Chapter 2

Securities Market
An Overview

Securities market in India consists of primary and the secondary market. The primary market deals with the new securities i.e. the securities, which were not previously available to the investing public. This means the securities that are offered to the investing public for the first time.

As such primary market deals with the raising of fresh capital either for cash or for consideration other than cash by companies, government, semi-government bodies and public sector undertakings (PSUs) etc. There are various forms in which these claims are incurred i.e. equity shares, preference shares, debentures, rights issues, bonus issues, deposits, miscellaneous loans etc. All the financial institutions in the capital market, which contribute, underwrite or directly subscribe, are part of primary market.

The recent trends of economic liberalization, privatization, foreign private participation, disinvestments in public sector and regulatory changes have provided a new impetus to the primary market.¹

In this chapter we will discuss the functions, methods of floating new issues, players in the new issue market, legal provisions and judicial pronouncements in this regard.

¹ E Gorden, K Natraj - Capital Market In India, 1st Edition 1999, P. 86
A. Functions of Primary Market

The primary market performs very important functions. It plays an important role in the economic growth of the country. The main function of the primary market is to facilitate transfer of resources from savers to the users means the actual utilization of the savings for the purpose of economic growth of the country. The savers may be individuals; commercial banks, insurance companies etc. and the users are public limited companies and the government, as the private companies are prohibited from inviting public to subscribe to its share capital or debentures. The primary market plays an important role of mobilizing the funds from the savers and transfers these funds to the borrowers for the purpose of production i.e. an important requirement of economic growth. In this way the primary market is a platform for raising finance to establish new enterprises, expansion, diversification, modernizations of existing units etc. On the basis of this the primary market can be classified as:

- the markets where firms go to the public for the first time through initial public offering (IPO), and
- the markets where firms, which are already, trade raise additional capital through seasoned equity offering (SEO).

The following are the main functions of the primary market:

(a) Origination,

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(b) Underwriting, and
(c) Distribution.

(a) Origination

Origination refers to the work of investigation, analysis, and processing of new project proposals. Origination starts before an issue is actually floated in the market. This work includes two aspects that is a careful study of the technical, economic and financial viability to ensure soundness of the project. This is a preliminary investigation undertaken by the sponsors of the issue and the advisory services, which improve the quality of capital issues and ensure its success.

The advisory services include type of issue that refers to the kind of securities to be issued whether equity shares, preference shares, debentures or convertible debentures. The advisory services also include magnitude of the issue, price of an issue i.e. whether shares are to be issued at par or at premium, methods of issue and technique of selling the securities.

The function of origination is done by merchant bankers who may be commercial banks, all India financial institutions or private firms.

Initially, these services were provided by specialised division of commercial banks. At present financial institutions and private firms also perform this service. In spite of all these the work of origination itself does not guarantee the success of the issue. The success of the issue mostly depends on
the efficiency of the market and the performance of the companies. Due to this
the underwriting, a specialized service is required in this regard.

(b) Underwriting

Underwriting is an agreement whereby the underwriter promises to
subscribe to a specified number of shares or debentures or a specified amount
of stock in case the public not subscribing to the issue. SEBI Rules\(^3\) defined
underwriting as "an agreement with or without condition 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." 
Palmer\(^4\) has explained underwriting as an expression used in company matters
signifying 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 proportions 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 proportions thereof. In its
simple form underwriting consists of undertaking given by some persons or
institutions engaged in the business of underwriting. By that undertaking they
promise that if the public fails to take up the issue or to subscribe the issue then
they will take up the un-subscribed part of the issue. For this undertaking the

\(^3\) Rule 2 (g) of SEBI (underwriters) Rules, 1993
\(^4\) Company Precedents, part I, 17\(^{th}\) Edition p. 175
company agrees to pay the underwriter a commission on all shares or debentures whether they were taken by public or underwriters.

In relation to an offer of securities, an underwriting agreement is a contract by which person called an underwriter agrees to take any shares that are not taken by the persons to whom the offer is made.\(^5\)

Therefore, if the issue is fully subscribed then there is no liability for the underwriters. If a part of shares issued remain unsold, the underwriter will buy the shares. In this way underwriting is a guarantee for the marketability of shares.

This agreement of underwriting may take any of the three forms...

**Standing behind the issue** - This is a method under which the underwriter guarantees the sale of a specified number of shares within a specified period. If that specified numbers of shares are not subscribed by the public then the underwriters have to buy the balance in the issue. That means the underwriters stands behind the public. Their liability arises if the public does not subscribe in the specific period for the specific number of shares.

**Outright purchase** - Under this method the underwriters make outright purchase of shares and then resell them to investors.\(^6\)

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\(^6\) Supra note 1 at page 76
Consortium - Under this method the underwriting is done jointly by a group of underwriters. The underwriters form syndicate for this purpose. This is a method, which is adopted for large issues.

Is underwriting mandatory in public issues - As per SEBI guidelines of June 1992 it was mandatory for the full issue however, SEBI revised its Guidelines by Press Release dated 10.10.1994 making it optional for the issuers to have a public issue underwritten by the underwriter.

At present the underwriting is of great significance. The issuing company has various advantages from the underwriters. By underwriting the issuing company is relieved from the risk of finding buyers for the issue offered to the public. The underwriters provide expert advise with regard to timing of security issue, the pricing of issue, the size and type of securities to be issued etc. Moreover, if the issue is underwritten by reputed underwriters then the public confidence in issue enhances. The underwriters also undertake the burden of highly specialised function of distributing securities.

The underwriters may be of two categories:

- Institutional underwriters, and

- Non-Institutional.

The institutional underwriters are: Life Insurance Corporation of India (LIC) Industrial Development Bank of India (IDBI) Unit Trust of India (UTI)

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1 Clause 8.11.1 of SEBI (DIP) Guidelines, 2000
Industrial Credit and Investment Corporation of India (ICICI), Commercial Banks, General Insurance Company etc.

The non-institutional underwriters are brokers. The brokers guarantee shares only with a view to earn commission from the company. Thus all the financial institutions in the capital market, which contribute, underwrite or directly subscribe, are part of the primary market.

(c) Distribution

Distribution is the function of sale of securities to ultimate investors. Brokers and agents who maintain regular and direct contact with the ultimate investors perform this service.

