CHAPTER IV

INFORMATION FOR INVESTOR DECISION MAKING:

THE LEGAL REQUIREMENTS

Capital Issues (Control) Act 1947, Companies Act, 1956 and the Securities Contracts (Regulation) Act 1956 provided, until 1991, the necessary framework of regulation for issue of securities and the functioning of the securities market.

The law affecting the securities market was fragmented and administered by different authorities. For promoting sustained growth in the securities markets over a long period, it becomes necessary to evolve a comprehensive securities law with a unified set of objectives, a development approach, a single administrative authority and an integrated framework to deal with all aspects of the securities market. A body like the Securities and Exchange Commission of U.S.A. was recommended to be set up in India. The need for a more comprehensive law and a better, single enforcement agency led to the creation of a Board called Securities and Exchange Board of India¹.

The Securities and Exchange Board of India (SEBI) Act, 1992 provided for the establishment of a statutory body with autonomous status. According to the Preamble of the Act, the objective of setting SEBI is to protect the interest of investors in securities and to promote the development and to regulate the securities market.

¹ The Department of Economic Affairs, Government of India by its resolution No.1(44) SE/86, dated 12th April 1988 constituted Securities and Exchange Board of India (SEBI). Since then it operated on the basis of this resolution until 21st February 1992 when it was granted statutory status.
interest of investors in securities and to promote the development and to regulate the securities market.

SEBI has formed two Advisory Committees namely, the Primary Market Advisory Committee and Secondary Market Advisory Committee. These committees are constituted from among the market players. Investor associations recognised by SEBI and eminent persons in the capital market provide important inputs to SEBI's policies.

These two committees are to advise SEBI on:

(i) matters relating to regulation of intermediaries, for ensuring investor protection in the primary market;

(ii) issues related to development of primary market in India.

(iii) disclosure requirement for companies.

(iv) matters required to be taken by for changes in the legal framework, to introduce simplification and transparency in the primary market; and

(v) matters relating to the development and regulation of the secondary market in the country.

OBJECTIVES OF SEBI

The SEBI Act, 1992 made provisions for the establishment of a Board to protect the interest of investors in securities and to promote the development of and to regulate the securities market.
The objectives of the Board may be stated to be as under:

i. To provide fair dealings by the issuers of securities and ensure a market place where they can raise funds at a relatively low cost.

ii. To provide a degree of protection to the investors and safeguard their rights and ensure that there is steady flow of savings into the market.

iii. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc., with a view to making them competitive and professional.

These objectives are proposed to be accomplished by being responsive to the needs of the three groups which basically constitute the market, viz, the issuers of securities, the investors and the market intermediaries. To the issuers it should afford a market place in which they can confidently look forward to raising finances they need in an easy and efficient manner; to the investors, it should provide reliable and authentic information and disclosure of information on a continuous basis; to the intermediaries, it should offer a competitive, professionalised and expanding market with adequate and efficient infrastructure so that they are able to render better services to the investors and the issuers.

It is observed that "the Securities and Exchange Board would seek to create an environment to facilitate mobilization of adequate resources through the securities markets."\(^2\)

\(^2\) 'History, Regulation and Organisation of the Stock Market in India' - (para 15) by Bombay Stock Exchange Foundation. 1995
This environment includes rules and regulations, institutions and their inter-relationship, instruments, practices, infrastructure and policy framework.

**EDUCATING THE INVESTORS**

The role of SEBI towards investor protection covering the regulatory and development aspects has many nuances. These include investor education and guidance.

As far as the secondary markets are concerned the investors have to be imparted education in the area of functioning of stock exchanges, role of stock-brokers and sub-brokers, trading hours, settlement cycles and payment procedure, the existence of grey market and price manipulation.

Additionally they also need to be made aware of the objectives and functioning of mutual funds, regulation governing their activities, norms to be observed by them in soliciting subscription for close-ended and open-ended shares and provision of services to investors.

Investors should be provided basic knowledge about their rights under the Companies Act, Securities Contracts (Regulation) Act and the Consumer Protection Act covering aspects of disclosures in offer documents, norms for listing of securities, despatch of allotment advices/refund orders, transfer of shares, payment of dividends/interest etc. The remedies available to them under these statutes also have to be broadly explained to them.

