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Red Herring Prospectus

SRAVANI K¹ AND K GUNA SEK HAR²

ABSTRACT

Red herring prospectus does not include the complete information of the quantum or value of the securities. In general terms the red herring prospectus consists of the particulars relating to the company's functions and operations and the prospectus, ultimately enabling the potential investors to acquire the required information to arrive to a decision. The Red herring prospectus should be filed before the concerned registrar 3 days prior to the list of subscription or offer. The obligations to the Red herring prospectus are similar to the obligations of the other prospects and if at all there is any variation between the prospectus and the Red herring prospectus, then such variations needed to be highlighted. After the closing of the offer the prospectus should state the total capital raised by ways of share capital or debt and also the securities closing price. The author systematically analyzes the process for the issuance of the Red herring prospects, the role of SEBI and judicial pronouncements concerning the same.

Keywords: *role of SEBI, Section 32 of Companies Act, 2013, Civil liability, Criminal liability*

I. INTRODUCTION

Before understanding about Red Herring Prospectus, knowing the definition of prospectus is important. The Section 2(70)³ of the Companies Act, 2013 defines a "prospectus" as under:

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

So, we can understand that the prospectus of any company is a document which is considered as a prospectus, it also have shelf prospectus as mentioned in Section 31⁴ and it should also include any notice, advertisement, circular or any other document which invites offers for the

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³ Section 2(70) of the Companies Act, 2013, Act No.18, 2013

⁴ Section 31 of the Companies Act, 2013, Act No.18, 2013

subscription or purchase of any securities of a company from the public.⁵

And here the word public is constituted as any section of the public whether they are considered as members or debenture holders or the person's [issuing prospectus] clients. The document is considered to be in public domain when the offer to endorse for the share capital is made open to everyone whoever brings money and apply for the share capital without considering whether such prospectus is issued to him or not. Thus, the proper test is who applies for the shares in reply to the invitation contained in the prospectus.⁶

Also, in certain cases issuance of prospectus is not required such as in the case of issuance of rights of shares or debentures to already existing members with or without any right of renunciation as per Section 26(a) of Companies Act, 2013⁷ [Equivalent to section 56(5)(a) of the Companies Act, 1956]. In another case when the prospectus is issued regarding the shares or debentures which are in all respects uniform with the previous prospectus and for time being the issuance of prospectus is not required as per Section 26(2)(b)⁸ of the Companies Act, 2013 [Equivalent to 56(5)(b) of the Companies Act, 1956]

II. MEANING OF RED HERRING OR PRELIMINARY PROSPECTUS

Red-herring prospectus [RHP] is a document circulated by a company that is going to sell shares for the first time, giving details of the company but no details of the price of the shares, etc. It is sent to people who might be interested in buying the shares.⁹ During a book-building process¹⁰, a red herring prospectus by a company is usually issued. It is important to understand that in the initial offer the building process is used to find out the better price by the company, to get a feel of the market. The issuing company will issue "red herring prospectus" prior to beginning of offer.

The "red herring prospectus" should indicate all details which are required in the prospectus, except that instead of specifying exact issue size or issue price, minimum price or band may be specified.¹¹ [As per SEBI guidelines, minimum floor price is required to be specified and not maximum price or band]. The directors of the company should sign the "Red herring prospectus".

⁵ Meaning of Prospectus, Guide to SEBI, Capital Issues, Debentures & Listings, 5th ed, K Sekhar in Lexis Nexis

⁶ Red Herring Prospectus, Chandratre: Company Secretarial Practice Manual by KR Chandratre in Lexis Nexis

⁷ Section 26(a) of the Companies Act, 2013, Act No.18, 2013

⁸ Section 26(2)(b) of the Companies Act, 2013, Act No.18, 2013

⁹ Oxford Business English Dictionary, 2006

¹⁰ The book building is a process of collecting offers from prospective investors based on an indicative price range which aims at fair pricing of the issue to be emerged out of the offers given by various investors. Final price is determined at a date close to the date of opening of offer.