B. Methods of Floating New Issues

There are four methods, which are used in the floatation of securities in the primary market. These methods are as follows:

(a) Offer for sale

(b) Private placement

(c) Rights issues

(d) Public issues

(a) Offer for Sale

This is a method of offer for sale that consists outright sale of securities through the intermediary of issue houses or share brokers. That means the
shares are not offered to the public directly. There are two stages of this method. The first stage is a direct sale by the issuing company to the issue house and brokers at an agreed price. In the second stage the intermediaries resell the above securities to the ultimate investors. Under this method the issue house or stockbrokers purchase the securities at a negotiated price and resell at a higher price. The difference in the purchase and sale price is called turn or spread.

Therefore, under this arrangement, the company allots or agrees to allot shares or debentures at a price to a financial institution or issue house for sale to the public. Later on the issue house publishes a document called an offer for sale, with an application form attached, offering to the public shares, debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be prospectus.\(^8\)

The advantage of this method is that the company is relieved from the problem of pricing and advertisement of prospectus and making allotment of shares. But this method of offer of sale is not very common in India. This method is generally used in two instances:

- Offer by a foreign company of a part of it to Indian investors and
- Promoters diluting their stake to comply with requirements of stock exchange at the time of listing of shares.

\(^8\) Section 64 (1) of Indian Companies Act, 1956
(b) Private Placement of Shares

In this kind of arrangement the issue houses or brokers buy the securities outright from the issuing company. Afterwards the issue houses or brokers finds persons, normally his clients who wish to buy the shares. Here the brokers act as almost whole sellers selling them in retail to the public. In this process of reselling, the brokers make profit from the public. They act as an agent and his function is simply to procure buyer for the shares i.e. to place them. The issue house or brokers maintain their own list of clients and through customer contact sell the securities.

Since in this process no public offer is made for shares, there is no need to issue a prospectus. However, such a company is required to file with the registrar a statement in lieu of prospectus at least 3 days before making allotment of any shares or debentures.9

Private placement by a public company of its shares should not be made by subscription of shares from unrelated investors through any kind of market intermediaries. This means promoters shares should not be contributed by subscription of those shares by unrelated investors through brokers, merchant bankers etc. However, subscription of such shares by friends, relatives and associates are allowed.10

Placement has following advantages:

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9 Section 70, Ibid
10 See SEBI (DIP) Guidelines, 2000
• Timing of issue is important for successful floatation of shares. In a depressed market conditions when the issue are not likely to get public response through prospectus, private placement method is a useful method of floatation of shares.

• This method is useful or suitable when small companies issue their shares.

The main disadvantage of this method is that the securities are not widely distributed to the large section of investors. There is only a selected group of small investors who are able to buy a large number of shares and they get a majority holding in a company.

This method of private placement is used to a limited extent in India. The promoters sell the shares to their friends, relatives and well wishers to get minimum subscription, which is pre-condition for, issue of shares to public.

(c) Rights Issues

Rights issue is a method of raising funds in the market by an existing company. A right share means an option to buy certain securities at a certain privileged price within a certain specified period. Shares, so offered to the existing shareholders are called right shares.\(^{11}\)

These shares are allotted to the existing equity shareholders in proportion to their original share holding e.g. one share against every two shares held by a member. That means the rights shares are offered to the

\(^{11}\) Supra note 1
existing shareholders in a particular proportion to their existing share ownership. The ratio in which the new shares or debentures are offered to the existing share capital would depend upon the requirement of capital. These rights are themselves transferable and saleable in the market. No new company can issue rights shares. Section 81 of the Companies Act provides that where a company increases its subscribed capital by issue of new shares either after two years of its formation or after one year of the first issue of shares whichever is earlier, these have to be first offered to the existing shareholders.

While issuing rights a company is required to send a circular to all existing shareholders. This circular letter should provide information on how the additional funds would be used and their effect on the earning capacity of the capital. The company should normally give a time of at least one month to two months to shareholders to exercise their right before it is offered to the public. Rights may also be offered through underwriters.

One of the conditions for issue of rights is that the shareholders be given an opportunity to apply for additional shares. Besides if the rights not fully taken up, the balance is to be equitably distributed among the applicants for additional shares. If there is any balance still left over after making such allotment is required to be disposed of by the company in the market at the selling price or the issue price.

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(d) Public Issues

Under this method, the issuing company directly offers to the general public or institution a fixed number of shares at a stated price through a document that is called prospectus. This is most common method followed by joint stock companies to raise capital through the issue of securities.

There are various advantages of this method. The sale through prospectus has the advantage of inviting a large section of the investing public through advertisement. As noted it is a direct method and no intermediaries are involved in it. Shares under this method are allotted to a large section of investors on a non-discriminatory basis. This procedure helps in wide dispersion of shares and to avoid concentration of wealth in few hands.

But this method is suitable only for large issues as it is an expensive method. The company has to incur expenses on printing prospectus, advertisement, banks commission, underwriting commission, legal charges, stamp duty, listing fee, registration charges etc. Prospectus is one of the major sources of information. A prospectus is the primary document that offers information about the company to potential investors about the investment proposal. It is the companies offer to sell its securities on the basis of the information provided in the prospectus. About the legal position, Lord kindersely in New Brunswick etc co. Vs Muggeride\textsuperscript{13} has stated as follows "those who issue a prospectus holding out to the public great advantages which

\textsuperscript{13} (1860) 1 Dr. 8 Smn. 363/30 L.J.Ch.242
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 effects the nature or extent or quality of the privileges and advantages which the prospectus holds out as inducements to take shares.”

Indian Companies Act requires that an application form for subscription of shares or debentures of a company must be accompanied by a prospectus or an abridged prospectus containing the salient features of the prospectus.

SEBI has also laid down the format and contents of the detailed as well as abridged prospectus for companies making public issues.

However, the law is rarely followed in letter and spirit. The companies generally circulate a brochure cum-application form, which present selective information to investors. In such brochures cum-applications there is always a warning that “this is neither a prospectus nor an invitation to subscribe to the company’s issues”, but still investors take decision on the information contained therein and the company in this way relieves from all the liabilities.

The prospectus would contains details with regard to the name of the company, address, activities, board of directors, location of industry,

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14 Section 56 of Indian Companies Act, 1956
15 Corporate Law Advisor, May 1993, Section II, P.20
authorized, subscribed and paid up capital, dates of opening and closing of the subscription list, names of brokers and underwriters etc. The draft of the prospectus should be approved by the Board, solicitors, lending financial institutions and the stock exchanges in which they are to be listed.16

C. Players in Primary Market

The securities market disintermediates by establishing a direct relationship between the savers and the users of funds. This disintermediation, however, requires the services of various intermediaries and the reassurance that it is safe to participate in the securities market.17

There are many players in the primary market but here we will discuss some important players.