It is generally believed that, the smaller the investor less protected he feels. With regard to issue of securities the approach, it is stated, would be for
the protection of rights and interests of the investor especially for true and fair information.

SEBI'S POWERS

The following powers have been vested under the provisions of SEBI Act, 1992.

1. Regulating the business in stock exchanges and any other securities markets.

2. Registering and regulating the working of the stock-brokers, sub-brokers, share transfer agents, bankers to an issue, merchant bankers, under writers, portfolio managers, investment advisers and other such intermediaries who may be associated with securities markets in any manner.

3. Registering and regulating the working of collective investment schemes, including mutual funds.


5. Prohibiting fraudulent and unfair trade practices relating to securities markets.

6. Promoting investors education and training of intermediaries in securities markets.
7. Prohibiting insider trading in securities.

8. Regulating substantial acquisition of shares and takeover of companies.

9. Calling for information, undertaking inspection, conducting inquiries and audits of the stock exchange and intermediaries and self-regulatory organisations in the securities markets.

10. Performing such functions and exercising such powers under the Securities Contracts (Regulation) Act, Companies Act, 1956 as may be delegated to it by the Central Government.

11. Levying fees or other charges for carrying out its work.

12. Regulatory powers over corporates in the issuance of capital, transfer of securities and other related matters. SEBI has also been empowered to impose monetary penalties on capital market intermediaries and other participants.

13. SEBI has also been empowered to summon the attendance of and call for documents from all categories of market intermediaries, including persons in the securities market to enable SEBI to investigate irregularities.
14. SEBI has been empowered to issue directions to all intermediaries and persons associated with the securities market, in order to protect investors or ensure the orderly development of the securities market.

15. SEBI has been provided with total autonomy in its operation whereby it can file complaints in courts without the prior approval of the Central Government or notify its regulations without the approval of the Central Government.

16. Conducting research for the above purposes; and

17. Performing such other functions as may be prescribed.

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It may be mentioned that the Department of Company Affairs had authorised SEBI to institute prosecution in respect of the following offences under the Companies Act 1956:

i. Issuing an application form for shares or debentures unaccompanied by abridged prospectus. (Sec 56(3)).

ii. Issuing prospectus in contravention of Section 57 or 58 of the Companies Act 1956 (Sec 56)

iii. 'Mis-statements' in a prospectus (Sec 63).

iv. Fraudulently inducing any person to invest money in shares or debentures (Sec 68).

v. Failure to refund application money on rejected share or debenture or excess application money within the stipulated time (Sec 73(b))

vi. Failure to despatch shares or debenture certificate after allotment or transfer, within the stipulated time (Sec 113)

vii. Failure to pay dividends within 42 days after declaration thereof (Sec 207)

The power to institute prosecution in respect of these offences was earlier vested with the Registrar of Companies and the Department of Company Affairs, besides the shareholders. SEBI is now to exercise the powers concurrently with the above mentioned authorities.
SEBI has been delegated with the following powers under the Securities Contract (Regulation) Act, 1956.

1. Power to call for periodical returns or direct enquiries to be made from any recognised stock exchange.

2. Grant approval to any recognised stock exchange to make bye-laws for the regulations and control of contracts.

3. Power to make or amend bye-laws of recognised stock exchanges.

4. Licencing of dealers in securities in certain areas.

5. Power to compel listing securities by public companies.

6. Granting approval to make amendment to the rules of a recognised stock exchange.

7. Power to ask every recognised stock exchange to furnish a copy of the annual report.

8. Power to direct stock exchanges to make rules.

9. Power to supersede the governing body of a recognised stock exchange.

11. Power to prohibit contracts in certain cases.

12. Establishing additional trading floor with the prior approval of SEBI⁴.

The Central Government has delegated certain additional powers later.

These powers include the submission of application for the recognition of stock exchanges, grant of recognition to stock exchanges, withdrawal of recognition of a stock exchange and making or amending rules or articles of association of a stock exchange about voting rights of members of a stock exchange at any meeting.