¹¹ Supra Note 5.

The corporation will then make allotment on the basis of price and issue size finalised and then submit final prospectus upon close of offer to ROC and SEBI. Consequently the final prospectus is prepared by stating the total capital received either by way of debt or share capital, the concluding price of securities and also mention about other details that are not mentioned in “Red Herring Prospectus”¹².

In this process, during the time when the IPO is open, investors bid at a variety of prices according to their estimates, which are more or less equal to the floor price. The floor price of securities given or a band of price along with the range within the bids are able to move are included in the Red herring prospectus. The applicants tender for the shares mentioning the amount and the amount that they intend to bid at. Merchant bankers use a red herring prospectus for understanding the demand of securities and their price that are to be offered. Later they use that to determine the final price of the securities and the quantity for the public offer, giving the company a better picture of the market.

A prospectus that has been filed for a stock issue but is not yet accepted by the SEC such prospectus is called as Red Herring as already mentioned above. The SEC wants such prospectus to have a notice which has to be printed in red lettering stating that the document is incomplete. Such notice, which is published in red ink, usually reads as below:

“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”

III. FILING OF RED-HERRING PROSPECTUS

The unlisted public company should file the red-herring prospectus with ROC. When it comes to a listed company he red herring prospectus should be filed by company with SEBI no less than 3 days earlier to the starting of the offer.¹³ Subsequently the final prospectus must be filed with ROC/SEBI by unlisted and listed company respectively after the conclusion of the offer of securities mentioning the total amount raised, concluding price and other information that is not mentioned in RHP¹⁴. Later on the implications that might crop up due to concealment,

¹² Section 32(4) of the Companies Act, 2013, Act No.18, 2013

¹³ Section 32(2) of the Companies Act, 2013, Act No.18, 2013

¹⁴ “SEBI’s Power to Monitor and Regulate the Securities of Unlisted Companies - An Analysis from Legal Perspective” by T.V. GANESAN, [2013] 30 taxmann.com 190 (Article)

misstatement and inaccuracies, along with the obligations to use proper care and diligence at the time of drafting a prospectus should be taken into account, even at the time of drafting a RHP, and it is a duty on every company.¹⁵

Thus, the *red-herring prospectus* is prominent way to get to know the price for a public offer by book-building using the *RHP*. As already mentioned such document would help the merchant bankers to test the demand of securities and their price for the public offer. The word “*red-herring prospectus*” has been specified in the explanation to the Section 32 of the Companies Act, 2013 to imply that, “A *prospectus* that does not include complete particulars of the quantum or price of the securities included in such *prospectus*.”¹⁶

IV. LAW INVOLVED

(A) The Companies Act, 2013

Under Companies Act, 2013, the Section 32¹⁷ of the Companies Act deal with Red Herring Prospectus. The said provision reads as follows

“S. 32. *Red herring prospectus*. —

(1) *A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.*

(2) *A company proposing to issue a red herring prospectus under sub-section (i) shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.*

(3) *A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.*

(4) *Upon the closing of the offer of securities under this section, the 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 are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.*

Explanation. —For the purposes of this section, the expression “red herring prospectus” means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.”

¹⁵ SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

¹⁶ Datta on the Company Law. Author, C. R. Datta. Edition, 5. Publisher, Orient Law House, 1992 in Lexis Nexis

¹⁷ Supra note 11

(B) Corresponding Provisions:

This provision is related to Section 60B of the Companies Act, 1956 which was included in 1956 act in the year 2000 by an Amendment to Companies Act, 1956. The concepts of Red Herring Prospectus and Information Memorandum are inserted in Section 60B by the Companies (Amendment Act) 2000¹⁸. It also authorized SEBI to control the provisions of S. 60B of the 1956 Act with respect to the listed companies and also regarding the companies which are willing to be listed. However, all the other companies must be controlled by the Central Government. The SEBI was also entrusted with the power to inspect the account books and other books & papers in relation to the listed companies and with companies which are willing to be listed. According to Section 621 of the Companies Act, 1956 the SEBI was also empowered to report complaints for crimes relating to issuance and transfer of securities & non-payment of dividend.¹⁹