(a) Merchant Bankers

Merchant banker means any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory services in relation to issue management.18 Merchant bankers are the issue managers; lead managers, co managers and they are responsible to the company and SEBI.

Merchant Banks are issue houses rendering such services to industrial projects or corporate units as floatation of new ventures and new companies,

16 Supra note 12
18 Rule (c) of SEBI (Merchant Bankers) Rules, 1992
preparation, planning and execution of new projects, consultancy and advice in technical, financial managerial and organisational fields. There are number of other functions such as restructuring, revaluation of assets, mergers, takeovers, acquisitions etc. which are also undertaken by the merchant bankers.

A major function of merchant banking is the issue management. Now the question arises what is the issue management?

The issue management involves the following functions in respect of issue through prospectus.

- Obtaining approval for the issue from SEBI.

- Arranging underwriters for the proposed issue. At the time of arrangement of underwriters lead merchant bankers must satisfy themselves about the ability of the underwriters regarding the discharge of their underwriting obligations. It is also a duty of the merchant bankers to incorporate a statement in the offer document to the effect that in their opinion the underwriter’s assets are adequate to meet underwriting obligations.

- Drafting and finalizing of the prospectus and obtaining its clearances from the underwriters, stock exchanges, auditors, solicitous, registrar of companies and other necessary consents required for filling of the prospectus.

\(^{19}\) Clause 5.5.1. Of SEBI Guidelines 2000

\(^{20}\) Clause 5.5.2, Ibid
• Drafting and finalization of other documents such as application forms, newspaper announcements of the prospectus material and application to the stock exchanges.

• Selection of the registrar to the issue, printing press, advertising agencies, underwriters, brokers and bankers to the issue and finalization of the fee and charges to be paid to them.

• Arranging through the advertising agency the press, brokers and investors conferences.

• Coordinating the printing, publicity and advertisements relating to the issue and work of the registrars to the issue, the receipt and processing of application and preparation of the basis of allotment negotiation of the same with the stock exchanges and preparation of the registrar of allotment.

Thus, the main function of merchant banks would appear to be sharing risks with the company, particularly for unquoted companies, either in terms of equity or some other basis and then help the development of the company. This role of helping the company to grow through new ideas will promote the corporate sector in a healthy fashion. Merchant banks also lend its name to the company, which is an asset, particularly, for small firms to raise funds in the market. By lending the name for placing issues on the market, the merchant bank helps the company in reducing the costs of floatation and financing the projects. Therefore the merchant bankers play an important role in this regard.
The lead merchant banker who is responsible for verification of the contents of prospectus or letter of offer in respect of an issue and reasonableness of views expressed therein, will submit to SEBI at least two weeks prior to the opening of issue for subscription, a due diligence certificate to the effect that:

they have examined various documents and other material relevant for adequate disclosures to the investors and on the basis of such examination and the discussion with the company, its directors and other officers, other agencies, independent verification of the statements concerning objects of the issue, the contents of the documents and other material furnished by the company, they conform that the draft prospectus or letter of document forwarded to SEBI is in conformity with the documents, material and papers relevant to issue, all the legal requirements connected with the issue have been duly complied with and the disclosures made in the draft prospectus or letter of offer are true, fair and adequate to enable the investors to make well informed decision as to the investment in the proposed issue.

Thus, the merchant banker verifies the facts stated in the prospectus or in offer document and also gives his compliance report that all the legal requirements related to the issue of securities have been complied with. Accordingly one of the main functions of the merchant banker is to check that the issue of securities, particularly prospectus or letter of offer is in conformity of laws related to the issue.

Regulation 23 of SEBI (Merchant Bankers) Regulations 1992
Now see the impracticability of SEBI regulations, which provide that merchant banker will appoint a compliance officer who will monitor the compliance of the Act, rules and regulations, guidelines, notification etc. and also to ensure that the observations made or deficiencies pointed out by SEBI in the draft prospectus or letter of offer will not recur. The compliance officer will immediately and independently report to SEBI any non-compliance observed by him.22

Accordingly, it is the duty of merchant banker to verify the contents of the prospectus and offer document and check the compliance of legal requirements related to the issue however, the compliance officer will report to SEBI that all the instructions or deficiencies given or pointed out by SEBI regarding prospectus of letter of offer will not occur again. Hence, two persons have been entrusted almost similar task. This assurance should be given by merchant banker and there is no need to appoint compliance officer. Moreover, it is not feasible that the compliance officer appointed by merchant banker will report against him.

(i) Irregularities in working of merchant bankers

SEBI has inspected the merchant bankers; this inspection of merchant bankers has exposed blatant false hoods in issue prospectuses regarding status of project and financials. The inspection report also shows how promoters and merchant bankers colluded to push through public issues. SEBI inspected 24

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22 Regulation 28A of SEBI (Merchant Banker) 1992 inserted by SEBI (investment Advice by Intermediaries (Amendment) Reg. 2001 w.e.f. 29.5.2001
merchant bankers, of which inspection reports of 12 merchant bankers have been processed. These 12 merchant bankers had managed a total of 701 public issues. The inspection team of SEBI observed the following types of major irregularities:

- Merchant bankers were found to be involved in arranging syndication of funds towards promoter’s contribution with a facility of buy back. An amount of one percent was charged as the syndication fee by merchant bankers, it is learnt.

- Even as the offer document mentioned that commercial production had commenced, the inspection team discovered that after the closure of the issue, even the land had not been leveled.

- The due diligence files contained two sets of financial statements. False claims in the prospectus stating that promoter’s contribution had been brought in.

- In certain cases the merchant bankers willfully tried to suppress material information regarding pending litigations against them.

- The objects clause stated in the offer document was different from that stated in the memorandum and article of association.

- The inspection report revealed that the merchant bankers did not make any effort to know the promoters background, both business and financial, before accepting the assignment.
• Merchant bankers did not verify or insist for supporting documents, allowing various statements in the offer document even in cases where the project were not appraised and the promoters did not have any experience in the business.

• Related party transactions were not disclosed in the offer document, rather they were concealed on specific query from SEBI.

From the above report it is clear that the merchant bankers were not acting in the interest of investors. It is obvious that some of the merchant bankers have not been professional in the sense they have not provided protection to the investors who flocked to the public issues sponsored by them.

