

PROSPECTUS AND ITS MISREPRESENTATION CASES

Shweta Pandit* Shirish Bhootra*

ABSTRACT

The economic development of a nation is possible only when there exists an environment of healthy and safe competition. In order to have such an economy, the Government of India framed a law that provides about the policies or practices, or agreements that are to be considered to have an appreciable adverse effect on the economy of the nation, in other words, such agreements are to be considered anti-competitive agreements having an appreciable adverse effect on the economy of the nation. In order to have clear interpretation and to the absence of ambiguity various agreements have been provided which are to be considered anti-competitive agreements. All such agreements are provided under Competition Act, 2002¹ and their coverage includes at all levels be it production, purchase, or sale of goods or rendering of services. Under the Competition Act, of 2002 an authority is constituted, known as the “ Competition Commission of India “ which has been entrusted with powers to evaluate the agreements entered by the entities which have an appreciable adverse effect on the economy of the nation and thereafter to penalize the entities accordingly if practices opted by them amounts to have appreciable adverse effects. Accordingly, CCI has decided on various cases and has provided judgements accordingly.

Keywords: Development, Misrepresentation, Competition.

INTRODUCTION

The prospectus² is defined under section 2 subclause (70)³. It is a document that is described as a prospectus; it could be a red herring prospectus, which does not disclose the complete price of the securities, or a shelf prospectus which is issued once for over a period of time. It has a notice, circular, advertisement, or any other document which invites offers from a public

*NATIONAL LAW SCHOOL OF INDIA UNIVERSITY, BANGALORE.

*JAI NARAIN VYAS UNIVERSITY, JODHPUR.

¹ Competition Act 2002

² Companies Act 2013

³ Companies Act 2013, s 2(70)

company, which is not a private company. A prospectus is used as an instrument to attract the public for the subscription or the purchase of any securities of a body corporate. In other words, a prospectus may be defined as a document that is to be filed with or to be submitted to regulating authorities like the Securities and Exchange Commission (SEC) which contains details prescribed under the Act at the time of offer of an investment to the public in general. Investments include and are not limited to stocks, bonds, and mutual funds.

The shelf⁴ prospectus and red herring prospectus are also included in the prospectus and as provided under the Companies Act 2013. A prospectus is further bifurcated into preliminary as well as final prospectus. **It is based on the theme of investor awareness, as investors are updated with company details concerning financial and other related credentials and also risks related to investment.**

Sec 26,⁵ Matter to be stated in prospectus. The matters which are to be stated in the prospectus for the awareness of the public are provided by the entity that intends to issue security. Its contents include business details and various other related aspects and don't include issue-related aspects like the number of shares, its price details as in issued size, a lot, etc. It's a tool to analyze the public interest concerning the security proposed to be issued

A Final Prospectus comprises of all the details that are relevant to the investment and focused on issues related to aspects such as shares to be issued [their quantum, price, issue size, etc.]

Contents of the prospectus comprise of various details which are as follows:

- Summary related to the company in terms of its background, and its financial records abstracts.
- Name of entity or company intended to issue stock.
- A number of shares, their variants, or types.
- Its nature, whether it is public or private.
- Disclosure related to the company's principles.
- Mention Banks or financial institutions entrusted with the task of performing underwriting functions.

⁴ Chris B Murphy, 'Prospectus, its meaning , users and example' (*Investopedia*, 2022)

<<www.investopedia.com/terms/p/prospectus.asp> accessed 22 September 2022

⁵ Companies Act 2013, s 26

- Disclosure regarding managerial personnel, their age, experience, and other related aspects.
- Matters which are to be disclosed are mandatory in the prospectus provided under the Companies Act 2013, these are provided under section 26 of the Act.

Matters which form part of Mandatory disclosure⁶ are as follows:

- Disclosure related to action [legal] which is pending in nature, court litigation, or action initiated by either statutory body or any department of government or any pending case within any court immediately preceding five years before the issuance of a prospectus.
- Disclosure of the sources, from whom the promoter received contributions,

The relaxation to a certain extent concerning disclosure norms has also been provided, some of the examples are mentioned below:

The details of all the companies, listed or unlisted which contributed the capital by any means during the last 3 years must be mentioned, which are controlled and managed directly by the similar/same company.

Disclosure related to export obligations and their various possibilities:

Disclosure related to Compromise or Arrangement [collaboration].