There are more than a few changes between the old and the new act, with respect to this section as follows²⁰:

- The option of filing information memorandum prior to red herring prospectus has been dispensed with under the new act.
- Procedure with respect to receiving subscription money through post-dated cheque or stock investment do not find mention in the new act of 2013.
- The new act does not cast an obligation to individually intimate the prospective investors about the variations in the interregnum period amid issue of “Red Herring Prospectus” and the prospectus.
- The new act does not grant an option to withdraw applications available to prospective investors, who has offered advance monies prior to the date of issue, without being aware of variations during the interregnum period between issue of red herring prospectus and the prospectus.

Apart from the above provision the SEBI Regulations of 2009 also deal with Red Herring Prospectus under various regulations which are mentioned below.

(C) SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

These regulations mention certain disclosures that are to be made in the red-herring prospectus

¹⁸ Red-Herring Prospectus and Information Memorandum by Sanjiv Agarwal, [2001] 34 SCL 28 (MAG.)

¹⁹ Red Herring Prospectus (Section 32), Guide to SEBI, Capital Issues, Debentures & Listings, 5th ed, by K Sekhar in Lexia Nexis

²⁰ A Ramaiya: Guide to The Companies Act, 18th Edition 2014, Lexis Nexis

that must be followed by every company. SEBI has made it mandatory for companies to file a draft RHP with SEBI, before going to the registrar, so that SEBI can review its documents, check the disclosures and make variations and give recommendation, before a final red herring prospectus is filed²¹. After making the changes the final document is filed with SEBI, registrar and stock exchanges and after its reviewed and approved the document becomes a red herring prospectus.

1. Regulation 2(1)(f) of SEBI (ICDR) Regulations, 2009 defines 'book-building' as follows:
"(f) 'book building' means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be, in accordance with these regulations"
2. Under Regulation 57(2)(a) of "SEBI (ICDR) Regulations, 2009", where a company proposes that through book building process the capital is issued to public then the pertinent "red-herring prospectus" must fulfill the disclosures mentioned in Schedule II of the Companies Act, 1956 and also the disclosures which are mentioned in Part A of Schedule VIII considering the provisions of Parts C and B thereof.
3. According to Schedule XI of para 7 of the above ICDR Regulations the price is not required to be provided in red herring prospectus. Where the size of the issue is mentioned in the the red herring prospectus and it might not include the price and quantity of securities. The draft "red herring prospectus" including all the disclosures with total size of issue, if relevant, as mentioned in Schedule VIII, excluding that of price and the quantity of securities to be given through it has to be recorded with the SEBI by the lead merchant banker. The draft Red Herring Prospectus is not required to be filed with SEBI in the case of Fast Track issue.
4. The Regulation 2(1)(o) of the said ICDR Regulations, 2009 provides that, "green shoe option means an option of allotting equity shares in excess of the equity shares offered in the public issue as a post-listing price stabilising mechanism." The Regulation 45 puts down the procedure of stabilizing price via green shoe option.

This is the legal position of Red Herring Prospectus in India. Each and every company is obligated to follow the above law before issuing the securities to public and in drafting RHP and Final Prospectus.

²¹ Dia Rekhi, Why Red herring prospectus is important?. Economic Times (May 20, 2016 03:08 am) <https://economictimes.indiatimes.com/why-is-draft-red-herring-prospectus-important/articleshow/52352430.cms>., Last Accessed on Jan 17th, 2021

V. VARIOUS ISSUES CONCERNING RED HERRING PROSPECTUS

After considering about the RHP's statutory provisions now let us consider the judicial stand regarding the Red Herring Prospectus. There can be discrepancies in amid the Red Herring Prospectus and the final prospectus which is given or circulated by a corporation and that might lead many to many numbers of grievances. The author would deal with three irregularities that would crop up concerning Red Herring Prospectus.

