA).

Conditions for payment of underwriting commission

The conditions are—

(1) it should be authorised by the articles of the company: authority in the memorandum is not sufficient. See *Republic of Bolivia Exploration Syndicate Ltd.*, (1914) 1 Ch 139;

(2) it should not exceed 5 per cent in the case of shares and 2½ per cent in the case of debentures; or any lesser amount as may be prescribed by the articles. If the articles authorise payment by a certain percentage, lump sum payment cannot be made;

(3) it should be disclosed in the prospectus or statement in lieu of prospectus, as the case may be, or in a statement filed with the Registrar before the payment of the commission; this would require a disclosure of the particulars of the main underwriting agreements and not those of the sub-underwriting;

(4) the number of shares or debentures which persons have agreed to subscribe absolutely or conditionally should also be disclosed as in (3) above; and

(5) a copy of the contract relating to the payment of the commission should be delivered to the Registrar;

(6) commission is payable only when the shares are offered to public for subscription, in terms of sub-section (4A).

Guidelines for underwriting commission and brokerage

Ministry of Finance, Stock Exchange Division *vide* its *Circular No.* F/14/1/SE/ 85, dated 7th May, 1985 has stipulated the following maximum rates for payment of underwriting commission:—

Shares	*On amounts devolving on the underwriters*	*On amounts subscribed by the public*
(i) Equity shares	2.5%	2.5%
(ii) Preference shares/convertible and non-convertible debentures		
(a) for amounts upto Rs. 5 lakhs	2.5%	1.5%
(b) for amounts in excess of Rs. 5 lakhs	2%	1%

The rates laid down in the circular are the maximum rates of underwriting commission and within the above rates, a company will be free to negotiate for lower rates of underwriting commission, if necessary.

SEBI Guidelines, 2000 for Underwriting of Issues

As per SEBI guidelines, underwriting is not mandatory but if underwritten, it must be for the full issue to the extent of offer to the public, excluding Reserved/Preferential allotment and certain other relaxations given below. The lead manager must satisfy himself about the ability of the underwriters to discharge their obligations.

No payment direct or indirect in the nature of a discount, commission, allowance or otherwise shall be made either by the issuer company or the promoters in any public issue

to the persons who have received firm allotment in such public issue [*Clause 3.6.1 of Chapter III*].

Timely payment of commission.—The company shall take steps to pay the underwriting commission and brokerage to the underwriters and stock brokers, etc. within the time specified in any agreement with such underwriters or within a reasonable time. [*Clause 11 of MOU : Sch. 1 to SEBI (DIP) Guidelines, 2000*].

Underwriting commission.—(1) In consideration of the underwriter agreeing to underwrite the shares/debentures as mentioned in clause 1 above, the company shall pay to the underwriter a commission at the following rates:

Notes : The rates as mutually negotiated between the company and the underwriter may be inserted. Needless to say that the rates so agreed upon shall be subject to the provisions of section 76 of the Companies Act, 1956.

(2) The underwriting commission shall be payable by the company within 15 days from the date of finalisation of allotment and proof of such payment within the specified time should be available with the company. The obligation to pay underwriting commission shall arise only upon the underwriter fulfilling his underwriting obligation and duly subscribing to the shares/debentures, if any, devolved on him. [*Para 13 of Model Underwriting Agreement*].

§ For full text see *Appendix* 216.

SEBI (Underwriters) Rules and Regulations, 1993

The Central Government has notified SEBI (Underwriters) Rules, 1993 and SEBI has issued SEBI (Underwriters) Regulations, 1993 under the SEBI Act, 1993.

§ For text of the above rules and regulations, refer *Appendices* 214 and 215.

With the notification of the above regulations, no person shall carry on any activity as underwriter unless he is registered with SEBI under section 12 of the Act. SEBI has issued SEBI—RUW Circular No. 1 (93-94), dated 19-11-1993. (For text, refer *Appendix* 216).

Operational Guidelines and Model Underwriting Agreement for Underwriters

No person shall carry on any activity as an underwriter unless he is registered with SEBI under section 12 of SEBI Act, 1992. For the purpose SEBI has formulated separately SEBI (Underwriters) Regulations, 1993 and the Government has promulgated SEBI (Underwriters) Rules, 1993. All persons acting as underwriters, whether as Registered Underwriters, or a registered Stock broker or as a registered merchant banker, holding a valid Certificate of Registration under section 12 of SEBI Act, 1992 shall be entitled to act as an underwriter and shall be referred to as Registered Underwriters (RUW).

Underwriters are required to enter into a legally binding agreement with the issuer company in terms of Reg. 14 of Underwriters Regulations, 1993. Accordingly SEBI has evolved a Model Underwriting Agreement. The model draft has been formulated to bring about standardisation in the legal relationship between the issuer company and the underwriters.

§ For the text of the Operational Guidelines/Instructions and Model Underwriting Agreement, see *Appendix* 216.

§ For further discussion, see under heading "Underwriters to the Issue" under section 56.

Payment of underwriting commission by private companies

The section applies to all companies, private and public. Where a private company pays commission, it must fulfil the conditions prescribed in sub-section (1), and, in particular, it will have to file a statement before the Registrar as required by Sub-s. (1)(b)(iii)

before paying the commission. As regards the payment of commission by a private company, this is what PALMER says : 'It is usual to empower the company to pay a commission to any person for his subscribing or procuring subscriptions for shares in the company. The power is useful if the company should require additional capital and have to get it from an outside source". (PALMER: PRIVATE COMPANIES, 41st Edn., page 64). See also *Dominion of Canada, etc., Syndicate v. Brig Stocke,* (1911) 2 KB 648.

Underwriter's remedies against misrepresentation in prospectus

Where an underwriting is on the basis of a prospectus, which, unknown to the underwriter, contains untrue statements, the remedies of the underwriter will generally be the same as those of any other subscriber. See *Karberg's* case, (1892) 3 Ch 1 (CA). Where, however, the complaint was only in respect of the omission to disclose the statutory particulars, the underwriter could not get any relief because he was not able to prove that he did not know of the contract not disclosed, something, which would not have to be proved by an ordinary subscriber. *Baty v. Keswick,* (1901) 85 LT 18; *Cackett v. Keswick,* (1902) 2 Ch 456, an ordinary subscriber's successful case. The underwriter may also have other remedies including those provided by the law of contract, the English Misrepresentation Act, 1907 and the Law of Torts.

Underwriter's remedy against Broker.—A Bank underwriting a whole issue to be made through private placement engaged a broker to bring about a successful hundred per cent placement. The letters of offer which were given to the broker did not carry any such condition. Broker communicated to his clients that the allotment was to go ahead only when there was hundred per cent placement. But hundred per cent placement could not be attained and therefore many clients withdraw their commitments. The underwriting Bank was left with a heavy allotment resulting in a big loss to him. The broker was held liable for the bank's loss. *County Ltd. v. Girozentrale Securities,* (1996) 1 BCLC 653 (CA).

Sub-underwriter

The underwriter usually chooses to spread his risk by using sub-underwriters who agree to take a certain number of shares for which they receive a commission. If the result of an issue to the public is a success, the underwriters receive their commission without having to take up any of the shares or debentures, but if it is a failure the underwriters and sub-underwriters have to take up a large proportion of it.

The liability of the sub-underwriter is contingent upon:

(a) the number of shares subscribed by the public and

(b) the intimation by the underwriter to the sub-underwriter that the latter shall subscribe or procure subscription. *Dena Bank v. K. Motiram Vakil,* AIR 1989 Bom 264, 266. See also PALMER'S COMPANY LAW, Para 5.209, 25th Edn., Loose Leaf, Vol. 1, 1992.

A sub-underwriting letter authorising an underwriter to apply for shares for a valuable consideration, if the offer is accepted by the underwriter, amounts to an authority coupled with an interest and is irrevocable. *Olympic Fire and General Re-Insurance Co. Ltd.,* (1920) 2 Ch 341 (CA). A sub-underwriter, on signing the application form and after receiving the allotment notice, cannot repudiate his agreement only because the underwriter did not communicate to him about his acceptance of offer contained in the sub-underwriting letter. *Premier Briquette Co. v. Gray,* 1922 Scottish Cases 329.

A sub-underwriter may not obtain rescission of his contract to take shares where he is an undisclosed principal, although he has relied on misrepresentations, unless he establishes that the underwriter who is his agent relied on the misrepresentations. The entry of the name of the sub-underwriter in the register of members, pursuant to an authority contained in a letter of renunciation signed by the underwriters, cannot of itself be treated as a contract entered into on the basis of the offer documents. *Collins v. Associated Greyhound Racecourses Ltd.,* (1930) 1 Ch 1 (CA).

Where there was discrepancy between an underwriting agreement and the sub-underwriting in the sense that sub-underwriting mentioned the shares at par whereas it was a premium issue, it was held that the sub-underwriter was bound by the allotment at premium. *Greater Britain Insurance Corpn. Ltd.,* (1920) 124 LT 194 (CA).

An underwriter was held not liable for the fact that one of his sub-underwriters, who was also a chief executive of the company, had financed his underwriting commitment out of the company's money. The court said that in carrying out underwriting obligations an underwriter does not act as a financial adviser of the company. There is no duty on the part of the underwriter to find out satisfactory sub-underwriters. *Eagle Trust plc. v. SBC Securities Ltd. (No. 2),* (1996) 1 BCLC 121 (Ch D); *Eagle Trust plc. v. SBCI Swiss Bank Corpn. Investment Banking Ltd.,* (1996) 1 BCLC 121 (Ch D).

Non-disclosure of sub-underwriting contracts.—Part I of Schedule II requires that only underwriting contracts are disclosed in the prospectus. A company is not bound to disclose sub-underwriting contracts in the prospectus. Where an underwriter makes arrangements with a subsidiary company of the company making the issue, for sub-underwriting the issue, the company is not bound to disclose the arrangement in the prospectus and this would not amount to misstatement in prospectus.

Payment of brokerage [Sub-section (3)]

According to the OXFORD ENGLISH DICTIONARY "brokerage" means the commission or percentage paid to a broker on the transactions negotiated by him and "broker" is a person who acts as a middleman in bargain, an intermediary who brings parties together and assists them in negotiating a contract or a deal. Brokers include stockbrokers, bankers and the like who exhibit offer documents and send to their customers and by whose mediation the customers are induced to subscribe for shares or other securities. He usually performs his service for a fee.

"Commission" means remuneration for services or work done as agent or factor, paid in the form of a percentage on the amount involved in the transactions; it is usually calculated *pro rata*.

The expression "brokerage as it has hitherto been lawful for a company to pay" points only to the payment of such brokerage as has been recognised as usual for companies to pay to brokers, *i.e.*, brokers who deal in shares and whose business includes the procuring of subscribers for shares. The payment of such brokerage by companies has been recognised as lawful for long time past and it is only such payment that is saved by sub-section (3). Paying any commission to other persons for procuring subscribers for shares cannot come within the expression "brokerage", as used in the sub-section, as it cannot be said to be "such brokerage as it has hitherto been lawful for a company to pay".

The law as to payment of brokerage by limited companies is as follows:—"If the company employs a broker to act as broker in the issue of its capital, the payment by the company to such broker of a proper commission or brokerage for placing shares is legitimate, and it is not necessary to look into the memorandum for authority to pay it". *Metropolitan Coal Consumers' Association v. Scrimgeour,* (1895) 2 QB 604 (CA). Sub-section (3) gives statutory sanction to the above decision. The brokerage must be payable to a broker for services as broker. Moneys really payable as commission cannot be obtained as brokerage unless the conditions of sub-section (1) are complied with. *Cf. Andreae v. Zinc Mines of Great Britain Ltd.,* (1918) 2 KB 454. Preparatory expenses and brokerage can be paid by the company even if there is no provision in the memorandum. *Licensed Victualler's Mutual Trading Assn., Re,* (1889) 42 Ch D 1 (CA).

The relation between a broker and his client are those of principal and agent, the broker playing as an agent for his client and therefore bound by all the fiduciary obligations of an agent. *Fazal D. Allana v. Mangaldas M. Pakwasa,* AIR 1918 Bom 303.

Liability for submitting false papers

A company and its share transfer agents were held liable to compensate the true owner of the shares whose shares were registered in the name of another person on the basis of duplicate share certificates. They could recover their indemnity amount from the share broker who had sent in false papers on the basis of which duplicates were issued. *Royal Bank of Scotland v. Sandstone Properties Ltd.*, (1998) 2 BCLC 429 (QBD).

SEBI (Stock Brokers and Sub-Brokers) Rules, 1992

For SEBI Rules relating to grant of certificates to brokers and sub-brokers and conditions for such grants see *Appendix* 222.

SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992

For SEBI Regulations relating to registration of brokers and sub-brokers, their obligations and responsibility, procedure for inspection and action in cases of default see *Appendix* 223.

Constitutionality of Regl. 28(5).—The Gujarat High Court has taken the view that Regulation 28(5) of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 deserve to be struck down as unconstitutional. It is violative of Arts. 19 and 21 of the Constitution inasmuch as it does not permit an enquiry officer or appellate authority to consider even a request of the charge-sheeted stock broker to permit him to defend himself through a lawyer in the enquiry, despite the hardship and prejudice to his civil rights that the enquiry may cause. *Mitesh Manubhai Sheth v. Secty., Govt. of India*, (1998) 91 Com Cases 910 : (1997) 26 Corpt LA 104 (Guj).

Member-broker to certify that a sub-broker is not guilty of malpractices.—It has been observed recently that cases of forged/fake/stolen shares which are introduced in the market are on the increase and most of them might have been introduced through the sub-brokers. You are, therefore, advised, that while forwarding applications for registration of sub-brokers a statement from the recommending member-broker should be furnished to the effect that the applicant sub-broker has not introduced any forged/fake/stolen shares in the market. Henceforth, all the applications for sub-broker registrations should be sent alongwith the recommending member-broker's statement as mentioned above. [*Circular No. SMD/Policy/Cir/ 31/97, dated 27th November, 1997, issued by SEBI*]

Additional information to be submitted at the time of registration of stock broker with SEBI.—SEBI has prescribed a format for the additional information required for the purpose of registrations alongwith the applications in Form A.

§ For the text of the format see *Appendix* 224(1).

Sub-broker Client Registration Form and Broker Client Agreement.—Mumbai Stock Exchange has devised a uniform format of the Client Registration Form and the Broker-Client Agreement devised by SEBI with Notice No. 1798/97, dt. 24-4-1997.

§ For the text of the format see *Appendix* 224(5).

SEBI Guidelines for dealing by Foreign Brokers on behalf of Registered FIIs

Guidelines, dated 15-10-1993.—SEBI has issued a set of Guidelines for dealing by Foreign Brokers in India on behalf of Registered Foreign Institutional Investors with a view to facilitating the operational procedures for foreign institutional investment in India and allowing them to provide assistance to the FIIs as they are familiar with their own brokers.

§ For the text of the Guidelines, see *Appendix* 224(7).

Market makers and SEBI Guidelines

SEBI Press Releases No. PR 231/99, dt. 4-10-1999 and No. PR 235/99, dt. 8-10-1999.—SEBI had constituted a Committee on March 24, 1998 under the charimanship of Shri G.P. Gupta, then Chairman, UTI and current Chairman and Managing Director of IDBI, with a view to study the concept of "Market Making" and to draft operational procedures for market making, eligibility criteria for market makers,

risk containment measures, etc. The Committee has submitted a final report containing the recommendations for the introduction of the Market Making in India. SEBI has approved the recommendations of the G.P. Gupta Committee Report on market making. The scheme would be voluntary. SEBI will issue formal guidelines to the exchanges. Summary of the recommenadtion is given in *Appendix* 224.

SEBI Regulation of transactions between member-brokers and their clients

Press release, dated 18-11-1993.—It shall be compulsory for all member-brokers to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the member-broker is taking a position as a principal will be allowed to be made from the client's accounts. The above principles and the circumstances under which transfer from client's account to member-broker's account would be allowed are enumerated in the said Regulations.

§ For the text of the Regulations see *Appendix* 224(4).

Precautions by member-brokers dealing with shares on behalf of clients

SEBI Letter No. SMD-I/23341, dated 18-11-1993.—It is expected that the member-brokers of stock exchanges know their clients through a proper introductory procedure and exercise due precaution while dealing with the clients. However, it is observed that in certain recent cases, such precautions in dealing with the clients have not been exercised by a few member-brokers resulting in serious problems for the market as well as investors. It is, therefore, considered necessary that these precautions may be listed so as to be uniformly followed by member-brokers of all the recognised Stock Exchange across the country. This will protect the interests of the member-brokers, instill transparency and discipline in the deal between clients and brokers and will contribute to the healthy working of the Secondary Capital Market. These precautions are classified into two categories as: (*a*) mandatory; and (*b*) precautions by way of a guideline.

SEBI is of the view that member-brokers of the exchanges should compulsorily follow the precautions suggested in Part (*a*) below which should form a part of their operating system, whereas those suggested in Part (*b*) may be treated as guidelines and followed as and when circumstances warrant.

§ For the text of the SEBI Guidelines on the subject, see *Appendix* 224(6).

SEBI Capital Adequacy Norms for Stock Brokers

Press Release, dated 21-10-1993.—SEBI has issued a set of Guidelines for Stock Brokers Capital Adequacy Norms, these guidelines shall be applicable to all the stock exchanges in the country. Accordingly all the stock exchanges have been asked to amend their bye-laws and regulations to incorporate these provisions and enforce the norms.

§ For the text of the norms see *Appendix* 224(8).

Complaints against Stock Brokers and Stock Exchanges

SEBI Press Release, dated 17-8-1994.—Securities and Exchange Board of India (SEBI) was attending to the complaints against registered brokers in any Stock Exchange and complaints against any Stock Exchange centrally from the Head Office at Bombay. With a view to provide improved access to the investors and enable close monitoring on the complaints, it is now decided to decentralize the work relating to the complaints against brokers and Stock Exchanges. The jurisdiction of different Regional Offices of SEBI are given in *Appendix* 235.

Mandatory use of unique client code for all brokers

SEBI has formulated the procedure for maintaining the unique client code for all brokers *vide* its Circular SMDRP/Policy/Cir-2001, dt. 18-7-2001.

§ For the text of the circular see *Appendix* 224(15).

SEBI (Portfolio Manager) Rules and Regulations, 1993

SEBI has formulated Rules and Regulations for registration and regulation of Portfolio Manager.

§ For the text of the upto-date amendment regulations, see *Appendix* 225 and *Appendix* 226.

Investor protection under Financial Services Act, 1986 (British)

Under the [English] Financial Services Act, 1986 a Securities and Investment Board has been constituted. Among other functions, the Board is authorised under the Act to claim monetary restitution for the benefit of those investors who have suffered losses as a result of an unauthorised business done with their money by an investment corporation. A worldwide mareva injunction was granted against the corporation restraining them from dealing with any of their assets. It was held that the Board is performing statutory functions and, therefore, the court would not in its discretion call upon the Board to give a cross undertaking in damages as a price for the injunction. *Securities and Investment Board v. Lloyd-Wright*, (1994) 1 BCLC 147 (Ch D).

For other cases on protection of investors under (British) Financial Services (Compensation of Investors) Rules, 1990 discussing the eligibility of investors for protection and liability of defaulting brokers see *R. v. Investors Compensation Scheme Ltd., Ex parte, Bowden*, (1994) 1 BCLC 494 (QBD); *R. v. Investors Compensation Scheme Ltd., ex parte, Weyell*, (1994) 1 BCLC 537 (QBD); *R v. Investors Compensation Scheme, Ex Parte, Taylor*, The Times, December 27, 1996 (U.K.); *Investors Compensation Scheme v. West Bramwich Building Society*, (1998) 1 493 (Ch. D), (CA) and (HL).

SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995

SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 prohibits (a) fraudulent dealings in securities; (b) market manipulation (of price or volume in trading of securities); (c) misleading statement or disseminate of information to induce sale or purchase of securities; and (d) unfair trade practices relating to securities.

If any person is found to be guilty of contravention of the Regulations (on the basis of the investigation report submitted in this regard), SEBI can:

(a) direct the person concerned not to deal in securities in any particular manner;

(b) require the person concerned to call upon any of its officers, other employees or representative to refrain from dealing in securities in any particular manner;

(c) prohibit the person concerned from disposing of any of the securities acquired in contravention of these regulations;

(d) direct the person concerned to dispose of any such securities acquired in contravention of these regulations, in such manner as it may deem fit, for restoring the *status quo ante.*

SEBI can also initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the SEBI Act.

§ For the text of the Regulations see *Appendix* 182.

For an example of investigation and proceedings against creation of false market under the above Regulations see *Press Release No.* 87/97, dated 31-7-1997 : 1997 Chartered Secretary (September) p. 1071.

These Regulations have been framed under s. 30 of the SEBI Act. They have a statutory force. They provide for an investigation in respect of the conduct and affairs of any person buying, selling or otherwise dealing in securities. "Persons connected with Securities Market" would include primary sellers or buyers. Summons can be issued to such persons for calling of information even if transaction has not been carried through a broker or agent. Securities market is not confined to stock exchanges only. Power is vested in SEBI to call for information and documents relevant for an inquiry even from persons against whom an inquiry cannot be or has not been constituted. *Karnavati Fincap Ltd. v. SEBI*, (1996) 87 Com Cases 186 (Guj).

§ See also Notes under section 291 under the heading "Insider Trading".

SEBI : Revised Carry Forward System

SEBI Circular SMB/SED/3703/95, dated 16-10-1995 has prescribed the prudential conditions and precautions to be excessed in carry forward transactions in stock exchanges.

§ For the text of the Circular, see Notes under section 9 of the Securities Contracts (Regulation) Act, 1956 in *Appendix* 246.

'Service Tax' on Brokers, *etc.*

A service tax has been levied w.e.f. July 1, 1994 on telephone, general insurance and stock brokerage. The services belonging to these categories which have been exempted from the levy have been specified in the Table. In the case of a stockbroker the value of taxable service would be the aggregate of the amount collected by him by way of commission or brokerage during the year including any payments made by him to his sub-broker; in the case of telephone it would be the amount received from the subscribers including the amount of deposit made along with an application for a telephone connection and in the case of general insurance it would be the total amount of money received from policy holders by way of premium.

§ For full text of the levy which is enacted through Chapter V of the Finance Act, 1994 see CHATURVEDI & PITHISARIA'S INCOME-TAX LAW, Series Vols. 1 to 13.

Payment of commission [Sub-section (4-A) Proviso]

The proviso has not expressed the idea behind it clearly. If a person has already subscribed for certain shares, there is no sense in any other person subscription for the same shares already subscribed for. What the proviso apparently means is that when a person *e.g.*, a broker undertakes to procure or subscribe for a given number of shares and is relieved from the undertaking by others coming forward to take up the shares commission may be paid to him, if the other conditions in the proviso are satisfied. The proviso would have been better expressed if instead of the words "subscribed or agreed to subscribe" the words "procured or agreed to procure or subscribe" had been used.

Jurisdiction for Investor Guidance, Grievances and Complaints

A complaint lies before SEBI. For the format of the complaint and addresses of the forum, See *Appendix* 234.

Penalty for default [Sub-section (5)].—Default under the section is punishable by fine. Under the previous Act, no penalty was provided. The fine may extend to Rs. 5000. It can be levied upon every officer of the company who is in default.

Compoundable offence.—The offence is compoundable under section 621A.

Balance-sheet to disclose

All sums paid by way of commission, brokerage, *etc.*, to the extent not written off or adjusted, must be shown in the Balance-sheet (*vide* Schedule VI, under heading "Miscellaneous expenditure").

Prescribed form of statement.—For form of statement to be filed under sub-section (1)(iii) see Form No. 4 in *Appendix* 1.

Secretarial Practice Notes : Power to pay commissions, *etc.*

Where a company paid commission to any person in consideration of his agreeing to subscribe or procuring subscription for shares in or debenture of the company, check whether:

(i) such payment was authorised by the articles?

(ii) commission to the underwriter is payable only on shares/debentures offered to public.

(iii) the commission agreed to be paid did not exceed the rate authorised by the Articles or 5 per cent of the price at which the shares issued (in case of debentures 2½ per cent) whichever is less?

(iv) commission must be paid out of proceeds of shares/debenture issue.

(v) the payment of commission and number of shares/debentures agreed to be subscribed were disclosed in the prospectus/statement in lieu of prospectus/circular, as the case may be?

(vi) a copy of the contract for payment of commission was delivered to the Registrar along with the prospectus/statement (Form 4)?

Documents Involved: 1. Articles, 2. Prospectus/statement in lieu of prospectus/circular, 3. Copy of the Contract, 4. Minutes of Board Meeting, 5. Form 4.

S. 77. Restrictions on purchase by company, or loans by company for purchase, of its own or its holding company's shares.—(1) No company limited by shares and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of capital is effected and sanctioned in pursuance of sections 100 to 104 or of section 402.

(2) No public company, and no private company which is a subsidiary of a public company, shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or in its holding company:

Provided that nothing in this sub-section shall be taken to prohibit—

(a) the lending of money by a banking company in the ordinary course of its business; or

(b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully paid-up shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company, including any director holding a salaried office or employment in the company; or

(c) the making by a company of loans, within the limit laid down in sub-section (3), to persons (other than directors, [1][* * * *] or managers) *bona fide* in the employment of the company with a view to enabling those persons to purchase or subscribe for fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

(3) No loan made to any person in pursuance of clause (c) of the foregoing proviso shall exceed in amount his salary or wages at that time for a period of six months.

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1. The words "managing agents and secretaries and treasurers" omitted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 33 (w.e.f. 13-12-2000).

(4) If a company acts in contravention of sub-sections (1) to (3), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [2][*ten thousand rupees*].

(5) Nothing in this section shall affect the right of a company to redeem any shares issued under section 80 or under any corresponding provision in any previous companies law.

NOTES

Eng. Act, 1948 : Sec. 54. Previous Act : Sec. 54-A.

Companies Act, 1956

Provision of funds for purchase of shares for benefit of employees.—Clauses (b) and (c) of the proviso to sub-section (2) and sub-section (3) give effect to the following recommendation of the Company Law Committee: "The only important recommendation that we make is that the prohibition imposed by section 54-A of the Indian Companies Act should not apply to the provision of funds by a company for the purchase of or subscription for fully paid-up shares by a trustee or trustees for the benefit of employees of the company or to grant of loan by the company to its employees for a similar purpose. We, however, suggest that such payment should be subject to the limit of three months' salary of the employees concerned. The object of our recommendation is to enable the purchase of its shares by a company on behalf of and for the benefit of its employees or by the employees themselves up to a limited extent. Section 54 of the English Companies Act, 1948, imposes no such limit on the purchase of a company's shares, but in the circumstances of this country we have considered it desirable to limit the purchases to three months' salary of the employees. We trust that this provision, if wisely and tactfully implemented will enable the employees to have a reasonable stake in the affairs of a company and promote the improvement of industrial relations". (*Report*: para 50).

The Joint Committee who considered the above recommendation have increased the maximum limit of loan from three months' salary or wages to six months' salary or wages, as in their view this would give greater encouragement to the employees to purchase shares in their company.

While the prohibition under sub-section (1) applies to all companies, including private companies, the restrictive provisions of sub-sections (2) and (3) do not apply to a private company which is not subsidiary of a public company and such a company may render such financial assistance or advance such loans to any person for purchasing shares in it, as it may think fit.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 1,000 rupees to 10,000 rupees under sub-section (4).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

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2. The words "one thousand rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 33 (w.e.f. 13-12-2000).

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Omission of terms 'managing agents, secretaries and treasurers".—The terms "managing agents, secretaries and treasurers" have been omitted by the Amendment, Act, 2000. The amendment is of consequential nature.

Object of section

The reason for the restriction on purchase of its own shares by a company is that such purchase either amounts to "trafficking" in its own shares thereby enabling the company, in an unhealthy manner, to influence the price of its own shares on the market or it operates as a reduction of capital which can only be effected with the sanction of the court, and in the manner laid down by sections 100 to 102. *Cf. British and American Trustee and Finance Corporation v. Couper,* 1894 AC 399; *Trevor v. Whitworth,* (1887) 12 App Cas 409, has been the leading authority on the subject. This case settled a controversy. The issue is not a domestic matter concerned with compliance with the articles, or even a question of *vires* dependent upon the powers set out in the memorandum, but a matter of legality under the Companies Act itself. The reasoning of the House of Lords in *Trevor v. Whitworth* appears from the following passage in the speech of LORD WATSON (1887) 12 App Cas 409 at 423-442 (HL):

"One of the main objects contemplated by the legislature, in restricting the power of limited companies to reduce the amount of their capital as set forth in the memorandum, is to protect the interests of the outside public who may become their creditors. In my opinion the effect of these statutory restrictions is to prohibit every transaction between a company and a shareholder, by means of which the money already paid to the company in respect of his shares is returned to him, unless the court has sanctioned the transaction. Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business." "When a share is forfeited or surrendered, the amount which has been paid upon it remains with the company, the shareholder being relieved of liability for future calls, whilst the share itself reverts to the company, bears no dividend, and may be re-issued. When shares are purchased at par, and transferred to the company, the result is very different. The amount paid-up on the shares is returned to the shareholder; and in the event of the company continuing to hold the shares (as in the present case) is permanently withdrawn from its trading capital. It appears to me that... it is inconsistent with the essential nature of a company that it should become a member of itself. It cannot be registered as a shareholder to the effect of becoming debtor to itself for calls, or of being placed on the list of contributories in its own liquidation..."

"A transaction which upon examination can be seen to involve a return of capital, in whatever form, under whatever label, and whether directly or indirectly, to a member, is void." HARMAN J in *Barclays Bank plc v. British & Commonwealth plc.,* (1996) 1 BCLC 1 at 7, 18. The majority of influential cases on this issue have been from Australia and New Zealand; for example, FARRAR, "*THE RESPONSIBILITY OF DIRECTORS AND SHAREHOLDERS FOR A COMPANY'S DEBTS*" (1989) 4 Cant. I.R. 12. Furey, "*The Protection of Creditors' Interests in Company Law*" in FELDMAN & MEISEL (eds), *CORPORATE AND COMMERCIAL LAW : MODERN DEVELOPMENTS* (1996); GRANTHAM, "*THE JUDICIAL EXTENSION OF DIRECTORS DUTIES TO CREDITORS*" (1991) B.L. 1.

In *Canji v. Colaba Press Company Ltd.,* (1913) 14 Bom LR 521, it was held that a power to buy-back its own shares whether contained in the company's memorandum or articles was *ultra vires.*

Any valuable consideration paid out of the company's assets will make a transaction a nount to a purchase and, therefore, invalid. A company cannot purchase its own shares sold in execution of a decree obtained by it against the shareholder: *Chotanagpur Banking Association Ltd. v. Rajb Nath Mukherji,* (1947) 17 Com Cases 17 (Pat).

The restriction as regards financing the acquisition of a company's own shares is to prevent improper use of its assets by speculators in management of a company who, by such acquisition, may seek to obtain control of the company for their own advantage.

Scope of section

The prohibition contained in this section is subject to the provisions of sections 77A, 77AA and 77B which permit companies to buy back their own securities on terms and conditions specified therein.

While sub-section (1) applies to all companies, sub-section (2) only prohibits public companies and private companies which are their subsidiaries giving financial assistance to persons purchasing their shares. Other private companies do not come under the prohibition in sub-section (2).

Another point to be noted is that the section does not apply to the case of any holding company purchasing the shares of or lending moneys to any person for purchasing shares of its subsidiary. Similarly the provisions of sub-section (1) may not be applicable to a case where a partnership firm acquires shares of the company otherwise than by way of purchasing even though such company itself is a partner in such a firm.

The section would not include the lending of money in accordance with the company's memorandum and articles to a shareholder on the security of company's shares. It would only be a charge on the shares for enforcing the shareholder's liability to the company. It creates only a lien on the shares. See, *Batu Pahat Bank v. Official Assignee,* (1933) AC 691 where however the lien was created by an alteration of the articles after the loan was made.

Redemption of preference shares constitutes an exception to the restriction contained in this section though redemption is the same thing as a company buying its own shares. *Anarkali Sarabhai v. CIT,* (1997) 89 Com Cases 29 (SC). **Affirming,** *Sub-nom, Anarkali Sarabhai v. CIT Gujarat,* (1997) 1 Comp LJ 369 (Guj); **Approving** *Sath Gwaldas Mathurdas Mohata Trust v. CIT,* (1997) 1 Comp LJ 359 (Bom).

The following are the exceptions to the general principle that a company cannot buy its own shares:

(1) Sections 77A, 77AA and 77B inserted by the Amendment Act, 1999 allow companies to purchase their own shares by following the prescribed procedure and subject to the conditions specified therein;
(2) Purchase resulting in reduction of capital with the sanction of the court under sections 100-104;
(3) Redemption of redeemable preference shares under section 80(3);
(4) Purchase under an order of court in a scheme of arrangement or amalgamation under sections 391-394;
(5) Purchase under an order of Company Law Board to purchase shares of minority shareholders under section 402(b);
(6) Forfeiture of shares by following the prescribed procedure under Articles;
(7) Surrender or gift of shares to the company.

Financial assistance, loans *etc.* [Sub-section (2)]

A contract entered into by a public company or a private company which is the subsidiary of a public company contrary to the provisions of this section is unlawful and on proof of knowledge on the part of the directors of such facts constituting illegality they and all other parties to the agreement are liable to the company in conspiracy. In BUCKLEY ON THE COMPANIES ACT, 14th Edition, it is observed (at page 156):

"What is made unlawful by the section appears to involve three elements:

(i) It must be something which can in the ordinary sense of the word be said to constitute the giving of help;

(ii) The help must be of a financial nature, which presumably involves money in one way or another (note the words "directly or indirectly"); and

(iii) What is done must have been done either "for the purpose of" or "in connection with" the past or contemplated (note the words 'made or to be made') purchase or subscription and this must surely require an investigation of what was in the mind of those (normally the directors) who procured the company to do the act. Although perhaps in other context "in connection with" is an expression of wider meaning than "for the purpose of", it is not easy to see in this context how an act such as the section seems to contemplate could be done "in connection with" the purchase or subscription unless it was done "for the purpose of" it. This view receives some assistance from a recent decision of the Court of Appeal in *Belmont Finance Corporation Ltd. v. Williams Furniture Ltd. (No. 2)*, (1980) 1 All ER 393 (CA) **reversing** (1979) 1 All ER 118 where the question what was the object of the transaction was the principal one considered in relation to this section. Perhaps the true view is that "for the purpose of" relates to a contemplated purchase or subscription and "in connection with" to a past one."

In *V.G.M. Holding Ltd.*, (1942) Ch 235 : (1942) 12 Com Cases 254; LORD GREENE M.R. observed that when a company makes a gift of its money, or grants a loan, or sells property to a person at a fraudulent consideration there is "financial assistance". In *Belmont Finance Corporation v. Williams Furniture Ltd. (No. 2), (Supra)*, it was held that where a company buys something that it genuinely needs with no other purpose in view and thereafter the vendor uses the sale proceeds to buy shares in the company, it would not amount to financial assistance but where the company, without regard to its commercial interests, buys something with the sole intention of putting the vendor into funds in order to buy shares in the company, this would be financial assistance. BUCKLEY LJ stated the possibilities by way of examples [(1980) 1 All ER 393 at p 402]: "If A Ltd. buys from B a chattel or a commodity, like a ship or merchandise, which A Ltd. genuinely wants to acquire for its own purposes, and does so having no other purpose in view, the fact that B thereafter employs the proceeds of the sale in buying shares in A Ltd. should not, I would suppose, be held to offend against the section; but the position may be different if A Ltd. makes the purchase in order to put B in funds to buy shares in A Ltd. If A Ltd. buys something from B without regard to its own commercial interests, the sole purpose of the transaction being to put B in funds to acquire shares in A Ltd., this would, in my opinion, clearly contravene the section, even if the price paid was a fair price for what is bought, and *a fortiori* that would be so if the sale to A Ltd. was at an inflated price. The sole purpose would be to enable (*i.e.* to assist) B to pay for the shares. If A Ltd. buys something from B at a fair price, which A Ltd. could readily realise on a resale if it wished to do so, but the purpose or one of the purposes, of the transaction is to put B in funds to acquire shares of A Ltd., the fact that the price was fair might not, I think, prevent the transaction from contravening the section, if it would otherwise do so, though A Ltd. could very probably recover no damages in civil proceedings, for it would have suffered no damage. If the transaction is of a kind which A Ltd. could in its own commercial interests legitimately enter into, and the transaction is genuinely entered into by A Ltd. in its own commercial interests and not merely as a means of assisting B financially to buy shares of A Ltd., the circumstance that A Ltd. enters into the transaction with P, partly with the object of putting B in funds to acquire its own shares or with the knowledge of B's intended use of the proceeds of sale, might, I think, involve no contravention of the section, but I do not wish to express a concluded opinion on that point."

Where a subsidiary company paid the debt of its holding company to a creditor, who thereafter sold his shares in the holding company to the directors of both the companies, it was held that the company had provided financial assistance. The court further held

that financial assistance is not confined to assistance given to a purchaser but also includes any one to whom assistance is given either for the purpose of or in connection with purchase of shares. *Armour Hick Northern Ltd. v. Armour Trust Ltd.*, (1980) 3 All ER 833 (Ch D).

A company in grave financial difficulties agreed to surrender its tax losses in favour of other companies (this is permissible under English taxing laws) by a complicated transaction which among other things involved an issue of rights shares for £ 7,80,000/- in favour of its holding company. The agreement also provided that all the shares of the issuing company would subsequently be sold to a Mr. Allam for the nominal sum of £ 1. It was held that the agreement to surrender the tax losses was part of a composite transaction and did not amount to giving any "financial assistance" to Mr. Allam in contravention of this section. *Charterhouse Investment Trust Ltd. v. Tempest Diesel Ltd.*, (1986) BCLC 1 (Ch D). HOFFMAN J added (at p. 10) that the term "financial assistance" should be given its normal commercial meaning. Thus, the section requires that there should be assistance or help for the purpose of acquiring the shares and that the assistance should be financial.

Where the managing director of family companies agreed to transfer his shares in one of the companies to his sons in return for the companies paying him a salary, a bonus and a pension on his retirement, the question arose whether this amounted to financial assistance by those companies for the purchase of their own shares. It was held that since at the date at which the agreement was made there was no necessity on the part of the companies to contribute to the cost of the plaintiff's salary, bonus and pension, the agreement did not have the effect of committing breach of provisions against such assistance. The company in question could have borne the cost of their managing director's salary *etc.* in the discharge of their contractual and statutory duties to him. Thus, there was to be no reduction in the net assets of the company and no financial assistance in violation of the provisions. The agreement was held to be valid and enforceable. *Parlett v. Guppys (Bridport) Ltd.*, (1996) 2 BCLC 34 (CA).

Substantive and Procedural requirements under the English Act.—Under the English Act, 1985, the five-point requirement for purchasing own shares by a company has been listed as follows in *R.W. Peak (Kings Lynn) Ltd. Re,* (1998) 1 BCLC 193 (Ch D):

(1) The company must be authorised to purchase its own shares by its articles (s. 162). [Eng. Act, 1985]

(2) Where, as here, the purchase is 'off-market' within the meaning of s. 163(1), then the purchase has to be pursuant to a contract which itself has to be approved in advance of the purchase (s. 164(1)). [Eng. Act, 1985]

(3) That contract has to be approved by a special resolution of the company before the contract is entered into (s. 164(2)). [Eng. Act, 1985]

(4) That special resolution has to be such that it is either passed without the holder of the shares to be bought voting them or the case being that, even if he had done so, the resolution would still have been passed as a special resolution (s. 164(5)). [Eng. Act, 1985]

(5) Such a resolution is not effective to authorise the proposed contract unless a copy of the contract, if it is in writing, shall have been available for inspection by members of the company at its registered office for at least the preceding 15 days before and at the meeting at which the resolution is passed (s. 164(6)). [Eng. Act, 1985]

The company here was a father-son company. A written agreement was made under which the son was to sell his shares to the company at a stated price. The father signed the agreement on behalf of the company which the son witnessed. The son signed on his own behalf which the father witnessed. The son's name was removed from the register of members. The company transferred an amount equal to the purchase price to the capital

redemption reserve account. The company's business flourished over the years. Some five years later the father was lost in a road crash. The son, having remained silent all these years, applied for rectification of the register of members and to have his name put back. The court was of the view that it was not possible to regard the provisions of sections 162 and 164 as merely procedural and for the benefit of only the current members. Even if there was a deliberate waiver by both members of the right to insist upon due performance of the statutory requirements, the non-compliance being a statutory violation, the transaction remained bad in law and could not be rendered good either by waiver, acquiescence, or ratification. At the time of the transaction neither there was authority in the company's articles for the transaction, nor there was a special resolution to that effect. The transaction had to be authorised in advance by a special resolution which it was impossible then because the son, being the seller, was interested in the transaction, his votes would not be counted and a resolution which could not have been passed in the beginning cannot be rectified by a subsequent ratification. The application for rectification of the register of members was allowed.

Prescribed Form of declaration under English Law

Under ss. 155 and 156 of [English] Companies Act, 1985 the directors have to make a statutory declaration of financial assistance in acquisition of shares in a prescribed form. It has been held that the statutory obligation is to make a declaration *in the prescribed form* and *not on a prescribed form*. Since the declaration in this case carried all the required particulars, the fact that a particular form was not used did not entail the consequence that there had been non-compliance with statutory obligation to deliver the prescribed particulars. It was further held that the failure to deliver the particulars within the time required by the law did not have the effect of making the financial assistance as improperly provided. The only consequence was a breach by the company to comply with its statutory duty. *N.L. Electrical Ltd., Re,* (1994) 1 BCLC 22 (Ch D).

Financing by foreign subsidiary

Section 77(2) and s. 151 of the [English] Act of 1985 prohibit the financing by subsidiary company of purchase of shares in its holding company. It has been held that the phrase "any of its subsidiaries" in s. 151 must be construed as limited to subsidiaries which are companies registered under the English Act and accordingly a foreign subsidiary is not prohibited from giving financial assistance in connection with the acquisition of shares in its English parent. *Arab Bank plc. v. Mercantile Holdings Ltd.,* (1994) 1 BCLC 330 (Ch D). The court added that the mere giving of financial assistance by the subsidiary does not *ipso facto* constitute it as an assistance given by the parent company.

Lending of money by Banking Company [Proviso (a) to sub-section (2)]

Note that only the lending of money by a banking company in the ordinary course of its business is exempted.

Guidelines for Bank Finance to Assist Employees to buy shares of their own Companies.—DBOD No. Dir. BC. /13.07.05/2003-04, Dated 6-2-2004.—As per the extant instructions issued vide circular DBOD.No.Dir.BC.1/ 13.07.05/95 dated January 6, 1995, bank finance to assist employees to buy shares of their own company under the employees' quota is restricted to Rs.50,000/- or six months' salary of the employee, whichever is less. The assistance is also limited to 90 per cent of the purchase price of the shares.

2. The above instructions have been recently reviewed by Reserve Bank of India, in the context of (a) more and more companies offering their employees stock options in conformity with SEBI guidelines as an incentive package as well as through specific reservation to the employees during IPOs; and (b) increased awareness among banks of risks involved in such financing as well as introduction of robust system of assessing risks in many banks. It has now been decided that while extending bank finance to employees for purchasing shares of their own company either under ESOP or IPO of the company concerned, banks may take their own decision in the matter subject to extant regulations including margin on IPO financing.

3. All such loans should be treated as banks' exposure to capital market within the overall ceiling of 5 per cent of banks' total outstanding advances as on March 31 of the previous year (vide paragraphs 2 and 3 of our circular DBOD. No. BP.BC.119/21.04.137/2000-2001 dated May 11, 2001).

4. The above instructions will not be applicable for extending financial assistance by banks to their own employees for acquisition of shares under ESOP/ IPO.

Loans deliberately made by a banking company for the direct purpose of financing the purchase of its own shares cannot come within the exception. *Louis Steen v. Charles Allen Law,* (1963) 3 All ER 770 : (1964) 34 Com Cases 195 (PC) **followed** in *Fordlie v. Slater,* (1979) 129 New LJ 465. Directors entering into a transaction which directly or indirectly infringes the provisions of this section are guilty of misfeasance and liable therefor. *Curtis's Furnishing Stores Ltd. v. Freedman,* (1966) 2 All ER 955 : (1967) 1 Comp LJ 62.

A mere provision in the objects clause of the memorandum enabling the company to do the business of lending money is not sufficient. It must be shown that lending money was part of the business of the company and that the loan given to enable purchase of the company's shares was given in the ordinary course of business. *Life Insurance Corporation of India v. Devendrappa Bujjappa Kadabi,* AIR 1987 Kant 129 (DB). This case was decided under S. 54A of the 1913 Act under which this proviso operated in favour of all companies, which were carrying on the business of lending money in the ordinary course of business.

In the case of a banking company also, section 20 of the Banking Regulations Act provides that "notwithstanding anything to the contrary in section 77 of the Companies Act, 1956 no banking company shall make any loans or advances on the security of its own shares or grant unsecured loans or advances to its directors".

It may be noted that the section does not prohibit financial assistance by any company (public or private) for the purchase of or subscription for shares in any of its subsidiary companies, except to the extent restricted by sections 295 and 370.

Provision of money for benefit of employees [Sub-section (2) Proviso (b)]

Holding shares under a trust and employees' stock option schemes.—The provision of money for the acquisition of fully paid-up shares in the company or its holding company in accordance with an employees' stock option scheme is valid. Directors will be included in the definition of employees if they are also employees because the proviso says that it would include any director holding a salaried office for employment under the company. Director should not however use this facility to fight a take over bid in circumstances in which it would amount to committing a breach of their fiduciary duties. The scheme can operate for the purchase of, or subscription for, fully paid-up shares in the company or its holding company. It should be a purchase or subscription by trustees of or for shares to be held by the employees of the company or for their benefit. Thus the proviso envisages the creation of a trust fund for the purpose. In England, on the other hand, as new facet of this exemption is that the finance need no longer take the form of a loan to trustees administering the scheme.

Loans to employees [Sub-section (2) Proviso (c)]

This proviso enables a company to provide loans to its employees with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by themselves and only by way of beneficial ownership. The employees must be persons other than directors or managers. They must be *bona fide* in the employment of the company. It means that they must have become employees in good faith. The intention is to ensure that the employment is genuine. It has been held on the equivalent section in New South Wales that this sub-section only applies if the sole or major purpose was to allow the employees to purchase shares. If the major purpose was to facilitate the change of control of a company then the exception cannot apply. *Saltergate Insurance Co. Ltd. v. Knight,* (1982) 1 NSWLR 369 (Aust). It is further necessary that no loan made to any person in pursuance of this exception shall exceed in amount his salary or wages at that time for a period of six months.

Financial assistance in contravention of sub-section (2)

It was held in *Victor Battery Co. Ltd. v. Curry's Ltd.,* (1946) 1 All ER 519 : (1946) 16 Com Cases 164, that, if a company provided financial assistance by way of giving security by issue of debentures for raising a loan for the purpose of purchasing its own shares, the transaction is not illegal and the security not invalid or unenforceable. This case was followed in *South Western Mineral Water Co. Ltd. v. Ashmore,* (1967) 2 All ER 953

where it was held that though section 54 of the (English) Companies Act was infringed, an agreement was held not altogether null and void. The correctness of this view has, however, been doubted in PALMER'S COMPANY LAW (24th Edn., 1987 page 601, para 39-12), on the ground that it is directly opposed to the provisions of the section and will have the effect of nullifying it to a great extent. Also the decision in *Selangor United Rubber Estates Ltd. v. Cradock (No. 3),* (1968) 2 All ER 1073 : (1969) 39 Com Cases 485 (Ch D); where there is an elaborate discussion and review of all the authorities on the subject would seem to doubt the correctness of the view expressed in *Victor Battery's Co. Ltd.'s case*. In another later case also (*Heald v. O'connor,* (1971) 2 All ER 1105 (QB) : (1971) 41 Com Cases 785) that view has not been accepted. In such a state of judicial disagreement, it is only prudent to follow the plain meaning of the provisions of sub-section (2) which points to the operation of the rule that a transaction vitiated by illegality is not enforceable, having regard to the maxim *in pari delicto est conditio defendentis*. It is not lawful for the company or any of its subsidiaries to give financial assistance in breach of this section. But an illegality of this nature is really severable in contract containing other valid provisions so as to enable the court to enforce the rest of the contract. *Carney v. Herbert,* (1985) 1 All ER 438 : (1985) BCLC 140 (PC).