In June 97, SEBI issued notices of cancellation and suspension of licenses against 134 outfits of merchant bankers for defaults in honoring underwriting commitments in public issue. Out of these 134, bankers 95 were category I merchant bankers. These included Allianz capital, Dugar Finance, Prudential Capital, Mefeom Capital, Hindustan Financial Management, Bank of Madura, Damania Capital Markets and Karvy.

In the list of 134, nine banks also figured and these included Bank of Madura, Dena Bank, PNB Caps, State Bank of Bikaner and Jaipur State Bank of Hyderabad, Catholic Syrain Bank, Nedungadi Bank, South Indian Bank and Vysya Bank. SEBI has issued notices for cancellation of merchant banking licenses since it felt that such defaults constituted a threat to the integrity of the
market. These outfits had taken underwriting commitments and after the issues devolved did not honour their commitments.\(^{23}\)

SEBI's move was an attempt to clear up the merchant banking industry to protect the integrity of the capital markets. Subsequently, SEBI also debarred 64 merchant bankers from undertaking any fresh merchant banking activity, which included top rung outfits like Escorts Finance, Videocon Leasing, State Bank of Patiala and Industrial Investment Bank of India.

Turning the heat on unscrupulous merchant bankers, SEBI has decided to incorporate a new disclosure norm in the public issue offer documents on the background of intermediaries. The provision will incorporate information on merchant bankers, such as penalties levied by SEBI for non-compliances with regulations or defaults, investigations conducted against the intermediaries and suspension cancellation notices issued against it.

These new norms will curb malpractices by merchant bankers by acting as deterrent, as any violation by them would be made public at a later stage thereby jeopardizing their reputation and business prospectus.

Recently, SEBI has amended its Merchant Bankers Regulations 1992 these amended regulations called SEBI (Merchant Bankers) (Amendment) Regulation 2003 which has prescribed a code of conduct for the merchant bankers.

(b) Registrar to an Issue

Registrar to an issue means a person appointed by company to carry activities of collecting applications from investors in respect of issue, keeping a proper record of applications and monies received from investors and to assist his client in determining the basis of allotment of securities in consultation with stock exchanges. He will also assist the company in finalizing the list of persons entitled for allotment of securities and in processing and dispatching allotment letters, refund orders and other related documents in respect of issue.24

Registrars are an important category of intermediaries who undertake all activities connected with new issue managements. The company in consultation with the merchant bankers to the issue appoint to the registrar. Registrars also have a major role in respect of servicing of investors.

Here we will discuss the role of registrar in the pre-issue, during the currency of issue, pre allotment, allotment and post allotment work.

During pre issue the registrar to an issue suggest draft application form to the merchant bankers. Registrar to an issue helps in identifying the collection centers for collection of application money. It is very difficult task. The choice of collection center and of collecting banker is critical to the success of the issue. Registrar assists in opening collection accounts with banks and lay down procedure for operation of these accounts. The instructions are send by him to

24 See SEBI (Registrar to an Issue, Share Transfer Agents) Rules, 1993
collecting branches, for collection of application along with cheques, drafts, stock invest separately and remittance of funds.

During the currency of issue the registrar to an issue receives the collection figures everyday. He keeps the merchant bankers and the company informed of the progress of total subscriptions. Registrar informs the stock exchange about the closure of issue.

The registrar of issues during pre-allotment work gets all the application forms from the collecting bankers and sort out valid and invalid application forms. The valid applications are to be categorized and grouped as cash, draft and stock invest application. Then he reclassifies the valid applications eligible for allotment. He prepares the list with inverted numbers and then approach to the regional stock exchange for finalizing the basis of allotment, in the event of over subscription.

Registrar finalises the allotment as per the basis approved by the stock exchange. He tallies the final list approved for allotment and rejection with the in house control numbers and corrects mistake if any.

During post allotment works the registrar to an issue gets the letters of allotment and refunds orders printed ready for dispatch. The registrar submits all statements to the company for final approval. He arranges to pay the brokerage and underwriting commission and submit their relevant statements. Registrar assists the company in getting the allotted shares listed on the stock exchange.
(i) Qualification for Registrar to an Issue

To be appointed as registrar to the issue, registration with SEBI is essential. The criteria adopted by SEBI for registration are the competency and expertise, quality of manpower, their track record, adequacy of infrastructure such as computers, storage space and capital adequacy etc. SEBI has also laid down a code of conduct for their observance.

(c) Collecting and Coordinating Bankers

Collecting bankers collect the subscription in cash, cheques, stock invest etc. Coordinating bankers collect information on subscription and coordinate the collection work. They monitor the work and keep inform them to the registrars and merchant bankers. Collecting and coordinating bankers may be the same bank or different banks.

(d) Underwriters and Brokers

Underwriter has been defined by SEBI Rules as “a person who engages in the business of underwriting of an issue of securities of a body corporate.” Underwriting has already been explained. The word person in the definition includes natural as well as artificial persons but nowhere it has been explained by SEBI. A person cannot involve in the business of underwriting unless he has a certificate. The certificate will be granted by SEBI if the person

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25 SEBI (DIP) Guidelines, 2000
26 Rule 2 (f) of SEBI (Underwriters) Rules, 1993
fulfills requirements laid down under the regulations. SEBI while granting the certificate will consider various matters including the infrastructure, past experience, capital adequacy etc.

Broker is an agent who in the ordinary course of business negotiates and makes contracts for the sale and purchase of goods (securities) and other property not in his possession or control. Brokers along with the net work of sub-brokers market the new issue. They send their own circulars and applications to the clients and do follow up work to market the securities.

(e) Printers and advertising agencies

Printers, advertising agencies, mailing agencies are other organizations involved in the new issue market operations.

(f) Code of Conduct for Market Players (Intermediaries)

SEBI has amended its regulations made for the intermediaries and prescribed a code of conduct for them. The intermediaries now have to abide the code of conduct in their business dealings. The different codes have been prescribed for each intermediary however; there are certain common principles applicable to all, which are as follows:

- The intermediaries shall maintain high standard of integrity, dignity and fairness in the conduct of their business.

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27 Regulation 6 and 7 of SEBI (Underwriters) Regulations, 1993
28 Alapati Ramamurthy Vs. Ramanujan, AIR 1961, A.P. 408
29 See Code of Conduct prescribed under different regulations for intermediaries.
- The intermediaries shall make all efforts to protect the interests of investors.

- The intermediaries shall fulfill their obligations in a prompt, ethical, and professional manner.

- The intermediaries shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment.