It also has powers relating to regulation and control of the business of dealing in spot delivery.

Other powers extended to SEBI include those pertaining to hearing appeals submitted by companies against refusal of a stock exchange to list their securities⁵ and those relating to the issue of a notification specifying any class of contracts as contracts to which the Securities Contracts (Regulation) Act⁶ apply.

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⁴ Additional powers delegated to SEBI by the Central Government vide notification dated 13th Sept 1994.

⁵ Under Section 22

⁶ Under Section 28 (2)
SEBI has noted certain general deficiencies with regard to disclosure of various categories of information and the proposals for reforms made by it are described below in ten major headings.

I. DISCLOSURE

i. The lead managers must invariably enter into a memorandum of understanding with the issuer on the lines approved by SEBI which will provide for an obligation on the part of the issuer to give all the necessary information required by the lead managers.

ii. Certain critical information which may otherwise be incorporated in the offer document but not sufficiently highlighted should henceforth be highlighted in the offer document. As an illustration a few such informations are:

a. Particulars relating to the issues made within the last 3 years of the proposed issue by the issuers and other companies under the same management.

b. "Other income" is normally disclosed in the profit and loss account and in the notes to the Accounts incorporated in the offer document. However, where such "other income" exceeds 10% of the total income, the offer document should highlight and state clearly and prominently the sources of the "other income" and whether it is of recurring or non-recurring nature.
c. In case of an existing company, any adverse event occurred within 2 years prior to the proposed issue which would have an effect on the operation of the company should be highlighted.

For eg. instances of shut-down of plants on account of labour disputes, problems in utility supplies, pollution control problems etc.

d. Any legal proceedings initiated within 3 years prior to the date of the proposed issue for economic or criminal offences and currently pending against the issuer or any key management personnel of the issuer should be highlighted.

e. Capacity utilisation in the last 3 years prior to the date of the proposed issue and the level of break-even operations, if not provided should invariably be incorporated in the operating results.

f. Any material change or turnover in key managerial and technical personnel if not provided should be incorporated while describing the operating results.

iii. Apart from the requirement of continual disclosures made pursuant to the listing requirements, any important event having a bearing on the project financed out of the issue proceeds, progress of implementation
of the project, any event affecting the issuers and investor's interest in the securities issued should be disclosed by periodical press releases.

iv. A separate note under the title "Investor Grievances and Redressal System" in the offer documents must give details of the following:

a. The number or nature and status of investor grievances pending with the issuer and its subsidiaries and the investor grievance redressal systems available with them should be disclosed separately in the offer document.

b. The number of times the issuer has figured in the Press Reports on investor grievances issued by SEBI during the 12 months preceding the issue. The issuer, if wished, may make a statement about the redressal of these grievances.

v. Financial disclosure is required both in terms of project appraisal and financial projections.

a. All projects whether set up by a new promoter or an existing company or incorporating a modernisation or an expansion programme must be compulsorily appraised.

b. The project could be appraised by a term lending financial institution or a bank if any of them is involved in providing financial assistance to the projects. Projects which have not been
assisted by a financial institution or a bank should be appraised by one of the lead managers associated with the issue.

c. The offer document of such issues must clearly state the name and background of the appraising institution and the purpose of the project being appraised by that institution.

d. The offer document must include the following information based on the appraisal report:

* Capital built up * Import
* Technology * Competition
* Market * Managerial competency

e. Financial projections based on appraisal for a period of three years from the commencement of commercial production must be incorporated in the offer document along with the assumptions underlying these projects. The issuer may also give his own projections, if he so desires, together with underlying assumptions and reasons for variations from the projections of the appraising institution.

Apart from the above mentioned specific disclosures, there are certain other disclosures to be made by the issuing company, as detailed below:
I. RISK FACTORS

The risk factors highlighted in the offer documents form critical inputs for an investor for his informed investment decision.

The risk factors are to be classified into those which are internal and specific to the issuer and the project and those which are external to it and not under the control of the issuer including factors peculiar to the relevant industry to which the project and the issuer are concerned.