But, as pointed out in the *Selangor United Rubber Estates' (Supra)* case, where a company by reason of illegality cannot recover the loan advanced by it or enforce the security provided by it for raising loan for providing financial assistance prohibited by the section, there is no reason why it cannot proceed against its own directors who in their fiduciary capacity as a constructive trustees of the company's assets in their hands are guilty of breach of trust in advancing the company's monies or creating the company's liability by providing security for raising loan providing for financial assistance contrary to the section. The directors are bound in law to make good any loss incurred by the company brought about by reason of their own breach of trust, in making the company a party to an illegal transaction prohibited by the section.

In *Unity Company (P.) Ltd. v. Diamond Sugar Mills,* AIR 1971 Cal 18. A.K. SEN, J. of the Calcutta High Court, **following** the view expressed in *Victor Battery Co. Ltd's* case has, however, expressed the opinion that the giving of financial assistance by the company does not render the sale of shares for valuable consideration void but will only entail a punishment for the company and its officers as provided in sub-section (4). As there is, however, no reference by him to the later decisions in *Selangor United Rubber Estates Ltd. v. Cradock* or *Heald v. O'connor*, which contain a very elaborate discussion and cogent reasoning on the subject, the observations of A.K. SEN J., would seem to require further consideration.

A director was held liable under a guarantee given by him that the company would perform its part of the transaction which was by virtue of this section not enforceable against the company. *Gaurard v. James,* (1925) Ch 616. A provision in the articles that the company would find a purchaser for shares was held not to offend the section. *Harlon (Pty.) Ltd., Re,* (1950) VLR 449 (Aust). Such a provision is very common in the Articles of a private company.

Financial assistance is not confined to assistance given to a purchaser but also includes any one to whom assistance is given either for the purpose of or in connection with purchase of shares. *Armour Hick Northern Ltd. v. Armour Trust Ltd.,* (1980) 3 All ER 833 (Ch D).

If a company purchases its own shares, and the purchase is *ultra vires* of the company, the effect of it is that the vendor in point of law does not cease to be the legal owner of the shares and cannot be removed from the register. *Sabaratnam Chettiar v. Official Liquidators. T.N. & Q. Bank Ltd.,* (1943) 13 Com Cases 61 : AIR 1943 Mad 111 and he is also liable to be restored to the register. *Bellarby v. Rowland,* (1902) 2 Ch 14 (CA); *General Property Investment Co. v. Matheson's Trustees,* (1888) 16 R 282.

"The financial assistance regime does not prohibit the provision of financial assistance by a parent company. This is a classic avoidance mechanism. Likewise, financial assistance by collateral subsidiary or "sister" companies is not prohibited." See David Cabrelli, *In Dire Need of Assistance? Sections 151-158 of the Companies Act 1985 Revisited*, 2002 JBL 272 at p. 273.

Transfer of shares to nominees

Although a company cannot purchase or hold its own shares, a bequest of his shares by a shareholder to the company is not illegal. The company may have the shares transferred to a nominee in trust for itself, the nominee being a person qualified to hold shares under the company's Articles of Association, *Re, Castiglione's Will Trusts, Re, Hunter v. Mackenzie,* (1958) 1 All ER 480 : (1958) 28 Com Cases 365. This method is often resorted to in amalgamation practices. Shares held by the amalgamated company in the amalgamating company are transferred to a nominee who will hold them for the benefit of all the shareholders of the transferee company. Such a scheme was approved by the Andhra High Court in *Sri Ganesh Anand Petro Chemicals Ltd., Re,* [Company petition No. 47 and 48 of 1994 (CP No. 47/94) **(unreported)** (AP)]; *Nagarjuna Fertilizers and Chemicals Ltd., Re,* [Co. Petition No. 47 and 48 of 1994 (CP No. 47/94) **(unreported)** (AP).]

However, a company cannot accept gift or bequest of partly paid shares in veiw of the fact that the company would have to pay for the unpaid calls and so it may tantamount to purchase of shares.

It may be noted that what sub-section (1) prohibits is the buying of its own shares by a company. It does not prohibit the receiving by way of gift, or surrender, if any, of such shares. But while the holding of its own shares by a company, in whatever manner acquired, will have the effect of a reduction of capital, the holding of them by a nominee or trustee will not have that effect, though the nominee or trustee will be obliged to vote as the company may, from time to time, direct. *Cf.* HALSBURY'S LAWS OF ENGLAND, 4th Edition, Vol. 7, para 419, and *Kirby v. Wilkins,* (1929) 2 Ch 444, *Trevor v. Whitworth,* (1887) 12 Appeal Cases 409 (HL). It is not *ultra vires* for a company to receive a transfer of its shares to itself in compromise of an action. At least, the company is estopped from setting up a plea of *ultra vires* after taking the benefit of the compromise. *E. J. Jane Ltd., Ex P., Milligan, Re,* (1924) 1 DLR 269 (Canada).

Their Lordships of the Privy Council have pointed out that the word "nominee" should not be given the narrow meaning of a "trustee" for the company, but should be given its ordinary meaning of any person nominated by the company. It is clearly wide enough to include a transferee of shares who was paying for them from his own resources. *Motor & General Insurance Co. Ltd. v. Gobin,* (1987) LRC (Comm) 824 (PC).

The provision in the English Companies Act, 1985 is in s. 143. An attempt was made to take advantage of this provision in *Vision Express (U.K.) Ltd. v. Wilson,* (1995) 2 BCLC 419 (Ch D). The company brought an action against one of its former employees alleging fraud. This action was stayed by an order which provided that the company would purchase the employee's rights in his shares in the company including any optional rights in respect of those shares. The company accordingly applied for an order that the employee should transfer his present holdings and his right to future holdings to the company. No such order was granted. The earlier order was in violation of s. 143 and, therefore, void and could not be implemented.

It has been held that a company is not precluded by s. 143 of the English Act 1985 or under the rule in *Trevor v. Whitworth,* (1887) 12 App Cas 409 from acquiring the shares of another company in circumstances where the sole asset of the acquired company is shares in the acquiring company. *Acatos & Hutcheson plc. v. Watson,* (1995) 1 BCLC 218. The court cited the following passage from an Australian decision:

> "The company, in addition to being a trading company, is also an investment company, and there is no reason in law why it should not exercise its power of investing in the shares of another company whatever ultimate effects may follow in dealing with the shares acquired, it cannot be said that the action now proposed is a purchase by the company of its own shares, either directly or indirectly". *Dyason v. J.C. Hutton Pty. Ltd.,* (1935) Argus LR 419 (Aust).

The court upheld in this case the validity of a purchase by a wholly owned subsidiary of shares in its holding company. In *August Investments Pty. Ltd. v. Poseidon Ltd. and Samin Ltd.,* (1971) 2 SASR 71 (Australia) the Supreme Court refused an injunction to

restrain the company from proceeding with a take-over offer to acquire the shares in Samin (another company) in exchange for shares of its own, the complaint being that Samin was holding 200,000 shares in the acquiring company. The court held that the rule prohibiting purchase of own shares did not apply because the company was acquiring shares in another company and not its own shares and because in any event, even if treated as acquiring its own shares, it was not thereby reducing its capital, but was acquiring them for new shares from its unissued capital, in effect exchanging assets for assets. The court refused the invitation to pierce the corporate veil and look at the commercial realities. The court accepted that there are occasions when the courts have lifted the corporate veil to look at the commercial reality underneath *e.g.* in order to prevent the evasion of fiscal, social and administrative legislation (citing *Littlewoods Mail Order Stores Ltd. v. McGregor,* (1969) 3 All ER 855 [not relevant in the present context]. The court found support in the decision in *Dyason v. J.C. Hutton, (Supra).*

Buy-back of shares

Certain shares were transferred to the promoters of a company under a buy-back scheme. An application was filed to restrain them from exercising their rights in respect of the shares. The Company Law Board did not grant an injunction. No *prima facie* case was made out. Hence there was no balance of convenience in favour of the applicants. No loss of irreparable nature was likely to be caused to them. They were the directors of the company. They never objected to the buy-back scheme at the time of its formulation and implementation. If there was violation of articles and they were deprived of any rights they could come before the Company Law Board under sections 397 and 398. *J.K. Puri v. H.P. State Industrial Development Corpn.,* (1998) 93 Com Cas 491 : (1998) 31 CLA 368 (HP).

Where certain shares of the borrowing company were transferred to the financial institution for providing loans and the agreement provided that the borrowing company would take back the shares in a phased manner, it was held that there was nothing illegal on the part of the financial institution in deducting the amount for the shares which were to be returned from the amount of loan to be provided to the company. The arrangement no doubt amounted to the purchase of its own shares by the borrower company making the company and its directors punishable under s. 77. But there was no such illegality on the part of the financial co-operation and therefore it was entitled to its reimbursement in respect of the shares which were returned to the borrowing company. *Greenfield Corporation Ltd. v. UPFC,* 2002 CLC 1494 (All—DB).

§ See Notes under section 77A *post.*

Taking shares under pledge.—A company may accept a deposit of its own shares by way of pledge as collateral security for indebtedness of the shareholder to it on the terms of an agreement under which the company is not allowed to enforce the obligation by selling or otherwise dealing with the shares or suing on the obligation. Such a transaction does not involve any trafficking by the company in its own shares or any question of unauthorized reduction of capital. *British American Timber Co. v. Ray W. Jones,* (1944) 2 DLR 481 (BCCA)(Canada).

Buy back of debentures

The prohibition does not apply to buy back of debentures because section 121(3) gives authority to the company to purchase its own debentures and to keep them alive may do so in the name of a nominee of the company. In the exercise of this power a company may not be able to buy its debentures which are convertible into shares because that would amount to a colourable device.

Scheme of arrangement, amalgamation and other forms of assistance

A company can buy its own shares where it is a necessary part of a scheme of amalgamation as sanctioned by the court. *Himachal Telematics Ltd. v. Himachal Futuristic Communications Ltd.,* (1996) 86 Com Cases 325 (Del).

A major institutional shareholder of the company desired to liquidate its holding. The company wanted to avoid the situation of its large number of shares being placed in the

market. A scheme was prepared with the approval of the court because it also involved reduction of capital. The holding was converted into redeemable shares to be redeemed in four branches. In order to cover up the situation arising out of any possible failure on the part of the company to carry out the redemption, an option (option agreement) was given to the shareholder to transfer the holding to a company formed for that very purpose and financed by a number of banks. The company covenanted with the banks to maintain certain asset rates. After redeeming two tranches of the shares the company went into administration and the shareholder exercised its right to ask the newly created company to buy the remaining shares. The banks which had financed the new company sued the company for its failure to maintain the requisite asset rates and misrepresentations in that connection. The Court of Appeal held the agreement to be valid and enforceable. The company was liable under the agreement for its failure to redeem and not for failure to buy back the shares. The scheme had also been approved by the court in advance. *Barclays Bank plc. v. British & Commonwealth Holdings plc.,* (1996) 1 BCLC 1 (Ch D and CA). The court referred to the decision in *Industrial Equity Ltd. v. Tocpar Pty. Ltd.,* (1972) 2 NSWLR 505 (Aust.) where distinction was made between financial assistance and inducement. A similar view was expressed by the Supreme Court of New South Wales in *Burton v. Palmer,* (1980) 2 NSWLR 878 (Aust.) where [at pp. 889-890] the court observed: "The fact that a company undertakes obligations, absolute or contingent, in connection with the proposal for the transfer of its shares does not of itself constitute the giving of financial assistance. The fact that a company facilitates a proposal for such a transfer will not involve it necessarily in (statutory) contravention. Thus a company may answer requests for information relevant to the proposed transfer knowing that it does so in circumstances such that it will be liable in damages if, for lack of care, the information is incorrect: *Cf. Mutual Life and Citizens' Assurance Co. Ltd. v. Evatt,* (1971) 1 All ER 150. But, by answering such requests, the company does not thereby give financial assistance.

There must be [something more than an obligation for payment of money. The obligation must be such that it is properly to be characterised as "financial assistance". The words "financial assistance" are words of a commercial rather than a conveyancing kind and the form of the obligation or transaction will not be conclusive. Thus a loan ostensibly given by a third party may in the context of "a round robin" of cheques, be seen as financial assistance in connection with the sale of the shares: see *Wallersteiner v. Moir,* (1974) 3 All ER 217. And a loan given by the company after the sale has been completed may be such that the Act might be contravened: *Cf. Glennon v. Comr. of Taxation,* (1972) 127 CLR 503 at 510 (Aust). Similarly, a warranty given with the intention that the company will be called upon to pay damages and to provide funds in connection with the transfer of its shares will contravene the section.

In the case of the sale of a loss-making subsidiary, debts were owed by other subsidiaries to the purchaser of the company. They were set-off against the purchase price. The question was whether the set off arrangement amounted to the provision of financial assistance for the purpose of acquisition of the company. The court did not agree that s. 151 of the 1985 [English] Act was violated. The reality of the loan assignment and rescheduling agreement in this case was that there was no net effect on the target company's assets position or its potential liabilities. The company, therefore, did not give any financial assistance for acquiring its own shares. *M.T. Realisations Ltd. v. Digital Equipment Co. Ltd.,* (2002) 2 BCLC 688 : (2002) EWHC 1628 (Ch. D).

Payment of professional fee as financial assistance.—The court of Appeal in *Chaston v. SWP Group plc.,* (2003) 1 BCLC 675 (CA) : 2003 BCC 140 noted that the mischief to which the provision was directed was the use, directly or indirectly, of the resources of the target company and its subsidiaries to assist the purchaser financially to make the acquisition. What matters is the commercial substance of the transaction. The acquiring company in this case was a listed company. For this reason, it had to inform the members of the target company before their consent could be taken. It had also to satisfy itself as to

the financial position of the target company. It, therefore, decided to carry out a due diligence exercise. For this purpose a well known firm of accountants was engaged from the side of the subsidiary of the target company to prepare certain information in order to facilitate the due diligence exercise. The accountants' invoices for their services were paid by the subsidiary. This payment was for the help of the acquiring company. Its payment by the subsidiary of the target company amounted to financial assistance to the acquring company. It was irrelevant that there had been no detriment to the company being acquired or that the financial assistance was given in advance of and not in the course of the takeover or that the payment of the fees had no impact on the shares price. Furthermore, the financial assistance had been given 'for the purpose of' the acquisition, as the objective of the payment was to further the acquisition which was sufficient to satisfy the statutory test in s. 151 (English Act) for prohibited financial assistance.

§ See also Notes under section 391 under the heading "Scheme involving buy back of shares".

Unlimited company

It would appear that an unlimited company is not prohibited from purchasing its shars from its members as Article 3(e) of Table E. Schedule I gives powers to such company to reduce its shares in any way. See *Re, Borough Commercial and Building Society,* (1893) 2 Ch 242.

Penalty for default [sub-section (4)]

Any contravention of the provisions contained in sub-section (1) (purchase of its own shares by a company) and in sub-sections (2) and (3) (providing financial assistance by the company for requisition of its shares) attracts penalty for the company and every officer of the company who is in default, of fine which may extend to Rs. 10,000.

Compoundable offence.—The offence is compoundable under section 621A.

ICSI Guidance Note on Compliance Certificate (August, 2003)

Loans by Company for Purchase of its Own or Holding Company's Shares.—This matter is not directly referred to in the 33 paragraphs appended to the Form prescribed under the Companies (Compliance Certificate) Rules. The Check List given by the ICSI is for the guidance of CSP who may, in the course of his scrutiny, come across non-compliance with regard to this matter. CSP need not qualify such non-compliance.

Check List

Check whether:

(i) the company gave any financial assistance for the purpose of or in connection with purchase of shares in the company or in its holding company;

(ii) the company had given any such financial assistance, it should be ensured that it fell within the exemption under section 77.

See *item (k) under the heading 'Check List for Other Companies'.*

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Secretarial Practice Notes

(i) Check that the company did not give any financial assistance for the purpose of purchase of shares in the company or in its holding company.

(ii) If the company had given any such assistance, ensure that it fell within the exemptions under the section.

Documents Involved: 1. Annual Report 2. Register of Members 3. Prospectus.

[1][*S. 77A. **Power of company to purchase its own securities.**—(1) Notwithstanding anything contained in this Act, but subject to the provisions of sub-section (2) of this section and section 77B, a company may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of—*

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities:

Provided *that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.*

(2) No company shall purchase its own shares or other specified securities under sub-section (1) unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed in general meeting of the company authorising the buy-back;

[2]['Provided *that nothing contained in this clause shall apply in any case where—*

(A) the buy-back is or less than ten per cent, of the total paid-up equity capital and free reserves of the company; and

(B) such buy-back has been authorised by the Board by means of a resolution passed at its meeting:

Provided further *that no offer of buy-back shall be made within a period of three hundred and sixty-five days reckoned from the date of the preceding offer of buy-back, if any.*

Explanation.—For the purposes of this clause, the expression "offer of buy-back" means the offer of such buy-back made in pursuance of the resolution of the Board referred to in the first proviso;'];

(c) the buy-back is or less than twenty-five per cent of the total paid-up capital and free reserves of the company:

Provided that the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year;

(d) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back:

Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.

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1. Ins. by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).
2. Ins. by the Companies (Amendment) Act, 2001 (57 of 2001), (w.e.f. 23-10-2001), earlier inserted by an ordinance (7 of 2001), dt. 23-10-2001.

Explanation.—For the purpose of this clause, the expression "debt" includes all amounts of unsecured and secured debts;

(e) all the shares or other specified securities for buy-back are fully paid-up;

(f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf[3]*;*

(g) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed[4]*.*

(3) The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of security intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back; and

(e) the time limit for completion of buy-back.

(4) Every buy-back shall be completed within twelve months from the date of passing the [5]*[special resolution or a resolutions passed by the Board] under clause (b) of sub-section (2).*

(5) The buy-back under sub-section (1) may be—

(a) from the existing security-holders on a proportionate basis; or

(b) from the open market; or

(c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(6) Where a company has passed a special resolution under clause (b) of sub-section (2) [6]*[or the Board has passed a resolution under the first proviso to clause (b) of that sub-section] to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed*[7] *and verified by an affidavit to the*

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3. SEBI (Buy-Back of Securities) Regulations, 1998. See *Appendix* 176.
4. Private Limited Company & Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999. for text see, *Appendix* 12.
5. Sub. for the words 'special resolution' by the Companies (Amendment) Act, 2001 (57 of 2001), (w.e.f. 23-1-2001), earlier inserted by an Ordinance (7 of 2001), dt. 23-10-2001.
6. Ins. by the Companies (Amendment) Act, 2001 (57 of 2001), w.e.f. 23-10-2001, earlier inserted by an Ordinance (7 of 2001), dt. 23-10-2001.
7. Prescribed Form is No. 4A, *vide* rule 5C of the Companies (Central Government) General Rules & Forms, 1956, *vide* GSR 23(E), dated 12-1-1999.

effect that the Board has made a full inquiry into affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any:

Provided *that no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.*

(7) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(8) Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares [including allotment of further shares under clause (a) of sub-section (1) of section 81] or other specified securities [8]*[within a period of six months] except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.*

(9) Where a company buys-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed[9]*.*

(10) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed[10]*:*

Provided *that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.*

(11) If a company makes default in complying with the provisions of this section or any rules made thereunder, or any regulations made under clause (f) of sub-section (2), the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both."

Explanation.—For the purposes of this section,—

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8. Sub. for 'within a period of twenty-four months' by the Companies (Amendment) Act, 2001 (57 of 2001), (w.e.f. 23-10-2001), earlier inserted by an Ordinance (7 of 2001), dt. 23-10-2001.
9. The register of securities bought back by a company shall be in Form 4B, vide R. 5C of the Companies (Central Govt's.) General Rules & Forms, 1956, inserted *vide* GSR 788(E), dt. 24-11-1999.
10. The return relating to buy-back of securities shall be in Form 4C, *vide* R. 5C of the Companies (Central Govt's.) General Rules and Forms, 1956, vide GSR 788(E), dt. 24-11-1999.

(a) "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time;

(b) "free reserves" shall have the meaning assigned to it in clause (b) of Explanation to section 372A.]

NOTES

Note.—§ See also Notes under section 77AA post.

Report of the Working Group on the Companies Act, 1956

The Working Group, constituted by the Central Government in its Report submitted to it on 12th February, 1997, recommended to provide for buy-back of shares in the Act, as follows:

"**3.9** There is an erroneous belief that the sole reason for buy-back is to block hostile take-overs. In this connection it is pertinent to list the five reasons why the Bank of England favoured the making of law to allow companies to repurchase their shares, of which blocking take-overs was only one:

(a) to return surplus cash to shareholders;

(b) to increase the underlying share value;

(c) to support share price during periods of temporary weakness;

(d) to achieve or maintain a target capital structure;

(e) to prevent or inhibit unwelcome take-over bids.

3.10 Almost all OECD countries allow companies to buy-back shares subject to certain regulations. Unfortunately, Section 77 (read with section 100) of the Act prevents buy-back. In today's context, the Group strongly believes that this section is antiquated, and goes against the long term interests of corporate sector growth and shareholder value. Hence, the Group recommends that the new Act should provide for buy-back of shares subject to certain provisions:

(1) Prior approval by shareholders through special resolution that clearly states (i) the amount allocated for buy-back of shares, (ii) time period for concluding buy-back operations and (iii) the funds allocated for buy-back are from 'free reserves' and share premium account;

(2) In the event of buy-back, the company shall not issue any *new* shares, which includes rights issues but excludes bonus, for a period of 12 months after the buy-back is completed;

(3) Since buy-back is for extinguishing share capital, it should not lead to an increase in debt-equity ratio in excess of 2:1;

(4) In case of buy-back is for 'treasury operations', *such* shares will not be re-issued for 24 months after the last date of buy-back, and will be subject to the restrictions given in the table below:

Buy-back for treasury operations	Upto 24 months	After 24 months but before re-issue	After re-issue
Voting rights	No	No	Yes
Dividend rights	No	No	Yes
Bonus rights	No	Yes	Yes
Rights issues	No	Yes	Yes

(5) In the case of non-secondary market buy-back from specific class of share holders, the potential sellers will not vote on the special resolution;

(6) The buy-back will be accompanied by a 'declaration of solvency' by the Board which will be signed by the Managing Director and at least one more Director, and will be in force for one year after the buy-back;

(7) Any deviation from such compliance will be punishable by a substantial fine and/or imprisonment.

3.11 The new Take-over Code has finally created a transparent environment for taking over the ownership and control of companies. This is to be welcomed, for take-overs play an important role in building corporate synergy, in raising shareholder value and in keeping companies on their toes. However, there is an important element that has been missed out by the new code, which ought to be rectified as soon as possible. This has to do with full buy-out.

3.12 Since the term "full buy-out" is not well understood in India, it requires some explanation. In many OECD countries, when a person, group, or body corporate, acquires over 90% or 95% of the equity of a public listed company, it is incumbent upon the residual shareholders to sell their shares to the buyer at a fair price that is set by the regulatory authority. This is not legislated for in India.

3.13 A key feature of shareholder democracy is that all shareholders who own a given class of equity are alike. Without full buy-out provisions, the residual shareholders face one of two options, both of which are inimical to the aspect of shareholders democracy. First, they may hold out for a higher offer, which is palpably unfair *vis-a-vis* the other shareholders who sold their stake. Or, second (and more likely if the company gets de-listed), these shareholders may get squeezed by the buyer to accept a lower price which is unfair to them. Therefore, in the interest of shareholders and companies, the Group recommends that in the event of any person, group or body corporate acquiring 95% of the shares of a public listed company—either through a take-over or otherwise—and the company getting de-listed, residual shareholders should sell their shares to the 95% owner at a price based upon SEBI guidelines."

Companies (Amendment) Act, 1999

Section 77A, 77AA and 77B have been inserted by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998) to provide for buy-back of its own securities by a company subject to safeguards specified therein. Under section 77, a limited company is prohibited from buying its own shares. The main reason for this prohibition is that such a purchase may either amount to "trafficking" in its own shares, thereby enabling the company in an unhealthy manner to influence the market price of its shares by reducing the floating stock or it would operate as a reduction of capital to the prejudice of its creditors. This general prohibition has been diluted by the statute which permits a company, whether public or private, after following the prescribed procedure to buy back its own securities with suitable safeguards specified in sections 77A, 77AA and 77B.

The provisions apply to buy-back of shares (*i.e.* equity or preference shares) and other specified securities. In terms of Explanation (a), "specified securities" include shares issued under Employees Stock Option Scheme (ESOS) or other securities as may be notified by the Central Govt. No such security has been notified by the Central Government so far. Though not stated in Explanation (b), sub-section 5 (d) also provides for sweat equity shares, a new instrument introduced by newly inserted section 79A, which may be bought back by a company.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to

get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Companies (Amendment) Act, 2001

The Amendment Act, 2001 has inserted two provisos to clause (*b*) of sub-section (2) of section 77A. The effect of the amendment is:

(*i*) a company (including a listed company) can buy-back its own shares by means of a resolution passed at the meeting of its Board of Directors, upto 10% of the total of its paid up equity capital and free reserves of the company;

(*ii*) sanction of the shareholders by means of a special resolution is necessary if the buy-back is in excess of the specified limit of 10% as stated above;

(*iii*) a *listed* company shall pass the special resolution only by means of a postal ballot, if the buy-back exceeds the 10% limit, in accordance with Companies (Passing of the Resolution by Postal Ballet) Rules, 2001;

(*iv*) a subsequent buy-back of shares can be made only on the expiry of 365 days from the date of earlier offer of buy-back of shares pursuant to the Board resolution.

Consequential amendments have been made in sub-sections (4) and (6) also. Under sub-section (4), the offer for buy-back of shares has to be made within 12 months from the date of passing of the Board resolution. The requirements specified in sub-section (6) are to be complied in the case of buy-back through Board resolution, as in the case of special resolution. The time limit of 24 months under sub-section (8) for issue of any further shares of the same kind as those which have been bought back has been reduced to 6 months. The Statement of Object and Reasons stated thus:

Statement of Objects and Reasons.—For a considerable time, the market sentiment has been very weak. Because of the recent developments in the United States of America and other places, the situation has become worse.

2. Section 77A of the Companies Act, 1956, permits a company to purchase its own shares or other specified securities (hereafter referred to as "buy-back") subject to the provisions contained in that section. The Ministry of Finance (Department of Economic Affairs) has suggested that the provisions for buy-back by companies should be liberalised with a view to improving the market sentiment. Liberalisation has also been supported by the SEBI, financial institutions and some others.

3. In view of the above, it was decided to liberalise certain provisions of section 77A of the Companies Act, 1956, relating to buy-back and for this purpose, the Companies (Amendment) Ordinance, 2001 (Ordinance 7 of 2001) was promulgated on the 23rd day of October, 2001, so as to, *inter alia*,—

(a) provide that if the buy-back was to the extent of or less than ten per cent. of the total paid-up capital and free reserves of the company and such buy-back had been authorised by means of a resolution passed at its Board meeting, such buy-back shall not require special resolution to be passed by a general meeting as required by clause (b) of sub-section (2) of section 77A which prohibits a company to purchase its own shares or other specified securities unless a special resolution is passed in general meeting of the company authorising such buy-back;

(b) provide that no offer of buy-back referred to in (a) above shall be made within a period of three hundred and sixty-five days reckoned from the date of the preceding offer of buy-back;

(c) reduce the time-limit from twenty-four months specified under sub-section (8) of section 77A of the Companies Act, 1956, to six months from issue of the same kind of shares.

Funding of buy-back [(sub-section (1)]

Shares or other specified securities may be purchased by a company out of (i) free reserves (ii) securities premium account or (iii) proceeds of an earlier issue of shares (or other specified securities) other than the earlier issue of the same kind.

"*Free Reserves*" under Explanation (b) shall have the same meaning as defined in the Explanation to Section 372A, according to which it connotes reserves which are free for distribution as dividend as per latest audited Balance Sheet including balance of securities premium account. Thus, reserves set apart for any specific purpose and revaluation reserve shall not be treated as free reserves. Under S. 77AA, when free reserves are applied to purchase its own shares there must be a compensating transfer to the capital Redemption Reserve Account in the same manner as on redemption of redeemable preference shares under proviso (d) to sub-section (1) of section 80.

Share (or securities) premium account may be applied for buy-back of its own shares by a company, apart from its application for purposes specified in sub-section (2) of section 78.

Proceeds of an earlier issue of same kind of security by a company cannot be used for buy-back of the said security, as it will frustrate the purpose sought to be achieved by such an issue and will make no sense.

Proceeds of an earlier issue may, however, be used for buy-back of another kind of security. In other words, proceeds of an earlier issue of equity shares may be used for buy-back of existing preference shares or *vice-versa*.

Clauses (i), (ii) and (iii) of sub-section (1) are mutually exclusive and all or any of these sources of funding, namely, free reserves, securities premium account and proceeds of any security may be used for buy-back by a company.

In an English case, *BGD Roof Bond Ltd. v. Doughlas,* (2000) 1 BCLC 401 (Ch D), the transaction of a company in purchasing its own shares was challenged for its validity on the grounds that the statutory requirement of funding the buy-back out of distributable profits was not complied with and that the mode of payment was also not proper. So far as payment out of distributable profit was concerned, the court said that the company did not have the necessary distributable profits under s. 160(1)(a) of the 1985 Act [English] to purchase the shares because its relevant accounts were qualified and the auditors' statement that the qualification was not material had not been made and laid before the company in general meeting as required by the Act. For that reason the own-share purchase was invalid, even though the auditors at the time believed that the company had sufficient distributable reserves and would have made a statement of the kind required by s. 271(4) [1985 English Act] if called upon to do so.

The second ground of challenge that there was no proper payment because payment was not made in cash was not accepted by the court.

The court said that the own-share purchase was not invalidated by ss. 162(2) and 159(3) [1985 English Act] which required the terms of the purchase to provide for payment on the purchase. In the same way as a dividend could be paid in cash or in kind, the company could pay for the own share purchase by a transfer of asset. The agreement did provide for a money consideration only a part of the amount changed hands in cash because the amount which the selling shareholder owed to the company for the property and the car was setoff. A *bona fide* set-off of one debt against another constituted payment. The prices in the transaction were agreed at arm's length. On the facts the money was not transferred to the shareholder before the company purchased his share, but even if it was it would not have invalidated the transaction because such a payment would only be conditional, and would be repayable to the company if for some reason the sale fell through.

The company's contention that the solicitor of the selling shareholder should be held liable to the company for was not accepted. He was the solicitor of the opposite party. He

owed no duty to the company either in contract or in tort to advise it as to the validity of the transaction. What would have been the position if he were the solicitor of the company? The court said that if the defendants had owed a duty to the company, either by virtue of being the company's solicitors as a matter of contract or under the common law duty of care, they would probably have been in breach of it if they failed to advise on the effect of s. 271(4) [1985 English Act]. But that breach would not have been causative because if correct advice had been given the company would still have proceeded with the transaction and suffered the same loss and for that reason as well the liquidator's claim would have failed.

Conditions and safeguards provided for buy-back [(sub-section (2)/(3)/(4)]

A company is required to ensure compliance with the provisions of sub-sections (2), (3) and (4). The procedure prescribed for resorting to buy-back of its own securities by a company is enumerated below:

(a) *Authorisation by Articles.*—Articles of Association must specifically empower the company to buy-back its securities. In case no such provision exists, the Articles should be amended by following the procedure laid down in section 31.

(b) *Board of directors power to buy-back [sub-section 2(b) proviso].*—A buy-back of 10% or less of the total paid up capital and free reserves can be made by the Board of directors by means of a Board resolution passed at its meeting. The Board can exercise this power only if it had not made an offer for buy-back of shares on its own authority during the preceding 365 days.

(c) *Authorisation by Special Resolution.*—The company must pass a special resolution in its general meeting after following the procedure laid down in sections 171, 172 and 173. The Explanatory statement pursuant to section 173(2) annexed to the notice of the general meeting shall state all material facts including the necessity for buy-back, nature and extent of security intended to be purchased, amount to be invested under buy-back and time limit for completing the buy-back in terms of sub-section (3). The provisions of sections 171, 172 and 173 do not apply to a private company *simplicitor* unless otherwise provided in its Articles in terms of section 170(1)(ii). However, for purposes of buy-back, it is required to annexe the Explanatory statement to the notice stating the particulars specified in sub-section (3).

The contents of the explanatory statement have been prescribed by SEBI in Schedule I for listed companies under SEBI (Buy-back of Securities) Regulations, 1998 and by the Department of Company Affairs for other companies under the Private Limited Company and Unlisted Public Company (Buy-back of Securities) Rules, 1999. Disclosures made as per Schedule I will be deemed to be in compliance of the provisions of section 77A.

It would be in order to pass two separate resolutions in the same General Meeting, one for amending the Articles authorising the company generally to buy-back its own securities and the other one, authorising the Board of Directors to buy-back specifically the particular security along with other particulars. Care must, however, be taken to propose and pass a special resolution for amendment of Articles under Clause (a) of sub-section (2) before the special resolution for buy back under Clause (b) thereof is proposed and passed.

The special resolution under clause (b) of sub-section (2) may be varied or revoked or by a subsequent special resolution of the company subject to the same procedural and voting restrictions. However Regulation 19(d) permits revocation before the draft letter of offer is either submitted to SEBI or public announcement is made.

When the resolution goes beyond the scope of revocation, it may become specifically enforceable against the company. Where the off market purchase resolution does not satisfy the requirements of the section, it is neither binding on the company nor enforceable against it or against any one else. *Vision Express (UK) Ltd. v. Wilson (No. 2),* (1998) BCC 173; *Western v. Rigblast Holdings Ltd.,* 1989 GWD 23-950 (Scot). A defective

resolution can be rectified before its implementation by a subsequent curative resolution. But where the resolution has already been implemented the illegality cannot be rectified. *R.W. Peak (Kings Lynn) Ltd.*, (1998) 1 BCLC 193 : (1998) BCC 596.

A copy of the special resolution under sub-section (2) has to be filed with SEBI and Stock Exchanges where the shares of the company are listed, within 7 days from the date of its passing. A copy thereof has also to be filed with ROC in terms of section 192(4)(a) in Form 23.

Special resolution to be passed through Postal Ballot by listed companies.—The special resolution for buy-back of its own shares by a listed company under sub-section (1) of section 77-A shold be passed through postal ballot by following the procedure laid down in the Companies (Passing of the Resolutions by Postal Ballot) Rules, 2001. For text of the Rules, see *Appendix* 41.

(d) *Quantum of buy-back.*—There are two limits upto which buy-back may be resorted to by a company. Firstly, the over-all limit is restricted to 25% of the company's paid up capital (*i.e.* equity and preference share capital) and free reserves. The Board of directors is empowered to buy-back not more than 10% of the aggregate of the paid up capital and free reserves.

Secondly, buy-back of equity shares in any financial year shall not exceed 25% of its paid up equity capital. Thus, for instance, while more than 25% of the equity shares cannot be bought back in any financial year, 100% preference shares may be bought back in a financial year subject to the upper limit. Further, both equity shares (up to 25%) and preference shares (up to 100%) may be bought back in the same financial year so long the over-all limit (25% of paid up capital and free reserves) is not exceeded.

(e) *Debt-equity ratio.*—The buy-back debt-equity ratio should be within the permissible range of 2:1. For this purpose, debt shall include long or short term secured and unsecured loans. The Central Government is empowered to relax the debt-equity ratio (higher ratio of debt) in respect of class of companies but not in respect of any particular company.

"The debt equity ratio for listed Housing Finance Companies for the purposes of clause (d) of sub-section (2) of section 77A shall be such as may be specified by the National Housing Bank being the regulator, in consultation with the Central Government." [*Vide Clause of Rule 5-C of Companies (General Rules & Forms, 1956 inserted by Notification No. GSR 479(E), dt. 12-6-2003*].

(f) *Fully paid up Securities.*—For purposes of buy-back, the impugned shares/securities must be fully paid up. Partly paid up securities cannot be bought back and falls outside the scope of section 77A.

(g) *Regulations prescribed for Listed Companies by SEBI.*—Buy-back of equity shares which are listed on any recognised Stock Exchange shall, additionally, comply with the provisions of SEBI (Buy-back of Securities) Regulations, 1998 issued by SEBI. Elaborate procedure has been prescribed for buy-back of its equity shares by a listed company from existing shareholders through tender offer; from open market through book-building process and stock market, and from odd-lot holders.

(h) *Rules made for private and non-listed Public Companies by Central Government.*—Buy-back of equity shares or other specified securities shall additionally comply with the provisions of the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 framed by the Central Government. The Rules envisage the procedure for buy-back of its shares by a company from its existing shareholders through private offers or from its employees pursuant to a scheme of stock option or sweat equity.

Permitted modes of buy-back by listed companies [Sub-section (5) read with Reg. 4 of SEBI (Buy-Back of Securities) Regulations, 1998.]

The buy-back may be—

(*a*) from the existing security-holders on a proportionate basis through tender offer; or

(*b*) from the open market through (i) stock exchange, (ii) book-building process; or

(*c*) from odd lot holders, that is, where the lot of securities of a public company whose share are listed on a recognised stock exchange is smaller than such marketable lot, as may be specified by the stock exchange; or

(*d*) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

'Tender offer' means an offer by a company to buy-back its securities through a letter of offer from the holders of the security of the company [Reg. 2(1)(o)].

Listed companies not to make buy-back offer resulting in reduction of non-promoters' shareholdings

Clause 40-A of the Listing Agreement lays down conditions for continued listing. Sub-clause (iii) states:

(iii) The company agrees that it shall not make preferential allotment or an offer to buy back its securities, if such allotment or offer results in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (Disclosure and Investor Protection) Guidelines as applicable at the time of initial listing or the limit specified in sub-clause (ii) for the existing listed company*, as the case may be.

This condition does not apply to companies referred to BIFR [*Sub-clause (iv)*].

* (ii) Where the non-promoter holding of an existing listed company as on April 01, 2001 is less than the limit of public shareholding as required at the time of initial listing, the company shall within one year raise the level of non-promoter holding to at least 10%, in case the company fails to do so, it shall buy back the public share holding in the manner provided in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Delisting not permissible on buy-back

Under Para 4.2 of the SEBI (Delisting of Securities) Guidelines, 2003, a listed company is not permitted to use the buy-back provisions to delist its securities.

§ For text of the Guidelines, see *Appendix* 167.

Prohibited modes of Buy-back

§ As to prohibited modes of Buy-back, see Notes under section 77-B.

A Buy-back by listed companies from existing security holders on proportionate basis by tender offer [(sub-section (5)(a)]

Validity of special resolution [Sub-sec. (4)]

Every buy-back should be completed within twelve months from the date of passing the special resolution or the Board resolution, as the case may be.

Board's Report on failure to complete buy-back

Sub-section (2B) of section 217 makes it obligatory on the Board of Directors to specify in its report the reasons for failure to complete the buy-back within the specified time.

Listing agreement conditions

Prior and post intimation of Board Meeting to Stock Exchange.—Consequent to the amendment to the Companies Act, 1956 the Listing Agreement has been amended to ensure transparency and disclosures to the investors on buy back of securities as follows:

- *Amendment to clause 19.*—The companies shall be required to give prior notice of at least 7 days to the stock exchanges about the Board meetings at which the proposal for buy-back of securities is to be considered.
- *Amendment to clause 20 (Announcement after the Board meetings).*—The companies shall be required to intimate the stock exchanges within 15 minutes of the closure of the Board meetings about the decision on buy-back of securities. *[SMDRP/POLICY/CIR-1/02 dt. 2-1-2002 issued by the SEBI, Secondary Market Department]*

Chapters II and III of SEBI (Buy-back of Securities) Regulations 1998 prescribes the procedure for a listed company to buy-back its shares from its existing shareholders on a proportionate basis, as follows:

Board resolution.—(1) A company, authorised by a resolution passed by the Board of directors at its meeting, to buy-back its securities not exceeding 10 per cent of the total paid-up capital and free reserves under first proviso to clause (b) of sub-section (2) may buy-back its securities subject to the following conditions:

(*a*) before making a public announcement under sub-regulation (1) of regulation 8, a public notice shall be given in at least one English national daily, one Hindi national daily and a regional language daily, all with wide circulation at the place where the registered office of the company is situated;

(*b*) the public notice shall be given within 2 days of the passing of the resolution by the Board of Directors;

(*c*) the public notice shall contain the disclosures as specified in Schedule I.

(2) A copy of the resolution, passed by the Board of directors at its meeting, authorising buy back of its securities, shall be filed with the Board and the stock exchanges where the securities of the company are listed, within two days of the date of the passing of the resolution. [*Reg. 5A*].

Additional disclosure in public notice.—The public notice under Reg. 5A above should also contain disclosure about the following matters:

(a) The maximum price at which the buy-back of securities shall be made and whether the Board of directors of the company are being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time.

(b) If the promoter intends to offer their securities.

(i) the quantum of securities proposed to be tendered, and

(ii) the details of their trnasactions and their holdings for the last six-months prior to the passing of the special resolution for buy back including information of number of securities acquired, the price and the date of acquisition.

Explanatory Statement.—(1) For the purposes of passing a resolution for buy-back of securities exceeding 10 per cent of the total paid up capital and free reserves, the Explanatory Statement annexed to the notice under section 173 shall, in addition to the disclosure as specified in Schedule I, disclose the price at which the buy-back shall be made. If the promoters propose to offer their securities, it should also disclose the quantum of securities proposed to be tendered and details of their transactions and holdings for the last six months, including the number of securities acquired, the price and details of acquisition.

(2) A copy of the resolution passed at the general meeting shall be filed with SEBI and the stock exchanges where the securities of the company are listed,' within seven days from the date of passing of the resolution.'[*Reg. 5*].

Filing of offer document.—Before buy-back of securities, the company shall make a public announcement in at least one English National daily, one Hindi National daily and Regional language daily with wide circulation at the place where the registered office of the company is situated. The public announcement shall contain material information as prescribed in Schedule II. The public announcement shall specify a date for purposes of determining the names of security-holders to whom the letter of offer shall be sent. The specified date shall not be earlier than 30 days and not later than 42 days from the date of public announcement. Within 7 working days of public announcement, the company shall file with SEBI a draft letter of offer containing particulars specified in Schedule III, through a Merchant Banker who is not associated with the company. The draft letter of offer shall be accompanied with the fee prescribed by Schedule IV. The letter of offer shall be dispatched not earlier than 21 days from the date of its filing with SEBI. The company shall also file a declaration of solvency prescribed in section 77A(6), along with the draft letter of offer [*Reg. 8*].

Offer procedure.—The offer for buy-back shall remain open to the members for not less than 15 days and not exceeding 30 days. The date of opening of offer shall not be earlier than 7 days or later than 30 days after the specified date. In case the number of securities offered by the security-holders is more than the total number of securities to be bought back by the company, the acceptances per shareholder shall be equal to the acceptances tendered by the security-holders divided by total acceptances received and multiplied by the total number of securities to be bought back. The company shall complete the verification of offers received within 15 days of the closure of the offer [*Reg. 9*].

Escrow Account.—The company shall deposit in escrow account 25% of the consideration payable if the sum does not exceed Rs. 100 crores. In case the consideration payable exceeds Rs. 100 crores, the deposit in escrow account shall be 25% up to Rs. 100 crores and 10% thereafter. The escrow account shall consist of cash deposit with a scheduled bank or by way of bank guarantee in favour of Merchant Banker or deposit of acceptable securities with proportionate margin with a Merchant Banker. On payment of consideration to the shareholders, the escrow amount, guarantees or securities shall be released to the company. SEBI may forfeit the escrow amount in case of non-fulfillment of obligations under the regulations [*Reg. 10*].

Payment to security-holders.—After closure of the offer, the company shall open a special account with a banker to an issue registered with SEBI and deposit the entire sum payable as consideration for buy-back, together with the amount lying in escrow account. The company shall, within 21 days of the closure of the offer, make payment of consideration in cash to those security-holders whose offers have been accepted and return the share certificates to the other shareholders [*Reg. 11*].

Extinguishment of Certificates.—The company shall physically destroy the security certificates so bought back in the presence of the Registrar or the Merchant Banker and statutory auditor within 7 days from the date of acceptance of the shares. In case of demat shares, the same shall be destroyed in the manner specified under SEBI (Depositories and Participants) Regulations 1996. A certificate in this regard shall also be filed with SEBI, verified by the Registrar or the Merchant Banker, two whole-time directors including managing director and the statutory auditor [*Reg. 12*].

Securities not purchasable

The following securities cannot be purchased:

(a) partly-paid securities [sub-sec. 2(*e*)]

(b) securities which are subject to lock-in period or otherwise non-transferable [*Reg. 19(5)*].

(c) securities held by promoters or person(s) in control of the company, *if the buy-back is through stock exchange* [Reg. 15(*b*)].

Effect of Buy-Back on ceiling of investments by FIIs

Press Release dt. 19-02-1999.—1. As per the Securities and Exchange Board of India (Foreign Institutional Investors) Second Amendment Regulations, 1998 the foreign institutional investors (FIIs) are permitted to invest in treasury bills. This avenue of investment is available to the FIIs investing through 100 per cent debt route as well as the equity route where upto 30 per cent investments can be made in debt instruments.

2. In terms of the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998, which have been notified on 14th November, 1998, corporates have been permitted to buy-back upto 25 per cent of their paid-up share capital. We have received queries from various FIIs regarding the action to be taken if the FIIs do not/partially participate in the buy-back and thereby exeed the investment limits as a percentage of the reduced capital/post buy-back capital of the company. It is clarified that in such situations, the limit would be frozen and further FII investment would not be permitted. The pre-buy-back FII investments would not be forced to be disinvested. Fresh FII investments would be permitted only when the FII investment levels fall below the limits applicable with respect to the reduced capital.

3. It is clarified that clause 3(*a*) of regulation 15 of the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, which stipulates conditions of compulsory delivery and no short selling in respect of FII transactions, is also applicable during the no-delivery period of a security. [*Press Release No. PR/99 dt. 19-2-1999 Issued by SEBI, FITTC Department*].

Effect of buy-back on investments in Indian joint ventures

The following further opinion on this point as expressed by the Chamber of Income Tax Consultants, Mumbai, in their booklet titled "Buy Back of Shares" (p. 35, 1st Ed., 2000) also deserves to be noted:

> "In cases of Joint Venture with foreign company or companies or in cases of multinational companies, where the Government (FIPB) has permitted a fixed percentage of investment, say, 51:49, it would not be permissible for such Indian Joint Venture companies to buy-back shares unless the ratio 51:49 is maintained throughout. Recently, reports were published in newspapers [*Economic Times : 23.11.1999*] about the Government proposing to exempt multinational companies' Joint Ventures from extinguishing shares bought back provided the foreign equity holding in the company is equal to Sectoral Caps after the buy-back. This will ease buy-back by companies which have foreign investment governed by Sectoral Caps."

Tax implications

Stamp duty on buy back of shares.—The Chamber of Income Tax Consultants, Mumbai, has expressed the opinion that stamp duty is not payable on buy-back of shares under section 77A. Here is what the Chamber says : "A question may arise as to whether any stamp duty becomes payable in a case where buy-back of shares is done by a company. One may note that "transfer" of shares attracts stamp duty vide Schedule I, Entry 62 to the Indian Stamp Act 1899. Since stamp duty is payable on "transfer" of shares buy-back cannot be equated with 'transfer". Transfer of shares to be complete requires the company to register the shares bought back in its name. In case of buy-back, as provided in section 77A(7), the shares bought back have to be statutorily extinguished within seven days of the last date of completion of buy-back. Hence, no registration of such shares takes place in the name of the acquirer. Even the names of the members/holders of the shares have to be struck off from the Register of members. Hence,

stamp duty would not become payable in a case where buy-back of shares takes place." [P. 35, 1st Ed., 2000].