- The intermediaries to ensure that:
  - inquiries from investors are adequately dealt with,
  - grievances of investors are redressed in a timely and appropriate manner, and
  - where a complaint is not remedied promptly, the investor is advised of any further steps, which may be available to the investor under the regulatory system.

- The intermediaries shall ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed decision. They shall also endeavor to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risk before taking any investment decision.
- The intermediaries shall not discriminate amongst their clients, save and except on ethical and commercial considerations.

- The intermediaries shall not make any statement, either oral or written, which would misrepresent the services that they are capable of performing for any client or have rendered to any client.

- The intermediaries shall avoid conflict of interests and make adequate disclosure of their interests.

- The intermediaries shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of their business or where any conflict of interest arise, shall take reasonable steps to resolve the same in an equitable manner.

- The intermediaries shall make appropriate disclosure to the client of their possible source or potential areas of conflict of duties and interest while acting in such capacities, which would impair their ability to render fair, objective and unbiased services.

- The intermediaries shall always endeavour to render the best possible advice to the clients having regard to their needs.

- The intermediaries shall not diverge to anybody either orally or in writing, directly or indirectly, any confidential information about their clients, which has come to their knowledge, without taking prior
permission of their clients, except where such disclosures are required to be made in compliance with any law for the time being in force.

- The intermediaries shall ensure that any change in registration status/any penal action taken by the board or any material change in their financial status, which may adversely affect the interests of clients/investors are promptly informed to the clients and any business remaining outstanding are transferred to another registered intermediary in accordance with any instructions of the affected clients.

- The intermediaries shall not indulge in any unfair competition, such as weaning away the clients on assurance of higher premium, or advantageous offer price or which is likely to harm the interests of other intermediaries or investors or is likely to place such other intermediaries in a disadvantageous position while competing for or executing any assignment.

- The intermediaries shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect their operations, their clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

- The intermediaries shall not make untrue statement or suppress any material fact in any documents, reports or information furnished to the board.
The intermediaries shall maintain an appropriate level of knowledge and competence and abide by the provisions of the act, regulations made there under, circulars and guidelines, which may be applicable, and relevant to the activities carried on by them. The intermediaries shall also comply with the award passed by Ombudsman.  

The intermediaries shall ensure that the board is promptly informed about any action, legal proceedings etc, initiated against them in respect of material breach or non-compliances by them, of any law, rules, regulations, directives of the board or of any other regulatory body.

The intermediaries or any of their employees shall not render, directly or directly, any investment advice about any security in any publicly accessible media, whether real-time or non real-time, unless a disclosure of their interest including a long or short position, in the said security has been made, while tendering such advice.

In the event of intermediary’s employees rendering such advice, the intermediaries shall ensure that such employees shall also disclose the interests, if any, of themselves, their dependent family members and the employer intermediaries, including their long or short position in the said security, while rendering such advice.

Award passed under SEBI (Ombudsman) Regulations, 2003
• The intermediaries shall provide adequate freedom and powers to their compliance officer for the effective discharge of the compliance officer's duties.

• The intermediaries shall develop their own internal code of conduct for governing their internal operations and laying down their standards of appropriate conducts for their employees and officers in carrying out their duties. Such a code may extent to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance or resolution of conflict of interests, disclosure of shareholdings and interest etc.

• The intermediaries shall ensure that good corporate policies and corporate governances are in place.

• The intermediaries shall ensure that any person they employ or appoint to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed.

• The intermediaries shall ensure that they have adequate resources to supervise diligently persons employed or appointed by them in the conduct of their business, in respect of dealings in securities market.

• The intermediaries shall be responsible for the acts or omission of their employees and agents in respect of the conduct of their business.

• The intermediaries shall not be a party to or instrumental for:
- creation of false market,
- price rigging or manipulation, or
- passing of unpublished price sensitive information in respect of securities, which are listed and proposed to be listed in any stock to any person or intermediary in the securities market.

D. Public Issue of Shares

This takes place when a company directly offers its own shares to the public. As we have mentioned earlier that a private company is prohibited from inviting public to subscribe to its share capital or debentures. Those who buy shares are known as subscribers. However a public company limited by shares generally issues shares to the public. For this purpose it has to issue a prospectus. Where a company issues a prospectus it has to follow a prescribed procedure, which is as follows:

After the certificate of incorporation is obtained by the public company the affairs of public company are taken over by the first directors in accordance with the provisions of law. The directors so appointed generally elect one of their members as the chairman of Board of Directors if none is named in the article of association. The Board attends to the following matters:

- Appointment of various expert agencies such as bankers, auditors, secretary etc.

31 See SEBI's regulations for intermediaries.
• Entering into underwriting contract and brokerage contract etc.

• Making arrangement for the listing of shares on stock exchange.

• Drafting of a prospectus for the purpose of issue to the public.

The appointment of a banker is necessary for the collection of the share application. The banker has to receive the share application along with application money.

The appointment of first auditor is primarily in the hands of board of directors. It becomes necessary to make the appointment of auditor or auditors before the issue of prospectus because they have to give their report on financial position of the company in the prospectus.  

The Companies Act makes it a requirement that the first auditor or auditors of a company shall be appointed by the board of directors within one month of the registration of the company.  

The appointment of a whole time secretary is obligatory in the case of companies having prescribed paid up share capital.

The board by directors enters into an underwriting contract with underwriters. Underwriting contract is a contract in which some person or persons engaged in the business of underwriting gives an undertaking to the company that in case the public fail to take up the issue, he or they will take up

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32 Schedule II of the Indian Companies Act, 1956
33 Section 224(5), Ibid
34 Substituted for "having a paid up share capital of Rs. 25 lakhs or more" by the Companies (Amendment) Act 1988 w.e.f. 1.12.1988. Rule 2(1) of the Companies (Appointment & Qualification of Secretaries) Rules 1988 lays down that with effect from 11.6.2002 every company having paid up share capital of Rs. 2 crore and above shall have a whole time secretary.
the un-subscribed part of the issue. In return to this undertaking given by the underwriters the company agrees to pay the commission to them on all shares or debentures whether they were taken up by the public or by the underwriters.

In addition to underwriting contract a company may also enter into a brokerage contract with brokers. Under that contract a broker undertakes to ‘place’ shares that means the broker find persons who will buy shares. But in case he fails to place any of the shares he is not personally liable to take them. For this work the brokers are paid agreed brokerage but they are not entitled to any brokerage in respect of shares not placed.