II. DEBT RETIRING BY ISSUE OF EQUITY

While capital issues for raising equity are made by companies it is often noticed that the ultimate but unstated objective of several issues have been to restructure the capital by increasing the equity component and bringing about corresponding reduction in the debt through the retiring of debt.

SEBI proposed that implications of retirement of debt or alteration of capital structure through the raising of additional equity on the future financial performance of the company and the manner in which the issuer proposes to service the expanded capital should be disclosed in the offer document.

III. PROSPECTUS

A public company which wants to raise capital by issue of shares to the public, has to issue a prospectus. A prospectus, as per section 2(36) of the Companies Act 1956, means "any document described or issued as prospectus and includes any notice, circular, advertisement or other documents inviting
deposits from the public or inviting offers from the public for the subscription or purchase of any shares or debentures of a body corporate”.

Thus, a prospectus

i) invites subscription to shares or debentures or invites deposits and

ii) the invitation is made to the public.

The contents prescribed for a prospectus are given in detail in Appendix B.

The “Golden Rule” for framing of a prospectus was laid down by Justice Kindersely in New Brunswick & Canada Rly & Land Co. V Mugeridge (1860). Briefly the rule is as follows:

Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representations contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted, the existence of which might in any degree affect the nature or quality of the principles and advantages which the prospectus holds out as inducement to take shares. In other words, the true nature of the company’s venture should be disclosed.

7 The statement which was described by Page - Wood V.C. in Henderson V. Lacon (1867) LR Eg. 249, 262 as a “golden legacy” was also quoted by the Supreme Court in N. Parthasarathy V. Controller of Capital Issues. (1991) 72 com cases 651 (SC).
Thus, the persons issuing the prospectus must not only include in the prospectus all the relevant particulars specified in Part I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

MIS-STATEMENTS IN A PROSPECTUS AND THEIR CONSEQUENCES

The prospective share holders are entitled to true and faithful disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material fact.

An untrue statement or mis-statement according to Section 65(1) of the Companies Act 1956 are as follows:

a. a statement included in a prospectus shall be deemed to be untrue if the statement is misleading in the form and context in which it is included; and

b. where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission, to be a prospectus in which an untrue statement is included.

To regard a prospectus as fraudulent, it is not necessary that there should be false representation in it; even if every word included in the prospectus is true, the suppression of material facts may render it fraudulent.
To judge its effect, it should be read as a whole. It is not necessarily enough if the prospectus refers to the contracts and puts the intending shareholder upon enquiry as to their contents. Sometimes a half truth is no better than a downright falsehood. The withholding of facts should be such that if not stated it makes that which is stated absolutely false.

**REMEDIES FOR MIS-STATEMENT IN A PROSPECTUS**

A person who has applied for shares in the company, and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus. But a buyer of shares in the open market or a subscriber to the memorandum has no such right.

If, however, a prospectus is issued with the object of inducing persons to buy shares in the open market, any person who buys shares even in the open market on the basis of the statement made in it has a right of action if the statements are untrue or there is material omission from the prospectus.

The principles to be applied in such cases were laid down in Gurney's case as follows:

i. Every man must be held responsible for the consequences of a false representation made by him to another, upon which that other acts, and, so acting, is injured or damned.

ii. Every man must be held responsible for the consequences of a false representation made by him to another, upon which a third person acts, and so acting, is injured or damned, provided it
appears that such false representation was made with the intent that it should be acted upon by such third person in the manner that occasions injury or loss;

iii. The injury must be immediate and not the remote consequences of the representation thus made.

A false statement or omission of material facts gives right to civil as well as criminal liability.

ABRIDGED PROSPECTUS

Each public issue application should be accompanied by abridged prospectus which is a memorandum containing salient features of the prospectus. The information contained therein should be in the prescribed form.