Income Tax, tax on capital gains.—Capital gains tax has become leviable on buy-back of shares by virtue of section 46A inserted in the Income Tax Act, 1961 by the Finance Act, 1999 effective financial year 1999-2000. The provision is as follows :

S. 46A. Capital gains on purchase by company of its own shares or other specified securities.—Where a shareholder or a holder of other specified securities receives any consideration from any company for purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities, then, subject to the provisions of section 48, the difference between the cost of acquisition and the value of consideration received by the shareholders or the holder of other specified securities, as the case may be, shall be deemed to be the capital gains arising to such shareholder or the holder of other specified securities, as the case may be, in the year in which such shares or other specified securities were purchased by the company.

Explanation.—For the purposes of this section, "specified securities" shall have the meaning assigned to it in Explanation to section 77A of the Companies Act, 1956 (1 of 1956).

B. Buy-back by Private and unlisted Public Companies

Permitted modes of buy-back by private company and unlisted public company [Rule 3 of Private Limited Company and Public Limited Company (Buy-back of Securities) Rules, 1999.

A company may buy-back its shares by either of the following methods:—

(a) from the existing shareholders on a proportionate basis through private offers;

(b) by purchasing the securities issued to employeed of the company pursuant to a scheme of stock option or sweat equity. [*Rule 3*].

A private company, or an unlisted public company may buy-back its shares as per the following procedure prescribed in Rules the said as follows:

Explanatory Statement:—The Explanatory Statement shall contain particulars as specified in Schedule I to the Rules. [*Rule 4*].

Filing of letter of offer.—A draft letter of offer containing particulars specified in Schedule II to the Rules shall be filed by the company with ROC along with the declaration of solvency in Form 4A in accordance with the provisions of section 77A(6). [*Rule 5*].

Offer procedure.—The letter of offer shall be despatched immediately after filing with ROC but not later than 21 days from the date of its filing with ROC. The offer shall remain open to the members for not less than 15 days and not exceeding 30 days from the date of despatch of the letter of offer. In case the number of shares offered by the members is more than total number of shares to be bought back, the acceptance per member shall be on proportionate basis. The company shall complete verification of offers received within 15 days from the date of closure of the offer and shares lodged shall be deemed to be accepted unless rejection is communicated within 21 days from the date of closure. [*Rule 6*].

Payment to the members.—Immediately after the date of closure of the offer, the company shall open a special account and deposit therein the entire sum due and payable as consideration for buy-back. The consideration will be paid in cash or by way of bank draft/pay order to the shareholders, whose offers have been accepted within 21 days from the date of closure of the offer and in respect of the share-holders whose offers have not been accepted, share certificates shall be returned to them forthwith. [*Rule 7*].

Return to be filed with ROC.—A return on buy-back of securities shall be filed by the company with the ROC in the form specified in Annexure A to the Rules after completion of buy-back. [*Rule 9*].

Extinguishment certificate.—The company shall physically destroy the bought back share certificates in the presence of the Company Secretary in whole-time practice within 7 days from the date of acceptance of the shares. A certificate in this behalf shall be filed

within 7 days thereafter with the ROC verified by two whole-time Directors including MD and Company Secretary in whole-time practice. [*Rule 10*].

Register of buy-back of Securities.—The company shall maintain a register of shares bought-back in Form at Annexure B to the Rules. [*Rule 11*].

General obligations of the company

(*a*) The company shall ensure that the letter of offer contains true, factual and material information and does not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document;

(*b*) the company shall not issue any shares including by way of bonus till the date of the closure of the offer under these rules;

(*c*) the company shall confirm in its offer the opening of separate bank account testifying the availability of funds earmarked for this purpose and pay the consideration only by way of cash or Bank draft/pay order;

(*d*) the company shall not withdraw the offer once the draft letter of offer has been filed with the Registrar of Companies; and

(*e*) the company shall not utilise any money borrowed from Banks/Financial Institutions for the purpose of buying-back its shares. [*Rule 8*].

Buy-back of securities by listed companies from open market—through Stock Exchange [(sub-section (5)(b)]

This mode of buy-back is available only to listed companies. As per Regulation 15 of SEBI (Buy-back of Securities) Regulations, 1998, the following procedure has been prescribed for buy-back of shares through Stock Exchange:

(a) The Board resolution for buy-back of securities not exceeding 10 per cent of the total paid up capital and free reserves [*Reg. 5A*]. The special resolution for buy-back in excess of 10 per cent. [*Reg. 5*] passed under sub-section (2) shall specify the maximum price at which buy-back shall be made;

(b) Buy-back shall not be made from the promoters or persons in control of the company;

(c) The company shall appoint a merchant banker and make a public announcement as referred to in Regulation 8.

(d) Public announcement shall be made as in the case of buy-back through tender offer, at least 7 days prior to the commencement of buy-back;

(e) A copy of the public announcement shall be filed with SEBI within 2 days of such announcement alongwith the prescribed fee specified in Schedule IV;

(f) Public announcement shall contain disclosures regarding brokers and Stock Exchanges through which the buy-back of securities shall be made. Stock Exchanges should be with electronic trading facility;

(g) The buy-back shall be made only on stock exchanges with electronic trading facility;

(h) Buy-back shall be made only through the order matching mechanism except "all or none" order matching system;

(i) The company and the merchant banker shall inform the Stock Exchanges on daily basis regarding the securities selected for buy-back and the same shall be published in a national daily.

(j) The identity of the company as a purchaser shall appear on the electronic screen when the order is placed. [*Reg. 15*].

The company shall complete the verification of acceptances within 15 days of the payout [*Reg. 16(2)*].

Buy-back by listed companies from open market through Book Building Process [(sub-section (5)(b)]

This mode of buy-back is open only to listed companies.

Book building refers to collecting orders from the investment bankers and larger investors on an indicative price range. In capital markets with sufficient width and depth, such a pre-issue exercise often allows the issuer company to get a better idea of the demand and the final offer price of an Initial Public Offering (IPO).

Apart from the procedure laid down for the buy-back through Stock Exchange, the listed company shall also comply with the following requirements for buy back through book building [*Reg. 17*]:

(1) The deposit in escrow account shall be made before the date of public announcement. The amount to be deposited in escrow account shall be determined with reference to the maximum price specified in public announcement;

(2) The public announcement shall also contain the detailed modality of the book building process, the manner of acceptance, the format of acceptance to be sent by the shareholders pursuant to the public announcement;

(3) Details of the bidding centres and the number of bidding centres shall not be less than 30 and there shall be at least one electronically linked computer terminal at all the bidding centres;

(4) The book building process shall be made through an electronically transparent facility;

(5) The number of bidding centres shall not be less than thirty and there shall be at least one electronically linked computer terminal at all the bidding centres.

(6) The offer for buy-back shall remain open to the security-holders for a period not less than fifteen days and not exceeding thirty days.

(7) The merchant banker and the company shall determine the buy-back price based on the acceptances received;

(8) The final buy-back price shall be the highest price accepted and shall be paid to all holders whose shares have been accepted for buy-back.

§ See also Notes under section 81 *post* under the heading "Book Building Process for Issue of Shares" and SEBI Guidelines 2000, issued thereunder.

Buy-back of odd lots [sub-section (5)(c)

The stock exchanges specify the number of shares covered by a share certificate which can be sold or purchased in the stock market. Such market lot is generally of 50 or 100 shares. The odd lot shares, which are more or less than the market lot, are not traded on the stock market.

The provisions pertaining to buy-back through tender offer as specified in Chapter III of SEBI (Buy-back of Securities) Regulations, 1998 shall be applicable *mutatis mutandis* to buy back of odd-lot shares. [*Reg. 13*].

Buy-back under the scheme of employees stock option or sweat equity [sub-section (5)(d)]

SEBI (Employees Stock Option Scheme and Employees Stock Purchase Scheme) Guidelines, 1999 regulate the grant of option to the employees to apply for purchase of shares at pre-determined price-under the Employees Stock Option Scheme (ESOS) or to offer shares to the employees at fixed price as part of the public issue or otherwise under Employees Stock Purchase Scheme (ESPS). See *Appendix* 174.

Employees Stock Option has been defined in section 2(15A) to mean option given to whole time directors, officers or employees of a company to purchase or subscribe for securities of the company at a future date at a pre-determined price. The said definition is

at variance with the SEBI (ESOS & ESPS), Guidelines 1999 in asmuchas only permanent employees besides whole time directors, are eligible to participate in ESOS. As per SEBI guidelines an employee who is a promoter or belongs to the promoter groups and a director who either by himself or through his relative or through any body corporate holds more than 10% of the outstanding equity shares of the company not eligible to participate in ESOS. There is no such prohibition under the definition in section 2(15A) which will prevail upon the SEBI guidelines for purposes of complying with the provisions of section 77A(5)(d).

Further while the SEBI guidelines specify that a permanent employee or a director of the company or of a subsidiary or holding company of the company is eligible to participate, there is no provision to this effect in section 2(15A).

Section 79A provides for issue of sweat equity shares to the employees or to the directors of a company at a discount or for consideration other than in cash for making available know-how, intellectual property rights or value additions. This is an equity instrument issued below par in recognition of the contribution made by the employees and directors to the company.

Sub-section (8) specifically provides that the prohibition to make further issue of same kind of shares within 24 months of buy-back by a company shall not apply to further issue under ESOS or sweat equity.

For buy-back of shares or other specified securities from employees under ESOS or sweat equity, no separate procedure has been prescribed under section 77A by SEBI or Central Government.

Declaration of Solvency [Sub-section (6)]

Buy-back of securities amounts to reduction of capital of the company and in the interest of its creditors, it is necessary to ensure that the company can meet its liabilities and subsisting obligations during the post buy-back period. Sub-section (6), thus, provides for filing a declaration of solvency prescribed in Form 4A. The declaration shall be made in the form of an affidavit on non-judicial stamp paper of requisite value and be executed on behalf of the company, by at least two directors including the managing director, if any, and attested by an Oath Commissioner or Notary Public.

The format of the declaration has been prescribed to be in Form 4A *vide* R. 5C of the Companies (Central Govt.) General Rules & Forms, 1956 inserted by Notification No. GSR 23(E), dt. 12-1-1999 (w.e.f. 12-1-1999). For the text of the Form No. 4A see Companies (Central Government) General Rules & Forms, 1956 in *Appendix 1.*

Extinguishment of Securities Certificates [sub-section (7)]

The listed company shall extinguish and physically destroy the security certificates so bought back within 7 days from the last date of completion of buy-back. Under Regulation 12 of SEBI Regulations, the listed company shall destroy the securities in the presence of the Registrar to an issue and/or the merchant banker and statutory auditor and the company shall furnish a certificate in this behalf to SEBI. Similarly, under Rule 10 of the Rules of 1999 framed by the Central Government, the share certificates in respect of an unlisted company shall be destroyed in the presence of the company secretary in whole-time practice and a certificate in this behalf be filed with Registrar of Companies, verified by two whole-time directors including the managing director and company secretary in whole time practice.

The securities offered for buy-back if already dematerialised should be extinguished and destroyed in the manner specified under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and the bye-laws framed thereunder [*Reg. 12(2)*].

Intimation of extinguishment to SEBI.—The company should furnish a certificate to SEBI duly verified by—

(*a*) the Registrar and whenever there is no Registrar, through the merchant banker;
(*b*) two whole-time Directors including the Managing Director and,
(*c*) the statutory auditor of the company,

within seven days of extinguishment and destruction of the certificates [Reg. 12(3)]. Certifying that the extinguishment has been made in the presence of the persons and within the time period mentioned above [*Reg. 12(1)*].

Intimation of extinguishment to stock exchange.—The particulars of the security certificates extinguished and destroyed shall be furnished by the company to the stock exchanges where the securities of the company are listed within seven days of extinguishment and destruction of the certificates [*Reg. 12(4)*].

Further issue of same kind of securities [Sub-section (8)]

A company which has bought-back its securities shall not issue the same kind of security, including rights shares, within 6 months from the date of completion of buy-back. This prohibition, however, does not apply to bonus issue, conversion of warrants under subsisting obligations, ESOS, Sweat Equity or conversion of preference shares or debentures into equity shares.

Regulation 19(1)(*b*) prohibits a company from issuing any shares including bonus shares till the date of closure of offer made under the Regulations.

Register of securities bought-back [sub-section (9)]

Every company shall maintain a Register of Securities bought back under SEBI Regulations, in Form 4B of the Companies (Central Government's) General Rules and Forms, 1956.

Return relating to buy-back [sub-section (10)]

A return is required to be filed with ROC in Form 4C vide rule 5C(3) of the Companies (Central Government's) General Rules and Forms 1956, in the format prescribed in Annexure A to the Rules of 1999.

Penalty for default [sub-section (11)]

In case of default in compliance of the provisions of this section, or the Regulations and Rules framed thereunder, the company and every officer in default is punishable with imprisonment upto two years or fine upto of Rs. 50,000/- or both.

Compoundable offence.—The offence is compoundable under section 621A.

Chapter V of the SEBI Regulations provides for the obligations of the company and the merchant banker. Chapter VI of the said Regulations also empower SEBI to order investigation. SEBI is also empowered to initiate action, including criminal prosecution under section 24 of the SEBI Act, 1992. In case any person is guilty of insider trading or market manipulation, he shall be dealt with in accordance with the provisions of SEBI (Insider Trading) Regulations, 1992 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995.

Buy back under Schemes of arrangement under section 391

§ For Notes and case study see under section 391 under the heading "Scheme involving buy back of shares".

Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999

Press Note 6/99, dt. 16-7-1999.—The Companies Act, 1956 was amended recently through the Companies (Amendment) Act, 1999. One of the amendments relate to introduction of a new Section *viz.* Section 77A into the Companies Act to facilitate companies to buy-back their own securities. The provisions of this section empower SEBI to notify the procedure relating to buy-back of securities by listed companies. In so far as Private Ltd. Companies and Unlisted Public Limited companies are concerned, the powers are vested with the Central Government.

2. SEBI have already notified the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998 to govern the procedure relating to Listed Public Ltd. Companies. This was notified in the Gazette of India Extraordinary as Notification No. SO 975(E), dated 14-11-1998.

3. The Central Govt. have now notified the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 by Notification No. GSR 502(E) in the Gazette of India Extraordinary dated 6-7-1999.

4. The Rules provide for buy-back of securities by companies either from the existing shareholders at a proportionate basis through private offers or by purchasing the securities issued to employees of the company pursuant to a Scheme of Stock Option or Sweat Equity. Before embarking on buy-back of securities, the company should obtain the approval of its members at the General Meeting by a special resolution. The Rules prescribe the format in which the requisite disclosures are to be made to the shareholders in the Explanatory Statement annexed to the notice for the General Meeting pursuant to section 173 of the Companies Act, 1956. After obtaining the approval of the shareholders, the company is required to file a draft letter of offer as prescribed in the Rules with the Registrar of Companies concerned. The company is also required to file a Declaration of Solvency in the prescribed manner alongwith the letter of offer. Thereafter the company can issue letter of offer. However, the time limits prescribed in the Rules have to be complied with. The company should also open a special bank account immediately after the date of closure of the offer. The company is duty bound to deposit into this account the entire sum due and payable as consideration for the buy-back. Thereafter, the company is required to make payments to the shareholders concerned within the prescribed time limit.

5. The Rules also prescribe the format of a Return to be filed by the company with the Registrar and also the format of the Register of Securities to be maintained with reference to buy-back of shares.

6. A copy of the Private Ltd. Company and Unlisted Public Ltd. Company (Buy-back of Securities) Rules, 1999 is available at the Web Page of Department of Company Affairs of the NIC Website at the following address : http://www.nic.in/dca. [*Issued by the Ministry of Law, Justice & Company Affairs, Department of Company Affairs vide F.No. 1/2/99-CL.V; Press Note No. 6/99, dated 16-7-1999*].

PIB Press Release, dated 15-7-1999.—The Department of Company Affairs has promulgated the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999, under section 77A read with sub-section (1) of section 642 of the Companies Act. A notification to this effect has been issued enforcing the rules with immediate effect.

These rules are applicable to buy-back of equity shares or other specified securities of a private limited company and unlisted public limited company not listed on any recognised stock exchange. The company may buy-back its shares from existing shareholder on a proportionate basis through private offers and by purchasing securities issued to the employees of the company pursuant to scheme of stock option or sweat equity.

Under these rules, for passing a special resolution under sub-section (2) of section 77A of the Companies Act, 1956, explanatory statement to be annexed to the notice for the general meeting pursuant to section 173 of the Companies Act will contain disclosures as specified in Schedule I.

The company which has been authorised by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a draft letter of offer containing particulars in Schedule II. The company shall also file along with the letter of offer a declaration of solvency.

The letter of offer shall be dispatched immediately after filing with Registrar of Companies but not later than 21 days from its filing with Registrar of Companies.

The company shall immediately after the date of closure of the offer open a special bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the buy-back in terms of these rules.

As for the general obligation of the company, the company shall ensure that the letter of offer should contain true factual and material information, the company shall not issue any shares by way of bonus till the date of the closure of the offer under these rules, the company shall confirm in its offer the opening of separate bank account testifying the availability of funds earmarked for this purpose and pay the consideration only by cash or bank draft or by pay order, the company shall not withdraw the offer once the draft letter of offer has been filed with the Registrar of Companies, and the companies shall not utilise any money borrowed from banks or financial institutions for buying-back shares.

The company, after the completion of the buy-back under these rules, will file with the Registrar a return in the form as specified.

As for extinguishment of certificate, the company shall extinguish and physically destory the share certificates bought back in the presence of the company's secretary within seven days from the date of acceptance of the shares. The company shall furnish a certificate to the Registrar of Companies duly verified by two whole-time directors including managing director and company secretary in whole-time

practice, certifying compliance with these rules within seven days of the extinguishment and destruction of the certificates. The company shall also maintain a record of share certificates which have been cancelled and destroyed within seven days of buy-back of shares.

The company shall maintain a register of shares bought back by the company in the form as specified.

These rules have been framed under the Companies (Amendment) Act, 1999, to enable Indian companies to compete with multinational companies. Indian companies have been allowed to buy back their own shares and securities under certain conditions with suitable safeguards. Directors of the company will ensure that the solvency certificate is issued and ensure its compliance. A company which has not complied with the provisions of sections 159, 207 and 211 of the Companies Act, 1956, will not be eligible to buy back its shares.

Relevant Rules and Regulations

For SEBI (Buy-Back of Securities) Regulations, 1998 refer to *Appendix* 176.

For the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 refer to *Appendix* 12.

See also Rule 5C of Companies (Central Government's) General Rules & Forms 1956, *Appendix* I.

***ICSI Guidance Note on Compliance Certificate (August, 2003)**

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of maintenance of registers. The relevant paragraph 1 of the Form prescribed under Rule 3 of the Companies (Compliance Certificate) Rules, 2001 states :

***"Paragraph 1.*— The company has kept and maintained all registers as stated in Annexure 'A' to this certificate, as per the provisions and the rules made thereunder and all entries therein have been duly recorded."**

Register of Securities Bought Back under Section 77A

Prescribed Check List

Check whether register of securities bought back has been maintained for entering the following particulars, namely, (i) the consideration paid for securities bought back; (ii) the date of cancellation of securities; (iii) the date of extinguishing and physically destroying of securities and such other particulars as prescribed in Form 4B of the Companies (Central Government's) General Rules and Forms, 1956 and Annexure B to the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

Paragraph 2.—**The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Return on Buy-Back of Securities

Prescribed Check List

Check whether the company has filed with the Registrar, Form No. 4A and 4C under the Companies (Central Government's) General Rules and Forms, 1956 and a return in the form specified at Annexure A to the Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999 after the completion of buy-back.

• Also check whether returns have been filed to the Securities and Exchange Board of India in case of buy-back of securities.

Paragraph 20 under Rule 3 relates to Buy-back of Shares and reads as follows:

***Paragraph-20.*—The company has bought back..... shares during the financial year ending..... after complying with the provisions of the Act.**

Buy-Back of Shares/Securities

Prescribed Check List

If the company has bought back any shares/securities, check whether:

(i) the Articles authorise buy back of securities;

(ii) where the buy back is more than 10% of the total paid-up equity capital and free reserves of the company, a special resolution was passed at a general meeting approving the buy-back of securities and the same was filed along with the Form No. 23 with the ROC within 30 days from the date of passing the resolution;

(iii) where the buy back 10% or less than 10% of the total paid-up equity paid-up capital and free reserves of the company, it has been authorised by Board by means of a resolution passed at its meeting and no offer is made within a period of three hundred and sixty five days reckoned from the date of preceding offer of buy back, made in pursuance of the resolution of the Board, if any [provision inserted on 23-10-2001 by the Companies (Amendment) Act, 2001];

(iv) the buy-back was made only out of the company's free reserves, securities premium account, the proceeds of any shares or other specified securities;

(v) the buy-back was not made out of the proceeds of an earlier issue of the same kind of shares/securities;

(vi) (a) the aggregate value of buy-back was not exceeding 25% of the total paid-up capital and free reserves of the company.

(b) if the buy-back was of equity shares in the financial year, it did not exceed 25% of the total paid-up equity capital in that financial year.

(c) all the shares/securities so bought back were fully paid-up.

(d) the ratio of debt including all amounts secured and unsecured owed by the company was not more than twice the capital and its free reserves after such buy-back, except where a higher ratio has been prescribed by the Central Government for a class or classes of companies.

(vii) the buy-back process was completed within 12 months from the date of passing of the special resolution; if it was not completed within the stipulated time also check whether the reasons thereof were stated in the Board's report;

(viii) **If the Company is an Unlisted Public Limited Company or a Private Limited Company,** Check whether:

(a) the buy-back was made in accordance with the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 issued by the Department of Company Affairs;

(b) the company had passed a special resolution and an explanatory statement was annexed to the notice containing disclosures as specified in Schedule 1 to the Rules, or a resolution had been passed by the Board, as the case may be;

(c) a draft letter of offer containing particulars specified in Schedule II to the Rules was filed with ROC;

(d) a declaration of solvency in form No. 4A was filed with the ROC along with the letter of offer;

(e) the letter of offer was despatched immediately after filing with ROC but not later than 21 days from its filing with ROC;

(f) the offer for buy-back remained open to the members for a period not less than 15 days and not exceeding 30 days from the date of despatch of letter of offer;

(g) the acceptance per shareholder was on proportionate basis where shares offered by shareholders are more than the total number of shares to be bought back;

(h) the company had immediately after the date of closure of the offer opened a special bank account and deposited therein such sum, as would make up the entire sum due and payable as consideration for the buy-back in terms of the Rules;

(i) the share certificates so bought back were extinguished and physically destroyed in the presence of a PCS within 7 days of the last date of completion of buy-back;

(j) the company had furnished with the ROC a certificate duly verified by two directors including the Managing Director and a PCS certifying compliance with above mentioned Rules and also specifically rule 10(1) of the said Rules regarding extinguishing of share certificates within 7 days of acceptance of shares;

(k) the company has filed with the ROC a return on buy-back of securities as prescribed in Annexure 'A' of the said Rules within 30 days of completion of the buy-back;

(l) the register on buy-back of securities has been maintained by the company as prescribed in Annexure 'B' of the said Rules.

(ix) **If the Company is a Listed Company** in addition to the requirements stated at (i) to (vii) above check whether:

(a) the buy-back was made as per the SEBI (Buy-back of Securities) Regulations, 1998;

(b) the company has filed with SEBI and the ROC a return on buy-back of securities within 30 days of completion of the buy-back in the prescribed format;

(c) the register on buy-back of securities has been maintained by the company in the prescribed format.

(x) the company which has completed buy-back has not made further issue (including rights issue) of the same kind of shares or other specified securities within 24 months except by way of bonus issues or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares;

(xi) prohibition for buy-back is not attracted in certain circumstances as set out under section 77B.

Secretarial Action Points

(i) Buy-back of shares must be authorised by Articles.

(ii) See whether pre-requisites as laid down in section 77A and relevant Regulations/Rules for buy-back is complied with.

(iii) If a listed company, give prior notice of at least 7 days to the stock exchange(s) concenred about the Board meeting at which the proposal of buy-back is to be considered.

(iv) Pass Board resolution if the buy-back is not more than 10% of the aggregate of paid up equity capital and free reserves, or for seeking shareholders approval if the buy-back is more than 10 per cent.

(v) Intimate the stock exchange(s) concerned within 15 minutes of the closure of the Board making the decision on buy-back.

(vi) Special Resolution duly backed by Explanatory Statement as specified in sub-section (2) to be passed in general meeting for buy-back of shares.

(vii) Follow postal ballot procedures given under Section 192A, if a listed company.

(viii) File declaration of solvency.

(ix) See whether post-buy back obligations as per section 77A and Regulation/Rules are complied with.

[1][*S. 77AA. **Transfer of certain sums to capital redemption reserve account.**—Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account referred to in clause (d) of the proviso to sub-section (1) of section 80 and details of such transfer shall be disclosed in the balance-sheet.*]

NOTES

Companies (Amendment) Act, 1999

This section has been inserted by the Companies (Amendment) Act, 1999 to provide for transfer to the capital redemption reserve account an equivalent amount of shares bought back by a company in the same manner as provided for redemption of preference shares under section 80(1)(d).

Capital Redemption Reserve [Sec. 77AA]

Where the buy-back is effected out of free reserves the company is required to transfer a sum equal to the nominal value of the securities purchased to its capital redemption reserve account.

The balance-sheet should disclose detail of the transfer.

§ **Note.**—See also under sections 77A and 80 *ante.*

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

[1][*S. 77B. **Prohibition for buy-back in certain circumstances.**—(1) No company shall directly or indirectly purchase its own shares or other specified securities—*

(a) through any subsidiary company including its own subsidiary companies; or

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1. Ins. by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).

(b) through any investment company or group of investment companies; or

(c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures, or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of sections 159, 207 and 211.]

NOTES

Companies (Amendment) Act, 1999

This section has been inserted by the Companies (Amendment) Act, 1999 to prohibit buy-back of securities in certain circumstances.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Prohibition for buy-back [sub-section (1)]

As per clauses (a) and (b), no company shall directly or indirectly purchase its own shares through any subsidiary including its own subsidiary companies or through any investment company or group of investment companies. The prohibition it seems is to prevent trafficking its own shares by the company by indirect means.

As per clause (c), a company has been prohibited to buy its own shares in case it has defaulted in (i) the payment of deposits, (ii) redemption of debentures, (iii) redemption of preference shares, (iv) the payment of term loan to any financial institution or bank. These provisions are salutary to ensure that the company proposing to buy-back its securities shall discharge its liabilities and subsisting obligations.

SEBI (Buy-back of Securities) Regulations.—Under Reg. 4(2) and (3), a listed company is prohibited from buying-back its securities—

(*i*) through negotiated deals, whether on or off stock exchange;

(*ii*) through spot transactions;

(*iii*) through private arrangement;

(*iv*) through insider dealings.

§ See further Notes under section 77A *ante*.

Non-compliance with provisions of sections 159, 207 and 211 [sub-section (2)]

A company which has not filed its annual return under section 159 or has not paid to all its shareholders the dividend declared in AGM within 30 days, under section 207, or its

annual accounts do not give true and fair view of the state of its affairs under section 211 read with Schedule VI is not entitled to buy-back its securities.

Issue of shares at premium and discount

S. 78. Application of premiums received on issue of [1][*securities*].—(1) Where a company issues [1][*securities*] at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those [1][*securities*] shall be transferred to an account, to be called "the [1][*securities*] premium account"; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the [1][*securities*] premium account were paid-up share capital of the company.

(2) The [1][*securities*] premium account may, notwithstanding anything in subsection (1), be applied by the company—

(a) in paying up unissued [1][*securities*] of the company to be issued to members of the company as fully paid bonus [1][*securities*];

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of [1][*securities*] or debentures of the company; or

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

(3) Where a company has, before the commencement of this Act, issued any [1][*securities*] at a premium, this section shall apply as if the [1][*securities*] had been issued after the commencement of this Act:

Provided that any part of the premiums which has been so applied that it does not at the commencement of this Act form an identifiable part of the Company's reserves within the meaning of Schedule VI, shall be disregarded in determining the sum to be included in the [1][*securities*] premium account.

NOTES

Eng. Act, 1948 : Sec. 56.
Eng. Act, 1985 : Sec. 130.

Companies Act, 1956

This section was introduced by the Act of 1956, on the recommendation of the Company Law Committee (Page 300 of the *Report*).

Companies (Amendment) Act, 1999

The word 'share' used in this section has been substituted by the word 'securities' by the Companies (Amendment) Act, 1999 with effect from 31st October, 1998.

Companies (Amendment) Act, 2000

The expression "securities" has been defined in the Act under section 2(45AA) inserted by the Amendment Act, 2000.

§ See Notes under sections 2(45AA), section 2(12B) and under section 73 under the heading "Derivatives".

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to

1. Subs. for the word 'share' by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).

get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Object and scope

There was no corresponding provision in the previous Act, and in the absence of any statutory prohibition, share premium amounts were being freely distributed as dividends, and the misuse of the funds collected as premiums was not lacking. The object of the present section is to lay down specifically how the premiums collected on the issue of shares should be utilised.

The expression "premium" is not defined. It may be that if, over and above the cash payment on the shares, some further advantage measurable in terms of money is conferred on the company the value of such advantage will have to be regarded, as in the nature of a premium.

A company is not bound to issue shares at a premium. Issue of shares at par even when premium could have been realised cannot be said to have been done at the cost of the company's capital. *Hilder v. Dexter*, (1902) AC 474 (HL); *Head (Henry) & Co. Ltd. v. Ropner Holdings Ltd.*, (1951) 2 All ER 994 (Ch D), **followed** in *Shearer (Inspector of Taxes) v. Bercain Ltd.*, (1980) 3 All ER 295. But if the directors can obtain a premium on the issue it is indeed their duty to do so. *Lowri (Inspector of Taxes) v. Consolidated African Selection Trust Ltd.*, (1940) 2 All ER 545, 565 (HL). There can be no objection to the charging of varying rates of premium in respect of blocks of shares carrying the same rights; *CIT v. Standard Vacuum Oil Co.*, AIR 1966 SC 1393.

The court did not interfere in the matter of a premium issue by a public sector bank which was approved by expert bodies like SEBI, RBI and Stock Exchange. Though there were some losses appearing in the accounts of the bank, they were due to revision of accounting requirements by RBI and they were also set off against capital. *Yugantar v. U.O.I.*, (1998) 94 Com Cases 621 : (1997) 14 SCL 145 : (1997) 27 Corpt LA 132 (Del).

As regards the practical application in some cases of the proviso to sub-section (3), difficult questions are likely to arise as to whether a premium does or does not form an identifiable part of a company's reserves.

Retention of share premium in a separate account [Sub-section (1)]

Any share premium collected by a company on issue of shares is required to be retained in a separate account. This amount cannot be utilised for any purpose, other than the ones specified in sub-section (2). If the amount lying in the securities premium account is used for any other purpose(s), it would tantamount to reduction in share capital, attracting the provisions of sections 100 to 105.

Application of the securities premium account [Sub-section (2)]

The securities premium account may be applied for the following purposes:—

(1) The paying up of fully paid Bonus Shares to be issued by the company to its members;

(2) The writing-off of preliminary expenses of the company;

(3) The writing-off of the expenses of, or underwriting commission paid or discount allowed on, any issue of shares or debentures of the company;

(4) The providing of a premium payable by the company on redemption of redeemable shares or redemption of debentures of the company.

(5) Purchase of its own shares or other specified securities in terms of section 77A.

If it is intended to apply share [*now securities*] premium account for any of the purposes not mentioned above, the procedure of reduction of share capital has to be followed. *Paringa Mining and Exploration Co., Re,* (1957) 3 All ER 424 : (1958) 28 Com Cases 252 (Ch D).

Nature of securities premium account

The effect of this section is to create a new class of capital of a company which is not share capital but not distributable as income any more than any other capital asset. On a winding up the surplus monies in the share [*now securities*] premium account will be returned to the shareholders as capital and so long as the company is a going concern, the same monies can never be returned to the shareholders except through the medium of a reduction petition or, in other words, except under exactly the same conditions as those under which any other capital asset can reach the shareholder's hands. [*Re, Duff's Settlement Trusts,* (1951) 1 All ER 869 (**following** *Re, Bates Mountain v. Bates,* (1928) Ch 682 **affirmed** in (1951) 2 All ER 534]. See also, *Addl. CIT v. Om Oils and Oil Seed Exchange Ltd.,* (1985) 57 Com Cases 592 (Del), where it has been held that premium on issue of shares is to be regarded as money paid on capital account and not as revenue receipt.

Another effect of the section is that distribution of share [*now securities*] premium amount as dividend is not permitted, and it is taken out of the category of divisible profits. But premiums received on the issue of shares, under the 1913 Act, were profits and so could be distributed as dividends. *Bharat Fire and General Insurance Ltd. v. CIT* (1964) 34 Com Cases 683 (SC). Any distribution of the amount among shareholders except in any of the modes specified in sub-section (2) can only be by way of reduction of capital and this will require the sanction of the court and the procedure laid down in section 100 *et seq.*

Where a company issues share at a premium, even though the consideration may be other than cash, a sum equal to the amount or value of the premium must be transferred to the share [*now securities*] premium account. *Head (Henry) & Co. Ltd. v. Ropner Holdings Ltd.,* (1951) 2 All ER 994 (Ch D).

A share [*now securities*] premium account is to be maintained and the share premium cannot be used otherwise than for the specific purposes mentioned in section 78(2). *CIT v. Allahabad Bank Ltd.,* (1969) 39 Com Cases 760, 763 : AIR 1969 SC 1058. These purposes are specified in Sub-section (2) and they do not include distribution by way of dividend. *Brown v. Gaumont British Picture Corpn. Ltd.,* (1937) 2 All ER 699.

The annual balance-sheet must disclose the amount of share premium as a separate item and if it is, partly or wholly disposed of, must indicate how it is disposed of or exhausted. [See Schedule VI Part I]

Any premium paid does not give the shareholder any preferential rights in case of a winding-up.

Department's Circular.—Monies in the share [*now securities*] premium account cannot be treated as free reserves, as they are in the nature of capital reserves (See *Departmental Circular No.* 3/77, dated 15-4-1977).

Reduction of securities premium account

The court has a discretion whether or not to confirm a reduction of a share [*now securities*] account and would normally do so where: (a) the shareholders are treated equally, (b) the reduction proposals are properly explained, (c) the creditors are safeguarded and (d) the reduction is for a discernible purpose. On the facts, the first two tests were satisfied. There was no danger to creditors since the use of the reserve created in the consolidated account by the reduction in the share [*now securities*] premium account to 'write-off' the goodwill in the consolidated accounts would not affect the creditors of the un-

derlying companies since they were the creditors of a particular company and not of the group. The undertakings given to the court protected the creditors in the parent company whose share [*now securities*] premium account was being reduced. The fourth test was also satisfied since the purpose of the reduction was to create a reserve against which the goodwill arising in the future on the consolidation of the accounts could properly be set-off. Since this was the practice every year, there was no chance of reverting and manipulating anything *Thorn EMI plc., Re,* 1989 BCLC 612 (Ch D); *Tip-Europe Ltd., Re,* 1988 BCLC 231 (Ch D); *Re, Ratners Group plc.,* 1988 BCLC 685 (Ch D).

In another case on the subject the main purpose of the cancellation of the company share [*now securities*] premium account was to write off an accrued deficit in the company's profit & loss account. In seeking the confirmation of the court the company gave the undertaking that the amount of the share [*now securities*] premium account would be transferred to a special reserve and the reserve would not be treated as realised profit and that the company would retain in the reserve a sum sufficient to repay certain preference shares. It was held that there was nothing in the scheme which was objectionable in principle. The creditors were protected by the undertaking and after satisfying the creditors the company could use the reserve for repayment of preference shares or as profits available for distribution. The court confirmed the cancellation. *B. Quayle Munro Ltd., Re,* (1994) 1 BCLC 410 (CS). The Court **followed** the principle laid down in *Drown v. Gaumont Bristish Picture Corporation,* (1937) Ch 402 to the effect that once the funds in the share [*now securities*] premium account are released by cancellation of the account, they become available to be distributed as profits by way of dividend. In the absence of any statutory restriction to the contrary they are also available for redemption of redeemable shares.

Cancellation of share Premium Account

§ For comments on this topic, see Notes under section 100, under the same heading.

In a Newzealand case the company sought confirmation by the court of a special resolution to distribute from time to time its share premium account to its ordinary shareholders. The directors were to transfer from the revenue reserves to a special capital replacement fund an amount equal to the amount to be distributed. That fund was not to be available for payment of dividends nor to be distributed to shareholders without the consent of the court but could be applied in paying up unissued shares as fully paid bonus shares. No objections had been received from creditors. The company was solvent. The sundry trade creditors had been regularly paid. The court said that the distribution of a share premium account is equivalent to an actual return of paid-up capital and can only be made in precisely the same way as a reduction of capital. The motives of the company enabling it to distribute dividends in part tax free in the hands of the shareholders did not affect confirmation by the court. Where there is evidence of the company's intention to pay its tax and its creditors, other than monthly trade creditors, consent to the reduction and the company is solvent, these are "special circumstances" in which the court may dispense with the provisions of the Act [s. 101(3)]. The court may dispense with an inquiry as to creditors on condition that a fund is held for their payment. *Hodder & Trolley Ltd.* (1975) 2 NZLR 395 (NZ).

For general guidance see *Ransomes plc Re,* (1999) 2 BCLC 591 (CA) where the Court of Appeal confirmed the sanctioning of a scheme to reduce the share premium account of a company and reviewed the relevant principles guiding the court in dealing with applications for sanction. For further Notes on this case see under section 100.

Reduction of premium per share

A company issued convertible debentures. The conversion was to be at a stated rate of premium. The market value of the shares was below the premium amount. The company passed a resolution for cancellation of the premium amount which was to be collected with the third and final call. The objecting creditors' interest was secured by making de-

posit in the court. The resolution for reduction was confirmed. *OCL India Ltd. Re,* (1999) 95 Com Cases 429 (Ori) : AIR 1998 Ori. 153.

Shares issued at premium before Companies Act, 1956 [Sub-section (3)]

The provisions of the section are equally applicable even where a company had issued shares at premium before the commencement of the 1956 Act, except to the extent the premium had become an integral part of the company's reserves and it is not separately identifiable.

Writ petition for general directions to SEBI

A writ petition was filed seeking following directions to SEBI, among others: (1) to stop all public as well as rights issues for which the SEBI had given permission and which were about to come to the market, (2) to prohibit such companies from utilising the premium for any purpose other than that stated in section 78, (3) to refuse approval to the rights issues coming with a premium above the face value, and (4) a direction to the Monopolies and Restrictive Trade Practices Commission to investigate such companies. It was held, dismissing the petition, that the court could not in its writ jurisdiction issue such type of general directions to respective bodies of the Government of India who were regulating the sale and purchase of shares of public limited companies. Such matters were essentially policy matters which lay exclusively within the domain of the Government. The court could only examine a particular action complained of in a particular transaction if a case to that effect was made out and if it fell within the four corners of the court's writ jurisdiction. *Murlidhar Sodani v. SEBI,* (2001) 105 Com Cases 815, 816 (MP).

Pricing by Companies Issuing Securities

SEBI (Disclosure and Investor Protection) Guidelines, 2000.—Chapter III of the Guidelines on pricing of securities in a public issue provides that the companies eligible to make public issue can freely price their equity shares or any security convertible at later date into equity shares as per the norms and the conditions laid down therein under the following heads:

(1) Public/Rights Issue by Listed Companies
(2) Public Issue by Unlisted Companies
(3) Public issue by Infrastructure company
(4) Initial public Issue by Banks
(5) Differential Pricing
(6) Composite issue and justification for the price difference
(7) Price Band

§ For details, See Notes under section 56.

§ For text of SEBI (Disclosure and Investor Protection), Guidelines, 2000, see *Appendix* 162.

Pricing norms for OTCEI issues under SEBI Guidelines, 2000

See Notes under section 73.

Penalty for default.—No penalty has been specifically provided in the section for the violation of its provisions. Accordingly, the company and every officer, who is in default, shall be punishable under section 629A.

Compoundable offence.—The offence, however, is compoundable under section 621A.

Secretarial Action Points for issue of shares at a premium

Follow the procedure for making public issue of shares. In particular, the following additional points should be considered for issue of shares at a premium:—

1. *Pricing of the issue*—The issue of shares on a preferential basis can be made at a price not less than the higher of the following:

(i) the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date, or

(ii) the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Explanation:

(a) "relevant date" for this purpose means the date thirty days prior to the date on which the meeting of general body of shareholders is convened in terms of section 81(1A) of the Companies Act to consider the proposed issue, as per revised SEBI Guidelines, Press Release, dated August 4, 1994.

2. Decide on the premium to be charged in consultation with the lead manager to the issue.

3. Give full justification for the premium in the offer document.

4. Give notice of the Board meeting to consider issue of shares at a premium to the stock exchanges at least 48 hours before the meeting and give intimation of the terms of the issue to the stock exchanges after the meeting.

5. Ensure that the share premium account is applied only for the purpose stated in section 78 of the Companies Act.

Secretarial Practice Notes : Premium received on issue of shares

Whether shares were issued at premium during the period? If so, check that:

(i) the amount had been transferred to the "Securities Premium Account";

(ii) the amount standing to the credit of securities premium account was applied in accordance with the provisions of the section for the specified purposes;

(iii) the balance in securities premium account had been shown properly in the balance-sheet;

(iv) the premium is fixed as per guidelines issued by SEBI.

Documents Involved: 1. Minutes of Board/General Meeting, 2. Annual Report.

S. 79. Power to issue shares at a discount.—(1) A company shall not issue shares at a discount except as provided in this section.

(2) A company may issue at a discount shares in the company of a class already issued, if the following conditions are fulfilled, namely :—

(i) the issue of the shares at a discount is authorised by a resolution passed by the company in general meeting, and sanctioned by the [1][*Central Government*];[2]

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1. **Subs. for "Company Law Board", by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 12. Earlier "Company Law Board" were subs. for "the Court" and the proviso to clause (ii) of sub-section (2) was added by the Companies (Amendment) Act (XLI of 1974), s. 9 (w.e.f. 1-2-1975).**

2. Application fee is Rs. 1000/- *vide* GSR 219(E), dt. 2-3-2000, w.e.f. 1-4-2000 under CLB (Fees on Applications & Petitions) Rules, 1991. See *Appendix* 6.

(ii) the resolution specifies the maximum rate of the discount [3][****] at which the shares are to be issued :

[4][*Provided* that no such resolution shall be sanctioned by the [5][*Central Government*] if the maximum rate of discount specified in the resolution exceeds ten per cent[6] [7][*unless the Central Government is of opinion*] that a higher percentage of discount may be allowed in the special circumstances of the case;]

(iii) not less than one year has at the date of the issue elapsed since the date on which the company was entitled to commence business; and

(iv) the shares to be issued at a discount are issued within two months after the date on which the issue is sanctioned by the [8][*Central Government*] or within such extended time as the [8][*Central Government*] may allow.

(3) Where a company has passed a resolution authorising the issue of shares at a discount, it may apply to the [8][*Central Government*] for an order sanctioning the issue; and on any such application, the [8][*Central Government*], if, having regard to all the circumstances of the case, it thinks proper so to do, may make an order sanctioning the issue on such terms and conditions as it thinks fit.

[9][*Provided that in the case of revival and rehabilitation of sick industrial companies under Chapter VIA, the provisions of this section shall have effect as if for the words "Central Government", the word "Tribunal" had been substituted.*]

(4) Every prospectus relating to the issue of the shares shall contain particulars of the discount allowed on the issue of the shares or of so much of that discount as has not been written off at the date of the issue of the prospectus.

If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [10][five hundred rupees].

[11] [Note :— Nothing contained in sub-section (1) shall affect any issue of shares at a discount which has been sanctioned by the court or any proceeding relating to such sanction which is pending before the court at the commencement of the Companies (Amendment) Act, 1974.]

NOTES

Eng. Act, 1948 : Sec. 57.

Previous Act : Sec. 105-A.

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Central Government to be exercised by it in place of the Company Law Board. The commentary and the procedure should

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3. Omitted by Amendment Act (XLI of 1974), s. 9 (w.e.f. 1-2-1975).
4. Ins. by Act 41 of 1974, s. 9 (w.e.f. 1-2-1975).
5. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 12.**
6. Allowed discount upto 25% to Mare Steel Castings (P) Ltd. in 1994.
7. **Subs. for "unless that Board is of opinion", by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 12.**
8. **Subs. for "Company Law Board", by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 12. Earlier subs. by Act (XLI of 1974), s. 9 for "the Court", (w.e.f. 1-2-1975).**
9. **Ins. by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 12.**
10. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) S. 34 (w.e.f. 13-12-2000).
11. Added by section 9(2) of the Amendment Act (XLI of 1974).

be read keeping this change in mind. However, the powers under this section have been vested in the Tribunal in case of revival and rehabilitation of sick industrial companies.

Companies Act, 1956

This is mainly based on section 105A of the previous Act. On the recommendation of the Joint Committee it was provided that discount higher than 10% may be allowable, with the permission of the Central Government. [§ See *Notes on Clause* 73 of the Companies Bill, 1953 and para 36 of the *Joint Committee's Report*].

Companies (Amendment) Act, 1974

Under the amendment of 1974, the Powers of the Court to sanction issue of shares at a discount, were, instead, conferred on the Company Law Board. Other were of a clarificatory nature. For the reasons for substituting "Company Law Board" for 'Court'. See Notes under section 17.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 50 rupees to 500 rupees under sub-section (4).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Central Government. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill initially stated thus:

Notes on Clause.—This clause seeks to amend section 79 of the Companies Act, 1956 relating to power to issue shares at a discount. The provisions contained in the existing section empower the Company Law Board to sanction issue of shares at discount. It is proposed to confer the said power upon the Tribunal [now Central Government] . This amendment is of consequential nature. (*Clause* 11 of the Companies (Amendment) Bill, 2001).

However the power under this section has been vested in the Tribunal constituted under Part 1B of the Act in case of revival and rehabilition of Sick Industrial Companies.

Issue of Shares at discount [Sub-sections (1) and (2)]

Shares can be issued at a discount on the fulfilment of the following conditions:

(1) The shares to be issued are of a class which has already been issued previously by the company,

(2) Such issue is authorised by a resolution of the shareholders,

(3) Sanction of the Company Law Board is obtained,

(4) The resolution must specify the maximum rate of discount, not exceeding 10%, unless the Company Law Board has sanctioned a higher rate,

(5) One year has elapsed since the company was entitled to commence business, and

(6) The shares are issued within two months of the sanction by the Company Law Board, or within such period as extended.

This section provides for allowing a higher discount than ten per cent in proper cases, where the permission of the Company Law Board is obtained therefor.

It is not necessary to disclose the issue of such shares or particulars of the discount allowed thereon, in any balance-sheet of the company, issued subsequent to the issue of the shares.

The section applies only to cases of discount allowed on the nominal value of the shares offered, and does not cover cases of collateral advantages offered by the company as an inducement or further consideration for the taking of shares in the company by any person as for instance, an agreement to give a sole or other distributing agency to the subscriber, for the products of the company.

Issue of shares in lieu of a bonus payable on debentures out of profits was held to be a discount issue when profits had not in fact been made. *Famatina Development Corpn. Ltd. v. Bury,* (1910) AC 439 (HL). An agreement to allot one fifth of every increase of capital as consideration for property acquired was held to be *ultra vires*. Where a valid contract is made by the company for allotment of shares in consideration of specific property or of services of substantial value, the court will not, as long as the contract stands, examine, whether the consideration is adequate but if the consideration is clearly not equivalent to the nominal value of the shares or is apparently illusory or colourable, the shares have to be treated as issued at a discount making the shareholder liable for full payment. *Hong Kong and China Gas Co. Ltd. v. Glen,* (1914) 1 Ch 527; *Gardner v. Iredale,* (1912) 1 Ch 700; *Wragg Ltd., Re,* (1897) 1 Ch 796, 836 (CA).

Allotment of shares under a scheme of amalgamation *etc.*, in lieu of the allottees surrendering their claims against the company, has been held to be not a discount issue. *Maneckchowk & Ahmedabad Mfg. Co. Ltd., Re* (1970) 40 Com Cases 819 (Guj).

Where shares are issued at a price lower than the market price but not below the nominal value of the shares, such an issue is not an issue at a discount. "At a discount" means at a price less than the nominal value.

The fact that the market quotation for the shares is already below par would not justify issuing shares at a discount. *Oarequm Gold Co. v. Roper,* (1892) AC 125.