Shares of public company may be sold or purchased on the stock exchange but for this purpose the shares of the company must be listed on a stock exchange or exchanges. Listing means admission of shares of a company to trading on the stock exchange. We will discuss the procedure and requirements for listing in next chapter.

Under Companies Act it is necessary for every public company, before issuing shares or debentures for public subscription by issue of prospectus, to make an applications for listing the securities in one or more recognized stock exchanges. The information that permission has been obtained from the stock exchanges or that an application for getting permission has been made or will be made, shall be mentioned in the prospectus.

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35 Section 73 of the Indian Companies Act 1956
36 For contents of prospectus see Schedule II to the Indian Copanies Act 1956 and SEBI (DIP) Guidelines 2000
(a) Statutory Requirements in Relation to Prospectus

(i) 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. That means the date of publication of the prospectus must be contrasted with the date of issue of prospectus. The date, which appears on the prospectus, will be assumed to be the date of publication of the prospectus and not necessarily to date of its issue. The date of issue is that date on which the prospectus first appeared in advertisement or is sent for circulation.

(ii) Registration of Prospectus

Section 60 of the Companies Act 1956 provides that the prospectus should be registered with registrar. In brief it requires:

- That prospectus shall not be issued by or on behalf of a company or in relation to an intended company unless the same has been delivered to the registrar for registration on or before the date of its publication, having been signed by all persons named therein as directors or proposed directors of the company. In alternative, it may be signed by his agent if authorized in writing.

37 Section 55 of the Indian Companies Act 1956
• The prospectus so delivered shall have endorsed on it or statements are attached to it in respect of (a) any consent to the issue of the prospectus as required by section 58 from any person as an expert. (b) a copy of every contract required to be specified in the prospectus by virtue of clause 16 of schedule II to the Companies Act 1956, or in the case of contract not reduced into writing, a memorandum setting out full particulars of the contract and (c) adjustments made in the financial statements required to be included in the prospectus in terms of clause 20^38 of part II of schedule II duly signed by person or persons making the report thereon, with reasons unless the reasons have been included while making the adjustments in the financial statements or while indicating in the report by way of note the adjustments considered necessary.

• Every prospectus shall on the face of it state that a copy of the prospectus has been delivered to the registrar for registration.

• Specification of documents required to be attached to or endorsed on the prospectus or refers to statements included in the prospectus, which specify those documents.

A copy of prospectus shall also be delivered to SEBI ^39. Recently under Companies (Amendment) Bill 2003 it is proposed that a copy of prospectus will have to be filed with SEBI also under section 60 (4) so now legal backing

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^38 Section 60, however continues to refer to earlier Clause 32 of Schedule II that deals with adjustments.

^39 See SEBI (DIP) Guidelines 2000
to this is proposed to be given. At present this is being done as per SEBI guidelines.

(iii) When registrar shall refuse registration of a prospectus

The registrar shall not register a prospectus if the following statutory requirements are not complied in the prospectus filed with the registrar:

- If it is not dated
- It does not comply with the requirements of Section 56 as to the matters and reports to be set out in accordance to Schedule II.
- It contains reports or statements of experts engaged or interested in the formation or promotion or management of the company.
- It includes statements purported to be made by an expert without statement that he has given and has not withdrawn his consent to the manner of its inclusion therein.
- A copy of prospectus delivered to the registrar is not signed by every person who is named therein as a director or proposed director of the company or by his agent authorized in writing and contains his consent to the issue of the prospectus and is not accompanied by a copy of the documents mentioned in section 60.

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40 Section 60 (3) of Indian Companies Act 1956
41 Section 55, Ibid
42 Section 57, Ibid
43 Section 58, Ibid
• If it is not accompanied by the consent in writing of the auditor, legal adviser, attorney, solicitor, issue house, banker, and managers to the issue, or broker, if named in the prospectus, to act in the respective capacity\textsuperscript{44}.

A prospectus shall not be issued after ninety days from the date on which a copy of it was duly delivered to the registrar complying with all the provisions of law. If a prospectus is issued after the lapse of ninety days it will be considered as a prospectus, a copy of which has not been delivered to the registrar. If the statutory requirement as to delivery of the copy of prospectus has not been complied or prospectus is issue without complying the provisions of law it will attract penalty on every person who is knowingly a party to such delivery or issue by way of fine which may extend to fifty\textsuperscript{45} thousand rupees.

(b) SEBI Guidelines for Issue of Shares

• The company before making the issue of securities has to file draft prospectus with SEBI at least 21 days prior to the filing of prospectus with ROCs. SEBI may suggest changes in the draft prospectus if it needs\textsuperscript{46}.

• As explained, Companies Act provides for compulsory listing of shares before their issue. The Guidelines also provides for listing of securities in stock

\textsuperscript{44} Section 60 (3), \textit{Ibid}
\textsuperscript{45} Substituted for “five” by the Companies (Amendment) Act 2000 w.e.f. 13.12.2000
\textsuperscript{46} Clause 2.1.1
exchange. It provides that the company will not make any public issue unless it has made an application for listing of those securities in the stock exchange.\footnote{Clause 2.1.4}

- The companies must have entered into an agreement with depository for dematerialisation of securities proposed to be issued to the public.\footnote{Clause 2.1.5.1}

- The promoters will participate in the public issues by listed companies, either to the extent of 20% of the proposed issue or ensure post issue shareholding to the extent of 20% of the post issue capital.\footnote{Clause 4.3.1} The entire contribution of the promoters must be bought one day prior to the issue of opening date.\footnote{Clause 4.9.1} No minimum promoter's contribution will be required in case of a 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.\footnote{Clause 4.10.1}

- The appointment of lead merchant banker is compulsory prior to the issue of securities to public. The company will not make an issue of security through public or rights issue unless a MOU has been entered into between the lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.\footnote{Clause 5.3.1}
- Subscription list for public issues will be kept open for at least 3 working days and not more than 10 working days. It should be disclosed in the prospectus.

- The minimum application value in public issue will be within the range of Rs.5,000 to Rs.7,000.

(c) Allotment of Shares and Statutory Provisions in this Regard

The term “allotment” is not defined under Companies Act 1956. It was explained by judiciary in various matters. What is termed ‘allotment’ is generally neither more nor less than the acceptance by the company of the offer to take shares. Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment.