(A) Claiming the Public Issuance of Shares as Private Distribution²²

There has been many cases where companies have evaded filing the prospectus after the collection of funds or after issuance of funds under the guise of private distribution. In the case of in "Re: Gitanjali Udyog Ltd and Others"²³ the court dealt upon the similar issue. In that case the company has published the offers for Non-convertible Debentures (NCDs) to a small number of allottees and later they asserted that they have done a private distribution. The offer was made to On-going 'Financial Institution, Mutual Funds, HUFs and Cooperate Bodies' and this was found out by the SEBI through the prospectus and offer documents. Subsequently, the SEBI has held that such issuance should not be considered as private distribution but a public issuance. Thus the SEBI held that the issuance of NCDs is of public nature and so the company has to register the prospectus with the ROC before the such issuance. Furthermore, the directions given under Section 40(2)²³ of the 2013 Act were not followed by the company which mandates that prospectus should mention the names of the Stock Exchanges. Therefore, the company was held liable for unlawful and illegal transfer of public funds.

In another case of "*In Re. Shah Group Builder*²⁴", the issue involved was whether the issuance of equity by a corporation signifies a public offer. The court considered Section 67 of the Companies Act, 1956 and held that the issuance of shares is of public offer and held the builders liable for contravention. The court has depended on the decision provided in the case of "*Sahara India Real Estate Corporations Ltd. And Others v. SEBI*²⁵", where the court held that, "If an offer or invitation is given to 50 or more persons, a public issue is carried out even if it is shown that the shares or debentures are not available for subscription or purchase by persons other than those receiving the offer or invitation."

²² Rights Offer of Shares with the right of Renunciation: Whether amounts to Public Offer under Companies Act 2013 - The never-ending Confusion and Controversy by DR. K.R. CHANDRATRE, [2016] 74 taxmann.com 51 (Article)

²³ Section 40(2) of the Companies Act, 2013, Act No.18, 2013

²⁴ In Re. Shah Group Builder, WTM/RKA/CFD/ 65/2015

²⁵ Sahara India Real Estate Corporations Ltd. And Others v. SEBI, (2013) 1 SCC 1

*In Sahara Case*²⁶, “The Supreme Court first culled out some hard facts from the case. The main issues before the Court were w.r.t. the nature of OFCDs. It was very clear from the Red Herring Prospectus that Sahara did not intend to list the securities and that the issues consisted of unsecured OFCDs with an option to convert the same to equity shares. Subsequently, it was also found that the six different kinds of bonds issued by SIRECL and SHICL were given the liberty to be transferred to any other person, subject to the approval of the company. Even though it was clear that the issue was based on private placement, yet the Information Memorandum was circulated to three crores people and was done through ten lakhs agents in more than 2900 branch offices, wherein Sahara had a capital base of only 10 lakhs rupees. It was also observed that Sahara did produce the documents regarding the persons who had invested in the securities, however, there was no relationship between the investors and the Sahara Group. The burden of proof was on Sahara to prove that the investors were associated with them, however, they failed to do so.²⁷”

The Justice Khekhkar also pointed out that the Companies had taken a position that they did not have all the information relating to the securities issued by them, which seemed preposterous and the denial of the companies to give information seemed to be a calculated and deliberate denial of information. The Court also observed that if there had been only forty nine subscribers to the issue, then each subscriber would have paid Rs. 98.84 crores, however, the face value of OFCDs issued varied from Rs. 5,000 to Rs. 24,000, thus, it could not be an offer to less than 50 persons.