The requirement that the shares issued at a discount should be of a class already issued is to enable the approving authority [CLB] to judge by reference to the market value of the existing shares, whether the proposed discount is reasonable or not, and the provision fixing the minimum period of one year after the commencement of business is to ensure that a reasonable time has elapsed in which the value of the existing shares may be established.

Issue at over 10% discount allowed by CLB

The Company Law Board allowed discount upto 25%. The matter before the Board was that of *Mare Steel Castings P. Ltd., Re,* (1994) 79 Com Cases 485 (CLB—Mad). Heavy losses were suffered by the company. The directors were not able to help the situation. Discount funding was, however, technically feasible and economically viable. Thus there was an adequate justification.

The Company Law Board sanctioned the issue of non-cumulative convertible preference shares permitting a discount of over 10% because the issue was in the interest of the company. The order was subject to the conditions that the promoters' holding was not to be increased, converted equity shares were to be listed within 10 weeks of conversion and that the sanction was valid only for two months after the date fixed for conversion. *Jersey India Ltd., Re,* (1997) 88 Com Cases 854 (CLB—NB).

Issue of sweat equity shares

Issue of sweat equity shares to employees and directors at a discount under section 79A is outside the scope of this section. Sanction of the Company Law Board is not required even if the issue is at a discount.

Reissue of forfeited shares

Where partly paid shares are forfeited for non-payment of further call, if they are reallotted not as partly paid shares but as fully paid shares, the reallotment will amount to allotment at a discount and will, therefore, be invalid. *Biochemical and Synthetic Products Ltd. v. ROC,* (1962) 32 Com Cases 654 : AIR 1962 AP 459.

Position under English Law

In England with effect from June 23, 1980, the date on which the Companies Act, 1980 came into force, it is unlawful for a company even with the sanction of the court to issue share at a discount, as per section 21 of Companies Act, 1980 [Section 100 of 1985 Act, (Eng)].

Discount issued in violation of the section

Where shares are issued at a discount contrary to the provisions of the section, not only the directors authorising the unauthorised issue but also the allottees, if their names have been entered in the register of members and they have accepted the allotment, will be liable to the company for the full amount of the shares. Full value of the shares can be recovered by the liquidator in the winding up of the company. *Welton v. Saffrey,* (1897) AC 299 (HL). Where share certificates have been issued showing full payment and the shares have been transferred to a *bona fide* transferee, the company would have to treat him as a fully paid shareholder and in such a case the company can receive from the directors an amount equal to the discount allowed on those shares. *Hirsche v. Sims,* (1894) AC 654 (PC). See also, *London Trust Co. v. Mackenzie,* (1893) 62 LJ Ch 870.

A person whose name is entered in the register of members in respect of shares unlawfully issued at a discount, may obtain the removal of his name from the register if he was not aware of the irregularity, did not subsequently assent to it and applied to the court promptly on discovering the facts and obviously before the commencement of winding-up. *Almada and Tirito Co.,* (1888) 38 Ch D 415 (CA). He will loose his right to be relieved if he gives assent to the transaction even though he may be ignorant of its legal effect. *Rly. Time Table Publishing Co., Re, Ex. P., Sandy's,* (1889) 42 Ch D 98 (CA); *James Pilkin Co. Ltd., Re,* (1916) 85 LJ Ch 318; A court may however grant relief if he was innocently mistaken about a fact and not about law. *Derham and Allen Ltd.,* (1946) Ch 31 : (1946) 16 Com Cases 51 (Ch D). In this case the subscriber had mistakenly assumed that the company's solicitor had carried out all the legal requirements in accordance with his directions.

Issue of convertible debentures at a discount

Where the debentures had been issued at a discount, however small and insignificant, such discount might be, if such debentures are to be converted into or exchanged for shares, of the same nominal amount, that will be tantamount to issuing the shares at the rate of discount at which the debentures had been originally issued, and, therefore, the issue of the shares in exchange or conversion will be illegal unless the conditions of section 79 are complied with and the sanction of the Company Law Board obtained for the issue. *Mosely v. Koffyfontein Mines Ltd.,* (1904) 2 Ch 108 (CA) and See *Famatina Development Corpn. Ltd. v. Bury,* (1910) AC 439 (HL); *Trustees Corporation (India) Ltd. v. CIT,* AIR 1930 PC 151.

However, it may be noted that the section does not apply to non-convertible debentures which can be issued at a discount, as such debentures do not form part of a company's capital.

Discounts paid on issue of debentures is an expenditure for income-tax purposes and whole of the amount can be deducted from income of the year and is not to be spread over to the duration of the debentures *Madras Industrial Investment Corpn. Ltd. v. CIT,* AIR 1997 SC 2063 : (1997) 25 Corpt LA 169 (SC).

Banking Companies

In the case of banking companies, section 13 of the Banking Regulations Act, provides: "Notwithstanding anything to the contrary contained in sections 76 and 79 of the Companies Act, 1956 (1 of 1956), no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one half per cent of the paid-up value of the said shares".

Petition before Company Law Board [Sub-section (3)]

The petition for seeking the sanction of the Company Law Board under sub-section (2) has to be made in Form No. 1 of Annexure II to the Company Law Board Regulations, 1991, with an application fee of Rs. 1,000/- [CLB (Fees on Applications & Petitions) Rules, 1991] and accompanied by the following documents:

(1) Copy of Memorandum and Articles of Association
(2) Copy of notice calling the meeting with explanatory statement and the resolution sanctioning issue
(3) Copy of minutes of the meeting at which the resolution was passed
(4) Copies of last 3 years audited balance sheets and profit and loss account, auditor's reports and director's reports
(5) Affidavit verifying the petition
(6) Bank draft evidencing payment of fee
(7) Memorandum of appearance in Form No. 5 of Annexure I.

§ For text of the Company Law Board Regulations, 1991 refer *Appendix* 3.

Penalty for default [Sub-section (4)]

Every prospectus relating to issue of shares at a discount by a company shall contain particulars of the discount allowed and the extent to which it has not been written off at the date of the issue of the prospectus. Non-compliance with the requirement is punishable with fine up to Rs. 500. The penalty is incurred by the company and every officer who is in default.

No penalty has been specifically provided in the section for the violation of its provisions, except in regard to sub-section (4) for non-disclosure of prescribed information in the prospectus. Accordingly, the company and every officer of the company, who is in default, shall be punishable under section 629A for issue of shares without sanction of the Company Law Board.

The Order of Company Law Board under this section shall be filed with Registrar within one month from the date of allotment under section 75(1)(*c*)(*ii*).

Compoundable offence.—The offence, however, is compoundable under section 621A.

Secretarial Action Points for issue of shares at a discount

1. Ensure that at least one year has passed since the company was entitled to commence business.
2. Ensure that the shares to be issued at a discount are of a class already issued.
3. Give notice to the stock exchanges where listed of the date of the Board meeting to consider issue of shares.

4. Hold Board meeting to consider issue of shares at a discount, decide on the date, time and place of the general meeting and approve the notice of the general meeting.
5. Immediately after the Board meeting intimate the stock exchanges where listed brief particulars of issue of shares at discount.
6. Despatch notice of the general meeting to the shareholders at least 21 clear days before the general meeting and also send 6 copies each to the stock exchanges where listed.
7. Pass the resolution at the general meeting, specifying the maximum discount at which shares are to be issued.
8. Forward a copy of the proceedings to the stock exchanges.
9. Make a petition to the CLB in Form 1 of Annexure II to the CLB Regulations, 1991 together with the documents specified in S. No. 7 of Annexure III thereto, along with fees of Rs. 1,000.
10. Upon receipt of order of CLB, give notice of the order to the Registrar in Form No. 21.
11. Deliver a certified copy of the order to the ROC within one month of the date of the order. For this purpose, the time taken for obtaining a copy of the order shall be excluded.
12. Ensure that the prospectus to be issued by the company contains particulars of the discount allowed on the issue of shares or the discount not yet written off on the date of issue of shares.

Secretarial Practice Notes : Issue of shares at a discount

Check whether the company had issued shares at a discount? If so, check whether:

(i) it is authorised by Articles.
(ii) it was duly authorised by a resolution passed by the company in general meeting?
(iii) the resolution specified the rate of discount?
(iv) not less than one year as at the date of the issue had elapsed since the date on which the company was entitled to commence business?
(v) a petition prescribed under the Company Law Board Regulations, 1991 along with the annexures specified therein was made to the Company Law Board?
(vi) the shares were issued within two months after the date of sanction by the Company Law Board?
(vii) order passed by the Company Law Board has been complied with and filed with Registrar in Form No. 21, along with return of allotment under section 75(1)(*c*)(*ii*)?
(viii) every prospectus relating to the issue of the shares contained particulars of the discount allowed and of the amount not written off?

Documents Involved : 1. Minutes of Board/General Meeting, 2. Order of the Company Law Board, 3. Prospectus, 4. Acknowledgment receipt of ROC.

[1][*S. 79A. Issue of sweat equity shares.—(1) Notwithstanding anything contained in section 79, a company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled, namely:—*

1. Ins. by Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).

(a) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;

(b) the resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations[2] made by the Securities and Exchange Board of India in this behalf:

Provided *that in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.*

Explanation I.—For the purposes of this sub-section, the expression "a company" means company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

Explanation II.—For the purposes of this Act, the expression "sweat equity shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

(2) All the limitations, restrictions and provisions relating to equity shares shall be applicable to such sweat equity shares issued under sub-section (1).]

NOTES

Companies (Amendment) Act, 1999

This section has been inserted by the Companies (Amendment) Act, 1999 to provide for issue of sweat equity shares subject to fulfilment of certain conditions, namely:

(i) Issue of sweat equity is authorised by a special resolution passed by the company in general meeting;

(ii) The special resolution shall specify the number of sweat equity shares to be issued, current market price of equity shares of the company, consideration, if any, payable on such shares and the class or classes of directors or employees to whom the same is proposed to be issued;

(iii) There must be a gap of at least one year from the date on which the company is entitled to commence business before issue of sweat equity shares, in case of a public company;

(iv) The listed companies shall follow regulations made by SEBI; private companies and unlisted public companies shall follow the rules prescribed by the Central Government, in this behalf.

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2. SEBI (Issue of Sweat Equity) Regulations, 2002 issued vide SO 1031(E), dt. 24-9-2002 are the prescribed guidelines relevant for the section, see *Appendix* 175.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Sweat Equity shares

Under this section equity shares can be issued to employees or directors of a company at a discount or for consideration other than cash, in recognition of their contribution for providing know-how or making available intellectual property rights or value additions to the benefit of the company (*vide Explanation II*). The contribution made by the employees/directors generate increased profits to the company for a number of years and sweat equity provides a new form of compensation to them by way of adequate return in the form of discounted share or shares for consideration other than cash.

Sweat equity may be issued by a company incorporated under the Companies Act, 1956 or its subsidiary incorporated in a country outside India (*vide Explanation I*). Under sub-section (2), these are equity shares for all intents and purposes and all limitations or restrictions and provisions made under the Act relating to equity shares also apply to sweat equity shares. The sweat equity shares must be of the same class of equity shares as already issued by the company.

Sweat equity may be issued to an employee or a director for providing technical know-how, drawings, design, development technology, software etc. to the company. The company will be benefited by use of improved technical know-how and research provided by them.

Intellectual Property Rights.—Sweat equity may be issued to an employee or a director for making available rights in the nature of intellectual property rights. These are exclusive property rights of which the owners can prevent them from being used by others without their authorisation. Such rights are:

(i) Patent for an invention;
(ii) Copyright in selected rights, including works in the literary, artistic and scientific domain;
(iii) Trade Mark registered under the Trade Marks Act, 1999 or trade marks in respect of which application is pending for registration before the Registrar of Trade Marks;
(iv) Industrial design;
(v) Layout design of integrated circuit;
(vi) Undisclosed information;
(vii) Any other such right.

Know-how.—Sweat equity may be issued to an employee/director for providing technical know-how, drawings, design, technology, software, etc. to the company.

Value additions.—Increase in the value of the company's products, in economic terms, which is attributable to the efforts of an employee or a director, may be in any form. Value addition in a tangible form can have this meaning that the employees contri-

bution brings about a better surplus in working results. There is, in consequence, a greater profitability which can be shared with employees by issuing sweat equity.

Issue of Sweat Equity at discount.—Section 79 provides for issue of shares at a discount with the approval of Company Law Board [*Now Central Government*]. Section 79A starts with a *non-obstante* clause and accordingly, sweat equity shares may be issued at a discount as per the provisions of section 79A without recourse to section 79 and approval of the Company Law Board.

Issue of Sweat Equity for consideration other than cash.—Shares may be issued for consideration other than cash for acquisition of an asset—tangible or intangible. Sweat equity shares are issued by a company to compensate the employees/directors for contributing an intangible asset which is for the benefit of the company for a long period in the form of technical know-how, intellectual property rights or value additions.

There can be a provision for allotment of shares under a rights issue for payment in kind. *Siemens AG v. Nold,* (1997) 1 BCLC 291 [Court of Justice of European Community (ECJ)].

SEBI (Issue of Sweat Equity) Regulations, 2002

Clause (d) of section 79A(1) empowers SEBI to make regulations in respect of issue of sweat equity shares by listed companies. Pursuant to these provisions, SEBI has issued SEBI (Issue of Sweat Equity) Regulations, 2002.

§ For text of the "SEBI (Issue of Sweat Equity) Regulations, 2002 refer *Appendix* 175.

Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 Proviso to clause (d) of section 79A(1) provides that in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed. Department of Company Affairs has issued Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 [*vide GSR 923(E), dt. 4-12-2003*].

§ For text of the said Rules, refer *Appendix* 45.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 19 under Rule 3 relates to issue of capital and securities and reads as follows:

Paragraph-19.—**The company has issued..... shares/ debentures/other securities during the financial year and compiled with the provisions of the Act.**

Issue of Sweat Equity Shares [Item (e)]

Prescribed Check List

Check whether:

(i) at least one year has elapsed since the date on which the company was entitled to commence business;

(ii) that the sweat equity shares issued are shares only of a class already issued;

(iii) that a special resolution was passed at a general meeting authorising the issue;

(iv) also that the special resolution specified the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such shares are to be issued;

(v) whether the company has filed Form No. 23 with the ROC along with a copy of the resolution within 30 days from the date the resolution was passed;

(vi) the issue of sweat equity shares by an unlisted company was in accordance with the guidelines as prescribed by the Central Government.

If the Company is a Listed Company also check whether:

(vii) the company had forwarded 3 copies of the notice and one copy of the proceedings of the general meeting to the stock exchange;

(viii) that the issue was in accordance with the regulations made by SEBI in this regard;

(ix) if the shares were issued for consideration other than cash, the Articles of the company permit the same.

For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

For the text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

[1][*Issue and Redemption of preference shares*]

S. 80. Power to issue redeemable preference shares.—(1) Subject to the provisions of this section, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed:

Provided that—

(a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) the premium, if any, payable on redemption shall have been provided for out of the profits of the company or out of the company's [2][*security premium account*], before the shares are redeemed;

(d) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have been available for dividend, be transferred to a reserve fund, to be called [3][the capital redemption reserve account], a sum equal to the nominal amount of the shares redeemed; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if [3][the capital redemption reserve account] were paid-up share capital of the company.

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1. Subs. by the Companies (Amendment) Act, 1988 for the heading "Redeemable preference shares" s. 12 (w.e.f. 15-6-1988) *vide* GSR No. 559(E), dated 10-6-1988.
2. Subs. for 'share premium account' by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).
3. Subs. by Act 65 of 1960, s. 23 for "the capital redemption reserve fund".

(2) Subject to the provisions of this section, the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided by the articles of the company.

(3) The redemption of preference shares under this section by a company shall not be taken as reducing the amount of its authorised share capital.

(4) Where in pursuance of this section, a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued; and accordingly the share capital of the company shall not, for the purpose of calculating the fees payable under [4][section 611], be deemed to be increased by the issue of shares in pursuance of this sub-section:

Provided that, where new shares are issued before the redemption of the old shares, the new shares shall not, so far as relates to stamp duty, be deemed to have been issued in pursuance of this sub-section unless the old shares are redeemed within one month after the issue of the new shares.

(5) [5][The capital redemption reserve account] may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

[6][(5A) Notwithstanding anything contained in this Act, no company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1996, issue any preference share which is irredeemable or is redeemable after the expiry of a period of twenty years from the date of its issue.]

(6) If a company fails to comply with the provisions of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [7][*ten thousand rupees*].

NOTES

Eng. Act, 1948 : Sec. 58.
Eng. Act, 1985 : Secs. 159, 160.

Previous Act : Sec. 105-B.

Companies Act, 1956

The section is mainly based on section 105-B of the previous Act and the section 58 of the English Act of 1948. See recommendation of the Company Law Committee (page 300 of the *Report*) and Notes on clause 74 of the Companies Bill, 1953. The Joint Committee made certain changes in the draft of the section, thus:

"The intention of this clause is to provide for the redemption of redeemable preference shares issued by a company either out of its profits or out of capital specially raised for the purpose and not from the sale-proceeds of other property of the company". (*Joint Committee Report*, para 37).

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4. Subs. by Act 65 of 1960, s. 23 for "Sec. 601".
5. Subs. by Act 65 of 1960, s. 23 for "the capital redemption reserve fund".
6. Subs. by the Companies (Amendment) Act, 1996 (w.e.f. 1-3-1997) for the following:
   "(5A) Notwithstanding anything contained in this Act, no company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1988, issue any preference share which is irredeemable or is redeemable after the expiry of a period of ten years from the date of its issue."
   which was inserted by the Companies (Amendment) Act 1988, s. 13 w.e.f. 15-6-1988 *vide* GSR No. 559(E) dated 10-6-1988.
7. The words "one thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) S. 35 (w.e.f. 13-12-2000).

The section as originally drafted contained the words "or out of the sale-proceeds of any property of the company". These words were deleted by the Joint Committee as in their opinion, the existence of such words would enable a company to redeem the shares practically at will.

Companies (Amendment) Act, 1960

The amendment in the section was carried out as per the recommendation of the Companies Act Amendment Committee of 1957, to the effect that in sub-sections (1)(d) and (5), the word 'account' was substituted for the word 'fund', to read as 'capital redemption reserve account'. [*Report*: Para 45]. See also Notes on clause 22 of the Companies Amendment Bill, 1959.

Companies (Amendment) Act, 1988

Sub-section (5A) introduced by Amendment Act of 1988 prohibited the issue of irredeemable preference shares or which are redeemable after more than 10 years from the date of issue. See section 80A and Notes thereunder.

Companies (Amendment) Act, 1996

Sub-section (5A) introduced by the Amendment Act of 1988 has been substituted by the Amendment Act of 1996. The effect of the substitution is that new issues of preference shares with effect from 1-3-1997 can be made redeemable within a period of twenty years from the date of issue instead of only ten years.

The change made by the Amendment Act of 1996 was recommended by the Parliamentary Committee on Home Affairs which stated thus: "This clause seeks to amend section 80(5A) of the Companies Act, 1956, to enhance the issue period of redeemable preference shares from ten years to twenty years so as to enable the companies to mop up finance for capital intensive projects, particularly, in the infrastructure sector. The Committee, while agreeing with the general principle of this clause, recommends that a provision should also be made in this clause whereby investors can exercise the option of redeeming the shares at the end of ten years' period, unless they opt to keep them with the companies for a full period of twenty years". (*Clause 5*).

Companies (Amendment) Act, 1999

The Companies (Amendment) Act, 1999 with effect from 31st October, 1998 has substituted the words, "share premium account" by the words, "security premium account" mentioned in clause (c) of sub-section (1) of this section, to cover premium collected on securities other than shares as specified in section 2(h) of the Securities Contracts (Regulation) Act, 1956.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 1,000 rupees to 10,000 rupees under sub-section (6).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Issue of redeemable preference shares and conditions governing redemption of such shares [Sub-sections (1), (2) and (3)]

A company may issue redeemable preference shares, if its articles of association so authorise. Redeemable preference shares may be issued stipulating a date on which they would be redeemed, or in the alternative they may be made redeemable at the option of the company. The period of redemption, however, cannot exceed *twenty* years from the date of issue of such shares by virtue of provisions of sub-section (5A).

The redemption can be effected only on the following conditions:

(i) Redemption of such shares must be effected on such terms and in such manner as laid down in the articles of association of the company;

(ii) Such shares can be redeemed out of the profits or out of proceeds of a fresh issue of shares made for this purpose;

(iii) Such shares must be fully paid-up;

(iv) Premium, if any payable on redemption of such shares should be provided from out of the profits or out of company's security premium account; and

(v) An amount equal to redemption amount must be transferred to 'capital redemption reserve account', where the redemption is effected out of profits, otherwise available for distribution as dividend.

The redemption of preference shares does not tantamount to reduction of the company's authorised share capital.

Fees and Stamp Duty [Sub-section (4)]

No fee is payable, for the issue of shares to redeem the preference shares is not an increase in capital, further, if the old shares are redeemed within one month of the issue of new shares, no stamp duty would be payable.

Utilisation of capital redemption reserve account [Sub-section (5)]

The amount credited to capital redemption reserve account, on redemption of the redeemable preference shares, can be applied by the company by way of issue of Bonus shares, in case of fully paid-up shares.

Shareholders remedy against failure to redeem

The section does not provide as to what remedy the shareholders will have, in case the company fails or is unable to redeem any preference shares which it has issued as redeemable by a certain date. If the shares are only liable to be redeemed at the option of the company, the shareholders can have no grievance. Where, however, the company has undertaken to redeem after the expiry of a particular period and fails to do so possibly an order for winding up may be obtained against the company on the just and equitable ground. According to PALMER'S COMPANY LAW (34.24 p. 536, 24th Edn., 1987) the company would be wound up by the court but this would depend upon the circumstances of each case. The court, however, will not, in the case of a going concern showing progressive results, lightly make an order for winding up merely on the ground that redeemable preference shares have not been redeemed at or before the time fixed either because of absence of sufficient profits out of which alone they could be redeemed or because circumstances are such that the raising of funds through a fresh issue of shares is not feasible.

The due date for redemption can be postponed with the consent of the preference shareholders. The procedure to be followed would be either approval of CLB where s. 80A is applicable or that of s. 106 for variation of class rights or that of s. 391 for sanction of a scheme of arrangement. They are also entitled to exercise voting rights under section 87(2).

It is, however, possible, to sustain a claim for compensation for breach of terms, where the terms of issue would permit such claim. See *Barclays Bank plc. v. British and Commonwealth Holdings plc.*, (1996) 1 BCLC 1 : (1996) 1 All ER 381.

Redeemable preference shareholder not a creditor

It must be remembered that a preference shareholder is only a shareholder and cannot as a matter of course claim to exercise the rights of a creditor. Preference shareholders are only shareholders and not in the position of creditors. They cannot sue for the money due on the shares undertaken to be redeemed, and cannot, as of right, claim a return of their share money except in a winding-up. In *Lalchand Surana v. Hyderabad Vanaspathy Ltd.*, (1990) 68 Com Cases 415 at 419 (AP), where a preference shareholder was denied redemption in spite of maturity, he was not allowed to file a creditor's petition for a winding-up order under section 433(e). An unredeemed preference shareholder does not became a creditor.

Redemption of preference shares

The redemption of preference shares can be effected out of the profits of the company available for distribution as dividend or from the proceeds of a fresh issue of capital. Where the preference shares are redeemed otherwise than out of a fresh issue the company must build up a capital redemption reserve under proviso (d) to Sec. 80(1). The reason for such a provision is the fundamental principle that the capital of the company must be maintained intact. The redemption of preference share capital would deplete the capital of the company. *Shashi Bala Namitlal v. CIT*, (1964) 34 Com Cases 985 (Guj). Any reserve created under section 80 by whatever name called is the capital redemption reserve and not a provision. *Addl. CIT v. Bharat Fritzner (P.) Ltd.*, 1979 Tax LR 1117 (Karn). Any redemption of redeemable preference shares should be notified to the Registrar within one month of the date of redeeming (Section 95).

If the company fails to honour its obligation to redeem redeemable shares it will clearly be in breach of contract. If the company is still a going concern the shareholder may sue for damages in respect of the breach of contract.

It must be noted that redeemable preference shares can be issued only where authorised by the articles of a company. The company may wipe them out in which case they will no longer be a part of the company's capital. *Serpell & Co., Re*, (1944) 14 Com Cases 223, 224 (Ch D).

Other shares already issued cannot be converted into redeemable preference shares even by means of a scheme of arrangement. If any issued preference shares are to be converted into redeemable preference shares the proper course is to effect a reduction of capital to be followed by a subsequent increase. See *Re, St. James Court Estates Ltd.*, (1944) Ch 6.

Redemption of preference shares constitutes an exception to the restriction contained in section 77 though redemption is the same thing as a company buying its own shares. *Anarkali Sarabhai v. CIT*, (1997) 89 Com Cases 28 (SC). **Affirming** *sub-nom Anarkali Sarabhai v. CIT, Gujarat* (1997) 1 Comp LJ 369 (Guj). **Approving** *Sath Gwaldas Mathurdas Mohata Trust v. CIT*, (1997) 1 Comp LJ 359 (Bom).

Redeemable preference shares must be specified in the balance-sheet. (See Scheduie VI).

Department's Circular.—It would not be desirable to use the general reserves of the company for purposes of redeeming the preference shares as long as there is a debit balance in the Profit & Loss Account. (*Department's Letter No.* 8/80/67-PR, dated 13-11-1957).

Redemption of preference shares by conversion

The redemption of preference shares can be effected only by payment in cash. Unless the terms of the issue of the shares provide for an option of conversion into equity shares,

the preference shares have to be redeemed in cash. Any scheme of conversion will require the compliance of sections 81, 106, 391 and 392 of the Companies Act.

Conversion of preference shares into loans

The Kerala High Court sanctioned a scheme for conversion of preference shares into loans under Sec. 391. The company was not functioning profitably and the preference share holders consented to the scheme. The Court said that the provisions of s. 80(1) would also have to be complied with. The provisions contained in section 80(1) are to protect the preferential shareholders and their interests from any unilateral action of the company and its equity shareholders. When the company unilaterally, without the participation of the preferential shareholders, decides to redeem their stake, naturally, it shall be in terms of section 80(1) of the Act and not otherwise. *PSI Data Systems Ltd. Re* (1999) 98 Com Cases 1 at 2 : AIR 2000 Ker 23 : (1999) 21 SCL 179 (Ker).

Notice of redemption

When preference shares have been redeemed, notice must be given to the Registrar within 30 days of the redemption [Section 95(1)(*e*)].

Extension of time for redemption

The company may find that as the time of redeeming the preference shares approaches it would be more advantageous to extend the date of redemption of the preference shares. This may be either because adequate provision for redemption has not been made, or because the company may have on hand an expansion programme and parting with funds at this particular point of time may not be advantageous. In such a situation the incentive offered to the shareholders is a higher rate of dividend if they agree to extend the date of redemption. The approval of both the equity and preference shareholders would be necessary if the date of redemption is being extended.

Penalty for default [Sub-section (6)]

For non-compliance with the provisions of this section, regarding the issue of redeemable preference shares, the company, and its every officer who is in default, are punishable with fine which may extend to ten thousand rupees.

Compoundable offence.—The offence is compoundable under section 621A.

Guidelines for Foreign investments in Preference Shares

Guidelines, dated 31-7-1997.— § For the Guidelines, see Notes under s. 81.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 21 under Rule 3 relates to redemption of preference shares and debentures and reads as follows:

***Paragraph-21.*—The company has redeemed..... preference shares/ debentures during the year after complying with the provisions of the Act.**

Prescribed Check List

Redemption of Preference Shares [Item (a)]

Check whether any preference shares have been redeemed; if so check :

(i) the provisions contained in Articles of Association have been complied with;

(ii) the conditions set out in section 80 of the Act have been met; and

(iii) Form No. 5 has been filed with the ROC within 30 days from the date of redemption.

For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Documents Involved : 1. Prospectus, 2. Articles.

[1][**S. 80-A. Redemption of irredeemable preference shares, etc.**—(1) Notwithstanding anything contained in the terms of issue of any preference shares, every preference share issued before the commencement of the Companies (Amendment) Act, 1988,—

(a) which is irredeemable, shall be redeemed by the company within a period not exceeding five years from such commencement, or

(b) which is not redeemable before the expiry of ten years from the date of issue thereon in accordance with the terms of its issue and which had not been redeemed before such commencement, shall be redeemed by the company on the date on which such share is due for redemption or within a period not exceeding ten years from such commencement, whichever is earlier:

Provided that where a company is not in a position to redeem any such share within the period aforesaid and to pay the dividend, if any, due thereon (such shares being hereinafter referred to as unredeemed preference shares), it may, with the consent of the [2][*Tribunal*], on a petition[3] made by it in this behalf and notwithstanding anything contained in this Act, issue further redeemable preference shares equal to the amounts due (including the dividend thereon), in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed shares shall be deemed to have been redeemed.

(2) Nothing contained in section 106 or any scheme referred to in sections 391 to 395, or in any scheme made under section 396, shall be deemed to confer power on any class of shareholders by resolution or on [4][*any court or the Tribunal*] Central Government to vary or modify the provisions of this section.

(3) If any default is made in complying with the provisions of this section,—

(a) the company making such default shall be punishable with fine which may extend to [5][ten thousand rupees] for every day during which such default continues; and

(b) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.]

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1. Ins. by the Companies (Amendment) Act, 1988, s. 14 w.e.f. 15-6-1988 *vide* GSR No. 559(E) dated 10-6-1988.
2. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 13.**
3. With fee of Rs. 1000/- vide GSR 219(E), dt. 2-3-2000 under CLB (Fees on Applications & Petitions) Rules, 1991. For text see, *Appendix* 6.
4. **Subs. for "any court" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 13.**
5. The words "one thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 36 (w.e.f. 13-12-2000).

NOTES

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Central Government/Tribunal to be exercised by it in place of the Company Law Board/High Court. The commentary should be read keeping this change in mind.

Companies (Amendment) Act, 1988

Sachar Committee's Recommendations.—This section was inserted in 1988, on the basis of the recommendations made by the high powered expert committee on Companies and MRTP Acts (Sachar Committee). In paras 17.13—17.15, Sachar Committee made the following recommendations: "Some suggestions were made that preference shares should be abolished. But the preponderant view is for retention of the same. The view of the financial institutions is that preference shares, though not a good investment, are still helpful to them because they ensure a steady income at the initial stages. Taking an overall view, the Committee is not in a position to recommend that preference shares as such should be abolished. At the same time, it was unanimously urged that the existence of irredeemable preference shares, was an anomaly as the shareholders are compelled to be satisfied with the amount of return which is totally unrealistic and unrelated to the prevailing circumstances. We find there is sufficient justification for such a complaint. There are also instances where the companies, even though the time for redemption and repayment, have not gone in for redemption but have extended the time by a further period. We are of the view that the continuance of irredeemable preference shares is not helpful to the investing class. We, therefore, suggest that all irredeemable preference shares will become redeemable at the end of five years from the date of the commencement of the new Act if they are not already made so redeemable, within the said period. However, a situation might arise where a company may have to redeem the existing redeemable preference shares as well as the existing non-redeemable preference shares within the period of five years. This would cast a heavy burden on the finances of the company, We, therefore, suggest that a provision should also be incorporated to the effect that in case a company is not in a position to effect redemption within the stipulated period of five years, the company should have the option to convert such irredeemable preference shares into redeemable preference shares. The period of redemption in such case should not exceed twelve years and interest at a rate not less than ten per cent would be payable on such shares. This particular option that we are suggesting here should be exercised by the company within six months from the date of the new Act and interest at the rate of not less than ten per cent would also become payable from the date. In this connection, we would specifically mention that no consent of any class of members should be necessary for such conversion. Our recommendations regarding redemption should equally apply to the preference shares which are at present redeemable at the option of the company.

"As a logical extension of the abolition of non-redeemable preference shares, we also recommend that in future no company should issue any preference shares which are not redeemable within a period not exceeding twelve years. We would further suggest that when the time for redemption of preference shares comes, it should be incumbent upon the company to redeem all the shares in cash, excepting those specifically agreed to be renewed. Further, it should no longer be open to the company to take recourse to section 106 or section 391 to have an arrangement by a majority decision, subject to the confirmation of the Court. This is to ensure that the existing irredeemable preference shares are redeemed within the five years or on the expiry of 12 years, as the case may be, after which such shares may be either renewed, or paid off in cash to those who do not agree to renewal. We, would, however, recommend, that so long as the total capital is not depleted, the procedure for Court's sanction for reduction of capital should not be made applicable to redemption of preference shares. This may be done either by issue of fresh shares or debentures either to the holders or redeemed preference shares or otherwise or by crediting an equivalent amount to Capital Redemption Reserve Fund from out of profits.

"It was also felt that it would be in order to provide for a remedy in cases of default in redemption. We, therefore, suggest that company which was capable to redeeming its preference shares but had failed to do so should be prohibited from declaring any dividend only equity shares or transfer any of its profits to reserves until such time as it redeems the preference shares."

Clauses 12 to 14 of Notes on clauses of the Companies (Amendment) Bill, 1987 read as follows: "Irredeemable preference shares in which substantial resources remain locked up have been working as a damper to further investments. A new provision is sought to be introduced in the Act to ensure that all existing preference shares which are irredeemable or redeemable not earlier than ten years, are compulsorily redeemed within five years. Further, companies can issue only such preference shares in future as are redeemable within ten years. It is also sought to be provided that irredeemable preference shares can be redeemed by issue of redeemable preference shares with the approval of the Company Law Board. Failure to redeem would attract penal provisions."

It may be noted that Section 80(5A) introduced by the Amendment Act of 1988 prohibit the issue of preference shares which are irredeemable or are redeemable after a period of ten years from the date of issue. Section 80(5A) brought in by the Companies (Amendment) Act, 1996 empowers companies to issue preference shares redeemable within a period of twenty years (w.e.f. 1-3-1997). Section 80-A has been introduced to regulate the redemption of existing preference shares, in keeping with the provisions of section 80(5A).

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 1,000 rupees to 10,000 rupees under sub-section (3).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill stated thus:

Notes on Clause.—"This clause seeks to amend section 80A of the Companies Act, 1956 relating to redemption of irredeemable preference shares, etc. Under the existing provisions contained in this section where a company is not in a position to redeem any such shares within the period specified in that section and pay dividend thereon, such company may with the consent of the Company Law Board issue further redeemable preference shares equal to the amount due in respect of the unredeemed preference shares. It is proposed to confer the said power upon the Tribunal. This amendment is of consequential nature. (Clause 12 of the Companies (Amendment) Bill, 2001)."

Scope of section [Sub-sections (1) and (2)]

All irredeemable preference shares, issued before the commencement of the Amendment Act of 1988, shall be redeemed by the company within a period of 5 years from 15-6-1988. Similarly, the redeemable preference shares, issued before the commencement of

the Amendment Act of 1988, if they are redeemable after 10 years from the date of issue and not redeemed before the commencement of the said Amendment Act shall be redeemed by the company within a period of ten years, unless the same are due for redemption earlier. To avoid hardship to such companies, which are not in a position to redeem such shares and to pay dividend due thereon, with the approval of the Company Law Board, the company may issue further redeemable preference shares of an equal amount and thereupon, the unredeemed preference shares shall be deemed to have been redeemed by operation of law. The concerned class of preference shareholders, the court and the Central Government are all prevented from modifying the provisions of the section. This section has an overriding effect over the provisions of sections 106, 391 to 395 and 396.

The preference shares required to be compulsorily redeemed pursuant to section 80A may be converted into equity shares by following the procedure laid down under sections 106 and 391 plus, of course, all the requirements of capital issue, such as s. 81 (rights issue) and SEBI regulations and guidelines.

Once the provisions of section 80A are attracted to any preference shares existing on the coming into force of the Companies (Amendment) Act, 1988 the said preference shares would be required to be redeemed in accordance with the provisions of section 80A within the period prescribed under sub-section (1) of the section and not under S. 80. The proviso to sub-section (1) provides that where a company is not in a position to redeem the preference shares within the periods laid down in sub-section (1) it may with the consent of the Company Law Board issue redeemable preference shares equal to the amounts due on the unredeemed preference shares and on such an issue the unredeemed preference shares shall be deemed to have been redeemed. A combined reading of the provisions of sub-section (1) and the proviso thereto makes it amply clear that it is only where the company is not in a position to redeem the preference shares in cash that, it may, with the consent of the Company Law Board issue fresh preference shares in lieu of the unredeemed preference shares. It appears that while exercising powers under this section, CLB has no power to allow redemption of preference shares by way of their conversion into equity shares.

It may be noted that the proviso to sub-section (1) is a transitory provision and is redundant after the expiry of 5 years from the commencement of the Amendment Act of 1988 on 14-6-1993 in respect of cases covered by sub-section (1)(a) and would be redundant on expiry of 10 years on 14-6-1998 in respect of cases covered by sub-section (1)(b). Therefore, redemption of redeemable preference shares by issue of further redeemable preference share will be governed solely by section 80. *Mangalore Chemicals and Fertilisers Ltd., Re*, (1994) 79 Com Cases 551 (CLB—Mad).

Thus, where in pursuance of an order of the Company Law Board under section 80A of the Act, fresh redeemable preference shares are issued for the total value of preference shares together with the amount of dividend due thereon, the amount of unpaid accumulated dividend will be deemed dividend, and the new redeemable preference shares are to be taken to have been issued to the preference shareholders, in lieu of the arrears of preference dividend also. Since section 80A over-rides the other sections of the Companies Act, 1956, the regulatory provisions of Section 205 (which prohibits payment of dividend by a company which has accumulated losses and also payment of dividend in cash only) will not be taken to have been contravened.

It may be noted that in terms of section 80(5A), as amended by the Companies (Amendment) Act, 1996 (w.e.f. 1-3-1997), preference shares may be issued which are redeemable within 20 years. However, no consequencial amendment has been made in clause (b) of sub-section (1) of this section.

Reissue where company unable to redeem

In *Kalyanpur Cements Ltd., Re*, (1993) 3 Comp LJ 109 (CLB—Cal) the company had large accumulated losses and no distributable profit. It neither was in a position to pay

any dividend to its preference shareholders, nor had the means to redeem them within the prescribed redemption dates. A vast majority of preference shareholders of both the categories had no objection to the issue of fresh redeemable preference shares. The CLB permitted the issue for the original and accumulated dividend amount. The proposal of one of the share-holders that the company should be required to issue equity in lieu of preference shares was not sustained. As for the small individual investors who objected to the scheme, the company was directed to pay them off before the issue of fresh preference shares. To the same effect, *British India Corporation Ltd., Re*, (1994) 79 Com Cases 688 (CLB); *Ganges Manufacturing Co. Ltd., Re,* (1994) 1 Comp LJ 465 (CLB). In *Mangalore Chemicals and Fertilizers Ltd., Re*, (1994) 79 Com Cases 551 (CLB—Mad) the company was allowed to issue redeemable preference shares in place of the existing irredeemable preference shares and the Board said that it was not necessary for this purpose to obtain the consent of the preference shareholders.

Explaining the reason why the amount of accumulated dividend though not declared and, therefore, not yet due can still be applied for issue of cumulative preference shares in lieu thereof, the CLB said in *Rishi Gases Pvt. Ltd., Re*, (1995) 83 Com Cases 589 (CLB—Del) that there is sufficient authority for this purpose in the *non obstante* proviso which has the effect of excluding the other provisions of the Companies Act. [*Proviso* to sub-s. (1)]. See also *Caledonian Jute & Industries Ltd., Re,* (1996) 85 Com Cases 180 : (1995) 18 Corp LA 44 (CLB–Cal).

In *Tims Products Ltd., Re,* (1994) 4 Comp LJ 96 (CLB) similar permission was granted and as for the company's desire to issue further redeemable cumulative preference shares carrying fixed cumulative but preferential right of dividend, CLB said that the company should settle the objections of the existing preference shareholders before the further issue.

Where the company proved its inability to redeem, it was allowed to make a fresh issue of preference shares including accrued dividend whether declared or not. The number of shares was thus to increase upon reissue, but to save the company from additional burden the percentage of dividend was so reduced that every shareholder would get his originally reserved amount by way of dividend. *Caledonian Jute and Industries Ltd., Re,* (1996) 85 Comp Cas 180 : (1995) 18 CLA 44 (CLB—Cal). A similar permission was granted where the company was not able to redeem and the entire issue of preference shares being held by the company's holding company and the latter had agreed to forego the claim as to arrears of dividend. *Madras Valves Ltd., Re*, (1995) 84 Com Cases 511 (CLB—Cal). A company consistently incurred losses. Some shareholders objected to the scheme of reissue. The Company Law Board ordered settlement of the objectors' claims by paying them out and reissue of the remaining shares including shares for accumulated arrears of dividend. *Eastern Investments Ltd., Calcutta, Re*, (1994) 4 Comp LJ 555 (CLB—Cal). In *Jessop & Co. Ltd. Re*, (2000) 27 SCL 82 (CLB), reissue along with accumulated dividend was allowed for period of 10 years from the date of reissue. The CLB said that there is no power to extend the period for redemption.

The Company Law Board can grant a conditional approval for redemption. Accordingly, the condition that new shares should be issued at a higher rate of dividend was upheld by the Punjab & Haryana High Court. *Raja Ram Corn Products (Punjab) Ltd. v. CLB,* (2001) 106 Com Cases 563 : (2001) 44 CLA 290 : (2001) 34 SCL 967 (P&H—DB).

A sick industrial company was continuing to incur heavy losses. It was not able to redeem the preference shares, nor to include unpaid dividend amount in shares proposed to be issued in lieu of shares to be redeemed. There was no objection from the holders of preference shares. The Company Law Board allowed the proposed reissue but subject to certain conditions. *Naihati Jute Mills Co. Ltd. Re*, (2000) 4 Comp LJ 182 : (2000) 27 SCL 95 (CLB).

Where the company's annual accounts showed that the amounts available in the profit and loss account were more than sufficient to cover the value of the preference shares, the permission for reissue was not granted. *Kettlewell Bullen & Co. Ltd., Re,* (1995) 84 Com Cases 757 (CLB—Cal); *Auckland Holdings Ltd., Re,* (1995) 82 Com Cases 622 (CLB—Cal). Where new shares were issued without the approval of CLB and subsequently an application was filed for approval and condonation of delay, the same was rejected. *Sahu Cylinders & Udyog P. Ltd., Re,* (1998) 91 Com Cases 381 : (1997) 13 SCL 244 (CLB—Mad).

Petition before Company Law Board [Proviso to Sub-section (1)]

Petition to give consent to issue further redeemable preference shares equal to the amount due, including dividend in arrears, on unredeemed preference shares shall be made in accordance with the Company Law Board Regulations, 1991, along with an application fee of Rs. 1,000/- (w.e.f. 1-4-2000) and accompanied by the following documents:

(1) Copy of memorandum and articles of association.
(2) Documents showing the terms of issue of the existing preference shares.
(3) Copy of Board resolution and resolution of general meeting for issue of further redeemable preference shares.
(4) Copy of latest audited balance sheet and profit and loss account with auditor's/directors' report.
(5) Affidavit verifying the petition.
(6) Bank draft evidencing payment of application fee.
(7) Memorandum of appearance in Form No. 5 of Annexure I.

§ For the text of CLB Regulations, 1991 refer *Appendix* 3.

Penalty for default [Sub-section (3)]

If irredeemable preference shares or redeemable preference shares which are redeemable after the expiry of ten years from the date of issue are not redeemed within a period of five years or ten years, as the case may be, as provided in the section, every officer of the company who is in default is liable to imprisonment up to three years, and also fine. The company making default shall be punishable with fine up to Rs. 10,000/- for every day of default.

Compoundable of offence.—While the default by the company is compoundable under section 621A. The default by officers concerned is not compoundable.

Prohibition for declaring dividend in the event of default

A company which fails to redeem its irredeemable or redeemable preference shares, as per the requirements of this section, is debarred from declaring any dividend on its equity shares, so long as the default continues [Section 205(2B)].

The decision in *Raja Ram Corn Products (Punjab) Ltd. v. CLB,* (2001) 106 Com Cases 563 (P&H) was **followed** in *Raja Ram Corn Products (Punjab) Ltd. v. CLB,* (2003) 113 Com Cases 33 (P&H—DB). It was held that the Company Law Board, in permitting a company which was unable to redeem its cumulative preference shares, to issue further cumulative redeemable preference shares in lieu of those existing, was entitled to lay down conditions to the further issue, *inter alia*, that the shares to be issued should carry a dividend at a certain percentage. By virtue of the *non obstante* clause contained in the proviso to section 80A(1) of the Companies Act, 1956, the provisions contained in that section override the articles of association of the company.

Secretarial Action Points for redemption of irredeemable preference shares

1. Ensure that all redeemable preference shares existing as on 15-6-1988 are redeemed within a period of 10 years of the commencement of the section 80A of the Act *i.e.*, by 14-6-1998 or within the period fixed for redemption by the terms of the issue, whichever is earlier.

2. In case the preference shares are to be redeemed by issue of further redeemable preference shares, make a petition to the Company Law Board under Company Law Board Regulations, 1991 together with the documents set out against serial No. 8 of Annexure III thereto. The new preference shares issued on or after 1-3-1997 are redeemable within a period of 20 years from the date of the issue pursuant to section 80(5A) of the Companies Act.

Secretarial Practice Notes

Check whether:—

(a) Preference shares issued prior to 15-6-1988 are redeemed in accordance with the provision of section 80A, or a petition is made to the CLB for issue of further redeemable preference shares in lieu of those liable to be redeemed?

(b) Where such a petition is made to the CLB, check whether it is in accordance with Form No. 2 of Annexure II to the Company Law Board Regulations, 1991, duly supported by an affidavit?

(c) On issue of further redeemable preference shares in lieu of the shares to be redeemed, as per the order of the CLB, check whether notice in Form 5 has been given to the Registrar for redemption of the old shares and for issue of further shares in lieu thereof?

Documents involved: 1. Copy of petition to the CLB supported by affidavit; 2. Copy of the memorandum and articles of Association; 3. Order of the CLB; 4. Form No. 5.

ICSI Guidance Note on Compliance Certificate (August, 2003)

Redemption of Irredeemable Preference Shares under Section 80-A

Check List

Check whether the company had issued before the commencement of the Companies (Amendment) Act, 1988 preference shares which were irredeemable or not redeemable before the expiry of ten years, if so :

(i) whether steps had been taken to comply with the requirements of section 80A(1)(a) or 80A(1) (b) as the case may be;

(ii) if the company was not in a position to redeem any such share within the period specified in clause (a) or (b) of sub-section (1) of section 80A, check whether consent of the Company Law Board† had been obtained for issue of further redeemable shares equal to the amounts due (including the dividend thereon) in respect of unredeemed preference shares.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

This matter is not directly referred to in the 33 paragraphs appended to the Form prescribed under the Companies (Compliance Certificate) Rules. The Check List given by the ICSI is for the guidance of CSP who may, in the course of his scrutiny, come across non-compliance with regard to this matter. CSP need not qualify such non-compliance. [*Item 4(h) under the head 'Check List for Other Compliances'*].

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† Power transferred to the National Company Law Tribunal from the commencement of the Companies (Second Amendment) Act, 2002.

Further Issue of Capital

S. 81. Further issue of capital.—(1) [1][Where at any time after the expiry of two years from the formation of a company or at any time after the expiry of one year from the allotment of shares in that company made for the first time after its formation, whichever is earlier, it is proposed to increase the subscribed capital of the company by allotment of further shares, then—]

(a) such [2][further] shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company, in proportion, as nearly as circumstances admit, to the capital paid-up on those shares at that date;

(b) the offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days from the date of the offer, within which the offer, if not accepted, will be deemed to have been declined;

(c) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (b) shall contain a statement of this right;

(d) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner as they think most beneficial to the company.

Explanation.—In this sub-section, 'equity share capital' and 'equity shares' have the same meaning as in section 85.

[3][(1-A) Notwithstanding anything contained in sub-section (1), the further shares aforesaid may be offered to any person [whether or not those persons include the persons referred to in clause (a) of sub-section (1)] in any manner whatsoever—

(a) if a special resolution to that effect is passed by the company in general meeting, or

(b) where no such special resolution is passed, if the votes cast (whether on a show of hands, or on a poll, as the case may be) in favour of the proposal contained in the resolution moved in that general meeting (including the casting vote, if any, of the Chairman) by members who, being entitled so to do, vote in person, or where proxies are allowed, by proxy, exceed the votes, if any, cast against the proposal by members so entitled and voting and the Central Government is satisfied, on an application made by the Board of Directors in this behalf, that the proposal is most beneficial to the company.]