The allotment of shares should be made by proper authority, i.e. the Board of Directors of the company or a committee authorized to allot shares on behalf of the Board. An allotment made without proper authority will be invalid. A valid allotment can not be made on an oral request. For becoming a member, a person should agree in writing. Therefore, allotment can not be made without a written application for allotments. Allotment of shares should not be made in contravention of any law, allotments made so confer no title on the allottee and it would be invalid and void. Similarly if an allotment of

53 Clause 8.1
54 Clause 8.6.1
55 Chatty J in re Florence Land and Public Works Ltd (1955) 29 Ch.D.421
56 Section 41 of Indian Companies Act 1956
57 re Trans Atlantic Life Assurance Company Ltd (1979) 3 All E.R. 352
shares made for any improper motive is bad and can be struck down. Allotment of shares must be made within a reasonable time, otherwise, the application lapses. What is a reasonable time is a matter of fact in each case. It is not fixed. The interval of about six months between application and allotment has been held to be not reasonable.

Some general principles of Indian Contract Act 1872 will also be applicable in this regard. Such as if shares are allotted on the application of minor the allotment will be void.

Section 6 of Contract Act becomes applicable and the applications for allotment of shares must be deemed to have been revoked. In Karachi Oil Products Ltd Vs Kumar Shree Narendrasinghji it was held that an allotment made after almost a year after the date of application was ineffective. In this case, an application for shares was made on 11-7-1941 and allotment was made on 15-6-1942. The court observed that an allotment to be valid should be made within reasonable time and the applicant is not bound to accept the allotment if made after the lapse of a reasonable time.

But in case there is an unreasonable delay in allotment of shares and shares are accepted by applicant and are not repudiated by applicant then he

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58 Unit Trust of India Vs Om Prakash Berlia (1983) 54, Comp. Cases 723 (Bom.)
59 Ramsgate Victoria Hotel Com Vs Montefiore (1866) L.R.I. Ex 109
60 See Indian Contract Act 1872
61 (1948) 18, Comp. Cases 215 (Bom.)
cannot plead that his offer has lapsed because of delay\textsuperscript{62} and the principle of estoppel will be applied in this regard.

The other important thing is that the allotment must be communicated to the applicant. In case there is no communication of allotment there would be no contract between the company and the person who makes an application to become a member. There must be the consent of the two parties. There must be acceptance of the offer by words or conduct to the knowledge of the person who made the offer. Just like in other contracts, it is also required in the case of an application for shares also.

In \textit{Universal Banking Corporation, In re}\textsuperscript{63}, one gentleman applied for the shares and remitted the application money, but he never received a certificate or a notice of allotment nor any information that shares had been allotted to him, nor was any demand made on him for remittance of the money on allotment, as was stipulated in the prospectus letter. When he enquired about the allotment, he was told that it would be looked into. However, it was recorded in the Minute Book that it has been resolved to allot shares to G. This name had already been entered in the register of shareholders. But as the company had been ordered to be wound up the question was whether G’s name had been properly put on the list of contributors. The court held that in the circumstances, it was impossible to held that any contract had been entered into or that any information of registration was given to G. Therefore, it was

\textsuperscript{62} St M.R.V.R. Murugappa Chettiar Vs Pudukottai Ceramics Ltd, (1955) 25, Comp. Cases, 78 (Mad.)

\textsuperscript{63} (1867) LR 3 CH APP 40 (CA)
not his duty to search the register, his name was to be deleted from the list of contributories.

Similarly in other case it was held that a person can not be treated as a shareholder unless a notice of allotment has been sent to him.\(^64\)

The allotment must be absolute and unconditional. Like if the applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company. Shares were allotted to him but he was not appointed the branch manager. Held that he was not bound by the allotment.\(^65\) The allotment must be made on the same terms as stated in the application.

Requirements under Companies Act must also be complied with which are briefly as follows:

- A copy of prospectus signed by every person who is named therein as a director or proposed director of the company or by his agent authorized in writing shall be duly filed with the registrar for registration on or before the date of publication.\(^66\)

- An amount payable on application on each share should not be less than 5% of the nominal amount of share.\(^67\) Now under Companies (Amendment) Bill 2003 it is proposed that application money shall not be less than 25% of nominal amount of security. However, the 25%, of

\(^{64}\) Changa Mal Vs Provincial Bank (1914) 36 I.L.R. 412 (All.)

\(^{65}\) Raman Bhai Vs. Ghasi Ram (1918) Bom. LR 595

\(^{66}\) Section 60 (1) of Indian Companies Act 1956

\(^{67}\) Circular No. 26/95, dated 5.3.95 of SEBI makes it mandatory for all investors to provide information in the Application Form about their saving/Current Bank account number with the name and address of bank to prevent fraudulent encashment of refund orders.
nominal value may be negligible amount in case of security issue at high premium therefore it should be 25% of issue price.

- A public limited company cannot make any allotment of shares unless (i) the amount stated in the prospectus as the minimum amount has been subscribed and (ii) the sum payable on application for such amount has been paid to and received by the company. These provisions of minimum subscription are applicable only to first issue of shares to public therefore the companies issuing the shares first time to the public are required to be complied with this requirement. Now it is proposed that the provisions are to be made applicable to issue of all securities. Moreover, it is proposed that interest rate and period within which minimum subscription should be received, will be as prescribed by notification. Public financial institutions are proposed to be exempted from provisions of minimum subscription.

- It is also proposed that in case minimum subscription is not received by the company, the whole amount should be refunded within 8 days. If it is not refunded within the prescribed period an interest not less than bank rate announced by RBI under section 49 of RBI Act should be paid.

- All money received by the company from applicants for shares shall be deposited in a scheduled bank until the certificate to commence business

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68 Section 69 (1) of Indian Companies Act 1956
is obtained under section 149 and in case such certificate has already been obtained, until the entire amount payable on applications of shares as minimum subscription has been received by the company.\footnote{Section 69 (4), Ibid} 

- In certain cases a statement in lieu of prospectus should be delivered to the registrar. In case a company having a share capital, which does not issue a prospectus on or with reference to its formation, or which has issued such 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 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 authorized in writing, is delivered at least before 3 days of first allotment of securities to the registrar for registration. The statement should be in prescribed form and must contain the particulars and reports set out in schedule III.\footnote{Section 70, Ibid}

Recently provisions of statement in lieu of prospectus have been proposed to be abolished and proviso to section 149(2) proposed to be inserted.\footnote{Companies (Amendment) Bill 2003} Thus a company which is not issuing security to public is not required to file a statement in lieu of prospectus. It is a good proposal as it is an unnecessary and fruitless formality.