Finally, the court upheld the proceedings of the SEBI and also the order of the SEBI (Whole-Time Member) (WTM). Sahara was required to refund the amount of Rs. 17,400 crores with an interest at 15 per cent within a period of three months from the day. Sahara was also required to furnish the details along with supporting documents to establish if they had refunded any amount to the persons who had subscribed to the Red Herring Prospectus. It was also ordered that Sahara should submit all documents with the SEBI to ascertain the genuineness of the subscribers. All expenses undertaken to investigate into the accounts of Sahara would be borne by Sahara itself. The Court also ordered that if the subscribers could not be traced, then the subscribed amount would be appropriated to the Government of India. The Court appointed Shri. B.N. Agrawal, a retired Judge of the Supreme Court, to oversee the steps adopted by the SEBI (WTM). He was given a remuneration of Rs. 5 lakhs along with the expenses of travelling, accommodation, etc., to be borne by the SEBI and thereby, Sahara.

²⁶ Ibid.

²⁷ Analysis of the Sahara Judgment by AKSHAY AMRITANSHU, 2013] 30 taxmann.com 198 (Article)

Thus, these cases provide a clear stand on the issue.

1. Non-disclosure of material information in the prospectus²⁸

Regarding this issue the famous case is *DLF Limited and Ors v. SEBI*²⁹, which came before the Securities Appellate Tribunal [Mumbai bench]. The draft Red Herring prospectus has been filed by DLF stating that Sudipti Estates Pvt. Ltd. (SEPL) was a collaborative venture of DLF. However such stand has been changed when the latest prospectus has been issued by them after revoking the earlier one. The DLF's six directors have been prohibited by the SEBI from trading in the securities market for three years basing on the compliant which appealed that the two wholly-owned subsidiaries which are disclosed in DLF's prospectus were the only shareholders of SELP but they have mentioned that it was not a co-venture in the later prospectus. The DLF argued that such non-disclosure of the relation between DLF and SEPL would have had any implication on the decision of investors and that there was nothing to submit that DLF was unfairly profiting from its alliance with the subsidiaries, the SEBI's prohibitive order should be set aside. The Tribunal has upheld that there was an abuse of the DIP guidelines by DLF due to the non-disclosure of data concerning to the subsidiary corporations but condemned the SEBI's prohibitory order stating that DLF has not used any material or documents that would've deluded the stockholders and also held that the interest of investors would affect if the DLF is prohibited from transacting in securities for a period of 3 years. There are many claims backing the argument that the three companies are not "acting in concert" and simply having subsidiary relation will not determine that they are misusing it. The very aim of issuing a draft prospectus, moreover, is to ensure that all material relating to any commercial activity or financial practice to which the resulting securities proceeds might be directly or indirectly applicable must be contained in the prospectus. It is also claimed that the inability to report a holding-subsiary arrangement between the entities would constitute essential material which would have to be contained in the prospectus.³⁰

2. Misrepresentation in red herring prospectus

The third issue is relating to misstatement or false representations in a prospectus. Both civil and criminal liabilities would attract in India for Misstatement. The civil liability would attract as the transaction include monetary harm and so the compensation has to be given under it. However, in the cases where an Initial Public Offer (IPO) which is false concerning securities

²⁸ Non-Disclosure of material facts in the offer documents may debar from accessing the Securities Market By DR. RAJEEV BABEL, [2016] 73 taxmann.com 290 (Article)

²⁹ DLF Limited and Ors v. SEBI, [2012] 170 COMPCAS 22 (DEL)

³⁰ DLF Saga : Debatable role of Merchant bankers in IPOs by PRASHANT PRANJAL, [2015] 56 taxmann.com 64 (Article)

has been filed in public domain then that would attract a minimum punishment of 3 years besides fine³¹. The term ‘Misrepresentation’ has not been described in the Companies Act, 2013. Although under Section 447’s explanation of the 2013 Act, a complete explanation of deceit has been provided. It asserts that,

“fraud in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.”

For fraud and misrepresentation under the Companies Act, 2013 the criminal liability is asame. There are concerns raised to have the same civil liability for fraud and misrepresentation. Such issue was considered in the case of “*R. v. Kylsant*³²”. In this case the court held that, “By treating civil liability of both fraud and misrepresentation as same, the company was jeopardizing the interests of the investors. Hence, the company was liable.” Apart from this, this case also emphasized the point that in civil proceedings, as opposed to criminal proceedings, even the genuine assertions rendered in the prospectus can be implied as fake if there is a suspicion of unfairness.