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1. Subs. by s. 24, Act 65 of 1960, for certain words.
2. Subs. by Companies (Amendment) Act 65 of 1960, s. 24.
3. Ins. by Companies (Amendment) Act 65 of 1960, s. 24.

(2) Nothing in clause (c) of sub-section (1) shall be deemed—

(a) to extend the time within which the offer should be accepted; or

(b) to authorise any person to exercise the right of renunciation for a second time, on the ground that the person in whose favour the renunciation was first made, has declined to take the shares comprised in the renunciation.

[4][(3) Nothing in this section shall apply—

(a) to a private company; or

(b) to the increase of the subscribed capital of a public company caused by the exercise of an option attached to debentures issued or loans raised by the company—

(i) to convert such debentures or loans into shares in the company, or

(ii) to subscribe for shares in the company:

[5][*Provided* that the terms of issue of such debentures or the terms of such loans include a term providing for such option and such term—

(a) either has been approved by the Central Government before the issue of debentures or the raising of the loans, or is in conformity with the rules, if any, made by that Government in this behalf; and

(b) in the case of debentures or loans other than debentures issued to, or loans obtained from, the Government or any institution specified by the Central Government in this behalf, has also been approved by a special resolution passed by the company in general meeting before the issue of the debentures or the raising of the loans.]]

[6][(4) Notwithstanding anything contained in the foregoing provisions of this section, where any debentures have been issued to, or loans have been obtained from, the Government by a company, whether such debentures have been issued or loans have been obtained before or after the commencement of the Companies (Amendment) Act, 1963, the Central Government may if in its opinion it is necessary in the public interest so to do, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to that Government to be reasonable in the circumstances of the case, even if the terms of issue of such debentures or the terms of such loans do not include a term providing for an option for such conversion[7].

(5) In determining the terms and conditions of such conversion, the Central Government shall have due regard to the following circumstances, that is to say, the financial position of the company, the terms of issue of the debentures or the terms of the loans, as the case may be, the rate of interest payable on the debentures or the loans, the capital of the company, its loan liabilities, its reserves, its

4. Subs. by Act 65 of 1960, s. 24 for sub-section (3).
5. Subs. by Act 53 of 1963, s. 5 (w.e.f. 1-1-1964).
6. Sub-sections (4), (5), (6) and (7) added by Act 53 of 1963, s. 5 (w.e.f. 1-1-1964).
7. Form No. 5 of the Companies (Central Government's) General Rules & Forms, 1956 is the relevant form for the sub-section.

profits during the preceding five years and the current market price of the shares in the company.

(6) A copy of every order proposed to be issued by the Central Government under sub-section (4) shall be laid in draft before each House of Parliament while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions.

(7) If the terms and conditions of such conversion are not acceptable to the company, the company may, within thirty days from the date of communication to it of such order or within such further time as may be granted by the Court, prefer an appeal to the Court in regard to such terms and conditions and the decision of the Court on such appeal and, subject only to such decision, the order of the Central Government under sub-section (4) shall be final and conclusive.]

NOTES

Previous Act : Sec. 105-C.

Companies (Amendment) Act, 1960

The scope of the amendments is thus explained by the Joint Committee : "The Committee feel that where the Board of Directors decides to increase the subscribed capital of a company by allotment of further shares, the further shares should ordinarily be offered to existing holders of equity shares *pro rata*; but these further shares may also be offered to any persons in any manner irrespective of the existing equity shareholders if a special resolution is passed by the company in general meeting or although no such special resolution is passed in that general meeting, if the proposal has been carried out by a majority of votes and the Central Government is satisfied on the application of the Board of Directors that the proposal is most beneficial to the company.

The Committee also feel that the provisions of section 81 should apply when the Board of Directors proposes to increase the subscribed capital of a company by allotment of further shares after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier.

The Committee further consider that the provisions of this section should not apply in relation to convertible loans or debentures, *i.e.*, in relation to the increased subscribed capital caused by the conversion of debentures or loans into shares of the company if the following two conditions are satisfied; namely, that the terms of issue of debentures or loans have been approved by the company by a special resolution and also have been approved by the Central Government before such issue, or such terms are in conformity with the rules made by the Central Government". (*Report*: para 26).

Companies (Amendment) Act, 1963

The Statement of Objects and Reasons appended to the Companies (Amendment) Bill, 1963 explained as follows: "In cases where Government has advanced a loan to a company, it is considered necessary that Government should have the power to direct the conversion of such a loan into shares of that company on fair and equitable terms. Where the loan agreement provides for such conversion, it is proposed to dispense with the procedure prescribed under section 81 of the Companies Act in regard to such conversion of loans given by Government and specified financial institutions. Section 81 is proposed to be amended accordingly."

In the sub-sections (4) to (7) originally drafted in the Companies (Amendment) Bill, 1963, the *Select Committee* recommended following further changes: "Sub-section (4) of

Section 81.—The Committee consider that the Central Government should direct the conversion of debentures or loans into shares in the company only when in the opinion of the Central Government public interest so demands. The Committee, however, feel that in respect of debentures issued and loans obtained by a company before the commencement of this Bill when enacted, no such conversion should be directed unless the company has made default in repayment of the amount of the debentures or loans with interest thereon or in the compliance with any other terms of such debentures or loans and the company has failed to remedy the default within three months of the service of a notice in this behalf. Sub-sections (5) and (6) of Section 81.—The amendments made are of a drafting nature. The clause has been amended accordingly." [*Report* : para 13].

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Scope of section

If a company wishes to increase its subscribed capital after one year of the first allotment of shares or after two years from the formation of the company, whichever is earlier, by allotment of further shares (popularly referred to as 'rights shares'), it will have to comply with the provisions of this section.

Any issue or allotment of shares within two years of the formation of a company or within one year after the first allotment, whichever event occurs earlier, will not be affected by the requirements of this section.

If a special resolution is passed in respect of further allotments, the procedure prescribed by sub-section (1) need not be followed.

The section is an application of the rule which was thus stated by the Court of Appeals of New York : "We are thus led to lay down the rule that a stockholder has an inherent right to proportionate shares of new stock issued for money only and not to purchase property for the purposes of the corporation or to effect a consolidation, and while he can waive that right, he cannot be deprived of it without his consent...." *Stokes v. Continental Trust Co.*, 186 NY 285 at 299 : 78 NE 1090 (1906). For a fuller account of the development of the rule in the United States see Iain MacNeil, *Shareholders' Pre-emptive Rights*, 2002 JBL 78 at p. 88. The author also considers at p. 95 the topic of "Self Regulation and Corporate Governance".

Where shares were alleged to have been allotted through a resolution passed at a meeting, the allotment was allowed to be questioned by showing that the notice of the meeting had not been sent to the respondents and the Company Law Board had recorded a finding on the basis of evidence before it that no meeting was in fact held. *M.K. Romeritics Engineers P. Ltd. v. S. Munusamy*, (2002) 50 CLA 245 : (2002) 38 SCL 846 (Mad).

This section is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the directors can decide to issue further, shares, unless, of course, they are precluded from even doing that by the Articles of Association of the company. Accordingly, the section

becomes applicable only when the directors decide to increase the capital within the authorised limit, by issue of further shares. *Nanalal Zaver v. Bombay Life Assurance Co. Ltd.*, AIR 1950 SC 172 : (1950) 20 Com Cases 179.

The judgment in *Nanalal Zaver (supra)* was **followed** by the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743, 812 : AIR 1981 SC 1298. The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if their powers are exercised not for the benefit of the company but simply and solely for personal aggrandisement and to the detriment of the company, the court will interfere and prevent the directors from doing so. Thus, the Supreme Court has recognised the limited ground on which the court would interfere in a rights issue. It follows that if the rights issue is for the *bona fide* purposes of the company, no injunction would be granted against such issue merely on the ground that it may alter the balance of power.

The power to issue shares need not be used only when there is a need to raise additional capital, although this is its primary purpose. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers, or to enable it to comply with statutory requirements. See *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743 (at p. 816) : AIR 1981 SC 1298 where the English authorities are also referred to.

Where the company is in genuine need of more capital as decided by the directors and there is nothing to doubt the director's *bona fides* or motives in a further issue of shares, the court cannot be called upon to strike down or stay the issue just only because the issue incidently benefits the directors also in their capacity as shareholders. If the company's interest are to be promoted by the issue and the statutory requirement of S. 81 have been complied with, the issue is valid even if the directors' interest are also promoted thereby. *Milan Sen v. Guardian Plastics Ltd.*, (1998) 91 Com Cases 105 (Cal).

A minority shareholder cannot ask the CLB that a further issue of shares, which he does not want to subscribe, should be stopped because it would constitute his oppression. *Sri Hari Rao v. Gopal Automotive Ltd.*, (1999) 96 Com Cases 493 : (1998) 30 CLA 373 : (1998) 17 SCL 313 (CLB–PB) The right of a company to make an issue of shares under this section is not dependent upon the capacity of any shareholder to take up the shares offered. In *Free Wheel (India) Ltd. v. Dr. Veda Mitra*, (1969) 39 Com Cases 1 : AIR 1969 Del 258 the Delhi High Court refused to grant an injunction sought by a holding company to restrain its subsidiary from making a further issue of rights shares (which the holding company would not have been able to subscribe to on account of its poor financial condition) only on the ground that the shareholding of the holding company would be reduced thereby. It may also be noted that the existing shareholders cannot object to increase on the ground that the value of the present shares would be thereby reduced. See, *Chandrakant Mulraj v. Tata Engineering and Locomotive Co. Ltd.*, (1985) 58 Com Cases 320 (Bom).

An allotment of further shares to the majority group to the total exclusion of the minority group was held to be not violative of the section because the company was in real need of more capital and the controlling group had assured the CLB that the original percentage of minority shareholding would be restored. *Suryakant Gupta v. Rajaram Corn Products (Punjab) Ltd.*, (2001) 2 Comp LJ 155 : (2001) 41 CLA 284 : (2001) 31 SCL 120 : (2001) 108 Com Cases 133 (CLB—PB—ND).

The fact that by the issue of shares the directors succeed, also or incidentally, in maintaining their control over the company or in newly acquiring it, does not amount to abuse of their fiduciary power. The mere circumstance that the directors derive benefit as shareholders by reason of the exercise of fiduciary power to issue shares, will not vitiate the exercise of the power. See *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd., (supra).*

This section is not applicable to any private company, including a private company which is a subsidiary of a public company. This means that any such company may offer its further issue of capital to any person or in any manner as it thinks best in its own interests. A private company's articles may (and usually do) provide for preemptive rights. See *Ashok Doshi v. Doshi Time Industries (P) Ltd.*, (2000) 38 CLA 278 (CLB).

In so far as a 'deemed public'* company is concerned, the Supreme Court in *Needle Industries* case (*supra*) held that—(*a*) its members do not have the right of renunciation of shares offered to them in favour of any other person(s), inasmuch as clause (c) of sub-section (1) of section 81 is not applicable to it, if it retains the characteristics of a private company, (*b*) sub-section (1A) is applicable to the limited extent that its shares can be offered to its members otherwise than on *pro rata* basis.

Any decision about the applicability of the section to such companies without taking into account the position of their articles is likely to go wrong. *Jayanthi Detergents P. Ltd. v. The Secretary, Company Law Board,* (1999) 3 Comp LJ 237 : (2001) 103 Com Cas 184 : AIR 1999 AP 174 : (1988) 18 SCL 528 (AP).

Without taking note of the decision of the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd., (supra)* and proceeding independently of it, the Madras High Court applied section 81(1) to a deemed public company* in its decision in *V. Radhakrishnan v. P.R. Ramakrishnan*, (1993) 78 Com Cases 694 (Mad). The decision is on facts, however, fully justified. The matter was between two companies of a group of companies. One of them was in winding up. It had a shareholding in the other company to the extent of nearly 31%. The minority group in that company holding 12% equity held a meeting of the Board of Directors and allotted to itself a number of shares which increased their holding to 53.91% and reduced that of the company in winding up to 16.17%. No notice whatsoever was given either to the company or to its liquidator. The validity of this issue was questioned. The company judge held that the issue was null and void. He restrained the use of voting rights in respect of the new issue. This was so because the requirements of section 81(1) were not satisfied. The company in liquidation should have been offered its proportion on rights basis. An appeal against this decision was dismissed. The company judge had jurisdiction to decide this question because it affected the property rights of the company in liquidation.

The directors have the discretion under this section to allot the unsubscribed portion to any person or persons in the best interest of the company. For the purposes of this discretionary allotment, unsubscribed portion means that part of the further issue which was offered to the existing shareholders and was either refused or deemed to have been refused by them. [at pp. 65, 66 *infra*]. An allotment of shares is a contract which, if made in contravention of a court injunction, would be contrary to public policy and void as between the company and the allottee. *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, (1997) 25 Corpt LA 54 : (1996) 87 Com Cases 705 (Guj—DB). The offer to subscribe for additional shares of a private company was sent to all the members by proper notice despatched under certificate of posting. It generated a limited response from only a few shareholders. The court naturally held that those who declined were not only not interested in the issue, they impliedly authorised allotment to others. *R Khemka v. Deccan Enterprises P. Ltd.*, (1998) 5 Comp LJ 258 : (1998) 16 SCL 1 (AP).

There has been a Canadian decision, described as a novel one, for the reason that the court held that any element of self interest on the part of directors would be fatal irrespective of whether the directors primary purpose was a proper one. *Exco v. Nova Scotia Savings & Loan Co.*, (1987) 78 NSR (2d) 91 NSSC (TD) (Canada). As a sequence to this decision there was the policy statement that nothing should be done to discourage defen-

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* The concept of deemed public companies [S. 43-A Companies] has been abolished by the Companies Amendment Act, 2000. The case literature on the subject has been retained in the interest of knowledge for handling pending matters.

sive tactics, *e.g.*, further issue or increased bid price or increased number of bidders. What is of importance is the consequence of a particular tactic and not the motives of the directors who adopted the tactic. The directors are not in breach of their fiduciary duty to the company if they act in good faith, on what they believe on reasonable and probable grounds, to be in the best interests of the company. It matters not when the directors act in the best interests of the company and in good faith that they also benefit as a result. The court found that there was no attempt on the part of directors to keep themselves entrenched in their offices. *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.*, (1987) 37 DLR (4th) 193 (Canada).

In spite of the words "Notwithstanding anything in the foregoing provisions of this section" appearing in sub-section (4), sub-sections (4) to (7) inserted by the Companies (Amendment) Act, 1963, do not apply to a Private Ltd., Company because of the wording of sub-section (3) which totally exempts Private Ltd. Companies from the operation of the section.

While the opening part of sub-section (1) generally refers to increase in the subscribed capital of the Company by allotment of further shares, without confining the same to the equity shares, by virtue of the provisions of clause (a) which speaks to offer to holders of equity shares, it may be inferred that issue of preference shares falls outside the ambit of this section.

Jurisdiction for Investor Guidance, Grievances and Complaints

Non receipt of offer for rights shares or bonus shares.—A complaint lies before the SEBI. For the format of the complaint and addresses of the forum, see *Appendix* 234.

Inclusion of a provision similar to s. 81 in the articles of a private company

Department's view.—Though under sub-section (3), the provisions of section 81 of the Companies Act, 1956 do not apply to a private company, there is nothing in the Act to prevent such a company from including in its Articles of Association, a provision on the basis of section 105C of the Indian Companies Act, 1913 or section 81 of the Companies Act, 1956. Such a provision in the Articles will be binding on the company. [*Letter No.* 8/81/58-PR, dated the 17th October, 1958.]

Powers of Board of Directors to make rights issue under sub-section (1)

The Board of Directors has inherent powers, unless otherwise provided in the articles, to increase the subscribed share capital by rights issue, so long as the procedure laid down in sub-section (1) is followed. The requirement of passing a special resolution under sub-section (1A) is necessary only when the shares are issued to the public or are placed privately in terms of s. 67(3) or proposed to be offered to any segment of the shareholders (*e.g.* promoters, foreign collaborators, employees *etc.*) to the exclusion of the rest. The shareholders' approval is, accordingly, not required for a rights issue, including the allotment of shares to the renouncees, who are not members of the company. It is, however, generally noticed that companies pass special resolution as a matter of abundant precaution.

In terms of the provisions of section 372A(8)(b), investment made in the shares allotted in pursuance of section 81(1)(a) are exempted from the provisions of section 372A.

Section 94 requires only an ordinary resolution for increase of capital *Janaki Printing P. Ltd. v. Nadar Press Ltd.*, (2000) 3 Comp LJ 285 : (2000) 36 CLA 357 : (2001) 103 Com Cases 546 (CLB–PB).

Further allotment out of unsubscribed portion of capital

Department's Clarification.—Any allotment of unsubscribed portion of issued shares as and where applications are received will not amount to an increase in the subscribed capital of the company by issuing new shares and every allotment of shares within the issued capital is the first allotment so far as those shares are concerned. Section 81(1) of the Companies Act is not therefore, applicable to the remaining shares which were issued already. The said section is also not applicable to the sale of forfeited shares for which no allotment is necessary. (*Letter No.* 2(27)/56-PR, dated 4-10-1976 to ROC, Madras.)

Right issue of shares

Department's views.—The issue of further shares by a company to its members with the right to renounce them in favour of third parties does not require the issue or registration of a prospectus. (*Letter No.* 8/81/56-PR, dated 4-11-1957.)

RIGHTS ISSUE

SEBI Guidelines, 2000

"Right issue" means an issue of capital under sub-section (1) of section 81 of the Companies Act, 1956, to be offered to the existing shareholders of the company through a Letter of Offer [*Clause 1.2.1.(xxv)*].

The following guidelines specifically relating to rights issue by a listed company[8] should be noted:

Exemption from eligibility norms.—The eligibility norms applicable to public issue by a listed company and Initial Public Offering by an unlisted company are not applicable to rights issue by a listed company [*Clause 2.4.1(iv)*].

Issue of securities in dematerialised form.—No company shall make rights issue of securities, unless—

(a) the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the existing shareholders; and

(b) the company gives an option to shareholders/investors to receive the security certificates or hold securities in dematerialised form with a depository.

Explanation:

A 'depository' shall mean a depository registered with the SEBI under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996. [*Clause 2.1.5.1*].

Partly paid-up shares.—No company shall make a rights issue of equity shares or any security convertible at a later date into equity shares unless all the existing partly paid up shares have been fully paid or forfeited. [*Clause 2.7.1*].

Filing of Letter of Offer (LOO).—No listed company shall make any issue of security through a rights issue where the aggregate value of securities, including premium, if any, exceeds Rs.50 lacs, unless the letter of offer (LOO) is filed with SEBI, through an eligible Merchant Banker, at least 21 days prior to the filing of the Letter of Offer with Designated Stock Exchange (DSE).

Incorporation of SEBI's modifications.—If, within 21 days from the date of filing of draft letter of offer, SEBI specifies changes, if any, in the draft letter of offer, (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes before filing the draft letter of offer with DSE [*Clause 2.1.2*]. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

However, in case of the rights issue where the aggregate value of the securities offered is less than Rs. 50 Lakhs, the company shall prepare the letter of offer in accordance with the disclosure requirements specified in these guidelines and file the same with the Board for its information and for being put on the SEBI website. [*Ins. by SEBI Circular No. 11, dated 14-8-2003*].

Free pricing.—A listed company may freely price its rights issue of equity shares and any security convertible into equity shares [*Clause 3.1.1*].

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8. The pre-issue obligations in relation to public issue are applicable to rights issue. See Notes under section 56.

Differential pricing.—A listed company making a composite issue of capital may issue securities at differential prices in its public and rights issue [*Clause 3.4.2*].

In the public issue which is a part of a composite issue differential pricing as per subclause 3.4.1 is also permissible [*Clause 3.4.3*].

Justification for price difference is to be disclosed in LOO [*Clause 3.4.4*].

Promoters' contribution.—The requirements of promoters' contribution shall not be applicable in case of rights issue [*Clause 4.10.1(c)*].

The existing shareholdings of the promoters and the extent to which they are participating in the proposed issue should be disclosed in LOO [*Clause 4.10.1, proviso*].

Promoters' Contribution in case of Composite Issues.—In case of composite issues of a listed company, the promoters' contribution shall, at the option of the promoter(s), be either 20% of the proposed public issue or 20% of the post-issue capital [*Clause 4.4.1*].

Rights issue component of the composite issue shall be excluded while calculating the post-issue capital [*Clause 4.4.2*].

Retention of Oversubscription.—The quantum of issue through a rights issue shall not exceed the amount specified in the letter of offer [*Clause 8.10.1*].

Period of subscription.—Right issue should be kept open for at least 30 days and not more than 60 days [*Clause 8.8.2.1*]

Despatch of LOO.—In the case of rights issues, lead merchant banker shall ensure that the letters of offer are dispatched to all shareholders at least one week before the date of opening of the issue. [*Clause 5.7.2*].

Post-issue advertisement.—1. The Lead Merchant Banker shall ensure that in case of a rights issue, an advertisement giving the date of completion of despatch of letters of offer shall be released in at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated at least 7 days before the date of opening of the issue.

2. The advertisement shall indicate the centres other than registered office of the company where the shareholders or the persons entitled to rights may obtain duplicate copies of composite application forms in case they do not receive the original application form within a reasonable time even after opening of the rights Issue.

3. Where the shareholders have neither received the original composite application forms nor are they in a position to obtain the duplicate forms, they may make applications to subscribe to the rights on a plain paper.

4. The advertisement shall also contain a format to enable the shareholders to make the application on a plain paper containing necessary particulars like name, address, ratio of right issue, issue price, number of shares held, ledger folio numbers, number of shares entitled and applied for, additional shares if any, amount to be paid along with application, particulars of cheque, etc. to be drawn in favour of the company Account - Rights Issues.

5. The advertisement shall further mention that applications can be directly sent by the shareholder through Registered Post together with the application moneys to the company's designated official at the address given in the advertisement.

6. The advertisement may also invite attention of the shareholders to the fact that the shareholders making the applications otherwise than on the standard form shall not be entitled to renounce their rights and shall not utilise the standard form for any purpose including renunciation even if it is received subsequently.

7. If the shareholder makes an application on plain paper and also in standard form, he may face the risk of rejection of both the applications [*Clauses 5.11.1 – 5.11.7*].

Minimum subscription and utilisation of funds.—The issuer company may utilise funds collected against rights issues after satisfying designated stock exchange that minimum 90% subscription has been received [*Clause 8.19.1*]. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Restriction on further issue.—No company shall make any further issue of capital in any manner whether by way of issue of bonus shares, preferential allotment, rights issue or public issue or otherwise, during the period commencing from the submission of offer document to the Board on behalf of the company for rights issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or undersubscription, etc. [*Clause 8.7.1*].

No company shall, pending conversion of Fully Convertible Debentures (FCDs) or Partly Convertible Debentures (PCDs), issue any shares by way of rights unless similar benefit is extended to the holders of such FCDs or PCDs, through reservation of shares in proportion to such convertible part of FCDs/PCDs. [*Clause 8.7.2 (a)*].

The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the rights issue was made [*Clause 8.7.2.(b)*].

Withdrawal of rights issue.—(a) An issuer company shall not withdraw rights issue after announcement of record date in relation to such issue.

(b) In cases where the issuer has withdrawn the rights issue after announcing the record date, the issuer company shall not make an application for listing of any securities of the company for a minimum period of 12 months from the record date:

Provided that shares resulting from the conversion of PCDs/FCDs/Warrants issued prior to the announcing of the record date in relation to rights issue may be granted listing by the concerned Stock Exchange(s) [*Clause 8.7.3*].

Post-issue monitoring reports.—It is the responsibility of the lead merchant banker to submit to SEBI post-issue monitoring reports in the prescribed format [*Sch. XVI*] irrespective of the level of subscription:

The due dates for submitting post-issue monitoring reports in case of rights issue:

(a) **3-Day Post-Issue Monitoring Report**

The due date for this report shall be the 3rd day from the date of closure of subscription of the issue.

(b) **50-Day Post-Issue Monitoring Report**

The due date for this report shall be the 50th day from the date of closure of subscription of the issue. [*Para 7.2.1.2*].

These reports have to be submitted within 3 working days from the due date [*Clause 7.2*].

CONTENTS OF THE LETTER OF OFFER

[*Section II of Chapter VI of SEBI (DIP) Guidelines, 2000 sets out the Contents of Letter of Offer'*]

The letter of offer shall fulfil the requirements and shall contain disclosures as specified under Section I of this Chapter for the prospectus under the following heads [*clause 6.38*].

(i) Cover Pages [*6. 39*]
(ii) General information [*6. 40*]
(iii) Capital structure of the company [*6. 41*]
(iv) Terms of the present issue [*6. 42*]
(v) Particulars of the issue [*6. 43*]

(vi) Company, management and project [*6. 44*]

(vii) Financial performance of the company for the last five years [*6. 45*]

(viii) Material changes between the last date of the balance sheet and profit and loss account sent to the shareholders and up to the end of the last but one month preceding the date of the letter of offer shall be furnished and Working results [*6. 46*]

(ix) Particulars in regard to the listed companies under the same management within the meaning of section 370(1B) which made any capital issue in the last three years. [*6. 47*]

(x) Management discussion and analysis of the financial conditions and results of the operations as reflected in the financial statement [*6. 48*]

(xi) Outstanding litigation [*6. 49*]

(xii) Expert opinion obtained if any [*6. 50*]

(xiii) Statutory and other information [*6. 51*]

(xiv) Undertaking by Directors [*6. 52*]

For particulars of disclosures to be made under each head, see section III of Chapter VI of the SEBI Guidelines in *Appendix* 162.

Issue of letters of offer by registered post

Departments' Circular.—I am directed to say that the Government has been receiving complaints from the investing public regarding non-receipt of refund orders, allotment letters, share certificates, rights of offer and dividend warrants. In this connection, it may be stated that the Ministry of Finance, Department of Economic Affairs, *vide* their *Circular letter* No. 8/15/SE/86-B, dated 3rd June, 1986, addressed to all stock exchanges, informed that the Government has decided that henceforth all companies listed or seeking enlistment on stock exchanges, shall issue refund orders, allotment letters/certificates only by registered post. It has now been considered necessary that with a view to protect the interests of investors, the letters of offer for rights issue be also issued to the shareholders by registered post, in future.

2. You are, therefore, requested to ensure strict compliance with these guidelines by your constituent member companies'. [*Department's Circular No.* 6 of 1992, dated 3-9-1992.]

COMPOSITE ISSUE

SEBI Guidelines, 2000

Important Note.—These Guidelines are to be read with the Guidelines as to "General Conditions for Issue of Securities" as issued by SEBI Guidelines, 2000 discussed under section 56.

"Composite Issues" means an issue of securities by a listed company on a public cum rights basis offered through a single offer document wherein the allotment for both public and rights components of the issue is proposed to be made simultaneously [*Clause 1.2.1(viii)*].

Differential pricing [See Notes under 'Rights Issue' *ante*.]

Promoters' Contribution—See Notes under 'Rights Issue' *ante*.

BONUS SHARES

What is bonus share.—The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates a large surplus, it converts this surplus into capital and divides the capital among the members in proportion to their rights. This is done by issuing fully paid shares representing the increased capital. The shareholders to whom the shares are allotted have to pay nothing. The purpose is to capitalise profits which may be available for division or to utilise *quasi*-capital gains. Bonus shares go by the modern name of "capitalisation shares". If the articles of association empower the company, the company can capitalise profits or reserves and issue fully paid shares of a

nominal value, equal to the amount capitalised, to its shareholders. But in some cases, the articles provide for an option to the shareholders to take cash instead of shares. This would make no difference in the position, except of course to the extent to which the option is exercised. When the articles authorise the satisfaction of a dividend or bonus in fully paid shares, the declaration of the dividend makes the shareholder a creditor of the company for the amount of his proportion; the release of his claim against the company for this amount is a good and valuable consideration or set-off, so as to make the shares fully paid, even though the release is compulsory. When the shares are quoted on the stock exchange the issue of bonus shares is a bull point which forces up the market value of the shares and enables the shareholders to realise the immediate profit. The idea behind the issue of bonus shares is to bring the nominal share capital into line with the true excess of assets over liabilities. A company would like to have more working capital but it need not go into the market for obtaining fresh capital by issuing fresh shares. The necessary money is available with it and this money is converted into shares which really means that the undistributed profits have been permanently "ploughed back" into the business and converted into share capital. Fully paid "bonus shares" are thus not a gift; they are merely a distribution of capitalised undivided profit. It would be a misnomer to call the recipients of bonus shares as donees of shares from the company. Bonus shares are not issued free or *ex gratia* as the company gets an adequate *quid pro quo* from the shareholders. It is also settled law that a bonus issued in the form of fully paid shares of the company is not income for income-tax purposes. The undistributed profits of the company applied and appropriated for the issue of bonus shares would never become profits in the hands of the shareholder at all. The bonus shares would be something in the nature of an extra share certificate in the company. The shares allotted to a shareholder do not represent taxable income in his hands. *Commissioner of Income-tax, Madras v. A.A.V. Ramachandra Chettiar,* (1964) 1 Mad LJ 281.

When fully paid-up bonus shares are issued to the shareholders, what actually happens is that the profits are capitalised and the existing shareholders, instead of receiving any moneys out of the undistributed profits only, receive *pro rata* fresh shares out of the old shares converted as fully paid-up or out of the new issue. *Sivagnanammal v. Thirumagal Mills Ltd.,* (1948) 18 Com Cases 286, 290 : AIR 1949 Mad 521. Issue of bonus shares is a bare machinery for capitalising profits. There is no distribution of profits among shareholders. Accordingly, where a company used its development rebate fund for issuing bonus shares, there was no disbursement of money and the company remained entitled to development rebate. *Hunsur Plywood Works Ltd. v. CIT,* (1998) 1 Comp LJ 22 (SC); **reversing** *CIT v. Hunsur Plywood Works Ltd.,* (1998) 1 Comp LJ 28 (Kar).

An issue and allotment of bonus shares was set aside and rectification of the register of members ordered where the position was that the memorandum prohibited the capitalisation of surplus obtained on sale of assets and the only other source was the surplus in the profit and loss account and that was found to be not real. *Clerland Trust Plc., Re,* 1991 BCLC 424. Members may be given bonus shares of the same class which they hold or of a different class. *White v. Bristol Aeroplane Co. Ltd.,* (1953) Ch 65 (CA).

Impact of Bonus Issue on value of shares

Some of the points as to the resulting value of shares after a bonus issue were considered in *Chandrakant Mulraj v. Tata Engineering and Locomotive Co. Ltd.,* (1985) 58 Com Cases 320 (Bom). The court cited the following passage from PENNINGTON'S COMPANY LAW, p. 371, 4th Edn. (Now p. 549 of 7th Edn.), 1995: "The mechanics of issuing bonus shares, debentures or debt securities are similar to those of issuing shares, debentures or debt securities which are subscribed for in cash. After the necessary resolution for the capitalisation of profits or reserves has been passed, certificates in respect of the bonus shares, debentures or debt securities are issued to the persons entitled to them, and appropriate entries are made in the company's register of members or debenture holders. Alternatively, if the bonus shares are to be renounceable for a period, letters of allotment or renounceable share certificates are issued. Where the articles of associa-

tion of companies place restrictions on the free transferability of shares issued by them, it would seem that they may not issue renounceable letters of allotment or renounceable certificates in respect of bonus shares without expressly restricting their transferability, but there is nothing to prevent them from issuing such documents in respect of bonus debentures or debt securities.

The practical advantages of bonus issues are:

(a) They enable the company to retain money required for its business undertaking which it would otherwise have to raise by issuing new shares, debentures or debt securities on the market or by borrowing;

(b) The market value of the company's shares is reduced to a figure nearer their nominal value by a bonus issue, and this makes them more saleable. But the issue increases the total market value of a shareholder's holding only marginally; he merely has more shares of a correspondingly lower value each;

[If a company has an issued capital of £1 million in ordinary shares of £1 each, and reserves of £500,000, and the market value of its shares is £1.50, a capitalisation of the reserves on the basis of one bonus share for each two shares already held will reduce the market value of each share to £1 or a few pence more. Each shareholder will now have three shares worth about £1 each instead of two shares worth £1.50 each. These observations are true, of course, only if the bonus shares are ordinary shares.]

(c) Formerly bonus shares were not treated as income in the hands of the recipient shareholder, and he did not have to pay income-tax on their value. *IRC v Blott,* (1921) 2 AC 171; *IRC v Fisher's Executors,* (1926) AC 395. This was so even if the resolution to capitalise profits gave shareholders an option to take a cash dividend instead. *IRC v. Wright,* (1927) 1 KB 333. But income tax at a rate equal to the difference between the higher and lower rates is now payable if a company issues redeemable shares or debentures or other debt securities as a bonus issue, whether on a capitalisation of profits or revenue reserves or otherwise, but not to the extent that the nominal value of the new shares is provided out of share premium account. Moreover, when the shares or debentures or other debt securities are redeemed, the company is treated as though it were paying a cash dividend equal to the amount paid on redemption (except any amount paid-up on the securities out of share premium account), and so the company must pay advance corporation tax on the redemption payment; the payment is treated as part of the income of the holders of the bonus securities for income-tax purposes, but the tax which has already been paid on the issue of bonus shares is allowed as a credit against the income tax payable on redemption."

The Bombay High Court concluded by saying [(1985) 58 Com Cases 320 at 324]: "Bearing these principles in mind and turning to the subject-matter, what must be apparent is that the consequences of this bonus issue must be that the number of shares would increase and must bring down (proportionately) the value of the shares, irrespective of as to whether the value is the market value, the book value, the intrinsic value or the notional value fixed for conversion."

Vesting of bonus shares.—In *Shree Gopal Paper Mills Ltd. v. CIT, Central Calcutta,* AIR 1970 SC 1750 the Supreme Court held that vesting of bonus shares takes place from the date of the company's resolution and not from the date of actual allotment. The court **followed** BUCKLEY ON COMPANIES ACTS, (129, 13th Edn.); *Dalton Time Clock Co. v. Dalton,* (1892) 66 LT 704 (CA) and In re, *Heaton's Steel and Iron Co.,* (1876) 4 Ch D 140, 142 (CA) and **reversed** Calcutta High Court in *Shree Gopal Paper Mills Ltd. v. CIT,* (1967) 37 Com Cases 240 (Cal). However, see, *CIT v. Chunilal Khushaldas,* (1974) 44 Com Cases 90 (Guj) where in ignorance of the above Supreme Court decision, it was held that vesting takes place when the shares are actually issued and not from any earlier date.

Only those person became entitled to bonus shares after the shareholders' resolution, whose names are there in the register of members on a date specified by the Board of directors as the cut off date. A person who had transferred his shares and his name consequently removed from the register before the cut off date was held not entitled to participate in the bonus issue. *Rajiv Nag v. Quality Assurance Institute (India) Ltd.*, (2000) 39 CLA 183 : (2000) 28 SCL 187 : (2000) 4 Comp LJ 385 : (2001) Com Case 178 (CLB—NB) **affirmed** by the Delhi High Court in *Rajiv Nag v. Quality Assurance Institute (India) Ltd.*, (2001) 106 Com Cases 262 : (2001) 1 Comp LJ 111 (Delhi).

An English decision is to the effect that for tax purposes shares should be taken to have been issued only when the name of the person concerned is entered in the company's register of members. *National Westminster Bank Plc. v. IRC*, (1994) 2 BCLC 30 (Ch D and CA) **affirmed** in House of Lords *National Westminster Bank Plc. v. IRC*, (1994) 2 BCLC 239 (HL).

No contractual liability arises towards shareholders unless the requisite formalities for allotment of bonus shares have been complied with. The court said in this case, *Topham v. Charles Topham Group*, (2003) 1 BCLC 123 (Ch D), the court said that a bonus issue required a process of capitalisation of undivided profits of the company followed by appropriation to shareholders by the company, acting on the shareholders' behalf, appropriating out of the capitalised profits the requisite amount needed to pay in full for the unissued shares that were to be allotted to them as fully paid up bonus shares. It would not be right to construe the resolutions as giving rise to a contract between the company and the former ordinary shareholders, because the process of allotment never reached the stage of capitalisation and appropriation as the company omitted the necessary step of recognising and thereafter resolving to capitalise any of its funds available for the purpose and, furthermore, was unable to do so because without a transfer of its subsidiary's undivided profits there was no profit in its subsidiary's available for the purpose of capitalisation and appropriation. The parties had plainly assumed, wrongly, that the resolutions were effective to allot preference shares.

Resolutions were passed for increase of capital and allotment of bonus shares. The doctrine of estoppel by convention could not create an obligation where otherwise none existed, and therefore it could not be invoked to bring about an allotment of preference shares when there was no obligation to do so. To permit an estoppel when in fact no steps had been taken validly to allot any preference shares by way of bonus issue would be to ride roughshod over the statutory requirements for the allotment of shares as fully paid.

SEBI Guidelines, 2000.— Issue of Bonus Issues

Chapter XV of SEBI Guidelines, 2000 lays down the guidelines for bonus issues. A listed company proposing to issue bonus shares shall comply with the following:

1. (a) No company shall, pending conversion of FCDs/PCDs, issue any shares by way of bonus unless similar benefit is extended to the holders of such FCDs/PCDs, through reservation of shares in proportion to such convertible part of FCDs or PCDs.

(b) The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issues were made.

2. The bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only.

3. Reserves created by revaluation of fixed assets are not capitalised.

4. The declaration of bonus issue, in lieu of dividend, is not made.

5. The bonus issue is not made unless the partly-paid shares, if any existing, are made fully paid-up.

6. The Company—

(a) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof; and

(b) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

7. A company which announces its bonus issue after the approval of the Board of directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

8. (i) The Articles of Association of the company shall contain a provision for capitalisation of reserves, etc.

(ii) If there is no such provision in the Articles, the company shall pass a Resolution at its general body meeting making provisions in the Articles of Association for capitalisation.

9. Consequent to the (proposed) issue of Bonus shares if the subscribed and paid-up capital exceed the authorised share capital, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital. [*Clauses 15.0 to 15.1.8*].

Unlisted, closely-held and private companies not to issue of bonus shares out of reserves created by revaluation of fixed assets

Department's Circular, dated 6-9-1994.—"It has come to the notice of the Department that a number of unlisted companies (existing private/closely-held public companies) are resorting to revaluation of their assets and issuing bonus shares therefrom. The latest SEBI's guidelines on bonus shares dated 13-4-1994, *inter alia*, stipulate that the bonus issue has to be made out of free reserves built out of the genuine profits or share premium collected in cash only and reserves created by revaluation of fixed assets cannot be capitalised for this purpose. These guidelines are applicable only to listed companies. This matter has been considered in the Department and the existing private/closely-held and unlisted companies are hereby advised not to issue bonus shares out of the reserves created by revaluation of fixed assets. The contents of this circular may please be brought to the notice of your constituent members-companies." (*Circular No.* 9/94; *F. No.* 17/32/93-CL-V, dated 6-9-1994. The tenor of the Department's Circular is advisory in nature, it does not have any legal force nor it is in terms of any of the powers delegated to it under any of the provisions of the Act.

A Critique.—There is no provision in the Companies Act, 1956 dealing with the kind of reserve which may be used for the purpose of issue of bonus share except for an enabling provision under proviso to section 205(3) which enables the company to capitalise profits or "reserves" for the purpose of issuing bonus shares. The term "reserve" is negatively defined in Schedule VI, Part III: "the expression "reserve" shall not include the amount written off or retained by way of providing for depreciation, renewals or diminution in the value of assets or retained by way of providing for known liability." "Revaluation Reserve", therefore, cannot be excluded in terms of this definition from being termed as "Reserve".

Position under English law.—The permissibility of capitalising Revaluation Reserve is judicially recognised in England as will be clear from the authority of the decision in *Dimbulla Valley (Ceylon) Tea Co. Ltd. v. Laurie*, (1961) 1 Ch 353 in which the eminent judge BUCKLEY J. observed as follows: "It has, I think, long been generally accepted view of the law in this country (though not established by judicial authority) that if the surplus on capital account results from a valuation made in good faith by competent valuers, and is not likely to be liable to short term fluctuations, it may properly be capitalised. See also *Inland Revenue Commissioners v. Thorton Kelley and Co. Ltd.*, (1957) 1 All ER 650, and PENNINGTON COMPANY LAW 429, 434-35-453 (6th edn., 1990).

Accounting view.—In terms of accounting view also there does not appear to be any objection in capitalisation of revaluation reserves so long as the valuation is made in good faith and by a competent valuer. Care has to be taken to see that in subsequent financial years, depreciation on revalued figures has to be written off against the profits of the re-

spective years before the dividend is declared. Conservation demands that unless the relative earning capacity of the revalued assets is capable of sustaining the adequate depreciation charge on the enhanced value over the period of residual life of the assets, such capitalisation should not be done.

ICAI's guidance note on availability of revaluation reserve for issue of bonus shares

1. In the recent past, a few private companies and closely-held public companies have resorted to the practice of utilising the reserve created on revaluation of fixed assets or issue of bonus shares. This Guidance Note discusses the nature of revaluation reserves and in this context examines the question whether such reserves can be utilised for issue of bonus shares. It supplements the Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets, issued in 1982.

2. Revaluation of fixed assets is one of the issues dealt with in Accounting Standard (AS) 10 on 'Accounting for Fixed Assets', issued by the Institute of Chartered Accountants of India, which states, *inter alia*, as follows:

> "**13.1** Sometimes financial statements that are otherwise prepared on a historical cost basis include part or all of fixed assets at a valuation in substitution for historical costs...
>
> **13.2** A commonly accepted and preferred method of restating fixed assets is by appraisal, normally undertaken by competent valuers. Other methods sometimes used are indexation and reference to current prices which when applied are cross checked periodically by appraisal method."

3. AS-10 lays down as below:

> "**29.** When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss statement.
>
> **30.** An increase in net book value arising on revaluation on fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as, credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account."

4. It may be noted that the excess of the revalued amount over the net book value of fixed assets, which is credited to revaluation reserve, is created as a result of a book adjustment only. The revaluation reserve does not result from an arm's length transaction; it represents an expert's perception of value. The revaluation reserve thus does not represent a realised gain.

5. Share capital represents the amount of money or money's worth received from the owners and the capitalisation of earned profits or other gains arising out of an arm's length transaction. It has, therefore, been a cardinal principle that only such profits as are earned or the relevant capital receipts (*e.g.* share premium) as are realised, can be capitalised.

6. In view of the above, in the opinion of the Institute of Chartered Accountants of India, bonus shares cannot be issued by capitalisation of revaluation reserve. If any company (including a private or a closely-held public company) utilises revaluation reserve for issue of bonus shares, the statutory auditor of the company should qualify his audit report. An illustrative manner of the qualification is given below:

> "The company has issued bonus shares for Rs. .....
> (..... equity shares of Rs. ..... each) by capitalising its

revaluation reserve. Accordingly, the Paid-up Equity Share Capital of the company stands increased by Rs. ..... and the revaluation reserve stands reduced by that amount. The issue of bonus shares as aforesaid is contrary to the recommendations of the Institute of Chartered Accountants of India.

Subject to the above ..... ".

7. The above would also apply to situations where the revaluation reserve is utilised to increase the amount paid-up on equity shares of a company.

8. In this context, it may also be noted that the Securities and Exchange Board of India (SEBI) has prohibited listed companies from issuing bonus shares out of revaluation reserves. [*Source: Chartered Accountant* November, 1994, p. 665]

Counting of period of one year under section 81(1)

Clause (1) refers to 'after the expiry of one year from the allotment of shares in that company.' Sometime, in respect of an issue of shares, shares are allotted on different dates without closing the subscription list. On the question whether the date of the first allotment is the one on which shares being part of the issue, are allotted for the first time, the Department of Company Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time. [*Letter No.* 8/16(1)/61-PR, dated the 9th May, 1961]

'Holder of shares', 'members' [Sub-section (1)(a)]

Although the term 'holders of the equity shares' is used in sub-section (1)(a) and members in sub-section (1-A)(b), that the two terms are synonymous and mean persons whose names are entered in the register of members. See, *Balkrishan Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Com Cases 563 : AIR 1985 SC 520; *Howrah Trading Co. v. CIT* (1959) 29 Com Cases 282 : AIR 1959 SC 775; *Killick Nixon Ltd. v. Bank of India*, (1985) 57 Com Cases 831 (Bom—DB). In *Worldwide Agencies (P.) Ltd. v. Margaret T. Desor*, (1990) 67 Com Cases 607 : AIR 1990 SC 737, it was held that persons who have become entitled to the shares of a deceased member can exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not. In view of these judgments the decision in *Kedar Nath Agarwal v. Jay Engineering Works Ltd.*, (1963) 33 Com Cases 102 (Cal). [Where it was held that the two terms are not synonymous and a transferor whose name remains on the register pending registration of the transfer cannot take up rights shares] is not correct.

Effect of death of member on rights shares.—A shareholder had questioned a resolution of the Board of directors to increase the share capital of the company. The shareholder had the right to do so because his shareholding was going to be reduced percentage wise. While the proceeding was pending, he died. It was held that the legal representatives of the deceased shareholder were entitled to be brought on record as plaintiffs. *Arjun Tukaram Shetgaonkar v. Urmila Vaikunth Desai*, (2001) 105 Com Cases 722 : (2001) 40 CLA 309 : (2001) 34 SCL 227 (Bom).

Notice and the date of offer [Sub-section 1(b)]

Notice and the date of offer means the date of service of the notice of the offer and not the date of posting of the notice or any other date. 'Offer' implies the *communication* of an intention or desire in respect of any matter and without such communication, there can be no offer. The minimum 15 days time must be counted from the date of service of the notice of the offer as provided in section 53.

An offer of rights shares by a company in Delhi was made by a letter to an offeree also in Delhi giving her 17 days time inclusive of the date of posting and date of receipt to accept the offer. The High Court of Delhi held this was a local posting and was, therefore, likely to be delivered the next day. The notice was therefore effective but even assuming that the notice was short, the court would not restrain the further issue since the

allottees were not parties to the proceedings. *Shrimati Jain v. Delhi Flour Mills Co. Ltd.*, (1974) 44 Com Cases 228 (Del).

Where the effect of the issue of further capital and allotment of shares would be to convert a majority shareholder, the notice informing the members of the further issue must give particulars of the allottees and the manner of allotment. Otherwise, it would be regarded as null and void notice. In ordinary cases, however, a detailed notice may not be necessary. *Jadabpore Tea Co. Ltd. v. Bengal Dooars National Tea Co. Ltd.*, (1984) 55 Com Cases 160 (Cal—DB).

Duty of transferor to his transferee in respect of rights shares

The shares offered to the existing shareholders under S. 81 in proportion to their respective shareholding are known as rights shares and the whole issue is called the rights issue. There may be many pending transfers at the time when a rights issue takes place. This raises the question whether the transferor of an unregistered transfer is under any duty towards his transferee to apply for the rights shares for the benefit of the transferee. The Supreme Court considered this question in *Mathalone (R.) v. Bombay Life Assurance Co. Ltd.*, AIR 1953 SC 385: (1954) 24 Com Cases 1 and said that after the transfer form has been executed the transferor cannot be compelled to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The Supreme Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour. Earlier to this the Bombay High Court had taken the view in *Dinge Venkatarama Reddy v. Padampat Singhania,* AIR 1950 Bom 76 that it was the duty of the transferor to apply for the new shares and to hold them in trust for the transferee. However no mention appears of this case in the Supreme Court decision in *Mathalone (R.) v. Bombay Life Assurance Co. Ltd., (supra).* Where transfer has been lodged but not yet registered by the company, section 206A provides that any dividend or rights shares or bonus shares accruing to the shares under the proposed transfer in the meantime shall be witheld until registration.

Issue of rights/bonus shares to non-residents under FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

Regs. 6, 6A and 6B of the Regulations, 2000 deal with acquisition of right/bonus shares by non-residents.