IV. MINIMUM SUBSCRIPTION

If the company does not receive minimum subscription which has been fixed at 90% of the issue, including the devolvement of underwriters within 120 days of the first issue of the prospectus, the entire subscription has to be refunded to the applicants within 128 days with interest @ 15% p.a. for the delayed period beyond 78 days from the closure of the issue, as per Section 73 of the Companies Act, 1956. This statement has to be prominently disclosed in the prospectus and all statutory advertisements.
V. GUIDELINES FOR PRICING

FIRST ISSUE OF NEW COMPANIES

A new company (defined as one which has not completed 12 months of commercial operation and its audited operative results are not available, and where it is set up by entrepreneurs without a track record) will be permitted to issue capital to public only at par.

Where a new company is being promoted jointly by the existing companies it will be free to price its issue provided the participation of the promoting companies is not less than 50% of the equity of the new company and 'issue price' is made applicable to all new investors uniformly, and provided that the prospectus or offer documents shall contain justification for issue price.

'Existing company' mentioned above is to be interpreted as existing private/unlisted closely held/listed companies. The expression 'track record of consistent profitability' is to be construed as distinct from continuous profitability. The promoting companies concerned should have shown profits in their respective audited profit and loss accounts after providing for interest, tax and depreciation in five out of preceding seven years with profits during the last two years, prior to the issue.

Where a new company is set up by existing companies, each one of them should fulfil the criterion of five-year track record of consistent profitability. However, where a new company is set up by existing private sector companies along with a state level agency or a government company or a foreign collaborator, it will be sufficient if the private sector companies satisfy the requirements of five-year track record.
ISSUE PRICE

a. The issue price stated therein is applicable uniformly to all investors in new companies including promoters and the promoters contribution being subject to lock-in-period of five years.

b. Where fully convertible debentures / partly convertible debentures (FCDs/PCDs) are issued by a new company being set up by the existing company(ies) having five years track record of consistent profitability, it may bring in its contribution by way of additional equity or by subscription to FCDs/PCDs such that the total contribution of the promoting company is not less than 50% of the total equity after the conversion of FCDs/PCDs. If the contribution is by way of equity, the promoting company may subscribe such equity at par, if the first conversion of the FCDs/PCDs is to take place after 18 months from the terms of conversion of the debentures. In other cases if the conversion is to take place at 18 months or less, the promoting company’s contribution towards equity shall be at the same price at which the subscribers to FCDs/PCDs are entitled to conversion.

The draft prospectus containing the disclosure will be vetted by SEBI before a public issue is made.

No private placement of the promoters share shall be made by solicitation of share contribution from unrelated investors through any kind of market intermediaries.
The extent of promoter's contribution and lock-in-period applicable to companies falling under this section are given below in a summary form.

<table>
<thead>
<tr>
<th>Class of Companies</th>
<th>Pricing of Public Issue</th>
<th>Promoters Contribution</th>
<th>Lock-in period</th>
</tr>
</thead>
<tbody>
<tr>
<td>New companies established by individual promoters &amp; entrepreneurs</td>
<td>At par</td>
<td>25% or 20% of the total issued capital, as the case may be with a minimum subscription of Rs.50,000 by each of the friends, relatives and associates</td>
<td>4 years from the date of allotment in public issue or the date of commencement of commercial production whichever is later</td>
</tr>
<tr>
<td>New companies set up by existing companies with a 5 year track record of consistent profitability</td>
<td>At premium</td>
<td>50% of total issued capital</td>
<td>5 year from the date of allotment in public issue or the date of commencement of commercial production whichever is later</td>
</tr>
</tbody>
</table>

FIRST ISSUE BY EXISTING PRIVATELY/CLOSELY HELD COMPANIES

Existing Privately / Closely held companies with a three year track record of consistent profitability shall be permitted to freely price the first issue and list their securities on the stock exchanges.

a. The provision will not apply to rights issue of any amount, by existing private companies and rights issues without right of remuneration of any amount by unlisted closely held companies.
b. The provision applies not only to the existing private companies, closely held companies but also to other existing unlisted companies going in for a public issue for the first time.

c. The guidelines for disclosure and investor protection issued by SEBI do not apply to the issue of securities by existing privately/closely held and other unlisted companies.

d. Three year track record means three years record of which at least two should be completed years of 12 months each and the third should be not less than 6 months.

e. The expression ‘three year track record of consistent profitability’ means that the concerned companies have shown profits in their respective audited statements after providing for interest, tax and depreciation in three out of five preceding years with profits during the last two years prior to the issue.

f. Under this section, the companies having three years track record of consistent profitability are allowed to freely price their issues.

g. In respect of Partnership firms, which have since been converted into companies, the track record of partnership firms will be considered.