In the case of *Kimsuk Krishna Sinha v. SEBI*,³³ there had been a misrepresentation in draft “Red Herring Prospectus”. The court held that, “SEBI was empowered to examine the draft red herring prospectus and insist on complete and truthful disclosure of all the relevant facts. The fact that the public issue has been closed, does not relieve SEBI of its statutory duty of inquiry into the veracity of statement made in the prospectus.”

In another prominent case *New Brunswick and Canada Railway and Land Co. v. Muggeridge*³⁴, the court held that, “Only true nature of the company’s venture shall be disclosed and Strict and scrupulous accuracy shall be maintained in drafting prospectus as it invites the public to take shares on the faith of the representations contained in the prospectus. In addition to the mandatory information required to be given as per Part I and Part II of Schedule II of the Act, there must be voluntary disclosures of information as would reasonably constitute a fair representation of facts for the public to act upon.”

³¹ SEBI’s Power to impose penalty for Mis-utilization of IPO proceeds - An Analysis by T.V.GANESAN, [2016] 75 taxmann.com 159 (Article)

³² *R. v. Kylsant*, (Lord) [1932] 1KB 442

³³ *Kimsuk Krishna Sinha v. SEBI*, (2010) 155 Com Cases 295 : (2010) 100 SCL 197(Del).

³⁴ *New Brunswick and Canada Railway and Land Co. v. Muggeridge*, (1860) 1 Dr. & Sm. 363, 381.

(B) Criminal liability:

According to the Section 34 of the Companies Act, 2013³⁵ if any prospectus has been issued or distributed or circulated which includes a false statement in any form or context, whether the inclusion or omission of any misleading matter then such person who is authorized to issue such prospectus would be held liable under the Section 447³⁶ of the Companies Act, 2013.

Section 447 reads as follows: *“Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.”*

“Fraud” with respect to any company contains any omission, act, or suppression of any detail or misuse of position devoted by any person or by another person in collusion in any way, with an intention to cheat and to obtain unwarranted benefit from, or to affect the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.³⁷

Since the fraud committed by way of suppression of facts in the prospectus in an preliminary public offer, with an intention to cheat the public shareholders, which includes interest of public then the minimum punishment would be 3 years.

It is important to note that punishment for false statements is enclosed by section 448 of the 2013 Act according to which if in any report, return, financial statement, *prospectus*, certificate, statement or other papers needed by, or for the purposes of any provisions of this enactment or the regulations made thereunder, any person who makes a declaration:

- (a) which is fake in any material details, knowing it to be erroneous, or
- (b) which excludes any important fact, by being aware of it to be a material fact

shall be liable as per the Section 447 of the Act.

The Sections 447 and 448 have been reported to come into existence from September 12, 2013.

³⁵ Section 34 of the Companies Act, 2013, Act No.18, 2013

³⁶ Section 447 of the Companies Act, 2013, Act No.18, 2013

³⁷ Criminal and Civil Liability for Misstatements in Prospectus, By VINEET SAWHNEY, [2015] 62 taxmann.com 112 (Article)

And the prescribed the punishment for fraud is both fine and imprisonment, and that would be a non-compoundable offence, *i.e.*, under section 441 of the Act, offences involving any misstatement in the prospectus shall not be compounded, which makes the fraud a serious offence.

The proviso to section 34 of the 2013 Act provides a defense to a person who could be held criminally liable for any misstatements in the prospectus by stating that nothing in section 34 of the Act should apply to any person if such person shows that such statement or omission was not significant or that he had some rational grounds to consider, and did believe upto the time such prospectus is issued that such statement as true or the omission or inclusion was mandatory.³⁸

(C) Civil liability

As per Section 35³⁹ of the 2013 Act,

“A person has subscribed to securities of a company acting on any statement, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who —

- (a) *is a director of the company at the time of the issue of the prospectus;*
- (b) *has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;*
- (c) *is a promoter of the company;*
- (d) *has authorized the issue of the prospectus; and*
- (e) *is an expert as defined in the Act*

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to *pay compensation* to every person who has sustained such loss or damage.”