Report of Auditor which should not be prior than 180 days from the date of issue of prospectus. Report contents include details related to the assets and liabilities of the entity. It has been provided under the Companies Act 2013. It has been mentioned under section 26 of the Act. Various Compliance as provided under the Companies Act 2013 have also to be complied with prior to issue [issue means the issue of securities to the public] wherein people are invited to subscribe to securities through the prospectus. It has been mentioned under section 23⁷ of the Act [Companies Act 2013].

- Disclosure with respect to Variation⁸ with respect to either objects or else contracts:

⁶ Hathi U, 'Companies Act 2013 : Its Highlights And Review' [2014] SSRN Electronic Journal

⁷ Companies Act 2013, s 23

⁸ Hathi U (n 6)

Compliance with respect to resolution is to be made in order to have an effect on variation. Variation related to either objects or contracts as provided or mentioned in the prospectus. This resolution is to be special in nature and not ordinary in nature is to be passed. An option of exit is also provided to shareholders who do not want to continue. It is provided by either controlling shareholders or management of the company [promoter]. It has been provided under the Companies Act 2013, and section 27⁹ of the Act deals with these aspects.

SHELF PROSPECTUS

As per SEBI Regulations, companies or Companies intended to issue securities have the option to submit a Shelf Prospectus. It is to be submitted to an authority known as Registrar. It is to be submitted when a company makes the securities offer which is first in nature. It is to be filed or to be submitted within a period of one year. The period starts from the date on which the offer of securities being first in nature opens. Furthermore in case of a subsequent issue of securities within a span of time which is to be considered the valid period of the prospectus, no compliance with respect to submission of the prospectus with the Registrar is required.¹⁰

Compliance with respect to submission of information memorandum is also to be made by the company which opts for filing shelf prospectus. The document comprises of contents related to the creation of charge [new], various changes that have an impact on the company's financial position, which took place during the period starting from the first offer and subsequent offer of securities, and also changes which were prescribed by the Registrar in this regard within prescribed time before subsequent offer of securities under shelf prospectus.

- Furthermore, it has been provided that where the company has received application money or advances from the applicant before the intimation of changes, the company shall intimate changes to the application along with an offer to exit, and if the applicant wants to withdraw the company may refund application money along with advances if any, within fifteen days from receipt of intimation from the applicant.
- Where the company filed an information memorandum along with a shelf prospectus, such filing shall be considered as company prospectus filing compliance has been complied with.

⁹ Companies Act 2013, s 27

¹⁰ 'Section 31 Shelf Prospectus' (Cairr, 2013) <<https://ca2013.com/>> accessed 21 September 2022

- A shelf prospectus is a variant or kind of prospectus. It is to be issued for securities or their classes as mentioned therein. Its coverage is not only first securities but also the securities [further or subsequent] which are issued within the period which is considered valid for the prospectus. Companies have not to have complied with prospectus-related compliance. It shall be deemed that the company has complied with such prospectus-related compliance for subsequent of further securities. It has been provided Companies Act 2013. Section 31¹¹ of Act [explanation] deals with it.

RED HERRING PROSPECTUS

Companies intending to issue securities have an option with respect to Prospectus. Red Herring Prospectus is an option that may be exercised by the company prior to the issue of the Prospectus. The term Red Herring Prospectus is said to be a prospectus in which there is no disclosure of contents related to the issue. Such non-disclosure is related with securities price, its number, etc. It has been provided under the Companies Act 2013 It has been mentioned under section 32 [explanation].¹²

It has to be submitted within the prescribed period. It has to be submitted to Registrar. It has to be submitted prior to the offer. Such a prior period should be in days which is thirty in number. A red herring prospectus possess the same characteristics or obligations as possessed by the prospectus and difference if any are disclosed in the prospectus. Under a heading known as variations between prospectus and red herring prospectus.¹³ When the subscription period is closed, the prospectus must disclose various details. Such details include a details amount of capital [total], either by way of the option of share capital to the option of debt, and other relevant information which have not been disclosed in the red herring prospectus. Such submission is to be made to Registrar and SEBI. SEBI has framed regulations with respect to Capital Issues and Requirements with respect to its disclosure, Company has to comply with these regulations also.

AMISSTATEMENTS IN PROSPECTUS: CIVIL LIABILITY

Where any person has applied for the subscription of securities on basis of facts or statements, such facts are in nature of either non-inclusion or omission or else either inclusion in the

¹¹ Companies Act 2013, s 31

¹² Companies Act 2013, s 32

¹³ Companies Act 2013, s 33

document. Such a document is referred to or termed as Prospectus. The nature of such facts is misleading. As a consequence of such acts of misleading facts in the prospectus¹⁴ the person who invests has to bear adverse consequences which may be either damage or loss or other related consequences. If such happens, then specified persons like promoter, a person having directorship of company or person having proposal of director of the company or other person possessing requisite skills as mentioned under the Act, then the company and above-mentioned persons shall be responsible to compensate the person for such loss or damage suffered. A specified person's consent at the time of the issue of the prospectus is to be taken into account.