Further, such financial statements should also make adequate disclosures similar to that required for companies as specified in Schedule VI of the Companies Act, 1956.
In addition, such financial statements should be duly certified by a chartered accountant stating unequivocally that -

i. the accounts as revised or otherwise and disclosures made are in line with the provisions of Schedule VI of the Companies Act 1956; and

ii. the accounting standards of the Institute of Chartered Accountants of India have been followed and that the financial statements present a true and fair picture of the firms accounts as in the case of companies.

The lead manager should also add his confirmation that the financial statements furnished on behalf of the partnership firms are in accordance with the accounting standards prescribed by ICAI.

**ISSUE PRICE BY OTHER COMPANIES**

a. An existing private/closely held/other unlisted company, which does not have three-year track record of consistent profitability, can issue to public for raising capital only at par provided not less than 20% of the total issued capital (expanded capital) is offered to public. However, a company, which does not have a three-year track record, but has been promoted by other company(ies) with a five-year track record of consistent profitability, will have freedom to price the shares; provided that, the participation of the promoting company(ies) issued capital, subject to lock-in period of 3 years. For reaching minimum percentage
of 50%, if the promoting company has to take additional equity out of the public issue, it will be at the same price at which the shares are offered to public.

b. It is clarified that, where an issue of share is to be made at premium or FCDs/PCDs with conversion(s) at premium, for rechecking the minimum specified percentage of 50% to be brought in by the promoting company(ies), only such portion of the issued capital have been held by the promoting company(ies) pursuant to the allotment made prior to 12 months of the proposed public issue would be taken into account. Accordingly, in cases, where it is not possible for the promoting company(ies) to bring in additional equity to make up the specified percentage of 50% in the issued capital after excluding the allotment of shares made within 12 months prior to the proposed public issue such public issue shall be made only at par.

V. DISINVESTMENT

Where private/closely held and unlisted companies having three-year track record of consistent profitability desire to get listed through disinvestment of the existing shareholding without raising additional capital, there is no prohibition against free pricing. Accordingly, the existing shareholders in such companies may freely price their shares offered to the public. It is clarified that the promoter's share holding after disinvestment shall not be less than 25% of the total issued capital of the company, subject to a lock-in-period of three years.
Not less than 20% of the issued capital should be offered by way of equity.

The draft prospectus will be vetted by SEBI to ensure adequacy of disclosures.

The pricing would be determined by the issuer and lead managers to the issue and would be subject to specific disclosure requirements including:

a. disclosures of the net asset value of the company as per the last audited balance sheet.

b. justification of the issue price.

VI. PUBLIC ISSUE BY EXISTING LISTED COMPANIES

a. These companies will be allowed to raise fresh capital by freely pricing their further issues.

b. The issue price will be determined by the issuer in consultation with the lead manager(s) to the issue.

c. Disclosures -

(i) the draft prospectus will be vetted by SEBI to ensure adequacy of disclosures

ii. the prospectus or offer documents shall contain the net asset value of the company and a justification for the price of the issue.

iii. high and low price of the shares for the last two years.
Companies investing to enhance their foreign shareholding upto 51% or more or permissible under the relevant guidelines of government/Reserve Bank of India can make issues at a price determined by the shareholders in a special resolution under section 81(1) (A) of the Companies Act. This will also apply to issue of shares to foreign investors by closely held companies and also by other companies where there is no foreign shareholding at present.

FRAUDULENT PRACTICES

Under the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995, “fraudulent” shall be construed as:

1. the suggestion, as to a fact, of that which is not true, by one who does not believe it to be true;
2. the active concealment of a fact by one having knowledge or belief of the fact;
3. a promise made without any intention of performing it;
4. any other act fitted to deceive;
5. any such act or omission as the law specially deems to be fraudulent;

Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the cases are such that regard being had to them, it is the duty of the person keeping silence to speak or unless his silence is itself, equivalent to speech.
As per these rules, no person shall buy, sell or otherwise deal in securities in a fraudulent manner.