- Where the prospectus is issued generally allotment of securities shall not be made until the beginning of the fifth day after the date on which the
prospectus is issued or such later date as may be specified in the prospectus. This date is known as the date of opening of the subscription date.\textsuperscript{72} This date can not be fixed before the 5\textsuperscript{th} day of issue of prospectus.

- Companies Act is silent as to the time for which the subscription list must be kept open. In this regards SEBI Guidelines issued on 11-6-1992 provide that the subscription list for public issue must be kept open for at least 3 working days and not more than 10 working days.

In case of rights issue, it shall remain open at least 30 days and not more than 60 days.\textsuperscript{73}

- Every company intending to offer shares, debentures to the public for subscription by the issue of prospectus shall, before such issue, make an application to one or more recognized stock exchanges for permission for the shares or debentures intended to be so offered to be dealt on the stock exchange or each such stock exchange.\textsuperscript{74}

Where a prospectus, whether issued generally or not states that an application has been made for permission for the shares or debentures offered thereby to be dealt on one or more recognized stock exchanges, the allotment made under such prospectus shall be void if the permission has not been

\textsuperscript{72} Section 72 of Indian Companies Act 1956
\textsuperscript{73} Clause 8.8.2.1 of SEBI (DIP) Guidelines 2000
\textsuperscript{74} Section 73 of Indian Companies Act 1956
granted by the stock exchange or each stock exchange, as the case may be, before the expiry of 10 weeks from the date of closing of the subscription list.

If the permission is not granted by each or everyone of all stock exchanges named in the prospectus for listing of shares to which application is made by the company, the consequences by virtue of section 73 (1A) is to render the entire allotment void and the grant of permission by one or more of them is inconsequential.75

However, where an appeal is preferred against the decision of the stock exchange, the allotment shall not be void till the disposal of the appeal.

(i) Effect of Irregular Allotment

Allotment made in contravention of the provisions of the Companies Act is termed as “irregular allotment”. Effect of irregular allotment depends upon the nature of irregularity involved. These may be noted as follows:

- If a allotment has been made without delivering a copy of prospectus along with other specified documents either before or on the date of its issue to the registrar, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extent to Rs.50,000.76 However, in such case allotment of securities will be valid.

In case allotment is made in contravention of section 69 and section 70 of the Companies Act that means if allotment is made without raising minimum subscription or without either collecting application money or collecting less than 5% as application money or failure to deliver a copy of statement in lieu of prospectus before at least 3 days the following consequences shall follow:

- The allotment is rendered voidable at the option of the applicant. However the option must be exercised (a) within two months after the holding of the statutory meeting of the company, and (b) where a 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 allotment.

- Any director who has knowledge of the fact of the irregular allotment of shares shall be liable to compensate the company and the shareholders respectively for any loss, damage or costs which the company or the allottee may have sustained or incurred thereby. Proceedings to recover any such loss, damage or costs can only be commenced within 2 years from the date of allotments.

In this connection, provisions of section 69(5) regarding the effects of not receiving minimum subscription should also be noted. If the company is unable to receive minimum subscription within 120 days after the first issue of the prospectus (according to SEBI guidelines, within 120 days from the date of
opening of the issue), it must refund within 130 days of the issue of the prospectus all moneys received from the applicants. If the money is not refunded within the prescribed period, i.e. 130 days, then the directors of the company shall be jointly and severally liable to repay that money with interest @ 6% per annum from the expiry of the 130 days.

- In case allotment is made in contravention of the provision of section 72 that is before the beginning of the fifth day from the date of issue of prospectus, the company and every officer of the company shall be punishable with fine, which may extend to Rs.50, 000. But allotment in such case shall be valid.

- In case where the prospectus of the company states that an application has been made for permission for the shares offered thereby to be dealt on one or more recognized stock exchanges the allotment shall be void, if either the permission has not been applied for or refused or not granted, before the expiry of 10 weeks from the date of closing of the subscription list.

Where an appeal against the decision of any recognized stock exchange refusing permission has been preferred under section 22 of the Securities Contracts (Regulation) Act 1956 such allotments shall not be void until the disposal of the appeal.

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77 Section 72 (3) of Indian Companies Act 1956. Substituted for “five” by the Companies (Amendment) Act 2000 w.e.f 13.12.2000
78 Section 73 (1) and (2) of Indian Companies Act 1956
79 Ibid Section 73 (1)
In case of allotment becoming void, the money becomes due to be refunded forthwith and must therefore be repaid.

If it is not so repaid within 8 days thereof, the company and every director of the company who is an officer in default shall be jointly and severely liable to repay that money with interest presently @15% per annum or as may be prescribed by the government.\(^{80}\)

Further the company and every officer of the company who is in default shall be punishable with a fine up to 50,000 and where the repayment is delayed beyond 6 months, also with imprisonment for term up to one year.\(^{81}\)

Recapitulation

From the above discussion it is clear that the primary market deals with the new securities that means the securities, which are not previously available to the investing public. There are four methods of raising the capital in primary market i.e. offer for sale, private placement, right issues and public issues. The methods of offer for sale and private placement are not very common in India and used to a limited extent. The big companies generally issue shares directly to public. With regard to public issue SEBI issued number of guidelines called the guidelines for disclosure and investor protection. These guidelines provide for promoter’s contribution, disclosures to be made in prospectus, appointment of intermediaries before issue of shares, pricing of issues etc. These guidelines also provide certain requirements for issue of rights

\(^{80}\) Ibid Section 73 (2A)
\(^{81}\) Ibid Section 73 (2B)
shares, issue of bonus shares etc. If the company is issuing shares through public issue it has to issue prospectus complying with all the legal requirements related to issue. At the time of issue of shares to public a company has to appoint many market players like merchant bankers, registrar to an issue, collecting bankers etc. and the prospectus must be delivered to SEBI and ROC prior to issue of prospectus to public. Thus, it is unnecessary duplication of efforts. The prospectus should be delivered to SEBI only. It is the duty of lead merchant banker to verify the contents of prospectus and submit a due diligence certificates to SEBI assuring it that all the legal requirements have been complied with. As discussed the functioning of merchant bankers exposed many major irregularities like they have submitted false reports to SEBI, concealed relevant and material facts etc. Keeping in view the functions and duties of merchant bankers it is desirable that they must share liability with companies in case of misleading or wrong information in the prospectus if they negligently or willfully allowed the mentioning of such information in the prospectus. Apart from cancellation and suspension of registration certificate heavy monetary penalties should also be provided for such irregularities.