The above-mentioned provision would not limit or cut down the scope of the punishment as mentioned under the Act. Such punishment is provided under section 36 of the Act.¹⁵ [However, if the above-mentioned person proves their innocence, that prospectus has been issued without their consent or they are not aware of such misleading of facts or possess no knowledge of such misleading of facts, and on becoming aware of such misleading of facts has issued a reasonable notice in this respect, then such above mentioned persons shall not be liable to pay for any compensation.

Furthermore, the opinion provided by an expert on reasonable grounds based on the abstracts provided possesses the competence to provide an opinion and consents to act as an expert as per section 26 (5)¹⁶ and not withdraw such consent, not liable for such compensation. In case if there is evidence that supports that prospectus has been issued with an intention for any purpose which is fraudulent in nature or to harm investors like to defraud them, then above mentioned persons shall be liable to compensate the sufferer, with liability being unlimited and personal in nature. It has been provided under Chapter III of the Act]

FRAUDULENT INDUCEMENT: FOR INVESTMENT

[Punishment mentioned in the Act [Companies Act 2013]:

Anyone who is either aware or recklessly submits or provides any facts in the form of either any statement or any prediction thereof [forecast]. Such facts are in nature like false in nature

¹⁴ Companies Act 2013, s 35

¹⁵ Companies Act 2013, s 36

¹⁶ Companies Act 2013, s 26(5)

or possess characteristics of deception in nature or possess characteristics of concealment by nature. Such an act is done with an inducement to a person to enter into below mentioned¹⁷:

- To acquire else to dispose of subscription else to have underwriting of securities, an agreement in this regard.
- An agreement to secure profits arising from fluctuations in prices of securities or return from securities or return on investment.
- To obtain credit facilities from banks or other financial institutions, an agreement in this respect.

Then anyone who commits such an act related to the inducement of a person for such above-mentioned agreements, then action as mentioned under section 447 of the Act¹⁸ shall be initiated against such person who performs the act of inducing. It has been n provided under Chapter III of the Act [Companies Act 2013].

RELEVANT JUDGEMENTS

Shiromani Sugar Mills Ltd. v Debi Prasad:

False representation is to be considered different from misrepresentation, false representation involves facts that are known to be false and are made deliberately to deceive, which also includes the concealment of facts and mere disclosure does not amount to misrepresentation. Mere silence could not be considered as a ground for fraud until and unless there is any obligation to speak or silence is to be considered equivalent to expressions. Allahabad High Court in the above-mentioned has provided a view that is contrary in nature. It provided that any fact or statement would not be in nature false for the sole reason that only the fact that a promise exists and it is not in nature of breach which is being falsified. In this case, the prospectus contains a fact that “the managing agents with their friends, promoters, and directors have already promised to subscribe shares worth rupees six lakh”, the situation in real was however different, the amount of subscription was less than as said, So it was provided that it can not be said as a fact in which there is the involvement of misrepresentation.

¹⁷ Companies Act 2013, s 36

¹⁸ Companies Act 2013, s 447

Derry v Peek¹⁹ - In the above-mentioned case, Plaintiff initiated a suit after the acquisition of shares in Defendant's company, based on the ground that Defendant would have the right to use steam power, as opposed to other companies, which would not issue.

The matter to be considered in the above-mentioned case was whether it is to be considered deceit when a company forms a prospectus to solicit investors, which later on is considered wrong. The House of Lords reversed the judgment of the court of appeals and reinstated the judgment of the lower court. The court was of opinion that this was an action of deceit, under which the establishment of misrepresentation alone is not enough to prove liability. In this case, Plaintiff considered the prospectus reliable, which may have been misrepresentation, but Defendants reasonably believed they could glean approval of the board of trade and should not be held liable for they later failed to do so.

An action of deceit will only stand in a court when a plaintiff can prove not only misrepresentation but also that defendants were aware of the fact they would be unable to follow through with their representations.

Rex v Keyslant, [1932]

In this case, it was mentioned in the prospectus that the company is regular in paying dividends, however, it failed to disclose that the company is paying dividends out of reserves and not from profits. The company was passing through a situation of loss. It was considered to be false with respect to materiality aspects. Key Managerial Persons like the Director and Chairman of the company who were aware of the fact should have disclosed the fact in the prospectus. They were considered guilty of fraud.