VII. PROHIBITION AGAINST MARKET MANIPULATION

The Rules also prohibit market manipulation. Accordingly, no person shall-

a. effect, take part in, or enter into, either directly or indirectly, transactions in securities, with the intention of artificially raising or depressing, the prices of securities and thereby inducing the sale or purchase of securities by any person;

b. indulge in any act, which is calculated to create a false or misleading appearance of trading on the securities market;

c. indulge in any act which results in reflection of prices of securities based on transactions that are not genuine trade transactions;

d. enter into purchase or sale of any securities, not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress, or cause fluctuations in the market price of securities;

e. pay, offer or agree to pay or offer directly or indirectly, to any person any money or money's worth for inducing another person to purchase or sell any security with the sole object of inflating, depressing, or causing fluctuations in the market price of securities.
VIII. MISLEADING STATEMENTS TO INDUCE SALE OR PURCHASE OF SECURITIES

Another important prohibition is regarding misleading statements. Accordingly, no person shall make any statement, or disseminate any information which -

a. is misleading in a material particular and;

b. is likely to induce the sale or purchase of securities by any other person or is likely to have the effect of increasing or depressing the market price of securities, if when he makes the statement or disseminates the information:

i. he does not care whether the statement or information is true or false; or

ii. he knows, or ought reasonably to have known that the statement or information is misleading in any material particular.

General comments made in good faith in regard to - the economic policy of the government or the economic situation in the country or trends in the securities markets, or any other matter of a similar nature or whether such comments is made in public or in private are not to be treated as misstatements.

The Regulation states that no person shall -

a. in the course of his business, knowingly engage in any act, or practice which would operate as a fraud upon any person in
connection with the purchase or sale of, or any other dealing in any securities;

b. on his behalf or on behalf of any person, knowingly buy or sell or otherwise deal in securities, pending the execution of any order of his client relating to the same security for purchase, sale or other dealings in respect of securities.

But this is not applicable where according to the clients instruction, the transaction for the client is to be effected only under specified conditions or in specified circumstances;

c. intentionally and in contravention of any law for the time being in force delays the transfer of securities in the name of the transferee or the despatch of securities or connected documents to any transferee;

d. indulge in falsification of the books, accounts and records (whether maintained manually or in computer or in any other form);

e. when acting as an agent, execute a transaction with a client at a price other than the price at which, whether on a stock exchange or otherwise, or at a price other than the price at which it was offset against the transaction of another client.

IX. POWER OF THE BOARD TO ORDER INVESTIGATION

The board may, suo-motto or upon information received by it, cause an investigation to be made in respect of the conduct and affairs of any person buying, selling or otherwise dealing in securities.
The purposes for which such investigation mitigated are -

a. to ascertain whether there are any circumstances which would render any person guilty of having contravened any of these regulations or any directions issued thereunder;

b. to investigate into any complaint of any contravention of the regulation, received from any investor, intermediary or any other person;

X. DEMATING

With the recent dematerialisation of shares, the share holders expenses of shareholding have increased. SEBI has informed that 717 crores of shares with a market value of Rs.1,06,000 crore have been dematerialised. Before the end of May 1999,40 additional securities are to be dematerialised. This would mean that 104 scrips, which were the most highly traded, would be tradable only in the dematerialised form.

The investors are provided with Depository Services for safe custody of their shares. But the cost of availing such services are substantial. There is initially a Demat charge of Rs.1.50 per certificate. For Rematting such certificates a fee of Rs.5/- per certificate or 0.02% of the market value of the securities, whichever is higher is collected.
For safe custody of the certificates, 0.015% on average asset value per quarter with a minimum of Rs.100 per quarter is collected. In addition it also collects transaction charges of 0.05% of transaction value with a minimum of Rs.25/- per trade. If the account is closed within a year, Rs.500/- towards closure of accounts is collected. For the small investor, the costs are substantial.