AP (DIR Series) Circular No. 38, dt. 3-12-2003.—In this Circular, RBI has given a gist of current regulatory provisions relating to foreign investments. Para 3.1 of the Circular relating to "Issue of Rights/Bonus Shares" reads thus:

General permission is also available to Indian companies to issue Bonus/Rights Shares. The rights shares or debentures purchased by the person resident outside India shall be subject to the same conditions including restrictions in regard to repatriability as are applicable to the original shares against which rights shares or debentures are issued. Further, the existing non-resident share holders may apply for issue of additional shares and the investee company may allot the same subject to the condition that the overall issue of shares to non-residents in the total paid-up capital does not exceed the sectoral cap. In other words, non-residents may subscribe for additional shares over and above shares offered on rights basis by the company and renounce the shares offered either in full or part thereof in favour of a person named by them. Residents may subscribe for additional shares over and above the shares offered on rights basis by the company and also renounce the shares offered either in full or part thereof in favour of a person named by them. However, as clarified in terms of AP DIR circular No. 14 dated September 16, 2003, this facility would not be available to investors who have been allotted such shares as OCBs.

Reg. 6 of the Regulations framed under FEMA, 1999 grants general permission to any person resident outside India to purchase shares/convertible debentures offered on right basis by an Indian company which satisfies the conditions stipulated in sub-regulation (2) of the said Regulation. The right shares so acquired shall be subject to same conditions regarding repatriability as are applicable to original shares. [*Vide Annexure II to AD (MA Series) Circular No. 11, dated 16-5-2000*]. Reg. 6 provides as follows:

"6. Acquisition of right shares

(1) A person resident outside India may purchase equity or preference shares or convertible debentures offered on right basis by an Indian company which satisfies the conditions specified in sub-regulation (2).

(2) An Indian company which satisfies the following conditions, may offer to a person resident outside India, equity or preference shares or convertible debentures on right basis, namely

(i) The offer on right basis does not result in increase in the percentage of foreign equity already approved, or permissible under the Foreign Direct Investment Scheme in terms of these Regulations;

(ii) The existing non-resident shareholders may apply for issue of additional shares, and the investee company may allot the same subject to the condition that the overall issue of shares to non-residents in the total paid up capital does not exceed the sectoral cap.] [*Ins. by GSR No. 229(E), dt. 12-11-2002*]

(iii) The existing shares or debentures against which shares or debentures are issued by the company on right basis were acquired and are held by the person resident outside India in accordance with these Regulations;

(iv) The offer on right basis to the persons resident outside India is at a price which is not lower than that at which the offer is made to resident shareholders;

(3) The right shares or debentures purchased by the person resident outside India shall be subject to same conditions including restrictions in regard to repatriability as are applicable to the original shares against which right shares or debentures are issued :

Provided that the amount of consideration for purchase of right shares or debentures is paid by way of inward remittance in foreign exchange through normal banking channels or by debit to NRE/FCNR account, when the shares or debentures are issued on repatriation basis :

Provided further that in respect of the shares or debentures issued on non-repatriation basis, the amount of consideration may also be paid by debit to NRO/NRSR/NRNR account."

AP (DIR Series) Circular No. 10, dt. 20-8-2003.—The existing non-resident shareholders may apply for issue of additional equity shares or preference shares or convertible debentures [under Reg. 6(2)(ii) above] over and above their rights entitlements and the investee company may allot the same subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

OCBs restricted from acquiring securities on right basis.—OCBs shall not purchase equity or preference shares or convertible debentures offered on rights basis by an Indian company. [*AP (DIR Series) Circular No. 14, dt. 16-9-2003*].

Issue of bonus shares to non-resident shareholders

Reg. 6A of the Regulations, 2000 provides as follows:—

"6A. Acquisition of bonus shares.—An Indian company may issue bonus shares to its non-resident shareholders, subject to the following conditions :

(a) the shares against which bonus shares are issued by the company (hereinafter referred to as 'the original shares') were acquired or held by the non-resident shareholder in accordance with the rules/regulations applicable to such acquisition;

(b) the bonus shares acquired by the non-resident shareholder shall be subject to the same conditions including restrictions in regard to repatriability as are applicable to the original shares.

Report to RBI by companies issuing right/bonus shares

Reg. 6B of the Regulations requires a company issuing rights shares or bonus shares interms of regulation 6 or regulation 6A, as the case may be, shall, within thirty days from the date of issue, report the transaction in Form FC-GPR to the regional office of

the Reserve Bank of India under whose jurisdiction the registered office of the company is situated."

Policy and Procedure for foreign direct investments in India by Non-residents, including NRIs and OCBs

A Manual on Industrial Policy and Procedures has been issued by the Ministry of Commerce and Industry. For text see *Appendix* 122.

Foreign Investments in Sick Industrial Units

§ The relevant subject-matter has been dealt with in *RBI Exchange Control Manual, 1993, para 10C.16*. For text see under section 72 *ante*.

Guidelines for Foreign Institutional Investors

Press Note, dated 14-9-1992.—Government has evolved a new set of guidelines for investments by Foreign Institutional Investors (FIIs) to invest in all the securities traded on the primary and secondary markets including the equity and other securities/instruments of companies which are listed or to be listed on various stock exchanges in India including the OTC Exchange of India. The FIIs would be required to obtain an initial registration from SEBI in accordance with these guidelines. For the text of the Guidelines and subsequent changes and various procedures to be followed, see *Appendices* 76, 77. See also Notes under section 72, *ante*.

SEBI (Foreign Institutional Investors) Regulations, 1995

SEBI has issued these regulations under *Notification SO* 918(E), dated 14-11-1995. For the text of these Regulations see *Appendix* 193.

Guidelines for Euro-Issues

§ See Notes under section 72, *ante* and also *Appendix* 120.

Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993

Notification dated 12-11-1993.—Central Government has notified a scheme for facilitating issue of Foreign Currency Convertible Bonds and Ordinary Shares through Global Depository Mechanism by Indian companies *vide* GSR 700(E), dated 12-11-1993. An issuing company desirous of raising foreign funds through Global Depository Receipts is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Government of India. See Notes under section 72.

§ For the text of the Scheme and eligibility for issue of convertible bonds or ordinary shares, see *Appendix* 119.

Allotment of preference shares in discharge of debts

In *Sree Ayyanar Spinning and Weaving Mills Ltd. v. V.V.V. Rajendran*, (1973) 43 Com Cases 225 (Mad), a Judge of the Madras High Court (RAMANUJAM J.) expressed the view that the provisions of this section will not apply to the allotment of any preference shares made in payment of the amounts due to directors or other persons. With respect it may be said that this is an erroneous view. The Hon'ble Judge has apparently ignored the fact that when a company allots shares to a person in discharge of the debts due to him, the obvious result of that allotment is to increase the subscribed capital of the company. Where the directors of a company resolve to allot say, a hundred shares to one or more directors in lieu of sitting fees due to him or them and thereby the subscribed capital is increased by the amount of the total number of shares resolved to be so allotted, what else can this mean than that the directors by the resolution propose to increase or cause to be increased the subscribed capital by the amount of the shares resolved to be allotted?

It is not necessary that the directors should formally express that they are proposing to increase the subscribed capital. If they proceed to issue shares for any purpose whatsoever, it means and necessarily involves a proposal to increase the subscribed capital to the extent to which the shares are issued. Where shares are issued to any extent, to the extent they are subscribed for, the subscribed capital will stand increased.

When the shares are allotted to any person for any purpose even if it be only a few shares to enable a director to obtain his qualification for holding the office, the issue or allotment will have to follow the procedure prescribed for allotment, as the allotment necessarily implies a decision on the part of the directors to increase the subscribed share capital to the extent of the value of the shares so allotted.

Further in this particular case dealt with by the learned Judge, as the facts stated by the Judge show, the directors at a Board meeting are said to have unanimously passed a resolution allotting preference shares to the several directors in discharge of arrears of sitting fees due to them. As all the directors were interested in the resolution embodying an arrangement among themselves, the vote of each and every one of the directors who voted at the meeting was void as per the provisions of section 300(1) of the Act, and the so-called unanimous resolution was a nullity, as all the directors were interested and, therefore, none of them could validly vote and, therefore, no resolution could validly be passed by the directors. The view of the learned Judge which has apparently ignored this aspect would, therefore, seem to require further consideration.

Allotment to renouncee [Sub-section (1)(c)]

As section 81(1)(c) is subject to the qualification 'unless the articles of the company otherwise provide', in interpreting this clause, it is necessary to have due regard to the company's articles of association. In other words, this clause shall not apply if the articles of the company 'otherwise provide' in this behalf. However, in order to attract the opening words of this clause, it is not necessary that the articles of the company must contain an express provision entitling right of renunciation. *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743 : AIR 1981 SC 1298. Where, however, the articles of association of a company restrict the right of renunciation, while making an offer of rights shares accompanied by a right to renounce in favour of a nominee, most companies reserve to the Board the right to refuse to allot the shares to the renouncee either in full or in part.

When under section 81(1)(c) the offeree of new shares exercises his rights to renounce the shares offered to him in favour of any other person, the nominee gets a right to accept the offer and complete the contract. Obviously, the nominee gets an enforceable right to compel the issue of shares. A share is a chose-in-action and is capable of being sold or dealt with. If the nominee is a nominee for valuable consideration, *bona fide* without notice of a breach of trust, he would have a higher right than an equitable right. Nothing can be clearer than that a purchaser for valuable consideration who obtains a legal estate at the time of his purchase without notice of a prior equitable right is entitled to priority in equity as well as at law. *Kedar Nath Agarwal v. Jay Engineering Works Ltd.*, (1963) 33 Com Cases 102 at 113, 114 (Cal).

In the event of renunciation of rights shares by a member, a nominee has no rights against company in the sense that if the company having reserved the right either in the articles or in the offer documents to refuse to accept a nominee, he cannot proceed against the company if the company refuses to accept him. *Ezekiel v. Carew & Co. Ltd.*, (1938) 8 Com Cases 161 (Cal).

When a shareholder renounces any of the rights shares offered to him, in favour of third person, it is not in the nature of a transfer of such shares, and Board of Directors cannot refuse to allot the shares to the third person unless the articles provide therefor. *In re, Simco Securities Trust Ltd.*, (1972) 42 Com Cases 457 : (1971) 1 WLR 1455 (Ch D); *Ezekiel v. Carew & Co. Ltd., (Supra).* See also *In re, Pool Shipping Co. Ltd.*, (1920) 1 Ch 251. However for taxation purposes it is deemed to be a transfer. *R.N. Gupta v. CIT*, (1972) 84 ITR 780 (Del).

From the provisions of section 81 of the Companies Act, 1956, it follows that the moment the rights shares are offered to an existing shareholder, a right to obtain the specified number of shares in the fresh issue of capital is conferred on him. Such a right is a tangible right which can be conveyed by renunciation and which can also be sold and,

therefore, such a right cannot be construed as an interest in future property. It is an existing property within the meaning of the Gift-tax Act. *S.R. Chockalingam Chettiar v. CGT*, (1968) 70 ITR 397, 400 (Mad). For position under Wealth Tax Act, see, *CWT v. Krishnamohan*, (1974) 96 ITR 432 (Del).

Right to renounce not applicable to deemed public companies*.—As stated earlier, this section does not apply to private companies, which become deemed public companies by virtue of section 43A. The Supreme Court has also observed that this clause cannot apply to a private limited company which is deemed to be a public limited company under s. 43-A and which continues to retain its Articles of Association the restrictions contained in s. 3(1)(iii). If this clause were to apply, it would be open to the offerees to renounce the shares in favour of non-members and thereby to infringe the provisions of the articles. An offer of shares giving a member the right to renounce the shares in favour of any other person is bound to result in infringement of the article relating to the matters specified in s. 3(1)(iii) because such a right can be renounced in favour of a non-member and is, in effect, an invitation to the public to subscribe to the shares of the company. *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743 at 843 : AIR 1981 SC 1298.

The right to renounce shares is not available to members of a section 43-A company* even to the limited extent of renouncing in favour of other members. The articles of a company may contain provisions enabling members to transfer shares to each other, but that is different from a renunciation of shares. *Needle Industries* case, (*Supra* at 843).

Joint holders and renunciation.—Where the names of two persons are entered as joint holders of a block of shares, each person is a member of the company. But it would be open to either joint-holder to lodge a letter of renunciation or seek allotment of shares covered by such letter.

Directors' fiduciary duty in further issue of shares

If any shares are allotted contrary to the provisions of the section, the allotment is not *per se* invalid. But the procedure being illegal, it can be avoided by the company or any director or shareholder aggrieved and may be used as a weapon of defence when any right or liability arising out of such allotment is sought to be enforced. See, for example, *Nanalal Zaver v. Bombay Life Assurance Co. Ltd.*, (1950) 20 Com Cases 179 : AIR 1950 SC 172, where a further issue was made so as to give more shares to the existing shareholders in a bid to fight back a take over attack on the company and the Supreme Court held it to be justified irrespective of the fact whether the company was in real need of more capital and in *Shanti Prasad Jain v. Kalinga Tubes Ltd.*, (1965) 35 Com Cases 351 : AIR 1965 SC 1535, where a majority resolution to exclude the existing shareholders from participating in the new issue was upheld because it was necessary to make the company more broad based though it incidently reduced the position of one of the shareholders to a negligible existence as compared with two other blocks in the company. The case of *Nanalal Zaver (supra)* was **followed** in *Prem Seth v. National Industrial Corporation Ltd.*, AIR 1994 Del 285, where also the increase of capital was found to be necessary for meeting the general business needs of company.

The disapplication of preventive rights should be subject to the requirement that it is to be on objective grounds in the interests of the company. *Siemens AG v. Nold*, (1997) 1 BCLC 291 (Court of Justice of European Community) [ECJ]. The court also held that there can be a provision for allotment of shares under a rights issue for payment in kind. [See section 79A which provides for issue of sweat equity shares]

The Supreme Court ruling in *Nanalal Zaver* case was also **followed** in *Jetu Jacques Taru Lalvani v. JBA Printing Inks Ltd.*, (1997) 88 Com Cases 759 (Bom) so as to hold

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* The concept of deemed public companies [S. 43-A Companies] has been abolished by the Companies Amendment Act, 2000. The case literature on the subject has been retained in the interest of knowledge for handling pending matters.

that when the need to increase capital arises because of the process of transforming a private company into a public company under statutory compulsion, it cannot be said by that reason alone that directors are misusing their power to increase capital and thereby oppressively compelling a minority shareholder to bring more money into the company so as to maintain his proportionate voting power in the company. The proposal was to increase capital partly by capitalisation of profits and partly by rights issue. The issue was approved by a special resolution. An incidental benefit to directors cannot be regarded as misuse of powers. The court cited at 769 the following observation from the opinion of the Privy Council in *Hirsche v. Sims*, (1894) AC 654 at 660-661 : 64 LJ PC 1: "If the true effect of the whole evidence is that the defendants truly and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with *dolus malus* or breach of trust merely because in promoting the interest of the company they were also promoting their own, or because they afterwards sold shares at prices which gave them large profits". The court also cited the following passage from PALMER'S COMPANY LAW (18th edn., p. 183) : "In exercising their powers, whether general or special, directors must always bear in mind that they are in a fiduciary position, and must exercise their powers for the benefit of the company, and for that alone." See also *Harlowe's Nominees P. Ltd. v. Woodside (Lakes Entrance) Oil Co.*, (1968) 121 CLR 483 (Aust).

The English Companies Act 1985, s. 89(1) has also introduced the requirement of allotting a further issue of shares to existing shareholders. It is in the discretion of directors as to when the capital is to be increased. The only control upon the directors' discretion in this respect is that envisaged under the fiduciary obligation that capital is not to be increased without a genuine need of the company and with a view to merely maintaining the present management of the company. The twin cases of *Hogg v. Cramphorn Ltd.*, (1966) 3 All ER 420 (Ch D) and *Bamford v. Bamford,* (1969) 1 All ER 969: (1970) 1 Comp LJ 133 are a pointer towards this direction with this overriding factor that the shareholders may in general meeting either ratify the new issue or approve it in advance. Subject only to this overriding factor, the English cases have consistently maintained the posture that where the dominant purpose of a new issue is to diminish the voting power of a minority shareholder as a strategy to squeeze him out it is an abuse of fiduciary power *Clemens v. Clemens Bros. Ltd.*, (1976) 2 All ER 268 (Ch D). Where, on the other hand, it was for the benefit of the company to reduce the strength of the majority shareholder so as to wipe off his control and towards that end shares were allotted in good faith to a third person, this was not a breach of duty on the part of directors, *Teck Corpn. v. Miller*, (1972) 33 DLR (3d) 288 (Canada). However, the Privy Council expressed some reservations about such freezing out techniques. See, *Howard Smith Ltd. v. Ampol Petroleum,* (1974) AC 821 (PC), where it was observed that *bona fide* is not the final thing. The final thing is the purpose with which the power is used. BUCKLEY J. observed in *Hogg v. Cramphorn,* (1963) 1 Ch 254 at 269 : "The power to issue shares was a fiduciary power and if, as I think, it was exercised for an improper motive, the issue of these shares is liable to be set aside".

Any allotment of new shares to directors themselves or their nominees which shows on the face of it that it has been done as a strategy for maintaining themselves in power or passing a special resolution for controlling the next meeting is an abuse of the fiduciary position. *Fraser v. Whalley*, (1861-73) All ER Rep Ext 1456; *Perey v. S. Mills Co.*, (1918-19) All ER Rep 313; *Punt v. Symons & Co.*, (1903) 2 Ch 506.

British Stock Exchange Regulations require that in the quoted securities it is necessary that they should first be offered to the existing equity shareholders unless those holders have agreed in General Meeting to other specific proposals. See, 1969 JOURNAL OF BUSINESS LAW (UK) 1, 4.

An illegal, improper or unfair issue of shares may be restrained by the Central Government [Now CLB] in exercise of its powers under section 250, or be restrained by an injunction in a properly framed suit by any person aggrieved or be dealt with by taking

other appropriate action or in any other appropriate manner. In *Jadabpore Tea Co. Ltd. v. Bengal Dooars National Tea Co.*, (1984) 55 Com Cases 160 (Cal) the Calcutta High Court set aside the allotment where it appeared to have been made only to reduce the strength of a shareholder. Alternatively, the Company Law Board ordered the 52% majority shareholders, who had kept to themselves the whole new allotment totally ignoring the 48% minority, to purchase the shares of petitioners so that their complaint of oppression was redressed, and the company's need for more capital was also met. The CLB did not consider desirable to set aside the allotment although it showed lack of probity and fair play because the need for raising additional resources was accepted by all the shareholders. *Standard Industries Ltd. v. Mafatlal Services Ltd.*, (1994) 80 Com Cases 764 (CLB).

Where the merger of TOMCO into HLL which was the subsidiary of UNILEVER with 51% holding made it necessary to maintain that percentage of holding that preferential allotment of equity should be given to UNILEVER and the shareholders approved the allotment by the requisite resolution, it was held that the High Court sanctioning the merger would not interfere in the matter unless it could be shown that the resort to preferential allotment was an abuse of majority power. The power to exclude pre-emptive rights is a power in the nature of trust to be used in goodfaith for the benefit of the company and that was the case here. *Tata Oil Mills Co. Ltd., Re,* (1994) 81 Com Cases 754 (Bom); *Hindustan Lever Ltd., Re*, (1994) 81 Com Cases 754 (Bom). **Affirmed** by the Supreme Court in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, AIR 1995 SC 470 (SC).

An agreement of a company with its foreign technical and financial collaborator entitling him to invest up to 26% of the company's equity capital was held to be not violated when the company in accordance with the provision of its articles of association and in compliance with s. 81(1A) issued equity shares to the Financial Institutions by capitalising the interest due to them in respect of their loans. The Bombay High Court refused to stay the implementation of the allotment. A company cannot be prevented from increasing its capital according to its business expediencies. The court also said that the further issue was not violative of rights of a class of shareholders because holders of equity shares to a certain extent cannot say that they are a class within the meaning of s. 106 and, even if they were by reason of their special status, class rights are not capable of being used to prevent the company from increasing its capital. *Spindel Fabrik Sussen v. Sussen Textile Bearings Ltd.*,(1989) 2 Corpt LA 202 (Bom).

The interest of a foreign collaborator with considerable stake in the company has to be given special consideration in deciding whether further funds should be raised by loaning process or making rights issue. The foreign collaborator had 30% stake in the company. The Indian controller was with 60%. The Indian controller proposed to increase capital by making rights issue. The foreign collaborator desired to make further contribution only by way of loans and not investment in shares. The Company Law Board told the Indian controller to revise the plan accordingly. He had taken huge contributions from the collaborator. He must take care of all the interests *Boiron v. SBL Ltd.*, (1998) 30 CLA 21 (CLB—PB).

Enforcement of the shareholders pre-emptive rights and of directors' fiduciary duties have not generally been linked in the U.K., may be, because the shareholders cannot enforce the directors' fiduciary duties which are owed to the company. But the relevance of the link was recognised by the New York Court of Appeals in *Katzowits v. Sidder,* (1969) 24 NY 2d 542 : 301 NY 470 : 249 NP (2d) 359, where it was said : "The corollary of a stockholder's right to maintain his proportionate equity in a corporation by purchasing additional shares is the right not to purchase additional shares without being confronted with dilution of his existing equity if no valid business justification exists for the dilution." Cited in Iain Mac Neil, *Shareholders' Preemptive Rights,* 2002 JBL 78 at p. 84.

§ As to the fiduciary duty of directors in the matter of issue of new capital, see Notes under s. 291 under the heading "Issue of new capital".

Injunction against rights issue.—A company purchased a tea estate with money borrowed from banks, financial institutions and companies. It resolved with 82% majority to issue convertible debentures on rights basis to repay loans. The letters of offer were issued. A small shareholder challenged the issue saying that it favoured companies in which majority shareholders were interested. Interim orders were issued restraining the company from utilising the funds of the issue. The Supreme Court, on appeal against the injunction, permitted the company to pay off only the debts due to the banks and public financial institutions from the issue money and maintained the injunction in other respects and leaving all other issues to be decided by the High Court or competent authorities. *Assam Brook Ltd. v. Krishan Kumar Kapoor*, (1994) 80 Com Cases 123 (SC).

Rights issue at discriminatory premium.—Where the shareholders of a company unanimously resolved to allot right issue at a higher premium to members and at a paltry premium to promoters, it was held that those shareholders who participated in the meeting, who had accepted the allotment to them at a higher premium and whose shareholding was miniscule, were not in a position to challenge the validity of the issue by saying that it was oppressive of members and causative of loss to the company. *N. Jagan v. Investment Trust of India Ltd.*, (1996) 85 Com Cases 75 (Mad). See also Notes on this point under section 397 under the heading "Issue of further capital and impropriety in Rights Issue".

Irregular allotment not dispute under Consumer Protection Act.—Failure on the part of a company to give to the shareholder his proportion of the rights shares does not constitute a consumer wrong and therefore no consumer action lies against it either under Consumer Protection Act, 1986 or MRTP Act, 1969. The action in this case was under S. 12B of the MRTP Act, 1969 for compensation for denial of rights shares. The remedy lies within the framework of the Companies Act and also by way of a civil suit. *Harish Sood v. Videocon International Ltd.*, (1996) 8 SCL 28 (MRTPC).

Rights offer and listing requirements

Section 81 confers pre-emptive right on the shareholders of a public company to subscribe to rights shares. The offer shall be made by notice specifying the number of shares offered and limiting a time not less than 15 days from the date of offer within which the offer, if not accepted, will be deemed to have been declined. The shareholder has also the right to renounce the shares offered to him in favour of any other person, unless the articles provide to the contrary. However, under the Stock Exchange Listing Agreement, companies are required to allow the right of renunciation to shareholders, (Clause 23 of the Listing Agreement). In case, a shareholder declines to accept the shares offered, the Board of Directors are competent to dispose of the shares as they deem fit.

Department's Circular.—As per the Stock Exchange Listing Agreement (Clause 23), draft letter of offer is required to be submitted to the Stock Exchange for its approval. Separately, the same is also required to be submitted to SEBI for vetting (*Press Release*, dated 17-6-1992), for ensuring disclosure requirements for investors protection. The letter of offer is required to be issued to all the shareholders by registered post. (*Circular No.* 17/8/ 89-CL-V, dated 3-9-1992).

SEBI (Delisting of Securities Guidelines, 2003

Clause 17 of the SEBI Guidelines relates to delisting of securities pursuant to rights issue. It provides as follows :

17.1 In case of rights issue, allotment to the promoters or the persons in control of the management shall be allowed even if they subscribe to unsubscribed portion which may result in public shareholding falling below the permissible minimum level.

Provided that the adequate disclosures have been made in the offer document to that effect.

Provided further that they agree to buyout the remaining holders at the price of rights issue or make an offer for sale to bring the public shareholding at the level specified in the listing conditions or listing agreement to remain listed.

17.2 In case the rights issue is not fully subscribed, which may result in the public shareholding falling below the permissible minimum level as specified in the listing condition or listing agreement, the promoter(s) of the company shall be required to delist by providing an exit opportunity in the manner specified in clause 17.1 of these guidelines or may be required to make offer for sale of their holdings so that the public shareholding is raised to the minimum level specified in the listing agreement or in the listing conditions within a period of 3 months.

§ For full text of the Guidelines, see Appendix 167.

Exclusion of pre-emptive rights [Sub-section (1-A)]

The manner of distribution of any further shares decided to be issued may be changed and the shares issued wholly or in part, to any person otherwise than in accordance with sub-section (1). But either a special resolution should sanction it or an ordinary resolution coupled with Central Government approval is necessary. The Central Government will not give its approval, unless the issue to such person or persons is beneficial to the company.

The power given to shareholders by S. 81(1A) to exclude the pre-emptive rights of shareholders by passing a special resolution or by ordinary resolution-cum-Central Government approval, being a statutory power, it has been repeatedly held that the shareholders cannot be restrained from using this power for the benefit of the company as a whole. Accordingly, where the shareholders passed a special resolution by a virtual unanimous vote authorising the Board of Directors to allot shares to the promoters' group, the implementation of the resolution was not stayed at the instance of some tiny shareholders. *N. Jagan v. Investment Trust of India Ltd.*, (1996) 85 Com Cases 75 (Mad). The same High Court faced another matter under S. 81 in *Kothari Industrial Corpn. Ltd. v. Maxwell Dyes and Chemicals P. Ltd.*, (1996) 85 Com Cases 79 (Mad). The proposal was to make a preferential allotment to non-resident Indians, overseas corporate bodies and promoters' group. Shareholders approved the mode of allotment by a majority and the scheme was approved by all the requisite authorities. The court refused to stay the implementation of the resolution. There was no evidence that the preferential allotment was contrary to the law. Listed companies also have the right of private placement. **Affirmed** by Division Bench on appeal in *Maxwell Dyes and Chemicals P. Ltd. v. Kothari Industrial Corpn. Ltd.*, (1996) 85 Com Cases 111 (Mad—DB).

The section preserves the power of a company in general meeting to give directions contrary to proportionate offer to equity shareholders of a new issue of shares and authorised the directors to dispose of the shares in such manner as they deemed fit, *Hindustan Commercial Bank Ltd. v. Hindustan General Electrical Corpn.*, (1960) 30 Com Cases 367 at 376 (Cal—DB).

The need for such a procedure arises in such cases as where a foreign firm or company collaborating with an Indian company is interested in equity participation.

Where the majority shareholders in a general meeting refuse to accept the scheme of offering shares to outsiders on the ground that they would be reduced to a minority status, they cannot be accused of acting in a *mala fide* manner. *Life Insurance Corpn. of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 at p. 639 (SC).

It is not open to the Board of Directors to cancel any reservation made under a special resolution passed under section 81(1-A) of the Companies Act, especially, after the sanction has been obtained from the Central Government. *Surendra Maganlal Mehta v. Reliance Textiles Ind. Ltd.*, (1982) 3 Comp LJ 103 (Bom) (which was in the context of CCI's approval for reservation in favour of shareholders of the transferor company).

Waiver of pre-emptive rights.—The Central Government permitted the Delhi Stock Exchange Ltd., to increase its membership by dilution and transfer of the existing members' shares to persons working as authorised assistants in the Stock Exchange and by issue of new shares to the public. The terms of the public issue were more onerous than the terms for transfer of shares to the authorised assistants. The court held that the object of dilution was different from the object of the public issue and a claim of the members of the public to be treated at par with the authorised assistants was not sustainable. The existing members who had to dilute their holdings by transfer to authorised assistant did not object, nor they pressed their preferential claim to the new issue under s. 81. *Rajesh Kumar Maheshwari v. Union of India*, (1992) 73 Com Cases 155, 166 : AIR 1992 Del 68.

Issue of debentures on preferential basis.—The issue of debentures on preferential basis with the authority of the company's special resolution was not allowed by the Supreme Court to be challenged under s. 81. *N. Parthasarthy v. CCI*, (1991) 72 Com Cases 651 (SC).

Terms of consent cannot be altered by Court.—The court has no jurisdiction to vary terms and conditions for issue of a prospectus to which consent has been accorded by the Controller of Capital Issues. *N. Parthasarthi v. CCI*, (1991) 72 Com Cases 651 (SC). The Capital Issues (Control) Act, 1947 which hitherto controlled the issue of capital by companies was repealed on 29-5-1992. The regulatory powers, in this regard now vest in the SEBI.

Issue of shares under scheme of amalgamation *etc.*—Where two separate meetings were held, one for the ordinary and the other for the preference, shareholders for approving a scheme of arrangement (under which 50% of the claims of unsecured creditors was to be converted into paid-up share capital), it was held that the resolution passed in both the meetings with statutory majority was in due compliance with the sub-section (1A). *Maneckchowk and Ahmedabad Mfg. Co. Ltd., Re*, (1970) 40 Com Cases 819 (Guj).

Issue of shares under scheme of takeover.—The petitioner intended to acquire the shares of a company. He sent a letter of offer to each shareholder indicating his terms. Many shareholders responded to the offer. Necessary resolutions were accordingly passed. But finally the mode of payment of price was revised under which some portion was to be paid in cash and the remaining by issuing optionally convertible redeemable preference shares. At the shareholders meeting the resolution regarding issue of preference shares was rejected by the shareholders of the petitioner company. The petitioner withdrew from the offer. This amounted to violation of SEBI Regulations for which the petitioners were required to pay a certain sum of money per share to those shareholders of the target company who had accepted the offer and tendered their shares. The Central Government upheld this order. The High Court declined to interfere but modified the relief and directed the payment to the shareholders in cash instead of the preference shares. *Sterlite Industrial (India) Ltd. v. UOI*, 2002 CLC 1280 : (2002) 38 SCL 592 (Del—DB).

Restraining Further Issue:

SEBI Takeover Code.—A matter before the Bombay High Court was under Regulation 23 of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 read with s. 81(1A) of the Companies Act. The petitioners made a public announcement that they would acquire the respondent company's shares by public offer. It was held that an interim order restraining the target company from passing any resolution for issuing further ordinary or preference shares could not be passed. *Praful Patel v. SEBI*, (1999) 19 SCL 186 (Bom). The court said that if the resolution was in violation of the code, it could be challenged afterwards.

***Bona fide* allottees protected by principle of indoor management.**—The allottees of the shares were contracting in good faith with the company, and they were entitled to assume, that the acts of the directors in making allotments of shares to them were within

the scope of their powers conferred upon them by the shareholders of the company. They were not bound to inquire whether the acts of the directors which, as in this case, related to internal management, had been properly and regularly performed. Even where the directors exceed their powers or infringe the restrictions imposed upon them, the company may be bound; for an outsider dealing with the company is only required to see, that the transaction on the face of it is regular and consistent with the articles. Strangers are justified in assuming that all matters of "indoor management" have been done regularly. *Dewan Singh v. Minerva Films Ltd.*, (1959) 29 Com Cases 263 at 269 (P&H).

Limitations governing the exercise of right of renunciation [Sub-section (2)]

The right of renunication available to a shareholder in terms of clause (c) of sub-section (1) does not lead to extension of time within which such shareholder as is required to accept the offer of rights shares. Also, such shareholder is not entitled to right of renunciation if the person in whose favour the renunciation was earlier made had declined to accept the shares so renounced.

Exceptions as to conversion of debentures and loans into shares [Sub-section (3)]

This provision brought in by the Amendment Act of 1960 and the proviso as substituted by the Amendment Act of 1963, enables the issue of shares to debenture-holders, and creditors in exchange for the amounts due to them, where the terms of the issue of the debentures or loans provide for such option and such terms are approved by the Central Government. Approval of the Central Government will not, however, be necessary, where the rules made by Government permit such issue of shares by companies. Additionally, except in the case of such debentures issued to, or loans obtained from, the Government or any specified institution, approval of the shareholders by a special resolution passed at a general meeting before the issue of such debentures or raising of such loan is necessary.

The validity of a clause in a debenture convertible into shares is not affected by the fact that the right to convert is exercised immediately after the issue. Where the special resolution has not sanctioned the conferment of the option before the issue of the debentures, the conferment is bad. *Om Prakash Berlia v. Unit Trust of India,* (1983) 54 Com Cases 469 at 528 (Bom).

Conversion of debentures issued at a discount

Where the debentures had been issued at a discount, however small and insignificant such discount might be, if such debentures are to be converted into or exchanged for shares, of the same nominal amount, that will be tantamount to issuing the shares at the rate of discount at which the debentures had been originally issued, and, therefore, the issue of the shares in exchange or conversion will be illegal unless the conditions of section 79 are complied with and the sanction of the Company Law Board obtained for the issue. See, *Trustees Corporation (India) Ltd. v. CIT,* AIR 1930 PC 151 and other English cases cited therein and also Notes under S. 79.

Issue of convertible debenture on rights basis.—A company made a fully convertible debenture issue on rights basis making the statutory declaration that it would refund the subscription money in case the issue does not materialise upto 90%. The issue failed and the company refunded the money to applicants. SEBI proceeded against the company on the ground that it should not have done so unilaterally and should have sought SEBI directions, and debarred the company from access to the capital market for ten years. The Calcutta High Court did not approve this line of action on the part of SEBI. The court said that SEBI is a *quasi*-judicial authority. It is bound to observe principles of natural justice. It should not have debarred the company from access to the capital market without hearing the company. Furthermore, SEBI had no power under s. 11A of the SEBI Act to issue any direction to the company that it should not refund the application money even if the subscription was below 90%, the company being bound under the Companies Act to do so. Nor the company was under any obligation to seek SEBI directions for refunding. *Jenson and Nicholson (India) Ltd. v. U.O.I.,* AIR 1997 Cal 308.

Conversion of loans into capital.—In a *bona fide* exercise of the right by following the due procedure and within limits of the authority the conversions of loans of an ex-director into shares does not violate the provisions of s. 106 relating to variation of class rights even if voting power of other shareholders would be affected. But because the company was under rehabilitation scheme before the BIFR under the Sick Industrial Companies (Special Provisions) Act, 1985 and because such a scheme of conversion would deprive the company of what belonged to it, the conversion would be violative of the SICA unless approved by BIFR. *Girish Kumar Kharia v. Industrial Forge & Engg. Co. Ltd.*, (1999) 21 SCL 234 : (1999) 35 CLA 364 : (2000) CLC 105 : (2000) 38 Corp LA 126 : (2001) 103 Com Cases 150 (Pat).

Rules as to loans and debentures with option to convert [Sub-sec. (3) proviso (a)]

In exercise of the powers conferred by section 642 read with cl. (a) of the proviso to sub-clause (3) of section 81 of the Companies Act, 1956, the Central Government has prescribed the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to convert such debentures or Loans into Shares) Rules, 1977.

Conversion of debentures or loans into shares does not require the approval of the Central Government under clause (a) of the proviso to sec. 81(3) if the terms of conversion conform to the requirements laid down in Rule 3 of the Rules, 1977.

A public financial institution or a scheduled bank cannot however, convert debentures issued by or loans given to a company which has defaulted in redemption or repayment of debentures or loans and interest thereon, without giving to the company notice of its intention to convert the debentures or loans at least 30 days prior to the date of intended conversion.

Power of Government to convert loans *etc.* into capital [Sub-section (4)]

The Central Government has been empowered to order the conversion of debentures or loans, obtained from the Government by a company, into shares, where it is so necessary in the public interest. The scope and object of the amendments introduced in this regard by the Amending Act of 1963 are sufficiently explained by the following extracts from the Finance Minister's speech in introducing the Bill, the Select Committee Report, and the further explanations given by the Finance Minister during the debate:—

Observations of the Finance Minister—"Under section 81 of the Companies Act, a company is under an obligation, when it proposes to issue further capital, to offer such capital to its own shareholders. If any variation is to be made it is to be made by means of a meeting of the shareholders. In regard to debenture stock or loans which are convertible into shares at the option of the debenture holders or lenders, this restriction will not apply, if the terms of issue of such debenture or loan include a term for conversion of the loan into shares—that is what is called convertible stock—and this has to be approved by the shareholders. While this position may be sound in regard to joint stock companies that come into the market for issue of convertible debentures or convertible loans, slightly different is the case of financial organisations which would like to take convertible stock for advancing loans instead of making a straight loan or taking debentures. In fact, the International Finance Corporation, which is an adjunct of the World Bank, invariably puts in a condition that their loans enable them, under certain circumstances, to convert part of the loan into shares. But a group of shareholders, for reasons of their own, can withhold the passing of a special resolution and thwart the efforts of the management to obtain the loan as convertible stock from recognised financial institutions like I.C.I.C.I., I.F.C. and international financial bodies like the Commonwealth Development and Finance Corporation and the International Finance Corporation. Therefore, the attitude of the minority stockholders might impede the flow of funds for industrial development.

"Progressive thinking is generally not for outright loans by Government to private enterprise. It is felt that Government should have a right, where it is necessary and desirable, to convert its loans into participating capital and the provision here will enable the

Government to do so. It is, therefore, being provided that the issue of convertible stock to Government and other financial organisations can be made by companies when the terms of the conversion are included in the loan agreement or loan debentures and have been approved by the Central Government. Where loans have been made or are going to be made by Government to joint stock companies, even if such loan agreements do not provide expressly or explicitly for such conversion, Government should have the right to direct such conversion of such loans on terms which are fair and equitable. Where such terms are not acceptable to the company, the right of appeal is being provided to High Court in regard to the terms of conversion". (Extracts from the Finance Minister's speech in introducing the Bill in the *Lok Sabha Debates,* dated 28th November, 1963, Vol. XXV, pages 2002-2003.)

Changes suggested by the Select Committee.—The Committee considers that the Central Government should direct the conversion of debentures or loans into shares, in the company only when in the opinion of the Central Government public interest so demands. The Committee, however, feel that in respect of debentures issued and loans obtained by a company before the commencement of this Bill, when enacted, no such conversion should be directed unless the company has made default in repayment of the amount of the debentures or loans with interest thereon or in the compliance with any other terms of such debentures or loans and the company has failed to remedy the default within three months of the service of a notice in this behalf.

The latter part of the recommendation of the Select Committee that the provision should not apply to debentures and loans existing prior to the commencement of this Amendment Act, was not accepted by Parliament; but as a safeguard against possible arbitrary action on the part of Government, sub-section (2) was inserted during passage of the Bill in the Lok Sabha.

Extracts from Finance Minister's statements during consideration of the Bill after report of the Select Committee:—"There has been some discussion outside about this particular clause whether the intention of the Government is to include loans issued by corporations over which Government has control like the I.F.C. and so on. I may at once deny that there is any such intention. The loans that are sought to be covered by this provision are loans directly given by Government and it is not even expected to include the loans given by the National Shipping Board for the purpose of encouraging shipping industry in this country". (*Lok Sabha Debates,* dated 13th December, 1963, Vol. XXII, page 4655.)

Terms and conditions of conversion of loans *etc.* obtained from the Government by a company when so ordered [Sub-section (5)]

In determining the terms and conditions of conversion of loans *etc.*, the Central Government is mandatorily required to take into account the following factors:

(1) financial position of the company;

(2) terms of issue of debentures or the terms of loan, as the case may be;

(3) rate of interest, payable on such loans or debentures;

(4) capital structure of the company including its loan liabilities and its reserves;

(5) profits of the company during the preceding five years; and

(6) current market price of the shares of the company.

Applicability of sub-s. (4) to private company (Conversion of Government loans, *etc.* into share)

Department's view.—Sub-section (4) of section 81 of the Companies Act, 1956 applies to a private company *simpliciter* notwithstanding clause (a) of sub-section (3) of section 81 *inter alia* for the reasons stated below:—

(i) Sub-sections (4), (5), (6) and (7) of section 81 were added by section 5 of the Companies Amendment Act (13 of 1963). It is obvious therefrom that section 81(3)(a) which was in the Statute before the introduction of sub-sections (4), (5), (6) and (7) could not possibly refer to sub-section (4).

(ii) It is well known that if two sections of the same Statute are repugnant, the rule is that the last must prevail. Sub-section (4), therefore, must prevail over sub-section (3) of section 81.

(iii) Sub-sections (1) and (2) deal with the offer of further shares to the existing shareholders and renunciation thereof by the said shareholders. Sub-section (1A) makes an exception thereto in the circumstances specified therein. Sub-section (3) provides that nothing in this section which, in the context, in my opinion, can only mean sub-sections (1) and (2), apply—

(a) to a private company; or

(b) to the increase of the subscribed capital of a public company caused in the circumstances specified in the said clause.

Sub-section (4), however, deals with an entirely different subject. It empowers the Central Government alone unilaterally to make the order and not on the basis of consent of the company or pursuant to some option attached to the debentures issued to or loan taken from the Government, by the company. It is a well known principle in interpretation of Statutes that one way in which repugnancy can be avoided is by regarding two apparently conflicting provisions as dealing with distinct matters or situations.

(iv) The opening words of sub-section (4), *viz.*, "notwithstanding anything contained in the foregoing provisions of this section" refer to sub-sections (1), (2) and (3) and as such sub-section (4) prevails over sub-section (3)(a) and in the premises, an order under section 81(4) can be made by the Central Government even in respect of any private company.

(v) The Hon'ble Finance Minister's speech in the Lok Sabha Debate referred to by the Solicitor in para 4 of his note dated 23-5-74 at p. 12-13/N *ante* has been reproduced in "A GUIDE TO THE COMPANIES ACT" BY A. RAMAIYA, 5th Edition, pages 142-143. It is well known that debate in Parliament cannot be referred to for the purpose of construction of the statute. However, for the sake of argument only and without admitting, if it is assumed that the speech is relevant, the scope and effect of the speech, in my opinion, is as follow:—

(a) The Honourable Minister did not refer to private company but stated that "progressive thinking is *generally* not for outright loans by *Government to private enterprises*". The expression "private enterprise" in this context, it is felt refers to enterprise which is not public enterprise, *i.e.* not an enterprise by the Government, and the expression has nothing to do with private company or public company.

(b) The Hon'ble Finance Minister did not refer to debentures to be issued to or loans to be obtained from the Government by a company in future, but to debentures which have already been issued to or loans which have already been obtained from the Government by a company. This is due to the fact that in regard to debentures to be issued to or loans to be obtained in future from the Government by a company, Government has the option even without the aid of the Statute to agree to subscribe for debentures of a company or to grant loans and advances to a company only on the condition that the Government will have the option to convert debentures or loans into equity shares in the company. In regard to debentures which have already been subscribed or loans which have already been granted, however, Government cannot exercise such option unless such option had already been attached to the debentures issued to or loans granted by the Government and in relation to such debentures issued or loans granted by the Government to a company in the past whereto no such option had been attached, it was necessary for the Government to have such power and that could be done only by amendment of the Companies Act. It is in that context that the Hon'ble Minister made his speech in introducing the Bill, resulting in the additions of sub-sections (4) to (7) after the Bill was passed. The speech, in my opinion, did not refer to any particular class of companies private or public, but to private enterprise comprising both public companies and private companies. (*Department's F. No.* 33/58/73-CL-III).

Conversion of loan into shares is prospective in effect

Department's view.—It is clear from the provisions of section 81(4) of the Act that the order passed for conversion is not retrospective in effect but only prospective in effect. When loans are converted into shares, the holder thereof is entitled to all the rights of a member including voting rights at meetings of the company. In case retrospective conversion is made, the entire voting pattern of meetings of the company which had taken place in the interim period would be upset. (*Extracts from File No.* 33/8/72-CL-III)

Prescribed Form.—For Form of notice to the Registrar for increase of Share Capital in consequence of order under this sub-section, see Form No. 5 in *Appendix* 1.

Appeal against Government's order [Sub-section (7)]

Where the Government exercises the power to convert loans or debentures into shares on certain terms and conditions which are not acceptable to the company, the company may within 30 days or within such further time as may be granted by the court, prefer an appeal to the court in regard to such terms and conditions and the decision of the court shall be final both regarding the position of the company and that of the Central Government.

Increasing membership by divesting and by public issue

A scheme was drawn by a stock exchange for making its membership more broad-based. It had 125 members. Each member held two shares. The existing members were called upon to divest themselves of one share each which was to be transferred to the authorised assistants. There was also to be a further issue of 125 shares to the public. The membership fee required from authorised assistants was to be less than that to be charged from members of the public. This was held to be a reasonable classification and not discriminatory because the authorised assistants were going to give to the organisation the benefit of their experience. The constitution of the Selection Committee for choosing new members was also held to be valid because it consisted of Government nominees and some directors of the Stock Exchange. *Rajesh Kumar Maheshwari v. Union of India,* (1992) 73 Com Cases 155 : AIR 1992 Delhi 68, **affirmed** by the Supreme Court in *Om Prakash Poplai and Rajesh Kumar Maheshwari v. Delhi Stock Exchange Assn. Ltd., Union of India and Kamlesh Kumar Jain,* (1994) 79 Com Cases 756 (SC).

Penalty for default

There is no specific penalty provided for contravening the section, and section 629-A will apply.

Compoundable offence.—The offence is compoundable under s. 621-A.

The Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to Convert such Debentures or Loans into Shares) Rules, 1977

[*Vide Notification GSR 602, dated 2-5-1977.*]

1. Short title and commencement

(1) These rules may be called the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to Convert such Debentures or Loans into Shares) Rules, 1977.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions

In these rules, unless the context otherwise requires—

(a) 'Act' means the Companies Act, 1956;

(b) "public financial institution" means—

(i) any of the financial institutions specified in sub-section (1) of section 4A of the Act;

(ii) any of the other institutions specified by the Central Government to be public [1][financial] institutions under sub-section (2) of the said section 4A.

[2][(c) "Scheduled bank" means a bank included in the Second Schedule to the Reserve Bank of India Act, 1934, but does not include co-operative banks, regional rural banks and foreign banks.]

3. Particulars regarding the terms of issue of debentures or the terms of raising of loans by a public company

The terms of issue of debentures or the terms of [3][raising of loans] by a public company which include a term providing for an option to convert such debentures or loans [1][or any part thereof] into shares in the company or to subscribe for shares in the company shall not require the approval of the Central Government under cl. (a) of the proviso to sub-section (3) of section 81 of the Act, if such terms conform to the following requirements, namely—

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1. Ins. by G.S.R. No. 623, dated 8-5-1978.
2. Ins. by GSR No. 275(E), dt. 1-4-2003.
3. Subs. by G.S.R. No. 623, dated 8-5-1978.

(a) the debentures or loans may be issued or raised either through private subscription or through the issue of a prospectus to the public;

(b) a [4][public] financial institution [5][or a scheduled bank] either underwrites or subscribes to or sanctions the whole or part of the issue of debentures or the raising of loans, as the case may be;

[6][(c) when and where necessary, the consent of the Central Government under the provisions of the Capital Issues (Central) Act, 1947 (20 of 1947), is obtained for the issue of shares consequent upon the conversion of debentures of loans into equity capital.

(d) having regard to the financial position of the company the terms of issue of the debentures or the terms of the loans, as the case may be, the rate of interest payable on the debentures or loans, the capital of the company, its loans, liabilities, its reserves, its profits during the immediately preceding five years and the current market price of the shares of the company, as may be applicable, the financial institutions [7][or scheduled banks, as the case may be,] provide for the terms including the term providing for an option to convert such debentures or loans or any part thereof, into shares in the company or to subscribe for shares therein, either at par or at a premium not exceeding twenty-five per cent of the face value of the shares.]