Nash v Lynde, [1929]²⁰

Case of "strictly confidential prospectus"

Nash, a managing director in the company of whom Lynde applied for the shares, on the basis of a document in the prospectus. The document did not disclose all the relevant information as

¹⁹ Melissa A Hale, 'Case Briefs Derry v Peek' (*Case Briefs*) <www.casebriefs.com/blog/law/torts/torts-keyed-to-epstein/misrepresentation/derry-v-peek/> accessed 23 September 2022

²⁰ Hemant More, 'Prospectus' (*thefactfactor.com*, 13 October 2019) <<https://thefactfactor.com/tag/nash-v-lynde/>> accessed 22 September

mentioned in the act due to the loss suffered by Nash.²¹ The prospectus was marked as private and confidential hence court held that the document was not a prospectus as it is not for the public but a confidential document for Nash only, so it will not come under the prospectus of the company. The claim made by Nash was not satisfied. The main element of a prospectus on the basis of section 2(70) of the company law act, is that the document should be described or specified as a prospectus, including notices, circulars, advertisements, or other documents, for public and not for private company or person. Private communication cannot amount to the prospectus.

Edington v Fitzmaurice, [1885]²²

Case for “misrepresentation”

This case is of false representation by the company through the prospectus. The company issued the prospectus for subscribing to the debentures bonds. The company represented in the prospectus that it will use the money for alterations in the buildings, and buying horses and vans. Later it was discovered that the company has liabilities and the money will be used for paying off the liabilities. The plaintiff mistakenly thought that he would have shares in the property of the company to which he is subscribing the bonds. Later when the company became insolvent the plaintiff filed a suit claiming his money charged on the subscribed bonds. The court held that the company misrepresented the statement that it is for the purpose of raising capital- building reconstruction, and purchasing assets but the real purpose was to discharge the liability which was material to the situation and due to that misstatement the plaintiff subscribed to the bonds. Hence the defendant would be liable for false representation.

Peek v Gurney, [1873]²³

Case of “bought in stock exchange”

The case was a misrepresentation of facts. The plaintiff alleged the directors of making false statements in the prospectus. The court found out that the defendant hide the information

²¹ 'Nash v Lynde' (*vlex.co.uk*, 12 November 1928) <<https://vlex.co.uk/vid/nash-v-lynde-793818357>> accessed 23 September

²² All Answers Ltd, 'Edington v Fitzmaurice - 1885' (*Lawteacher.net*, September 2022) <<https://www.lawteacher.net/cases/edington-v-fitzmaurice.php?vref=1>> accessed 23 September 2022

²³ Encyclopedic, 'Peck v Gurney' (*legaldictionary.lawin.org*, 29 April 2013) <<https://legaldictionary.lawin.org/peck-v-gurney/>> accessed 22 September 2022

regarding the deed of arrangement under which the liabilities of the company of the defendant and Overend were purchased. When the company wound up the plaintiff was held liable to pay £ 100,000. The court held that the defendant is not liable for misrepresentation only by not disclosing the fact about the deed. The facts that were mentioned in the prospectus were not false hence it would not amount to misrepresentation. Also, the plaintiff was found to subscribe to the shares through the market and not through the prospectus.

Candler's Case- innocent misrepresentation, [1951]

Negligence means the breach of duty of care recognized by law which results in damage due to carelessness. There are three elements of forming negligence. First, the duty of care should be owed by one person to another. Second, there is a breach of that duty. And third, the breach of duty resulted in the damage. The duty of care will be owed when it could be possible to foresee the damages by the act or omission of the duty.²⁴

In this case, the defendant was not under any contractual agreement to pay due care to the plaintiff. The plaintiff suffered a loss due to wrong financial statements prepared by the defendant. Defendant received careless advice from the accountant and prepared the financial statement without performing due diligence and care for his employees, clients, or any third party who could use the statement for their financial use. Court held that there was no contractual as well as a duty imposed to care for the plaintiff.

Hedley Byrne & Co Ltd v Heller & Partners, [1963]²⁵

In this case, the special relationship was explained between the parties. The plaintiff took expert advice from the defendant creating a special relationship between the plaintiff and defendant, because the defendant knew that their advice would be used for financial purposes, there exists a duty of care towards the plaintiffs in case of any negligence and financial loss. The defendant, aware of the depth of the situation, added an exclusion clause in the statement of their advice that any damages caused by the plaintiff would be solely responsible for it. The court held that due to the exclusion clause the damages could not be borne from the defendant even though the duty of care was there by the defendant, the plaintiff took the advice voluntarily even after reading the exclusion clause.