By applying the accurate measure of reparations to be awarded in order to reimburse a person who has been induced fraudulently to buy shares and the important criterion is the distinction between the price at which they purchased and the actual value of it. It may be proper to utilize the subsequent market shares price after the fraud which has become public and the market has

³⁸ Ibid.

³⁹ Section 35 of the Companies Act, 2013, Act No.18, 2013

remained at the shares actual price value.⁴⁰

Furthermore, when it is shown that a prospectus is issued in order to defraud the investors in the securities of a company or any other person or for any such unlawful purpose then every such person who are mentioned above should be held liable personally without any limitation to any losses or damages that may have been suffered by any person who has opted or invested in such Securities relying on such fraud prospectus.

However, no person should be held liable for any civil wrong if he can prove that the consent which has been given before as a director of the company to RHP, has been withdrawn by him before the issuance of prospectus and such issuance of prospectus has been done without the consent or authority and without his knowledge and later upon knowing about such illegal prospectus the he should have given a reasonable public notice highlighting that such prospectus was issued without his consent then in such circumstance a person is not liable under civil liability.

According to Section 36⁴¹ of the 2013 Act,

“Any person who either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts to induce another person to enter into or to offer to enter into—

- (a) *any agreement for or with a view to acquiring, disposing of, subscribing to, or underwriting securities; or*
- (b) *any agreement the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or*
- (c) *any agreement for or with a view of obtaining credit facilities from any bank or financial institution*

shall be liable for action under section 447 of the Act.”

As already mentioned above in criminal liability the punishment that is prescribed for fraud under the Companies Act, 2013 was covered under section 447 for all cases of fraud, distinct from the Companies Act, 1956 where various punishments are given for different actions which leads to fraud. Also, the Punishment for fraud which is mentioned in the Companies Act,

⁴⁰ Ibid.

⁴¹ Section 36 of the Companies Act, 2013, Act No.18, 2013

2013 is a supplement to another liability under the Companies Act, 2013, including the repayment of debt wherever the Act mandates for such repayment of debt. In other words a person who is found guilty of fraud has to endure that other liability apart from the punishment provided for fraud as per Section 447 of the Companies Act, 2013.⁴²

VI. ADDITIONAL JUDICIAL PRONOUNCEMENTS CONCERNING RED HERRING PROSPECTUS

1. Indowind Energy Limited v. Wescare (India) Ltd. & Ors. Subuthi Pvt. Ltd.

In the case of *Indowind Energy Limited v. Wescare (India) Ltd. & Ors. Subuthi Pvt. Ltd.*,⁴³ where the second respondent in this case is a promoter of the appellant's company. Subhuthi entered into an agreement of sale with respondent 1, agreeing to transfer some business assets for an amount of Rs. 98.19 crores of which Rs. 24.19 crores which has been paid in cash and Rs. 74 crores by issuance of shares. The agreement provided arbitration as a dispute settlement mechanism in case a dispute arose. The agreement, however, could only be enforced after approval from all three companies, but the appellant never approved it. The companies went forward to perform their obligations under the contract. In between a dispute arose and respondent filed for an arbitration proceeding and asked for an interim relief to prohibit appellants to proceed with an IPO by issuing "Red Herring Prospectus". The court stated that the appellant was bound by the sale agreement as their issue of "Red Herring Prospectus" for issuance of equity shares clearly indicates their intention to be bound by the agreement. The red herring prospectus issued by applicant states that the appellant entered into agreement for sale with respondent.