[8][*Provided* that a public financial institution or a scheduled bank shall not convert all or any part of such debentures or loans unless,—

(a) the company that has issued the debentures or raised the loan has defaulted in the repayment/redemption of, or payment of interest on, such loans or debentures; and

(b) such scheduled bank or public financial institution has given the company notice of its intention to convert such loans or debentures at least 30 days prior to the intended date of conversion."

Employees Stock Option Scheme [Sub-section (5)]

SEBI (Employees Stock Option Scheme and Employees Stock Option Purchase Scheme) Guidelines, 1999 (ESOS & ESPS).—Further capital can be raised by a company without prior offer to its equity shareholders under sub-section (1) by allotting shares to its employees, officers or working directors, subject to the following conditions:

(a) the company has framed a scheme of Employees State Option (ESOS);

(b) the scheme so framed is in accord with the provisions of sub-sections (3) and (6);

(c) (i) the scheme so framed is in accord with the conditions prescribed by the Central government for unlisted companies, or

(ii) the scheme is as per guidelines of SEBI for listed companies

§ For SEBI (Employees Stock Option Scheme and Employees Stock Purchase Scheme), 1999 refer to *Appendix* 174.

Preferential allotment to employees who are residents outside India under Employees Stock Options Scheme under FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000

AP (DIR Series) Circular No. 38, dt. 3-12-2003.—RBI has issued a Circular containing gist of current regulatory provisions relating to foreign investments.

Para 3.3. of the Circular under heading 'Issue of Shares under ESOPS' reads thus:

A company may issue shares under the ESOPS to its employees or employees of its joint venture or wholly-owned subsidiary abroad who are resident outside India, directly or through a Trust subject to the conditions that the scheme has been drawn in terms of regulations issued under the Securities Exchange Board of India Act, 1992, and face value of the shares to be allotted under the scheme to the non-resident employees does not exceed 5% of the paid-up capital of the issuing company. The Trust and the issuing company should ensure that value of shares held by persons resident outside India under the scheme does not exceed the limit specified in clause (b) of Reg. 8(1).

Reg. 8 of the Regulations, 2000 framed under the FEMA, 1999 grants general permission to an Indian company to issue shares to its employees or employees of its joint ven-

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4. The word 'Public' was omitted by GSR No. 623, dated 8-5-1978 and it was reinserted by GSR No. 1489, dated 25-11-1978.
5. Ins. by GSR No. 275(E), dt. 1-4-2003.
6. Subs. by GSR No. 623, dated 8-5-1978.
7. Ins. by GSR No. 275(E), dt. 1-4-2003.
8. Ins. by *Ibid.*

ture/subsidiary abroad, who are resident outside India either directly to such employees or through a Trust subject to the provisions of that Regulation which provides as follows:

(1) An Indian company may issue shares under the Employees' Stock Options Scheme, by whatever name called, to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India, directly or through a Trust:

Provided that—

(a) the scheme has been drawn in terms of regulations issued under the Securities Exchange Board of India Act, 1992; and

(b) face value of the shares to be allotted under the scheme to the non-resident employees does not exceed 5% of the paid-up capital of the issuing company.

(2) The Trust and the issuing company shall ensure that value of shares held by persons resident outside India under the scheme does not exceed the limit specified in clause (b) of sub-regulation (1).

(3) The issuing company shall furnish to the Reserve Bank, within thirty days from the date of issue of shares under the scheme, a report giving the following particulars/documents,—

(i) names of persons to whom shares are issued under the scheme and number of shares issued to each of them;

(ii) a certificate from the Company Secretary of the issuing company that the value of shares issued under the scheme does not exceed 5% of the paid up capital of the issuing company and that the shares are issued in compliance with the regulations issued by the SEBI in this behalf.

Termination of Employment

A provision in a contract of employment for termination of a share option scheme in the event of the termination of employment relationship must be construed as applying only to cases of lawful termination of the contract of employment—*Levett v. Biotrace International plc.*, The Times May 11, 1999 (CA)

Insider trading and Employees Stock Option Scheme

For Notes on the subject see under section 291 under the same heading. See also clause 5.4 of ESOS, 1999 in *Appendix* 174.

Employees Stock Option Scheme for Public Sector Enterprises

Ministry of Industry has announced "Employees Stock Option Scheme" for employees of public sector enterprises. The scheme applies to all cases of disinvestments and fresh issues of securities by the enterprises *vide* Press Note, dated 16-12-1997.

§ For the text of the Scheme see *Appendix* 279.

RESERVATIONS/FIRM ALLOTMENT IN PUBLIC ISSUE

SEBI Guidelines, 2000.—The issuer company is free to make reservations and/or firm allotments to various categories of persons mentioned hereafter for the remaining of the issue size* subject to other relevant provisions of these guidelines [*Clause 8.3.4*].

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* **Capital Structure.**—1. For the purposes of presentation of the capital structure in the specified format, the lead merchant banker shall take into account the following:

(a) Proposed issue amount = Promoters' contribution in the proposed issue (+) firm allotment (+) offer through the offer document.

(b) Offer through the offer document shall include net offer to the public and reservations to the permitted reserved categories and shall not include the promoters' contribution in the proposed issue and firm allotment.

2. Net offer to the public shall mean the offer made to Indian public and does not include reservations/firm allotments/promoters' contribution. [*Clause 8.4*].

3. The net offer to the public shall be at least—

(a) in the case of a listed company, 25% of the size of the issue;

(b) in the case of an unlisted company, 25% of the post-issue capital;

(c) in the case of unlisted company in the information technology sector, 10% of the issue size, subject to satisfaction of certain conditions [*Clause 8.3*].

Meaning of "reservation".—The expression "reservation" shall mean reservation on competitive basis wherein allotment of shares is made in proportion to the shares applied for by the concerned reserved categories [*Explanation 1 to clause 8.3.4*].

Categories of persons eligible for reservations.—Reservation on competitive basis can be made in a public issue to the following categories:

Sr. No.	*Category of Persons*
(i)	Permanent employees (including working directors) of the company and in the case of a new company the permanent employees of the promoting companies
(ii)	Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company
(iii)	Indian Mutual Funds
(iv)	Foreign Institutional Investors (including non-resident Indians and overseas corporate bodies)
(v)	Indian and Multilateral Development Institutions.
(vi)	Scheduled Banks [*Explanation 2 to Clause 8.3.4*]

Meaning of "Firm allotment".—"Firm Allotment" means allotment on a firm basis in public issues by an issuing company made to Indian and Multilateral Development Financial Institutions, Indian Mutual Funds, Foreign Institutional Investors including non-resident Indians and overseas corporate bodies and permanent/regular employees of the issuer company [*Clause 1.2.1(xiii)*].

Categories of persons eligible for firm allotment.—"Firm allotment" in public issues can be made to the following specified categories:

Sr. No.	*Category of Persons*
(i)	Indian and Multilateral Development Financial Institutions
(ii)	Indian Mutual Funds
(iii)	Foreign Institutional Investors (including non-resident Indians and overseas corporate bodies)
(iv)	Permanent/regular employees of the issuer company
(v)	Scheduled Banks [*Explanation 3 to Clause 8.3.4*].

Extent of reservation or firm allotment.—The Lead Merchant Banker(s) can be included in the category of persons entitled to firm allotments subject to an aggregate maximum ceiling of 5% of the proposed issue of securities [*Explanation 4 to Clause 8.3.4*].

The aggregate of reservations and firm allotments for employees in an issue, shall not exceed 10% of the total proposed issue amount [*Explanation 5 to Clause 8.3.4*].

For shareholders, the reservation shall not exceed 10% of the total proposed issue amount [*Explanation 6 to Clause 8.3.4*].

The allotment of securities to the specified categories for firm allotment/reservation shall be subject to such conditions as may be specified by the Government and regulatory authorities [*Explanation 8 to Clause 8.3.4*].

Employees/shareholders of DFI promoted companies.—In case promoting companies are Designated Financial Institutions/State and Central Financial Institutions, the employees and the shareholders of such promoting companies, shall not be eligible for the said reservations [*Explanation 7 to Clause 8.3.4*].

Requirements in reservations/firm allotments

(a) (i) If any firm allotment has been made to any person(s) in the specified categories, no further application for subscription to the public issue from such person(s) [excepting application from employee's category] shall be entertained.

(ii) Where reservation has been made to specified category(ies), person(s) belonging to category(ies) [except employees and shareholders categories] shall not make an application in the 'net public offer' category.

(b) (i) An applicant in the net public category cannot make an application for that number of securities exceeding the number of securities offered to the public.

(ii) In the case of reserved categories, a single applicant in the reserved category can make an application for a number of security which exceeds the reservation.

(c) (i) Any unsubscribed portion in any reserved category may be added to any other reserved category.

(ii) The unsubscribed portion, if any, after such *inter se* adjustments amongst the reserved categories shall be added back to the net offer to the public.

(d) In case of undersubscription in the net offer to the public portion, spill-over to the extent of undersubscription shall be permitted from the reserved category to the net public offer portion.

(e) If any person to whom firm allotment is proposed to be made withdraws partially or fully from the offer made to him after filing of the prospectus with the Registrar of Companies, the extent of shares proposed to be allotted to such person shall be taken up by the promoters and the subscription amount shall be brought in at least one day prior to the issue opening date.

(f) The shares so acquired by promoters under sub-clause (e) above shall also be subject to a lock-in for a period of 3 years.

(g) No buy-back or stand-by or similar arrangements shall be allowed with the persons for whom securities are reserved for allotment on a firm basis [*Clause 8.5*].[9]

Lock in of shares—*SEBI Guidance Note, dt. 10-01-2000.*—Any firm allotment whether to promoters, friends, relatives, financial institutions, mutual funds etc. in the proposed offering, would be subject to lock-in of 3 years from the date of allotment in public issue.*

Differential Pricing.—Any unlisted company or a listed company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided that the price at which the se-

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9. **Buy-Back' and 'Stand-by' arrangements.**—In many cases, promoters and promoter groups enter into buy-back' arrangements in terms whereof parties agree to subscribe to the shares with an agreement that after the issue closes, the shares allotted to such parties will be purchased back by the promoter or promoter groups. There are also stand-by arrangements with parties to agree to subscribe to the shares in the event of a short-fall in the public subscription. The cost of these arrangements is often passed on to the company in some form. We would suggest that disclosure may be required in the prospectus of all such arrangements. [*Vide* para 12.5 of *Malegam Committee's Report at Appendix 2.31.*]

* It has been decided by Sr. ED (OPG) and approved by Chairman that the subject matter would be taken up to Malegam Committee for further discussion. Meanwhile pending discussion, the following decision is to be implemented for the entire offer documents pending with us as on date as advised by Policy Division: Any firm allotment whether to promoters, friends, relatives, financial institutions, mutual funds etc. in the proposed offering, would be subject to lock-in of 3 years from the date of allotment in public issue. These guidelines would apply in addition to other existing guidelines. [*Guidance Note dated 10-1-2000 issued by SEBI*].

curity is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public.

Explanation.—The net offer to the public means the offer made to the Indian public and does not include firm allotments or reservations or promoters' contributions [*Clause* 3.4.1].

Payment of Discounts/Commissions.—No payment, direct or indirect, in the nature of a discount, commission, allowance or otherwise, shall be made either by the issuer company or the promoters in any public issue to the persons who have received firm allotment in such public issue [*Para 3.6.1*].

Disclosure in prospectus.—Under the heading 'Capital structure of the Company', after details of capital structure, the following notes should be incorporated:

(1) (a) Unsubscribed portion in any reserved category may be added to any other reserved category.

(b) The unsubscribed portion, if any, after such *inter se* adjustments amongst the reserved categories shall be added back to the net offer to the public [*Clause 6.4.2.1(h)*].

(2) In case of under-subscription in the net offer to the public portion spillover to the extent of undersubscription shall be permitted from the reserved category to the net public offer portion [*Clause 6.4.2.1(i)*].

Pricing of Preferential Issue by Private Sector Banks.—Paras 5 and 6 of RBI Guidelines for Issue and Pricing of shares by Private Sector Banks deal with preferential issue by banks.

All preferential issues would require prior approval of RBI. Pricing of preferential issues by listed banks may be as per SEBI formula, while for unlisted banks, the fair value may be determined by a chartered accountant or a merchant banker.

In case of pricing of issues where RBI approval is not required, pricing of issues should be as per SEBI guidelines; in cases where prior approval of RBI is required, princing should take into account both SEBI and RBI guidelines. [*RBI Notification No. DBOD No. 79/16.13.100/2001-2002, dt. 20-3-2002*]

OFFER TO PUBLIC THROUGH BOOK BUILDING

Book Building Process for Issue of Shares.—Book-building is an international practice which refers to collecting orders from investment bankers and larger investors based on indicated prices.

SEBI decided "to provide an additional facility of book-building in the capital issuance process which would retain the retail characteristics but at the same time allow capital to be raised in a more efficient manner. The existing public offering process involves fixation of issue price by the issuer and the lead merchant banker without the flexibility of testing the market and correcting the price suitably. Book-building is considered to be possible solution." Pursuant to this decision, SEBI issued guidelines for issue of capital through book-building process under Clarification No. XIII dated 12-10-1995 as part of the erstwhile SEBI (Disclosure and Investor Protection) Guidelines, 1992. The facility of book-building process was initially available only for 75% of the issue size. SEBI "further decided that the process of public issues need to be strenghtened further by allowing the book-building process prior to an offering to the public. The Board has decided that companies with an issue size of Rs. 100 crores or more would be allowed to use the book-building process for that part of the issue which can be allotted on a firm basis as per the present guidelines. This will be optional for the companies and will enable the lead managers of the companies on one hand to be able to assess the demand for the issue in the market at different prices. On the other hand, it will help the retail investor because the offer to the retail investor would be made at a price which has been decided after the assessment of the institutional buyers has been taken into account". Accordingly the fa-

cility of book-building process was extended for 100% of the issue size by Clarification No XXI dated 27-10-1997. In this context, it was observed:

"SEBI has introduced the facility of book-building in the capital issuance process which would provide the issuer and the lead merchant banker the flexibility of price and demand discovery. Accordingly, in Clarification XIII the guidelines for book building were introduced which was subsequently modified in Clarification XVII. These guidelines, however, restricted the facility of book-building to 75% of the issue size thereby severely constraining the benefits arising out of price and demand discovery. In order to extend the facility of book building for 100% of the issue size, SEBI has now framed the guidelines for book-building which would be applicable for 100% of the issue size and shall be available to issuer companies which propose to make an issue of capital of and above Rs. 100 crores."

SEBI Guidelines, 2000.—SEBI has issued consolidated guidelines on disclosure and investor protection called SEBI (Disclosure and Investor Protection) Guidelines, 2000. Chapter XI of the Guidelines lay down the requirements to be fulfilled by the issuer company proposing to issue capital through book building process. *In case an issuer company is making an initial public offer to equity shares through book building mechanism, the company can avail of the Green Shoe Option (GSO) for stabilising the post listing price of its shares subject to the provisions of Chapter VIII-A of the Guidelines.

Meaning of 'book-building'.—Clause 1.2.1(v) of Chapter I of the Guidelines, define the term book-building as follows:

"Book Building" means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document.

Hearing of Green Shoe Option.—Clause 1.2.1 (xiii-a) of Chapter I of the Guidelines, define the term green shoe option as follows: "Green Shoe Option" means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilising mechanism in accordance with the provisions of Chapter VIII-A of the Guidelines, which is granted to a company to be exercised through a Stabilising Agent.

(A) 75% BOOK BUILDING PROCESS [Clause 11.2]

In an issue of securities to the public through a prospectus the option for 75% book building shall be available to the issuer company subject to the following:—

(i) *Eligibility.*—The option of book-building shall be available to all body corporate which are otherwise eligible to make an issue of capital to the public.

(ii) *Option.*— (a) The book-building facility shall be available as an alternative to, and to the extent of the percentage of the issue which can be reserved for firm allotment, as per these Guidelines.

(b) The issuer company shall have an option of either reserving the securities for firm allotment or issuing the securities through book-building process.

(iii) *Identification of securities.*—The issue of securities through book-building process shall be separately identified/indicated as 'placement portion category', in the prospectus.

(iv) *Net offer to the public.*—(a) The securities available to the public shall be separately identified as 'net offer to the public'.

(b) The requirement of minimum 25% of the securities to be offered to the public shall also be applicable.

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* Ins. by SEBI/CFD/DIL/DIP/Circular No. 11, dt. 14-8-2003.

(v) *Underwriting mandatory.*—In case the book-building option is availed of, underwriting shall be mandatory to the extent of the net offer to the public.

(vi) *Filing of draft prospectus with SEBI.*—The draft prospectus containing all the information except the information regarding the price at which the securities are offered shall be filed with the Board.

(vii) *Lead merchant banker as book runner.*—One of the lead merchant banker to the issue shall be nominated by the issuer company as a Book Runner and his name shall be mentioned in the prospectus.

(viii) *Circulation of draft prospectus.*—(a) The copy of the draft prospectus filed with the Board may be circulated by the Book Runner to the institutional buyers who are eligible for firm allotment and to the intermediaries eligible to act as underwriters inviting offers for subscribing to the securities.

(b) The draft prospectus to be circulated shall indicate the price band within which the securities are being offered for subscription.

(ix) *Record to be maintained by book runner.*—The Book Runner on receipt of the offers shall maintain a record of the names and number of securities ordered and the price at which the institutional buyer or underwriter is willing to subscribe to securities under the placement portion.

(x) *Record to be maintained by underwriter.*—The underwriter(s) shall maintain a record of the orders received by him for subscribing to the issue out of the placement portion.

(xi) *Aggregation of offers received by underwriter.*—(a) The underwriter(s) shall aggregate the offers so received for subscribing to the issue and intimate to the Book Runner the aggregate amount of the orders received by him.

(b) The institutional investor shall also forward its orders, if any, to the book runner.

(xii) *Issue price.*—On receipt of the information, the Book Runner and the issuer company shall determine the price at which the securities shall be offered to the public.

(xiii) The issue price for the placement portion and offer to the public shall be the same.

(xiv) *Underwriting agreement.*—On determination of the price of the underwriter shall enter into an underwriting agreement with the issuer indicating the number of securities as well as the price at which the underwriter shall subscribe to the securities.

Provided that the Book Runner shall have an option of requiring the underwriters to the net offer to the public to pay in advance all monies required to be paid in respect of their underwriting commitment.

(xv) *Filing of prospectus with ROC.*—On determination of the issue price within two day, thereafter the prospectus shall be filed with the Registrar of Company.

(xvi) *Collection of application moneys.*—The issuer company shall open two different accounts for collection of application moneys, one for the private placement portion and the other for the public subscription.

(xvii) *Collection of application form/money by book runner.*—One day prior to the opening of the issue to the public, Book Runner shall collect from the institutional buyers and the underwriters the application forms along with the application moneys to the extent of the securities proposed to be allotted to them/subscribed by them.

(xviii) *Allotment of private placement.*—(a) Allotments for the private placement portion shall be made on the second day from the closure of the issue.

(b) However, to ensure that the securities allotted under placement portion and public portion are *pari passu* in all respects, the issuer company may have one date of allotment

which shall be the deemed date of allotment for the issue of securities through book building process.

(xix) *Advance payment by underwriter.*—In case the Book Runner has exercised the option of requiring the underwriter to the net offer to the public to pay in advance all moneys required to be paid in respect of their underwriting commitment by the eleventh day of the closure of the issue the shares allotted as per the private placement category shall be eligible to be listed.

(xx) *Allotment of securities under public category.*— (a) Allotment of securities under the pubic category shall be made as per the Guidelines.

(b) Allotment of securities under the public category shall be eligible to be listed.

(xxi) *Adjustments in case of under subscription.*— (a) In case of undersubscription in the net offer to the public spillover to the extent of under subscription shall be permitted from the placement portion to the net offer to the public portion subject to the condition that preference shall be given to the individual investors.

(b) In case of undersubscription in the placement portion spillover shall be permitted from the net offer to the public to the placement portion.

(xxii) *Interest on application money.*—The issuer company may pay interest on the application moneys till the date of allotment or the deemed date of allotment provided that payment of interest is uniformly given to all the applicants.

(xxiii) *Record to be maintained by book runner and intermediaries.*—(a) The Book Runner and other intermediaries associated with the book building process shall maintain records of the book building process.

(b) The Board shall have the right to inspect such records.

(B) OFFER TO PUBLIC THROUGH BOOK BUILDING PROCESS [*Clause 11.3.1*]

An issuer company may, subject to the requirements specified in this Chapter, make an issue of securities to the public through a prospectus in the following manner:

(i) 100% of the net offer to the public through book building process, or

(ii) 75% of the net offer to the public through book building process and 25% at the price determined through book building.

Reservation/firm allotment.—Reservation or firm allotment to the extent of percentage specified in these Guidelines shall not be made to categories other than the categories mentioned in sub-clause (iii) below.

Book Building portion.—Book Building shall be for the portion other than the promoters contribution and the allocation made to;

(a) 'permanent employees of the issuer company and in the case of a new company the permanent employees of the promoting companies';

(b) 'shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company' either on a 'competitive basis' or on a 'firm allotment basis'.

Appointment of book runners.—The issuer company shall appoint an eligible Merchant *Banker(s) as book runner(s)* and their name(s) shall be mentioned in the draft prospectus.

[10][(iv) (a) *Agreement with stock exchange.*—The issuer company shall enter into an agreement with one or more of the Stock Exchange(s) which have the requisite system of on-line offer of securities. The agreement shall specify *inter-alia*, the rights, duties, responsibilities and obligations of the company and stock exchange (s) inter se. The agree-

10. SEBI Circular No. 11, dated 14-8-2003.

ment may also provide for a dispute resolution mechanism between the company and the stock exchange.

(b) The company may apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the on-line system]

(v) *Lead book runner (LBR).*—The Lead Merchant Banker shall act as the Lead Book Runner and the other eligible Merchant Banker(s), so appointed by the Issuer, shall be termed as Co-Book Runner(s).

(va) 'In case the issuer company appoints more than one book runner, the names of all such book runners who have submitted the due diligence certificate to SEBI, may be mentioned on the front cover page of the prospectus. A disclosure to the effect that 'the investors may contact any of such book runners, for any complaint pertaining to the issue' shall be made in prospectus, after the 'risk factors'.]

(vi) *Responsibility of LBR.*—The primary responsibility of building the book shall be that of the Lead Book Runner.

(vii) *Appointment of intermediaries.*—The Book Runner(s) may appoint those intermediaries who are registered with the Board and who are permitted to carry on activity as an 'Underwriter' as syndicate members.

[11][(vii) (a) The Book Runner(s)/syndicate members shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting bids, applications and placing orders with the company and ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors, if any.

(vii) (b) For the purposes of this Chapter, the brokers, so appointed accepting applications and application monies, shall be considered as 'bidding/collection centres'.

(vii) (c) The broker/s so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client/investors fails to pay for shares allocated as per the Guidelines, the broker shall pay such amount.

(vii) (d) The company shall pay to the broker/s a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients/investors in lieu of his services.]

(viii) *Filing of draft prospectus with SEBI.*—The draft prospectus containing all the disclosures as laid down in Chapter VI except that of price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with the Board:

Provided that the total size of the issue shall be mentioned in the draft prospectus.

[12][(viii-a) *Disclosure in red-herring prospectus.*—The red herring prospectus shall disclose, either the floor price of the securities offered through it or a price band along with the range within which the price can move, if any].

[13][(viii-b) *Price-band.*—In case the red herring prospectus discloses the price band, the lead book runner shall ensure compliance with the following conditions:

(a) The cap of the price band should not be more than 20% of the floor of the band; *i.e* cap of the price band shall be less than or equal to 120% of the floor of the price band

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11. SEBI Circular No. 11, dated 14-8-2003.
12. SEBI Circular No. 11, dated 14-8-2003.
13. SEBI Circular No. 11, dated 14-8-2003.

(b) The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% *i.e* floor of price band can move up or down to the extent of 20% of floor of the price band disclosed in the red herring prospectus and the cap of the revised price band will be fixed in accordance with Clause (a) above;

(c) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members.

(d) In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding thirteen days.

(e) The manner in which the shortfall, if any, in the project financing, arising on account of lowering of price band to the extent of 20% will be met shall be disclosed in the red herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up.]

(ix) *Inter-se allocation of responsibilities.*—(a) In case of appointment of more than one Lead Merchant Banker or Book Runner for book building, the rights, obligations and responsibilities of each should be delineated.

(b) In case of an under subscription in an issue, the shortfall shall have to be made good by the Book Runner(s) to the issue and the same shall be incorporated in the *inter se allocation* of responsibility given in **Schedule II**.

(x) *Incorporation of SEBI's suggestion.*—(a) The Board within 21 days of the receipt of the draft prospectus may suggest modifications to it.

(b) The Lead Merchant Banker shall be responsible for ensuring that the modifications/final observations made by the Board are incorporated in the prospectus.

[14][(xi) *Advertisement of final prospectus.*—(a) The issuer company shall after receiving the final observations, if any, on the offer document from the Board, make an advertisement in an English National daily with wide circulation, one Hindi National newspaper and a Regional language newspaper with wide circulation at the place where the registered office of the Issuer company is situated, containing the salient features of the final offer document as specified in Form 2A of the Companies Act circulated along with the application form. The advertisement in addition to other required information, shall also contain the following:

(i) 'the date of opening and closing of the issue

(ii) the method and process of application and allotment

(iii) the names, addresses and the telephone numbers of the stock brokers and centres for bidding.]

[15][(b) The issuer company shall circulate the application forms to the Brokers.]

(xii) [* * * * *]

(xiii) *Pre-issue obligations and disclosure requirements.*—The pre-issue obligations and disclosure requirements as specified in Chapter V and VI respectively of these Guidelines, shall be applicable to issue of securities through book building unless stated otherwise in this Chapter.

(xiv) *Determination of issue price.*—The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the 'syndicate members'.

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14. SEBI Circular No. 11, dated 14-8-2003.
15. SEBI Circular No. 11, dated 14-8-2003.

(xv) On determination of the price, the number of securities to be offered shall be determined (issue size divided by the price which has been determined).

(xvi) *Determination of entitlement.*—Once the final price (cut-off price) is determined all those bidders whose bids have been found to be successful (i.e. at and above the final price or cut-off price) shall become entitle for allotment of securities.

(xvii) *No incentives to be paid to investors.*—No incentive, whether in cash or kind, shall be paid to the investors who have become entitled for allotment of securities.

[16][(xvii-a) *Margin money.*—The broker may collect an amount to the extent of 100% of the application money as margin money from the clients/investors before he places an order on their behalf. The margin collected from categories other than Qualified Institutional Buyers shall be uniform across the book runner(s)/syndicate members, for each such category

(xvii-b) *Limit for acceptance of bids.*—Bids for securities beyond the investment limit prescribed under relevant laws shall not be accepted by the syndicate members/brokers from any category of clients/investors]

(xviii) *Intimation to investors.*—On determination of the entitlement under sub-clause (xvi), the information regarding the same (*i.e.* the number of securities which the investor becomes entitled) shall be intimated immediately to the investors.

(xix) *Filing of final prospectus with ROC.*—The final prospectus containing all disclosures as per these Guidelines including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.

(xx) *Collection Centres.*—Arrangement shall be made by the issuer for collection of the applications by appointing mandatory collection centres as per these Guidelines.

[16][(xx-a) *On-line display of data.*—"The online, real time graphical display of demand and bid prices at the bidding terminals, shall be made. The book running lead manager shall ensure the availability of adequate infrastructure for data entry of the bids on a real time basis.]

(xxi) *Application by certain investors.*—The investors who had not participated in the bidding process or have not received intimation of entitlement of securities may also make an application.

Additional Disclosures *[Clause 11.3.2]*

[17][(i) *Particulars of syndicate members, etc.*—The particulars of syndicate members, brokers, registrars, bankers to the issue, etc.]

(ii) *Basis for issue price.*—The following statement shall be given under the 'basis for issue price':—

> "The issue price has been determined by the Issuer in consultation with the Book Runner(s), on the basis of assessment of market demand for the offered securities by way of Book-building."

[18][(iii) *Accounting ratios.*—The following accounting ratios shall be given under the basis for issue price for each of the accounting periods for which the financial information is given:

1. EPS, pre-issue, for the last three years (as adjusted for changes in capital).
2. P/E pre-issue
3. Average return on net-worth in the last three years.
4. Net-Asset value per share based on last balance sheet.

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16. SEBI Circular No. 11, dated 14-8-2003.
17. SEBI Circular No. 11, dated 14-8-2003.

5. Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (*i.e.* companies of comparable size in the same industry. (Indicate the source from which industry average and accounting ratios of the peer group has been taken)
6. The accounting ratios disclosed in the offer document shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital shall be exercised.]

Underwriting [*Clause 11.3.3.*]

(i) In case the issuer company is making an issue of securities:

(i) under sub-clause (a) of clause 11.3, 100% of the net offer to the public;

(ii) under sub-clause (b) of clause 11.3, the book built portion – 75% of the net offer to the public,

shall be compulsorily underwritten by the syndicate members/book runner(s):

[19][*Provided* that nothing contained in sub-clause (i) shall apply to 50% of the net offer to the public, mandatorily to be allotted to the Qualified Institutional Buyers under proviso to clause 2.2.2 or clause 2.3.2 of these guidelines, in case the company is making an issue of securities under clause 2.2.2 or clause 2.3.2, as the case may be.]]

Underwriting agreements

(ii) (a) *Between syndicate members and book runners.*—The 'syndicate members' shall enter into an underwriting agreement with the Book Runner(s) indicating the number of securities which they would subscribe at the predetermined price.

(b) *Between book runners and company.*—The Book Runner(s) shall in turn enter into an underwriting agreement with the Issuer company.

(iii) In the event of the syndicate members not fulfilling their underwriting obligations the Book Runner(s) shall be responsible for bringing in the amount devolved.

(iv) * * * * *]

Procedure for bidding [*Clause 11.3.4*]

The method and process of bidding shall be subject to the following:

[20][(i) *Opening of bid.*—Bid shall be open for atleast 5 days and not more than 10 days, which may be extended to a maximum of 13 days in case the price band is revised in accordance with clause 11.3.1(viii-b).]

(ii) *Contents of advertisement.*—The advertisement mentioned at clause 11.3.1 (xi) shall also contain the following:

(a) the date of opening and closing of the bidding(not less than 5 days).

(b) the names and addresses of the syndicate members as well as the bidding terminals for accepting the bids.

(c) the method and process of bidding.

(iii) *Bidding through electronic media only.*—Bidding shall be permitted only if an electronically linked transparent facility is used.

(iv) *'Syndicate members' presence at bidding centres.*—The 'syndicate members' shall be present at the bidding centres so that at least one electronically linked computer terminal at all the bidding centres is available for the purpose of bidding.

(v) *Number of bidding centres.*—[20][(a) The number of bidding centres, in case 75% of the net offer to the public is offered through the book building process, shall not be less

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19. SEBI Circular No. 11, dated 14-8-2003.
20. SEBI Circular No. 11, dated 14-8-2003.

than the number of mandatory collection centres as specified in these regulations. In case 100% of the net offer to the public is made through book building process, the bidding centres shall be at all the places, where the recognised stock exchanges are situated.]

(b) The same norms as applicable for collection centres shall be applicable for the bidding centres also.

[21][(vi) *Brokers' rights to vet bids.*—Individual as well as qualified institutional buyers shall place their bids only through the 'brokers' who shall have the right to vet the bids. The applicant shall enclose the proof of DP ID and Client ID along with the application, while making bid.]

[22][(vi-a) *Order for bidding through SEs/brokers.*—During the period the issue is open to the public for bidding, the applicants may approach the brokers of the stock exchange/s through which the securities are offered under on-line system, to place an order for bidding to the securities. Every broker shall accept orders from all clients/investors who place orders through him

Duties of broker.—

(vi-b) The broker shall collect the client registration form duly filled up and signed from the applicants before placing the order in the system as per "Know your client rule" as specified by SEBI and as may be modified from time to time.

(vi-c) The broker shall, thereafter, enter the buy order in the system, on behalf of the clients and enter important details including the name, address, telephone number, and category of the applicant, the number of shares applied for, amount paid, beneficiary ID, DP code and Bid-cum Application Form number, Bid price, etc., and give an order number/order confirmation slip to the investor.

(vi-d) The broker shall open a separate bank account [Escrow Account] with the clearing house bank for primary market issues and the amount collected by the broker from his clients/investors as margin money shall be deposited in this account]

[23][(vii) *Investors right to revise bids.*—The investors shall have the right to revise their bids provided that Qualified Institutional Buyers shall not be allowed to withdraw their bids after the closure of the bidding].

(viii) *Bidding Form.*—

(a) There shall be a standard bidding form to ensure uniformity in bidding and accuracy.

(b) The bidding form shall contain information about the investor, the price and the number of securities that the investor wishes to bid.

(c) The bidding form before being issued to the bidder shall be serially numbered at the bidding centres and date and time stamped.

(d) The serial number may be system generated or stamped with an automatic numbering machine.

(e) The bidding form shall be issued in duplicate signed by the investor and countersigned by the syndicate member, with one form for the investor and the other for the syndicate member(s)/Book Runner(s).

(ix) *Display of demand.*—At the end of each day of the bidding period the demand shall be shown graphically on the terminals for information of the syndicate members as well as the investors.

[24][(x) *Identity of QIB.*—The identities of the Qualified Institutional Buyers making the bidding, shall not be made public

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21. SEBI Circular No. 11, dated 14-8-2003.
22. SEBI Circular No. 11, dated 14-8-2003.
23. SEBI Circular No. 11, dated 14-8-2003.
24. SEBI Circular No. 11, dated 14-8-2003.

(xi) *Furnishing of data order by S.E.*—The Stock exchange shall, by the end of each day while the issue is open for subscription, send the order data to the Registrar to the Issue and Lead Managers/Book Runners. This data shall consist of only valid orders (excluding those that are cancelled). On the date of closure of the issue, the final status of orders received shall be sent to the Registrar to the issue and Lead Managers/Book Runners.]

Allocation/Allotment Procedure ***[Clause 11.3.5]***

[25][(i) *Issue of 100% of net offer.*—In case an issuer company makes an issue of 100% of the net offer to public through 100% book building process—

(a) not less than 25% of the net offer to the public shall be available for allocation to retail individual investors ;

(b) not less than 25% of the net offer to the public shall be available for allocation to non institutional investors i.e. investors other than retail individual investors and Qualified Institutional Buyers;

(c) not more than 50% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers.

Provided that, 50% of the issue size shall be mandatorily allotted to the Qualified Institutional Buyers, in case the issuer company is making a public issue under Clause 2.2.2 and 2.3.2of these guidelines].

[26][(ii) *Issue of 75% of net offer.*—In case an issuer company makes an issue of 75% of the net offer to public through book building process and 25% at the price determined through book building—

(a) in the book built portion, not less than 25% of the net offer to the public, shall be available for allocation to non Qualified Institutional Buyers and not more than 50% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers.

(b) the balance 25% of the net offer to the public, offered at a price determined through book building, shall be available only to retail individual investors who have either not participated or have not received any allocation, in the book built portion."

Provided that, 50% of the issue size shall be mandatorily allotted to the Qualified Institutional Buyers, in case the issuer company is making a public issue under Clause 2.2.2 and 2.3.2of these guidelines].

(iii) *Basis of allotment.*—Allotment to retail individual investors and non institutional investors], shall be made on the basis of the proportionate allotment system as specified in **Schedule XVIII**.

[26][(iv) *Adjustments in case of under subscription.*—In case of under subscription in any category, the undersubscribed portion may be allocated to the bidders in the other categories:

Provided that, the unsubscribed portion in the 'qualified institutional buyer' category, shall not be available for subscription to other categories, in case the issuer company has made an issue of securities under clause 2.2.2. or clause 2.3.2. of these guidelines]

(v) (a) *Allocation to QIBs.*—[26][The allocation to the qualified institutions buyers] shall be determined by the Book Runner(s) based on prior commitment, investor quality, price aggression, earliness of bids, etc.

(b) [* * * * *]

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25. SEBI Circular No. 11, dated 14-8-2003.
26. SEBI Circular No. 11, dated 14-8-2003.

[27][(vi) *Furnishing of allocation details to SE/brokers.*—After finalisation of basis of allocation, the Registrar to the Issue/company shall send the computer file containing the allocation details i.e. the allocation numbers, allocated quantity of successful applicants, etc. along with broker-wise funds pay-in obligation, to the Broker to the Issue and the stock exchange (s).]

[28][(vii) *Announcement of pay-in day.*—The Company, Lead Manager/Book Runner shall announce the pay-in day and intimate the same to Brokers and stock exchange. It shall be responsibility of the broker to deposit the amount in the Escrow Account to the extent of allocation to his clients on the pay-in date].

[29][(viii) *Intimation of allocation to applicants, etc.*—On receipt of the basis of allocation data, the brokers shall immediately intimate the fact of allocation to their client /applicant. The broker shall ensure that each successful client/applicant pays submits the duly filled-in and signed application form to him along with the amount payable towards the application money by the pay-in date. Amount already paid by the applicant as margin money shall be adjusted towards the total allocation money payable. The broker shall, thereafter, hand over the application forms of the successful applicants who have paid the application money, to the exchange, which shall submit the same to the Registrar to Issue/company for their records.]

[30][(ix) *Refund of margin money by broker.*—The broker shall refund the margin money collected earlier, within 3 days of receipt of basis of allocation, to the applicants who did not receive allocation.]

[31][(x) *Disclosure of application money received.*—The brokers shall give details of the amount received from each client/investors and the names of clients/investors who have not paid the application money to Registrar / Book Runner the exchange. The brokers shall also give soft copy of this data to the exchange.

(xi) *Brokers liability for default of client.*—In the event of the successful applicants failing to pay the application money, the broker through whom such client placed orders, shall bring in the funds to the extent of the client's default. If the broker does not bring in the funds, he shall be declared as a defaulter by the stock exchange and action as prescribed under the Bye-Laws of the stock exchange shall be initiated against him. In such an event, the Book Runners in case of issues through book building process, who have underwritten the issue, shall bring-in the shortfall.

(xii) *Escrow account of broker.*—On pay-in date, the clearing house shall, without any instruction from the broker, debit the escrow account of each broker to the extent of allocation made to his clients/investors and credit the amount so collected from each broker to the 'Issue Account'."

(xiii) The concerned Exchange shall not use the Settlement/Trade Guarantee Fund of the Exchange for honoring brokers commitments in case of failure of broker to bring in the funds.

(xiv) The broker shall open an 'Escrow Securities Account' with any depository for the purpose of receiving credit of securities on behalf of the clients.

(xv) *Allotment on receipt of minimum subscription.*—On payment and receipt of the sum payable on application for the amount towards minimum subscription, the company shall allot the shares to the applicants as per these Guidelines.

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27. SEBI Circular No. 11, dated 14-8-2003.
28. SEBI Circular No. 11, dated 14-8-2003.
29. SEBI Circular No. 11, dated 14-8-2003.
30. SEBI Circular No. 11, dated 14-8-2003.
31. SEBI Circular No. 11, dated 14-8-2003.

Post-allotment procedure

(xvi) After the allotment, the Registrar to the issue shall post the share certificates to the investors or, instruct the depository to credit the Escrow Securities Account of each Broker, as the case may be.

(xvii) On receipt of the credit of securities to the Escrow Securities Account, the Broker shall transfer the shares to the clients'/applicants' depository account, after receipt of confirmation of full payment from the clients/applicants. For this purpose broker shall be considered as Agent of the client/applicant. Broker shall confirm to the Book-runner/Registrar to the issue that shares have been credited to the account of clients /applicants not later than the day of commencement of trading, in case full payment had been received.

(xviii) Any cases of dispute, amongst the broker and the clients, would be referred to arbitration as per the by-laws/regulations of the stock exchange

(xix) The Allotment details shall be put on the website (if available) of the Registrar to the issue and the issuer. Further, online messaging facility of NSDL/CDSL or of stock exchanges may be used to communicate the Allotment details to Brokers, as an alternative of physical Confirmation of Allocation Note"

(xx) Trading shall commence within 6 days from the closure of the issue failing which interest at the rate of 15% p.a. shall be paid to the investors.

(xxi) Schedule XX may be referred to for Clarificatory Examples for issue size and allocation has been specified in Schedule XX.

(xxii) Model Time Frame for Book Building is specified in Schedule XXI.

(xxiii) In case the issuer company has made an issue of 75% of the net offer to public through book building process and 25% at the price determined through book building -

(a) the offer of 25% of the net offer to the public, made at a price determined through book building, shall open within 15 days from the date of closure of bidding;

(b) the offer for subscription to the public, shall remain open for a period of atleast 3 working days after completing all the requirements of advertisement and despatch of issue material to all the stock exchanges;

(c) during the time when the offer is open, the investors who have received an intimation of entitlement of securities under sub clause (xviii) of clause 11.3.1, shall submit the application forms along with the application moneys;

(d) the other retail individual investors who had not participated in the bidding process or have not received intimation of entitlement of securities under sub clause (xviii) of clause 11.3.1 may also make an application.]

11.3.6 Maintenance of Books and Records

(i) A final book of demand showing the result of the allocation process shall be maintained by the book runner/s.

(ii) The Book Runner/s and other intermediaries in the book building process associated shall maintain records of the book building prices.

(iii) The Board shall have the right to inspect the records, books and documents relating to the Book building process and such person shall extend full co-operation.

SCHEDULE XXI

BOOK BUILDING – MODEL TIME FRAME

T	T+1	T+2	T+3	T+4	T+5	T+6
Book Closed	• Price Determination • Determination of offer size	• Registrar draws the allocation list • All entered bids assumed as valid	• Stock Exchanges approve the basis of allocation • Final prospectus printed and dispatched • CANs sent to QIBs • Allocation details electronically communicated by Registrar/Company to brokers	• Pay –in (Only high-value) • Bankers to confirm clearance of fund • Board Meeting • Stock Exchanges to issue the listing and trading permission • Company to instruct NSDL/CDSL to credit shares to the demat account of brokers	• Brokers account to be credited with shares • Brokerto credit shares to the demat account of investors	• Trading commences

§ See full text of the SEBI Guidelines, 2000 in *Appendix* 162.

Guidelines for Foreign Investment in Preference Shares

§ Refer Notes under section 72, *ante*.

FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 framed by RBI under FEMA, 1999.

Rate of Dividend on Preferenc Shares.—The rate of dividend on preference shares or convertible preference shares issued under these Regulations shall not exceed 300 basis points over the Prime Lending Rate of State Bank of India prevailing as on the date of the Board meeting of the company in which issue of such shares is recommended. [*Para 7 of Sch. 1 to the Regulations*]

Conditions for continued listing

The requirement of quantitative continuous listing conditions as a measure of investor protection would ensure availability of floating stock on a continuous basis. Therefore, Clause 40A of the Listing Agreement lays down the conditions for continued listing:

(i) The company agrees that in the event of the application for listing being granted by the Exchange, the company shall maintain on a continuous basis, the minimum level of non-promoter holding at the level of public shareholding as required at the time of listing.

(ii) Where the non-promoter holding of an existing listed company as on April 01, 2001 is less than the limit of public shareholding as required at the time of initial listing, the company shall within one year raise the level of non-promoter holding to at least 10%, in case the company fails to do so, it shall buy back the public share holding in the manner provided in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(iii) The company agrees that it shall not make preferential allotment or an offer to buy back its securities, if such allotment or offer result in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (Disclosure and investor Protection) Guidelines as applicable at the time [illegible] in sub-clause (ii) for the existing listed

(iv) The conditions stipulated in sub-clauses (i), (ii) and (iii) shall not apply to the companies referred to BIFR.

[*Issued by the SEBI, Secondary Market Deptt. vide SMDRP/Policy/CIR-28/01 dt. 2-5-2001*].

Preferential allotment for raising of foreign equity to 51% in existing companies and Guidelines for determining issue price

Ministry of Industry.—Press Note No. 2/94, dated 3-6-1994—In implementing the Statement on Industrial Policy of July 1991, the procedure for raising foreign equity in existing companies in India, including those which do not have any foreign equity at present, has been laid down in this Ministry's Press Note No. *13 of 1992* issued on 29-6-1992. In *superession of Press Note No. 13 of 1992* the revised guidelines for determining the issue price of preferential shares are outlined below:

A. ELIGIBILITY CRITERIA FOR INCREASE IN FOREIGN EQUITY

The following categories of companies will receive automatic approval from the Reserve Bank of India for raising foreign equity, including those which have no foreign equity at present.

(i) Companies wishing to raise foreign equity as part of an expansion programme.—An existing company wishing to raise foreign equity upto 51 per cent may do so as part of an expansion programme. The expansion programme must be in high priority industries shown in Annexure III to the Statement on Industrial Policy of 24th July, 1991. The fresh/additional equity should be part of the financing of the expansion programme. The increase in equity level must result from expansion of the equity base of the existing company and the money to be remitted should be in foreign exchange. The company itself need not be exclusively engaged in activities listed in Annexure III, only the proposed expansion must be predominantly in the high priority industries shown in Annexure III.

(ii) Companies wishing to raise foreign equity without any expansion programme.—An existing company predominantly engaged in high priority industries listed in Annexure III can also raise foreign equity upto 51 per cent without an expansion programme. The increase in equity level must result from expansion of the equity base of the existing company. The foreign equity must be from remittance of foreign exchange.

2. OTHER PROPOSALS

All other proposals for inducting or raising foreign equity in existing companies will be subject to prior approval of the Government. This will include proposals for raising foreign equity upto 51 per cent in existing companies which do not meet any or all of the criteria outlined for automatic approval as also proposals for raising foreign equity beyond 51 per cent in existing companies.

B. REQUIREMENT FOR PREFERENTIAL SHARE ALLOCATION

3. Preferential share allocation of the required volume of equity to the foreign investor will have to be approved by the shareholders through a special resolution under section 81(1A) of the Companies Act. All proposals for raising foreign equity or inducting new foreign equity in existing companies through preferential share allocation must be accompanied by this resolution.

C. ISSUE OF SHARES AND SHARE VALUATION

Every preferential allotment of shares (other than allotment on rights basis) by listed companies, to foreign investors shall be at market price of the shares. For the purpose, the price shall not be less than the higher of the following:

The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date.

OR

The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Explanation

(a) "relevant date" for this purpose means the date thirty days prior to the date on which the meeting of General Body of shareholders is convened, in terms of section 81(1A) of the Companies Act to consider the proposed issue;

(b) "stock exchange" shall mean any of the stock exchanges in which the shares are listed and in which the highest trading volume in respect of the shares of the company has been recorded during the preceding six months prior to the relevant date.

The above guidelines of pricing in connection with preferential allotment to non-residents will apply to all foreign investment approvals to be issued by the Reserve Bank of India under the automatic route as

well as by the Government. While submitting applications for raising foreign equity or for inducting foreign equity under automatic norms to the Reserve Bank of India or for obtaining approval of the Reserve Bank of India for allotment of shares under the applicable provisions of the Foreign Exchange Regulation Act, 1973 and guidelines thereunder, the companies shall work out the price according to the above guidelines and enclose them duly certified by Statutory auditors.

However, in case of approvals from the Government, the question of pricing of shares would be considered in accordance with above guidelines by the RBI and only after such Government approval is given. The Government approval thus, would not go into the question of pricing of shares.

The shares allotted on preferential basis will not be transferable in any manner for a period of five years from the date of their allotment.]

D. PROCEDURES FOR APPROVAL

5. Applications for automatic approval under the eligibility criteria outlined in para A above will be filed with the Reserve Bank of India. In the case of expansion programme the application shall state clearly the description of the article to be manufactured in ITC (HS) classification. The proposal shall be a composite one including detailed information on the capital goods to be imported for the project expansion programme. Under the provisions of the policy the proposed foreign equity must cover the import of capital goods required for the expansion programme.

Similarly, in the case of companies not undertaking expansion programmes, the application shall describe the existing products of the company in ITC (HS) classification.

6. The Reserve Bank of India will issue the necessary permission for the foreign equity investment under the Foreign Exchange Regulation Act, 1973 (FERA) and guidelines thereon. Simultaneously the Reserve Bank of India will confirm that the import of capital goods is covered by the foreign equity. The import of capital goods will be governed by the Import and Export Policy in force.