²⁴ All Answers ltd (n 23)

²⁵ Edeh Samuel Chukwuemeka ACMC, 'Hedley Byrne v Heller: Facts, Issues and Judgment of Court' (*bscholarly.com*, 11 August 2021) <<https://bscholarly.com/hedley-byrne-v-heller/>> accessed 23 September 2022

Taksheel solution limited, [2013]²⁶

Taksheel Solution Ltd was incorporated in 1999, it is an IT Solution Company engaged in the business of providing services and products to the Information Technology & Telecom, and financial services industry.²⁷ It was found by SEBI that Taksheel Solutions ltd. had hidden vital information about the Red Herring Prospectus as there were vital pieces of important information missing. It was found that various misstatements were made by Taksheel in their Red Herring Prospectus, which failed to disclose the vital facts to the public. Untrue statements and inaccurate data in electronic media were also found in the shares of the company on its opening day of subscription. SEBI, the Securities and Exchange Board of India, put restrictions on the promoters, and directors from trading in the markets. Board also declared that it is the duty of the company to make a full entry in the prospectus about the details of the company and relevant information asked in section 26 of the company law act.

Inventure Growth & Securities, [2019]

It was found by SEBI the Securities and Exchange Board of India that Inventure Growth and Securities Ltd. initiated IPO proceeds that were not utilized as per the objects mentioned in the prospectus. The long-term working capital augmentation was not done and by using the IPO proceeds certain shares were purchased. IFPL increased its lending against the unsecured loan, gold, etc. thus mis-utilizing the IPO proceeds, bridge loan was raised from some parties which were later on repaid and security deposits were accepted without disclosing the same as required in the prospectus. The penalty imposed on Inventure Growth and Securities Ltd. was seventy lakhs on the company, fifteen lakhs on directors in control, five lakhs on other directors, and three lakhs on independent directors.

Birla Pacific Medspa Ltd, [2020]²⁸

SEBI found that the misstatements were made by the company in its prospectus regarding its objectives at its IPO. The money was raised to utilise in the setting up of Evolve Med Spa

²⁶ SEBI, 'Adjudication Order in respect of Taksheel Solution' (*casemine.com*, 10 August 2021) <<https://www.casemine.com/judgement/in/611385fd342cca25938bd251>> accessed 23 September 2022

²⁷ 'Sebi bans Taksheel Solutions, others from mkts for 3 years' (*Economic Times*, 16 November 2017) <<https://cfo.economicstimes.indiatimes.com/news/sebi-bans-taksheel-solutions-others-from-mkts-for-3-years/61675968>> accessed 23 September 2022

²⁸ 'SEBI bans Birla Pacific Medspa, Yashovardhan Birla, 8 others from securities markets for 2 years' (*Money Control*, 26 October 2020) <<https://www.moneycontrol.com/news/business/markets/sebi-bans-birla-pacific-medspa-yashovardhan-birla-8-others-from-securities-mkts-for-2-yrs-6016251.html>> accessed 23 September 2022

centers, the SEBI has found that the money was not used for Medspa, instead, money was deployed as interstate corporate deposits, and 60% of them was not returned to the company. It was not disclosed in the prospectus that the IPO fund will be used in ICD to group companies. SEBI declared that the interim use of funds and objects of issue were untrue on material facts and misleading. Hence, SEBI barred the company and prospectus signatories from accessing the securities market and making any transactions for two years.

CONCLUSION

Misrepresentation in the prospectus is not defined in the company law act. It can be understood that any misleading or untrue information presented in context or form which is included or any relevant information which is omitted from the prospectus could mean as misleading. Sec²⁹34 of the companies act has criminal liability punishment for misstatement, S.447 of fraud for six months to ten years imprisonment or three times the fine of the amount involved in the fraud. S.35 has a punishment for civil liability, S.36 has a punishment of compensation, S.37 for filing a suit, and a class action suit can also be filed against the alleged company.



²⁹ Sudipto Dey, 'Any misrepresentation in prospectus is treated as fraud' (*Business Standard*, 19 October 2014) <https://www.business-standard.com/article/opinion/any-misrepresentation-in-prospectus-is-treated-as-fraud-114101900724_1.html#:~:text=To%20start%20with%2C%20there%20is%20no%20specific%20definition,mislead%2C%20said%20a%20corporate%20lawyer%2C%20quoting%20the%20Act> accessed 24 September 2022