2. S.V. Khandekar v. SEBI

In the case of *S.V. Khandekar v. SEBI*⁴⁴, there was an appeal against the order of SEBI in its appellate tribunal. Here the appellant filed an application under right to information act seeking a copy of red herring prospectus of a company with respect to its acquisition of another company. This case shows how if the prospectus is not available in any public platform, one can file an RTI application to seek the same from the issuing company. Further this case differentiates between a red herring prospectus with respect to acquisition of a private company by a public company and with respect to IPO.

3. Palco Recycle Industries Limited v SEBI

⁴² Companies Act, 2013 - A big leap to prevent and punish fraud by Lalit Kumar

⁴³ *Indowind Energy Limited v. Wescare (India) Ltd. & Ors. Subuthi Pvt. Ltd.*, 2010) 5 SCC 306

⁴⁴ *S.V. Khandekar v SEBI*, Appeal no. 1206 of 2011 (SEBI).

In the case of Palco Recycle Industries Limited⁴⁵, where the company in question filed a draft red herring prospectus with the SEBI for its recommendations and approval as per regulation 6 of SEBI (Issue of capital and Disclosure requirements) Regulation, 2009. The company complied with all the queries of the SEBI but did not receive approval and hence this case was filed. There was a huge delay by the board in giving its approval. This case exemplifies that the board takes cognizance of situations that may cause delays in getting approvals. The board directed the respondents to take actions within two weeks.

4. Casa Paradiso, Owner Welfare Association v. M/s Sanathnagar Enterprises Limited⁴⁶

In this case the bookings were made in respondent's building but later on respondent made unilateral changes in his oral assurances to the petitioner and thus because of these inconsistencies, the aggrieved petitioner filed this case before the commission. The aggrieved approached the commission claiming that the enterprise was abusing its dominant position and this fact could be proved based on its red herring prospectus. This case is important as here the commission held that self-acclaims by enterprises in their own documents like red herring prospectus cannot be taken as evidence of dominance per se by respondent to show that its major real estate developer in India.

5. Ajay Jain v. Registrar of Companies⁴⁷

In this case, the company for inviting the investors has issued a prospectus in which it has mentioned that it would handle the leasing activities. The company has also mentioned that it has been having profits in the Red Herring Prospectus. But the actual intention of the company's directors behind such prospectus is to get funds from public. Therefore, the prima facie clear that is the directors has knowledge regarding such prospectus which is false. Thus, the petition under Section 482 of Criminal Procedure Code filed by the director has been quashed by the court in this case.

VII. CONCLUSION

This section is very important as any company which wants to issue its securities to the public, must adhere to requirements that it has to provide some basic relevant information to the investors. One such form of providing the information is by way of issuing a red herring prospectus. It is an important requirement that needs to be followed by the companies. The

⁴⁵ Palco Recycle Industries Limited v SEBi, (Securities Appellate Tribunal), Appeal No. 199 /2011

⁴⁶ Casa Paradiso, Owner Welfare Association v. M/s Sanathnagar Enterprises Limited, Case No. 34 of 2013

⁴⁷ Ajay Jain v. Registrar of Companies, (2015) 4 PLR 303

member and the company would suffer great loss and penalties for misstatement and providing wrong information in a red herring prospectus. The primary motive behind having such a document is ensuring welfare of investors and misappropriation of funds raised by companies through sale of securities does not happen and the interest and rights of investors are protected. On perusing through the statutes and judicial precedents on RHP it can be surmised that there hasn't been a substantial change in the guidelines set for issuance of a RHP except for inclusion of provisos and stricter punishments. The primary motive behind having such a document is ensuring welfare of investors and misappropriation of funds raised by companies through sale of securities.

VIII. SUGGESTIONS

From the above explanation and scrutiny of various cases concerning different issues of RHP and the law involved the author has understood that Red Herring Prospectus (RHP) is incredibly significant in the Securities market. Hence, the author suggests that the directors of a company have to monitor the drafting of Red Herring Prospectus with paramount precaution and make sure that the document is not misleading in any way, which can later affect the investor's decision in a negative way.