E. DIVIDEND BALANCING

7. The Statement on Industrial Policy had provided for the monitoring of outflow of foreign on account of dividend payments which are to be balanced by export earnings over a period of time, and that this monitoring will be done by the Reserve Bank of India. The dividend balancing will be done on the following basis only in respect of foreign investment approvals in the consumer goods sector:

(i) The balancing of dividend would be over a period of 7 years reckoned from the date of commencement of production for companies raising foreign equity for an expansion programme. For companies which are raising foreign equity without an expansion programme, this period will start from the date of allotment of the shares for raising foreign equity.

(ii) Remittance of dividends should be covered by earnings of the company from export of items in Annexure III. The amount of dividend payment may be covered by export earnings of such items recorded in years prior to the payment of dividend or in the year of payment of dividend. The Reserve Bank of India will issue appropriate instructions to give effect to these provisions. Dividend balancing applicable to 22 specified consumer goods industries has been removed w.e.f. 14-7-2000 [*Press Note No. 7/2000 dt. 14-7-2000 issued by Deptt. of Industrial Policy & Promotion*].

F. OTHER PROPOSALS FOR RAISING FOREIGN EQUITY IN EXISTING COMPANIES

8. All other proposals for inducting or raising foreign equity in existing companies will be subject to usual procedures. Applications will be made to the Secretariat of Industrial Approvals in the Department of Industrial Development, Udyog Bhavan, New Delhi in the prescribed Form FC (SIA) or to the Chairman, FIPB, PM's Office, South Block, New Delhi. Plain paper applications carrying all relevant details are also accepted. No fee is payable. These applications can also be filed with the Indian Mission/Embassies abroad. This will include proposals involving raising foreign equity upto 51% in existing companies which do not meet any or all of the criteria outlined for automatic approval.

G. CLASSIFICATION SYSTEM

9. Entrepreneurs may note that the description of article(s) to be manufactured should be stated according to the Indian Trade Classification (Harmonised System).

10. The description of industries listed in Annexure III of the Statement on Industrial Policy in the Indian Trade Classification (Harmonised System) is available in Press Note No. 11 (1991 Series). (Copies of the Indian Trade Classification Based on Harmonised Commodity Description and Coding System), published by the Ministry of Commerce, Directorate General of Commercial Intelligence and Statistics, Calcutta, can be obtained on payment from the Secretariat of Controller of Publications, 1, Civil Lines, Delhi-110 054, or from any of the agents authorised to sell Government of India publications.

[*Issued by the Ministry of Industry, Department of Industrial Development, Secretariat for Industrial Approvals (Foreign Collaboration Division) vide Press Note No. 2, 1994 Series; F.No. 9(30)/92-FC(1), dated 3-6-1994*].

PREFERENTIAL ALLOTMENT OF SECURITIES TO SELECT GROUP OF PERSONS UNDER SECTION 81(1A)

While issuing its earlier guidelines dated 4-8-1994 governing the issue of securities on preferential basis, SEBI noted the need for such guidelines as follows :

"Of late, the practice of making preferential allotments of shares, etc., at a price unrelated to the prevailing market price of such instruments seems to be on the increase. This development is particularly undesirable as the allotments are made to select persons, who are considered to be the promoters or persons for the time being in charge of the affairs of management of the company. Besides, companies have also been issuing warrants to select persons with a right to obtains shares in future at a price, not bearing a fair relation to the market. Therefore, there appears to be a need for protecting the interest of the investors, who do not receive such preferential treatment by ensuring that the pricing of the preferential allotments is market related." [*Press Note, dated. 5-8-1994*].

SEBI Guidelines, 2000.—Chapter XIII of the SEBI (DIP) Guidelines, 2000 lay down the guidelines for making preferential allotment of securities.

"Preferential Allotment" means an issue of capital made by a body corporate in pursuance of a resolution passed under sub-section (1A) of section 81 of the Companies Act, 1956. [*Clause 1.2.1(xxii)*].

Applicability.—The preferential issue of equity shares/Fully Convertible Debentures (FCDs)/Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under section 81(1A) of the Companies Act 1956 on private placement basis shall be governed by these guidelines. [*Clause 13.0*].

Such preferential issues by listed companies by way of equity shares/Fully Convertible Debentures (FCDs)/Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into/exchanged with equity shares at a later date, shall be made in accordance with the pricing provisions mentioned below. [*Clause 13.1*].

Pricing of the issue.—The issue of shares on a preferential basis can be made at a price not less than the higher of the following:

(i) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;

OR

(ii) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Explanation

(a) "relevant date" for the purpose of this clause means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 81(1A) of the Companies Act, 1956 to consider the proposed issue.

(b) "stock exchange" for the purpose of this clause means any of the recognised stock exchanges in which the shares are listed and in which the highest trading volume in respect of the shares of the company has been recorded during the preceding six months prior to the relevant date. [*Clause 13.1.1.1*].

Pricing of shares arising out of warrants, etc.—Where warrants are issued on a preferential basis with an option to apply for and be allotted shares, the issuer company shall determine the price of the resultant shares in accordance with Clause 13.1.1.1 above. [*Clause 13.1.2.1(a)*].

The relevant date for the above purpose may, at the option of the issuer, be either the one referred in *Explanation (a)* to Clause 13.1.1.1 above or a date 30 days prior to the date on which the holder of the warrants becomes entitled to apply for the said shares. [*Clause 13.1.2.1.(b)*].

The resolution to be passed in terms of section 81(1A) shall clearly specify the relevant date on the basis of which price of the resultant shares shall be calculated. [*Clause 13.1.2.2.*].

An amount equivalent to atleast ten percent of the price fixed in terms of Clause 13.1.1.1 above shall become payable for the warrants on the date of their allotment. [*Clause 13.1.2.3 (a)*].

The amount referred to in sub-clause (a) shall be adjusted against the price payable subsequently for acquiring the shares by exercising an option for the purpose. [*Clause 13.1.2.3 (b)*].

The amount referred to in sub-clause (a) shall be forfeited if the option to acquire shares is not exercised. [*Clause 13.1.2.3(c)*].

Pricing of shares on conversion.—Where PCDs/FCDs/other convertible instruments are issued on a preferential basis, providing for the issuer to allot shares at a future date, the issuer shall determine the price at which the shares could be allotted in the same manner as specified for pricing of shares allotted in lieu of warrants as indicated in clauses 13.1.2.1 & 13.1.2.2 above. [*Clause 13.1.3.1*].

Contents of special resolution.—[The explanatory statement to the notice for the general meeting in terms of section 173 of the Companies Act, 1956 shall contain—

(i) the object/s of the issue through preferential offer,

(ii) intention of promoters/directors/key management persons to subscribe to the offer,

(iii) shareholding pattern before and after the offer,

(iv) proposed time within which the allotment shall be complete,

(v) the identity of the proposed allottees and the percentage of post preferential issue capital that may be held by them (*Clause 13.1A*).

Compliance with continued listing conditions

A listed company shall not make any preferential issue of equity shares, Fully Convertible Debentures, Partly Convertible Debentures or any other instrument which may be converted into or exchanged with equity shares at a latter date if the same is not in compliance with the conditions for continuous listing. [*Clause 13.1A*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Currency of financial instruments.—In case of Warrants/PCDs/FCDs/or any other financial instruments with a provision for the allotment of equity shares at a future date, either through conversion or otherwise, the currency of the instruments shall not exceed beyond 18 months from the date of issue of the relevant instrument. [*Clause 13.2.1*].

Non-transferability of financial instruments.—The instruments allotted on a preferential basis to the promoter/promoter group as defined in Chapter VI in Clause [6.4.2 (k)] of these guidelines, shall be subject to lock-in of 3 years from the date of their allotment. [*Clause 13.3.1.(a)*].

In any case, not more than 20% of the total capital of the company, including capital brought in by way of preferential issue, shall be subject to lock-in of three years from the date of allotment. [*Clause 13.3.1.(b)*].

In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/promoter group as per clause 13.3.1 (*a*) and (*b*), the instruments allotted on preferential basis to any person including promoters/promoters group shall be locked-in for a period of one year from the date of their allotment except for such allotments on preferential basis which involve swap of equity shares/securities convertible into equity shares at a later date, for acquisition. [*Clause 13.3.1(c)*]].

The lock-in on shares acquired by conversion of the convertible instrument/exercise of warrants shall be reduced to the extent the convertible instrument warrants have already been locked-in. [*Clause 13.3.1.(d).*

Explanation:

(a) For the purpose of this clause "total capital" of the company shall mean—

(i) equity share capital issued by way of public/rights issue including equity shares emerging at a later date out of any convertible securities/exercise of warrants, and

(ii) equity shares or any other security convertible at a later date into equity issued on a preferential basis in favour of promoter/promoter groups.

(b) (i) For computation of 20% of the total capital of the company, the amount of minimum promoters contribution held and locked-in, in the past as per guidelines shall be taken into account.

(ii) The minimum promoters contribution shall not again be put under fresh lock-in, even though it is considered for computing the requirement of 20% of the total capital of the company, in case the said minimum promoters contribution is free of lock-in at the time of the preferential issue.

These locked in shares/instruments may be transferred to and amongst promoter/promoter group or to a new promoter(s) or person(s) in control of the company, subject to continuation of lock-in in the hands of transferee(s) for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, is applicable. [*Clause 13.3.2*] [*Subs. by SEBI Circular No. 9, dt. 2-5-2003*].

Currency of shareholders resolutions.—Allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument shall be completed within a period of three months from the date of passing of the resolution. [*Clause 13.4.1.(a)*].

The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment.

Provided that payment in case of warrants shall be made in term of clause 13.1.2.3 above. [*Clause 13.4.2*]

If allotment of instruments and dispatch of certificates is not completed within three months from the date of such resolution, a fresh consent of the shareholders shall be obtained and the relevant date referred to in explanation (a) in clause 13.1.1.1 above will relate to the new resolution. [*Clause 13.4.3*].

Certificate from Auditors.—In case of every issue of shares/warrants/FCDs/PCDs/or other financial instruments having conversion option, the statutory auditors of the issuer company shall certify that the issue of said instruments is being made in accordance with the requirements contained in these guidelines. [*Clause 13.5.1.(a)*].

Copies of the auditors certificate shall also be laid before the meeting of the shareholders convened to consider the proposed issue. [*Clause 13.5.1.(b)*].

In case of preferential allotment of shares to promoters, their relatives, associates and related entities, for consideration other than cash, valuation of the assets in consideration for which the shares are proposed to be issued shall be done by an independent qualified valuer and the valuation report shall be submitted to the exchanges on which shares of the issuer company are listed.

Explanation—For the purpose of this clause the word valuer shall have the same meaning as assigned to the term under clause (r) of sub-regulation (1) of Regulation 2 of

the SEBI (Issue of Sweat Equity) Regulations, 2002. [*Clause 13.1.5(c)*] [*Ins. by SEBI Circular No. 11, dt. 14-8-2003*].

The details of all monies utilised out of the preferential issue proceeds shall be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised. The details of unutilised monies shall also be disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilised monies have been invested. [*Clause 13.5A*]

Preferential allotments to FIIs.—Preferential allotments, if any, to be made in case of Foreign Institutional Investors shall also be governed by the guidelines issued by the Government of India/Board/Reserve Bank of India on the subject. [*Clause 13.6.1*].

Non-Applicability of the Guidelines.—Clauses 13.1 to 13.5 shall not be applicable in the following cases:

(i) where the further shares are allotted in pursuance to the merger and amalgamation scheme approved by the High court;

(ii) (a) where further shares are allotted to a person/group of persons in accordance with the provisions of rehabilitation packages approved by BIFR;

(b) in case such persons are promoters or belong to promoter group as defined in *Explanations I & II*, clause 6.4.2.1 of Chapter VI of SEBI Guidelines, 2000, the lock-in provisions shall continue to apply unless otherwise stated in the BIFR order;

(iii) where further shares are allotted to All India public financial institutions in accordance with the provision of the loan agreements signed prior to August 4, 1994. [*Clause 13.7.1*].

Promoters Participation in Excess of the Required Minimum Contribution to be Treated as Preferential Allotment.—In case of a listed company, participation by promoters in the proposed public issue in excess of the required minimum percentage referred in Clauses 4.3.1 and 4.4.1 of Chapter IV of SEBI Guidelines, 2000 (*i.e.*, 20% of the proposed issue or such percentage as to constitute 20% of the post-issue capital) shall attract the pricing provisions of Guidelines on preferential allotment, if the issue price is lower than the price as determined on the basis of said preferential allotment guidelines [*Clause 4.8.1*].

Preferential Allotment to Foreign Investors

RBI Circular, dated 16-6-1995.—1. Every preferential allotment of shares (other than allotment on right basis) by listed companies to foreign investors shall be at market price of the shares. For the purpose, the price shall not be less than the higher of the following:—

"The average of the weekly high and low of the closing price of the related shares quota on a stock exchange during the six months preceding the relevant date;

or

The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Explanation:

(*a*) "relevant date" for this purpose means the date thirty days prior to the date of which the meeting of the general body of shareholders is convened, in terms of section 81(1A) of the Companies Act to consider the proposed issue;

(*b*) "stock exchange" shall mean any of the stock exchanges on which the shares are listed and on which the highest trading volume in respect of the shares the company has been recorded during the preceding six months prior to the relevant date."

2. The shares allotted on preferential basis shall not be transferable in any manner for a period of five years from the date of their allotment.

3. The pricing of shares (*i*) arising out of warrants, and (*ii*) conversion of PCDs, FCDs, other instruments and the currency of shareholders resolution, will be as per SEBI guidelines, dated 4th August, 1994. [*For SEBI Guidelines, 2000 on Preferential Allotments, see post*].

4. An Indian company (whose shares are listed on stock exchanges) intending to issue equity shares on a preferential basis to non-residents (either under automatic route under FIPB/SIA approvals) should, therefore, submit an application to the Reserve Bank in terms of paragraph 10B.2 of the Exchange Control Manual (1993 Edn.) along with a certified true copy of the general body resolution passed under section 81(1A) of the Companies Act, 1956 relating to preferential allotment, and (*ii*) the particulars of the working out of the price as per the above guidelines duly certified by its statutory auditors. In cases where section 81(1A) is not applicable, the company should subscribe certificate of its statutory auditors to this effect.

5. To facilitate the companies to complete the formalities for issue of shares with the stipulated period of three months as per SEBI guidelines, dated 4th August, 1994, companies may, if they so desire, submit their applications to the Reserve Bank for principle approval prior to the passing of the general body resolution under section 81(1A) of the Companies Act, 1956 along with a certified copy of Board resolution indicating therein, among others, the date of the holding of general body meeting of shareholders.

6. Authorised dealers may please note that the guidelines issued by the Ministry of Industry, Government of India *vide* Press Note No. 2 (1994 Series) and RBI Press Release, dated 3rd June, 1994 remain unchanged in respect of allotment of shares by company whose shares are not issued or are listed but not regularly traded.

7. The directions contained in this circular have been issued under section 73(3) of the Foreign Exchange Regulation Act, 1973 (46 of 1973) and any contravention or not observance thereof is subject to the penalties prescribed under the Act. [*AD (MA Series) Circular No.* 12, dated 16th June, 1995 *issued by the Reserve Bank of India, Exchange Control Department*].

Preferential allotment to NRI by Private Placement

FEM (Transfer or Issue of Security by Person Resident Outside India) Regulations, 2000.—General permission has been granted to NRIs and OCBs for purchase of shares/convertible debentures on private placement on non-repatriation basis. Reg. 5(3)(ii) of the aforesaid Regulations provides that a non-resident Indian or an overseas corporate body may purchase shares or convertible debentures of an Indian company on non-repatriation basis *other than under Portfolio Investment Scheme* subject to the terms and conditions specified in Schedule 4, provided that NRI shall not purchase shares or convertible debentures of an Indian Company which is engaged in print media sector.

Schedule 4 provides, *inter alia,* that a Non-resident Indian Body may, without any limit, purchase *on non-repatriation basis*, shares or convertible debentures of an Indian company issued by private placement.

§ See notes under the heading 'Purchase and sale of shares/convertible debentures by NRI/OCB on Repatriation basis' in sec. 72.

Preferential Allotment to Foreign Institutional Investors (FIIs) by Private Placement

FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

Under Para 1(5) of Sch. 2 to the Regulations, a registered FII may be permitted by the RBI to purchase shares/ convertible debentures of an Indian company through private placement/ arrangement, subject to the ceilings specified in Para 1(4) :

The total holding by each FII/SEBI approved sub-account of FII shall not exceed 10% (ten per cent) of the total paid-up equity capital or 10% (ten per cent) of the paid-up value of each series of convertible debentures issued by an Indian company and the total holdings of all FIIs/sub-accounts of FIIs put together shall not exceed 24 per cent of paid-up equity capital or paid up value of each series of convertible debentures.

However, the limit of 24 per cent may be increased upto the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned by passing a resolution by its board of directors followed by passing of a special resolution to that effect by its general body.

For arriving at the ceiling on holdings of FIIs, shares/convertible debentures acquired both through primary as well as secondary market will be included. However, the ceiling will not include investment made by FII through off-shore Funds, Global Depository receipts and Euro-Convertible Bonds.

Investment in shares or convertible debentures of a company engaged in the print media sector will not be permitted.

With a view to broaden the FII base and augment the availability of funds, funds such as university funds, endowments, foundations, charitable trusts/societies with a track record, several of which have expressed interest in investment in Indian securities markets would also be eligible for investment as FIIs. [*Ref. No. PR 73/96 dated July 24, 1996 issued by IIMARP Department*]

II. ***Press Release, dt. 4-4-1997.***—In his Budget Speech 1997-98, the Finance Minister had announced an increase in FII investment ceiling. In pursuance of the announcement, the following modifications are made in the guidelines publicised through the Press Note on 14-9-1992.

Companies would be permitted to raise the aggregate portfolio investment limits by all FIIs; NRIs and OCBs up to 30 per cent of the issued and paid-up capital of a company subject to:

(a) Approval by the board of directors of the company to the enhanced limit up to 30 per cent; and

(b) A special resolution passed by the general body of the company approving the enhanced limit up to 30 per cent.

The present investment limits for an individual FII, NRI or OCB would remain unaltered. [*Press Note issued by the Government of India, Ministry of Finance, Department of Economic Affairs (Investment Division), New Delhi, dated 4th April, 1997.*]

III. ***Press Release, dt. 22-6-1998.***—A Press Note enhancing individual and aggregate portfolio investment ceiling by Non-resident Indians (NRIs)/Persons of Indian Origin (PIOs)/Overseas Corporate Bodies (owned by such persons to the extent of at least 60 per cent) (OCBs) was issued on 11th June, 1998. In that note the investment limit by a single NRI/PIO/OCB for purchase of shares in a company through stock exchanges under portfolio investment scheme was raised from 1 per cent to 5 per cent and the aggregate limit for all NRIs/PIOs/OCBs was raised from 5 per cent to 10 per cent of the paid-up equity capital. These limits for NRIs/PIOs/OCBs were part of the aggregate ceiling of 24 per cent for all FIIs/NRIs/PIOs/OCBs in the paid-up capital of a company which would be raised to 30 per cent by a Board/General Body resolution.

2. As the aggregate investment limit have been reached in the case of many companies the enhancement of the NRI/PIO/OCB limit would not provide greater freedom in practice in these cases. In order to provide a greater margin of flexibility for NRI/PIO/OCB investment it has been decided that the individual and aggregate ceiling for portfolio investments by NRIs/PIOs/OCBs will be exclusive of the aggregate portfolio investment ceiling for FIIs. The NRIs/PIOs/OCBs aggregate portfolio investment ceiling would be 10 per cent of the paid-up equity capital of a company. FII investment would continue to be subject to a separate aggregate ceiling of 24 per cent/30 per cent of the paid-up equity capital of a company. [*Issued by the Ministry of Finance, Department of Economic Affairs (Foreign Trade & Investment Division) vide F. No. 10/15/98-NRI, dated 22-6-1998*]

IV. ***Press Release, dt. 1-3-2000.***—Foreign Institutional Investors registered with SEBI are permitted to invest subject to an aggregate investment limit of 24 per cent. of the issued and paid-up capital of an Indian company. In terms of the Press Note dated 4th April, 1997, the Indian companies were permitted to enhance the normal aggregate portfolio investment limit from 24 per cent. to 30 per cent. under specified special procedure. The aggregate investment limits applicable to FIIs had also been segregated through a Press Note issued on 22nd June, 1998, from the portfolio investment limits for NRIs/PIOs/OCBs.

Further issue of capital

In his budget speech 2000-2001, the Finance Minister had announced an increase in the portfolio investment ceiling applicable to Foreign Institutional Investors (FIIs). Pursuant to the announcement, Indian companies would henceforth be permitted to raise the aggregate ceiling for FIIs portfolio investments from the normal level of 24 per cent. to 40 per cent. of the issued and paid-up capital of an Indian company subject to:

(a) Approval by the board of directors of the company to the enhanced limit up to 40 per cent. and

(b) A special resolution passed by the general body of the company approving the enhanced limit up to 40 per cent.

All other conditions applicable to FII portfolio investment would continue to be operative as before. [*PIB Press Release, dated 1st March, 2000*]

Preferential allotment by unlisted public companies

Preferential allotment of securities by unlisted public companies will be governed by the Unlisted Public Companies (Preferential Allotment) Rules, 2003 reproduced below:-

Unlisted Public Companies (Preferential Allotment) Rules, 2003

Notification No. GSR 922(E), dated 4-12-2003, issued by Department of Company Affairs.—In exercise of the powers conferred by sub-section (1A) of section 81 of the Companies Act, 1956 read with section 642 of the said Act, the Central Government hereby makes the following rules, namely:—

1. Short title and commencement.—(1) These rules may be called Unlisted Public Companies (Preferential Allotment) Rules, 2003

(2) They shall come into force on the date of their publication in the official gazette.

2. Applicability.—These rules shall be applicable to all unlisted public companies in respect of preferential issue of equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments which would be convertible into or exchanged with equity shares at a later date.

3. Definitions.—(1) "Preferential Allotment" includes issue of shares on preferential basis and/or through private placement made by a company in pursuance of a resolution passed under sub-section (1A) of section 81 of the Companies Act, 1956 and issue of shares to the promoters and their relatives either in public issue or otherwise.

(2) "Promoter" means—

(a) the person or persons who are in over-all control of the company; and

(b) the person or persons who hold themselves as promoters.

Explanation.—Where a promoter of a company is a body corporate, the promoters of that body corporate shall also be deemed to be promoters of the company.

(3) "control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

4. Special Resolution.—No issue of shares on a preferential basis can be made by a company unless authorized by its articles of association and unless a special resolution is passed by the members in a General Meeting authorizing the Board of Directors to issue the same. The special resolution shall be acted upon within a period of 12 months.

5. Pricing.—Where warrants are issued on a preferential basis with an option to apply for and get the shares allotted, the issuing company shall determine before hand the price of the resultant shares.

6. Disclosures.—The explanatory statement to the notice for the general meeting as required by section 173 of the Companies Act, 1956 shall contain the following particulars:

(a) the price or price band at which the allotment is proposed;

(b) the relevant date on the basis of which price has been arrived at;

(c) the object/s of the issue through preferential offer;

(d) the class or classes of persons to whom the allotment is proposed to be made;

(e) intention of promoters/directors/key management persons to subscribe to the offer;

(f) shareholding pattern of promoters and others classes of shares before and after the offer;

(g) proposed time within which the allotment shall be completed;

(h) whether a change in control is intended or expected.

7. Audit Certificate.—In case of every issue of shares/warrants/fully convertible debentures/partly convertible debentures or other financial instruments with conversion option, the statutory auditors of the issuing company / company secretary in practice shall certify that the issue of the said instruments is being made in accordance with these Rules. Such certificate shall be laid before the meeting of the shareholders convened to consider the proposed issue.

PROMOTERS' CONTRIBUTION

SEBI Guidelines, 2000

Minimum promoters' contribution.—The basic criterion is that promoters' stake in the capital of the company should not be less than 20% of its issued capital at any point of time. If their pre-issue holding is large enough to constitute 20% of the post-issue capital, additional contribution by way of subscription to the proposed issue of capital may not be necessary.

Promoters contribution in any public issue shall be in accordance with the following provisions [*Clause 4.0*]. For specific requirements to be complied with in respect of promoters contribution in issues referred to at (1) to (4) above, please see under respective headings under section 56.

1. Public issue by *unlisted* company	20% of the post-issue capital [*Clause 4.1.1*]
2. Public issue by *listed* company	20% of the proposed issue *OR* such percentage so as to constitute 20% of the post-issue capital [*Clause 4.3.1*]
3. Composite issue by listed company	20% of the proposed issue *OR* 20% of the post-issue capital (excluding rights issue component) [*Clauses 4.4.1 and 4.4.2*]
4. Offer for sale	20% of the post-issue capital [*Clause 4.2.1*]

Securities Ineligible for computation of promoters contribution.—Where the promoters of any company making an issue of securities have acquired equity during the preceding three years, before filing the offer documents with SEBI (Board), such equity shall not be considered for computation of promoters contribution if it is:

(i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction(s); or

(ii) resulting from a bonus issue out of revaluation reserves or reserves without accrual of cash resources [*Clause 4.6.1*].

Shares acquired pursuant to merger.—Shares acquired in pursuance to a scheme of merger or amalgamation approved by a High Court shall be eligible for computation of promoters contribution [*Clause 4.6.4*].

Minimum monetary value.—Minimum contribution of Rs.25000 per application from each individual and minimum contribution of Rs. 1 lac from firms and companies (not being business associates like dealers and distributors) shall be eligible to be considered towards promoters' contribution [*Clause 4.6.5*].

Private placement.—Promoters contribution shall not consist of any private placement of securities made by solicitation of subscription from unrelated persons either directly or through any intermediary [*Clause 4.6.6*].

Consent of shareholders.—Securities for which a specific written consent has not been obtained from the respective shareholders for inclusion of their subscription in the minimum promoters contribution subject to lock-in shall not be eligible for promoters contribution [*Clause 4.6.7*].

Promoters contribution to be brought in before public issue opens.—Promoters shall bring in the full amount of the promoters contribution including premium at least one day prior to the issue opening date [which shall be kept in an escrow account with a Scheduled Commercial Bank and the said contribution/amount shall be released to the company along with the public issue proceeds]. [*Clause 4.9.1*].

Where the promoters' contribution has been brought prior to the public issue and has already been deployed by the company, the company shall give the cash flow statement in the offer document disclosing the use of such funds received as promoters' contribution. [*Clause 4.9.1 First proviso*].

Where the promoters minimum contribution exceeds Rs.100 crores, the promoters shall bring in Rs.100 crores before the opening of the issue and the remaining contribution shall be brought in by the promoters in advance on *pro-rata* basis before the calls are made on public [*Clause 4.9.1, Second Proviso*].

Allotment to promoters.—The company's board shall pass a resolution allotting the shares or convertible instruments to promoters against the moneys received. [*Clause 4.9.2*]

Certification of promoters contribution.—A copy of the resolution alongwith a Chartered Accountants' Certificate certifying that the promoters contribution has been brought in shall be filed with the SEBI (Board) before opening of the issue [*Clause 4.9.3*].

The certificate of the Chartered Accountants shall also be accompanied by a list of names and addresses of friends, relatives and associates who have contributed to the promoters' quota along with the amount of subscription made by each of them [*Clause 4.9.4*].

LOCK-IN REQUIREMENTS

Lock in period of minimum specified promoters contribution in public issues.—In case of any issue of capital to the public the minimum promoters contribution shall be locked in for a period of 3 years [*Clause 4.11.1*].

Commencement of lock in period.—The lock-in shall start from the date of allotment in the proposed public issue and the last date of the lock-in shall be reckoned as three years from the date of commencement of commercial production or the date of allotment in the public issue whichever is later [*Clause 4.11.2*].

Explanation.—The expression "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

Lock-in of shares taken up by promoters on short fall in firm allotment.—Clause 8.5.(e) of Chapter VIII of the SEBI Guidelines, 2000 provides that if any person to whom firm allotment is proposed to be made withdraws partially or fully from the offer made to him after filing of the prospectus with the Registrar of Companies, the extent of shares

proposed to be allotted to such person shall be taken up by the promoters and the subscription amount shall be brought in at least one day prior to the issue opening date. Such subscription shall be locked in for a period of three years [*Clause 4.12.3*].

Pledge of securities forming part of promoters contribution.—Locked-in securities held by promoters may be pledged only with banks or financial institutions as collateral security for loans granted by such banks or financial institutions, provided the pledge of shares is one of the terms of sanction of loan [*Clause 4.15.1*].

***Inter se* transfer of locked-in securities**

(a) Shares held by the person other than the promoters, prior to initial public offering (IPO), which are locked in as per clause 4.14 of these Guidelines, may be transferred to any other person holding shares which are locked in as per clause 4.14 of these Guidelines subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as applicable.

(b) Shares held by promoter(s) which are locked in as per the relevant provisions of this chapter, may be transferred to and amongst promoter/promoter group or to a new promoter or persons in control of the company, subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, as applicable. [*Clause 4.16.1*] [*Subs. by SEBI Circular No. 9, dt. 2-5-2003*].

Inscription of Non-Transferability

The securities which are subject to lock-in shall carry the inscription 'non-transferable' along with duration of specified non-transferable period mentioned, in the face of the security certificate [*Clause 4.17.1*].

Pre-issue obligations of issuer company

List of promoters' group.—The issuer company is required to submit to SEBI a list of persons who constitute the promoters' group and their individual holdings [*Clause 5.3.6*]. As to the meaning of 'promoter' and 'promoter group', see Clause 6.4.2. (Notes to Capital Structure) of Chapter VI.

Note: It is patently clear that a conscious distinction has been made between "promoters" and "promoters group". The relaxation as to transferability of shares does not apply to the constitutents of the promoters group, *i.e.*, promoter's relatives, friends, associates, *etc.* The relaxation covers transfers amongst promoters specifically described as such in the prospectus." *SPS International Ltd. v. Vijay Remedies Ltd.*, (1998) 93 Com Cas 547 : (1998) 30 CLA 113 : (1998) 3 Comp LJ 524 (CLB–NB). In this case, four promoters were named in the prospectus to whom the restriction was not to apply. The petitioners, as original allottees in the promoters quota, were not among them. Transfers of their shares to other allottees in the promoters' group were not exempt. They were in violation of SEBI Guidelines. The prayer of the petitioners for rectification of the register of members was not allowed under section 111A of the Companies Act.

Report on promoters' transactions in securities to ROC/Stock Exchange

Company's Undertaking to SEBI.—The issuer shall submit an undertaking to SEBI to the effect that transactions in securities by the 'promoter' the 'promoter group' and the immediate relatives of the promoters during the period between the date of filing the offer documents with the Registrar of Companies or Stock Exchange as the case may be and the date of closure of the issue shall be reported to the Stock Exchanges concerned within 24 hours of the transaction(s) [*Clause 5.3.5.1*].

Disclosures in prospectus regarding promoters and promoter's group

Attention is drawn to the following clauses of Chapter VI, Section I (Contents of Prospectus) of SEBI Guidelines, 2000:

Notes to Capital Structure.—After the details of capital structure, the following notes shall be incorporated—

(a) Note relating to promoters' contribution and lock-in period stating date of allotment, date when made fully paid up, nature of allotment (rights, bonus, etc.), number of securities, face value of securities, issue price of securities, percentage of promoters contribution to total issued capital and the date up to which the securities are locked-in.

(b) An illustrative format of promoters contribution and lock-in is specified in Schedule VIII [*Reproduced below*].

(i) Percentage of contribution by the promoters whose name figured in the prospectus as promoters in the paragraph on "Promoters and their background" and the date up to which the securities are locked-in.

(ii) An illustrative format of promoters contribution (by person) whose name figures in prospectus is specified in Schedule IX.

(c) Statement that promoters contribution has been brought in not less than the specified minimum lot and from persons defined as promoters under the Guidelines.

(d) Statement that the promoters undertake to accept full conversion, if the promoters contribution is in terms of the same optionally convertible security as is being offered to the public [*Clause 6.4.2.1 sub-clauses (a) to (d)*].

The details of:—

(i) the aggregate shareholding of the Promoters group and of the directors of the Promoters, where the promoter is a company;

(ii) aggregate number of securities purchased or sold by the Promoters Group and the directors of the promoter during a period of six months preceding the date on which the draft prospectus is filed with Board and to be updated by incorporating the information in this regard till the time of filing the prospectus with the Registrar of the Company;

(iii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant dates.

(l) In the event of it not being possible to obtain information regarding sales and purchase of securities by any relative of the promoters, a statement to that effect shall be made in the prospectus on the basis of the transfers recorded in the books of the company [*Clause 6.4.2.1 sub-clause (k)*].

Disclosure of Promoters and their Background in Prospectus.—See Notes under 'Contents of Prospectus' in sec. 56, *ante*.

***Due diligence certificates* (DDC) from lead merchant banker.**—1. DDC to be given by lead merchant banker(s) along with draft offer document should contain, *inter alia*, the following statement:

> "We certify that written consent from shareholders has been obtained for inclusion of their securities as part of promoters' contribution subject to lock-in and the securities proposed to form part of promoters' contribution subject to lock-in, will not be disposed/sold/transferred by the promoters during the period starting from the date of filing the draft prospectus with the Board till the date of commencement of lock-in-period as stated in the draft prospectus." [*Sch. III (Para 5) read with clause 5.3.3.1*].

2. DDC to be given (i) at the time of filing the prospectus with ROC; (ii) at the time of opening of the issue and (iii) after opening but before closing of the issue, should contain confirmations by lead manager(s) to the effect—

(i) that written consent from shareholders has been obtained for inclusion of their securities as part of promoters' contribution subject to lock-in;

(ii) that the securities proposed to form part of promoters' contribution and subject to lock-in, have not been disposed/sold/transferred by the promoters during the period starting from the date of filing the draft prospectus with SEBI till date. [*Schs IV, V and VI read with Clause 5.3.3.2.*].

ISSUE OF SECURITIES BY PRIVATE SECTOR BANKS

RBI Guidelines for Issue and Pricing of Shares by Private Sector Banks

Notification Ref. DBOD.No. 79/16.13.100/2001-2002, issued by RBI, dt. 20-3-2002.—Issue and pricing of shares by private sector banks would be governed by the following guidelines:

2. Initial Public Offers (IPOs).—All banks should obtain RBI approval for IPOs. After listing on the stock exchanges, banks are free to price their subsequent issues.

Issue price should be based on merchant banker's recommendation. There need be no reference to the CCI formula for deciding on the pricing of such issues.

3. Rights issues.—RBI approval would not be required for rights issues by both listed and unlisted banks.

4. Bonus issues.—Private sector banks, both listed and unlisted, need not seek RBI's approval for bonus issues. The issues would, however, be subject to SEBI's requirements on issue of bonus shares, *viz.*, bonus issues (a) should be made from free reserves built out of genuine profits or share premium, (b) should not dilute the value or rights of partly or fully convertible debentures, (c) should not be in lieu of dividend, and (d) should not be made unless all partly paid-up shares are fully paid-up. Further, bonus issues may be issued without linkage to rights issues.

5. Preferential issue.—All preferential issues would require prior approval of RBI. Pricing of preferential issues by listed banks may be as per SEBI formula, while for unlisted banks, the fair value may be determined by a chartered accountant or a merchant banker.

6. In case of pricing of issues where RBI approval is not required, pricing of issues should be as per SEBI guidelines; in cases where prior approval of RBI is required, princing should take into account both SEBI and RBI guidelines.

7. These instructions come into force with immediate effect.

RBI Guidelines on Bank Financing of Equities and Investments in shares

The Standing Technical Committee on Bank Financing of Equities, comprising officials of RBI and SEBI, set up to develop operating guidelines for a transparent and stable system of bank financing of equities and investment in shares submitted its report on August 30, 2000. The report was released for public comments. On the basis of the comments received from the media and other market participants on the proposals made by the Committee as will as the views expressed by banks in the meeting taken by RBI with the Chief Executive of major banks on September 19, 2000, RBI prepared new draft guidelines. These draft guidelines were again circulated among select banks and also placed on the RBI website for comments from banks, financial institutions and other market participants.

Based on the feed back received from banks and others, the guidelines on bank financing of equities and investments in shares have now been finalised. These are given below.

1. Bank financing of equities

(i) Financing of Initial Public Offerings (IPOs)

(*a*) The financing of Initial Public Offerings (IPOs) should be treated as advances against shares to individuals. Accordingly, banks may grant advances for subscribing to IPOs only to individuals. Further, the terms and conditions for financing of IPOs should be the same as those applicable to advances against shares to individuals, set out in our Master Circular DBOD No. Dir. BC. 90/13.07.05/1998 dated August 28, 1998. [For the text see

Appendix 62]. The maximum amount of finance that can be extended to an individual against IPOs should be Rs. 10 lakh, as applicable to advances against physcial shares. The corporate should not be extended credit by banks for investment in other companies' IPOs. Similarly, banks should not provide finance to NBFCs for further lending to individuals for IPOs.

(*b*) Finance extended by a bank for IPOs should be reckoned as an exposure to capital market.

(*ii*) *Issue of guarantees on behalf of brokers.*—A minimum margin of 25 per cent inclusive of cash margin, should be obtained by banks for issue of guarantees on behalf of share brokers. Banks may, at their discretion, obtain margin higher than 25 per cent as per the policy approved by their Board of directors.

(*iii*) *Total exposure.*—The Board of directors of banks may lay down a prudential ceiling on the bank's aggregate exposure to capital market, keeping in view its overall risk profile. Boards of each bank should also take a view on the exposure on a particular corporate either through primary or secondary market or through book building route, keeping in view its overall risk management policy. The bank's exposure should, however, meet the statutory requirements regarding holding of shares of a company contained in sections 19(2) and (3) and 20(1)(*a*) of the Banking Regulation Act, 1949, as also the single borrower and borrower-group exposure norms stipulated by the RBI. The following may be excluded for reckoning the bank's aggregate exposure to capital market:

(*a*) Advances against collateral security of shares.

(*b*) Advances to individuals for personal purposes like education, housing, consumption, etc., against the security of shares.

(*c*) Credit substitutes like Commercial Paper, non-convertible debenture, etc., may not be reckoned as part of credit portfolio for arriving at the bank's exposure to capital market.

2. Bank's investments in shares and debentures

(*i*) In terms of Circular DBOD No. Dir. BC. 61/13.07.05/94 dated May 18, 1994, banks are free to acquire shares, convertible debentures of corporate and units of equity oriented mutual funds, subject to a ceiling of 5 per cent of the incremental deposits of the previous year. The RBI-SEBI Technical Committee has recommended that the ceiling prescribed for bank's investments in shares, convertible debentures, etc., should be related to outstanding advances and not to incremental deposits of the previous year. It has, therefore, been decided that within the overall exposure to sensitive sectors, a bank's total exposure to capital market by way of investments in shares, convertible debentures and units of mutual funds (other than debt funds) should not exceed 5 per cent of the banks' total outstanding credit as on March 31 of the previous year. It is further clarified that the ceilings for investments in shares, etc., are maximum permissible ceiling and a bank's Board of Directors is free to adopt a lower ceiling for an individual bank, keeping in view the bank's overall risk profile and volatility in equity prices. In respect of those banks where the present outstanding investments in equitites are relatively small and well below the 5 per cent overall ceiling, as a prudential measure, the Board should also lay down an annual ceiling for fresh investments in equities take place in a phased, gradual and cautious manner, within the absolute ceiling fixed by the Board for each year.

(*ii*) Banks may make investment in shares directly or through UTI and SEBI approved other diversified mutual funds with good track records. Investment in UTI/mutual funds will be as per the investment policy approved by the Board of Directors, taking into account the in-house expertise available within the

bank. It is advised that the decisions in regard to investments in shares, etc., should be taken by the Investment Committee set up by the bank.

(*iii*) Underwriting commitments taken up by the banks in respect of primary issues through book building route would also be within the above norms.

(*iv*) Loans sanctioned to corporates for meeting promoters' contributions and bridge loans sanctioned to companies for a period not exceeding one year against expected equity flows/issues, expected proceeds of non-convertible debentures, external commercial borrowings, GDRs and/or funds in the nature of foreign direct investments (which are now within the ceiling of 5 per cent of the incremental deposits of the previous year), would also continue to be within the above overall ceiling.

(*v*) The decision on investments in shares, debentures, etc., may be made by the Board/ALCO of each bank keeping in view the permitted tolerance levels of mismatch. The quantum and tenure of such investments may be decided by Boards of each bank.

(*vi*) Banks whose investments in shares, etc., are now in excess of 5 per cent of outstanding credit as on March 31, 2000 may bring down their investments gradually to conform to this prudential norm, by March 31, 2001.

3. Valuation and disclosure

Banks should mark to market their investment portfolio in equities like other investments on a quarterly basis. Further, banks should disclose the total investments made in shares, convertible shares and units of equity oriented mutual funds as also aggregate advances against shares, etc., in the 'Notes on Accounts' to their balance sheets, beginning from the year ending March 2001.

Financial institutions specified under cl. (b) of proviso to sub-section (3)

As per *Notification S.O. No.* 2577, dated 30-7-1977, supplemented by further *Notification S.O. No.* 1328, dated 8-5-1978 and also by other undernoted Notifications, the Central Government has specified the following institutions for purpose of clause (b) of the proviso to sub-section (3):—

(i) The Industrial Finance Corporation of India, established under the Industrial Finance Corporation Act, 1948 (15 of 1948);

(ii) The Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956 (31 of 1956);

(iii) The Unit Trust of India, established under the Unit Trust of India Act, 1963 (52 of 1963);

(iv) The Industrial Development Bank of India, established under the Industrial Development Bank of India Act, 1964 (18 of 1964);

(v) The Industrial Credit and Investment Corporation Limited, a company registered under the Companies Act, 1913 (7 of 1913);

[1][(vi) The Industrial Reconstruction Bank of India established under the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984)];

(vii) The General Insurance Corporation of India established under General Insurance Business (Nationalisation) Act, 1972 (57 of 1972);

(viii) The National Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956);

(ix) The New India Assurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956);

(x) The Oriental Fire and General Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956);

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1. Subs. by Notfn. SO 2902, dated 9-10-1987 : [1988] 64 Com Cases (St) 39.

(xi) The United Fire and General Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956);

[2][(xii) The Shipping Credit and Investment Company of India Ltd.];

[3][(xiii) The Tourism Finance Corporation of India Limited];

[4][(xiv) The Risk Capital and Technology Finance Corporation Ltd.];

[5][(xv) Technology Development and Information Company of India Limited].

Private companies exempted

Though under sub-section (3), the provisions of the section 81 do not apply to a private company, there is nothing in the Act to prevent such a company from including in its Articles of Association, a provision on the basis of section 81. Such a provision in the Articles will be binding on the company. (*Letter No.* 8/81/58-PR, dated the 17th October, 1958).

Listed Companies

Under the Listing agreement, every listed company is required to promptly furnish to the stock exchange six copies of all notices, resolutions and circulars relating to a new issue of capital prior to their despatch to the shareholders [*Clause 31(b)*].

Three copies of all notices, resolution and circular relating to new issue of capital immediately prior to their despatch to the shareholders [*Clause 31(c)*].

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 19 under Rule 3 relates to issue of capital and securities and reads as follows:

***Paragraph-19.*—The company has issued..... shares/ debentures/other securities during the financial year and complied with the provisions of the Act.**

Issue of capital and securities

Prescribed Check List

In Case of Private Companies [*Item (a)*]

Check whether:

(i) the relevant provisions in Articles of Association have been complied with and the increase is within the authorised capital of the company;

(ii) the company has issued equity share capital with differential rights as to dividend, voting or otherwise, if any and the same were in accordance with the provisions of the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 and the articles of association;

(iii) the Board has passed a resolution for allotment of shares;

(iv) return of allotment was filed with the ROC in Form No. 2 in accordance with the provisions of section 75;

(v) the register of shareholders/members has been properly maintained and the number of shareholders are not more than 50;

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2. Added by Notification No. SO 1033(E), dated 12-12-1989 : (1990) 67 Com Cases 342 (St).
3. Added by Notification No. SO 6(E), dated 3-1-1990 : (1990) 68 Com Cases 35 (St).
4. Added by Notification No. SO 238(E), dated 20-3-1990.
5. Added by Notification No. SO 269(E), dated 26-4-1993.

(vi) share certificates, have been issued to the allottees in accordance with the provisions of section 86 and Companies (Issue of Share Certificates) Rules, 1960 within the prescribed period; and

(vii) where the company has issued preference shares, provisions of sections 80(5A) and 80A have been complied with;

(viii) the company has privately placed Debentures and if so it has complied with provisions of section 117C and a copy of the Trust Deed has been forwarded on payment of requisite fee to any member or debenture-holder,

(ix) the company, which has completed a buy-back of its shares or other specified securities has not made further issue of the same kind of securities in the last 24 months as stipulated in section 77A(8).

In Case of Public Companies [*Item (b)*]

Check whether :

(i) at the first instance the shares are offered to the existing shareholders in proportion to the capital paid-up on shares held;

(ii) in case shares are offered to any persons whether or not those persons include existing shareholders in any manner whatsoever:

(a) special resolution was passed; or

(b) else the votes cast in favour of the resolution exceeded the votes cast against the proposal and the approval of the Central Government was obtained;

(c) in case of special resolution, Form No. 23 was filed with the ROC;

(d) in case of Public Issue, separate Bank Accounts have been opened and whether Board resolutions have been passed.

(iii) the company has issued equity share capital with differential rights as to dividend, voting or otherwise, if any, in accordance with the provisions of the Companies (Issue of Capital with Differential Voting Rights) Rules, 2001 prescribed by the Central Government;

(iv) the Board has approved the draft prospectus/letter of offer of rights/offering circular (restricting circulation to below 50 persons) before issue;

(v) the appointments of all the agencies dealing with the issue were duly approved by the Board;

(vi) initial listing application/s has/have been filed with the Stock Exchanges before filing the prospectus with the ROC;

(vii) minimum subscription has been raised;

(viii) the company has received the minimum subscription in terms of guidelines issued in this regard;

(ix) the basis of allotment has been approved by the Regional Stock Exchange;

(x) in the case of listed companies permission for listing of securities has been received from all the Stock Exchanges mentioned in the prospectus.

(xi) refund orders were sent in time;

(xii) listing agreements were signed with the Stock Exchanges where the shares were to be listed and the executant on behalf of the company had the authority from the Board and whether listing/trading permissions have been obtained;

(xiii) in case debentures have been issued with an option to convert whole or part into shares, check the applicability of the Public Companies (Terms of Issue of Debentures and Raising of Loans with Option to Convert such Debentures and Loans into Shares) Rules, 1977;

(xiv) the company which has completed a buy-back of its shares or other specified securities has not made further issue of the same kind of securities within a period of 6 months as stipulated in section 77A(8).

Preferential Issue by Listed Companies [*Item (c)*]

Check whether listed company has issued capital by way of shares/FCDs/PCDs or any other financial instruments on a preferential basis which would be converted into or exchanged with equity shares at a later date to any select group of persons. If yes, then:

(i) check that the issue was not offered to more than 50 persons in conformity with sub-section (3) of section 67;

(ii) in case shares are offered to any persons whether or not those persons include existing shareholders in any manner whatsoever :

(a) special resolution was passed; or

(b) else the votes cast in favour of the resolution exceeded the votes cast against the proposal and the approval of the Central Government was obtained;

(c) in case of special resolution, Form No. 23 was filed with the ROC.

Capitalisation of Profit/Issue of Bonus Shares [*Item (f)*]

Check whether :

(i) Articles of Association of the company provide for capitalisation of profits;

(ii) the Board has passed the resolution recommending the issue of bonus shares;

(iii) requisite resolution was passed by the shareholders in their Meeting for capitalisation of profits and issuing bonus shares;

(iv) bonus issue is made out of free reserves built out of genuine profits or share premium collected in cash only and reserves created by revaluation of fixed assets are not capitalised;

In the Case of Listed Company, also check whether:

(v) guidelines issued by SEBI relating to bonus shares for disclosure and investor protection have been duly compiled with;

(vi) issue of bonus shares is not made prior to 12 months after a public/rights issue;

(vii) the bonus proposal has been implemented within six months from the date of Board's approval.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Check List of Post-issue Activities for Public Issue of Equity Shares

§ For the check List, see K. SEKHAR'S *Guide to SEBI Capital Issues, Debentures and Listing*, 3rd Edn. 2003, § 11.09, pp. 516-524