XI. INVESTOR GRIEVANCES, INVESTORS’ RIGHTS AND REMEDIES

The grievances of investors can be broadly classified as relating to the following:

1. Advertisement regarding the capital issues  
2. Disclosures in prospectus  
3. Delay in listing of securities  
4. Delay in despatch of allotment letters/ refund order  
5. Delay in despatch of securities  
6. Delay in transfer of securities  
7. Trading in odd lots  
8. Stock market transaction.  
9. Bad delivery  
10. Sub-brokers.  
11. Default by a broker  
12. Delay in payment of interest on debentures  
13. Non-payment of dividends and  
14. Miscellaneous grievances.

As this study concerns with the risk perception of investors based on the information disclosed by the company, the first two types of grievances namely, advertisement regarding the capital issues and disclosure in the prospectus may be dealt with in detail. The guidelines issued by SEBI with regard to these two aspects of investors grievances followed by the real grievance of the investor and their rights and remedies are described below:
1. ADVERTISEMENT REGARDING THE CAPITAL ISSUES

Companies, brokers or intermediaries like merchant bankers, issue circulars or other publicity material inviting applications from the public for subscription to shares. These publicity materials which do not form part of the prospectus or the letter of offer contain exaggerated claims of the performance of the company and misleading information. These publicity materials are widely distributed and freely available, yet they are marked "this is only an announcement and not a prospectus" or for "private circulation only".9

The investors have a right to receive true and adequate disclosures. Information given to the investors through circulars, brochures etc., should contain only such genuine information as is contained in the prospectus.10

"In the interest of dissemination of factual information for the benefit of the investing public, the companies and other agencies connected with the public issue may give publicity through various media such as newspapers, posters, hoardings etc., of the public issue of capital, subject to the condition that the information furnished are as contained in the prospectus".

The company, management and promoters are to make use of the proforma.11 The adoption of the proforma is not obligatory but if the company chooses to make an announcement in any other form, it would do so, at its own risk.

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9 Letter issued by the Stock Exchange Division, Government of India No.F/1/SW/74 dated 5.4.74.
10 This is reinforced by the letter issued by the Ministry of Finance No.F.No.1/28/SE/86 dated June 24th 1987.
11 The Department of Company Affairs regulates the issuance of advertisements by way of circular No.5 (13) - CL - VI/62 dated 21.5.62 which gives a proforma of announcement regarding the proposed issue of capital.
The proforma is to contain the following informations:

- Name of the company and the address of the registered office.
- Existing and proposed activities including location of industries.
- Board of Directors, Managing Director/Manager.
- Authorised capital, subscribed capital, proposed issue to the public (whether at par, discount or premium).
- Dates of opening and closing of the subscription list.
- Application forms along with copies of the prospectus can be had from the underwriters / bankers / brokers.

It is stated\(^\text{12}\) that "the Government is of the considered opinion that companies should not be permitted to publish either by themselves or through their issue houses any material relating to the issue between the date of announcement and the date of closing of the subscription list.

Company advertisements inviting deposits from the public are regulated by separate rules called "Non-banking Financial Companies and Miscellaneous Non-banking Companies (Advertisement) Rules, 1977". These rules prescribe the form and particulars of advertisement to be issued by the companies intending to invite deposits from public.

Section 68 of the Companies Act, 1956, imposes a penalty for fraudulently inducing persons to invest money.

\(^{12}\) In the letter issued by the Stock Exchange Division, Government of India No.F1/1/SE/74 dated 5.4.94.
Section 621 of the Companies Act, 1956 gives the shareholder the right to file criminal proceedings before the court for any violation of the companies act committed by the company or officer in default.

The MRTDP Commission treats misleading advertisements as an Unfair Trade Practice under Sec. 36A of the Act. Once the fact of unfair trade practices is established, the MRTDP Commission can issue a "cease and desist" order against the company.

The investors can file complaints before the District Forum, State Commission or National Commission established under Section 9 of Consumer Protection Act, 1986 (COPRA). The District Forum has the jurisdiction to hear complaints to the value of less than Rupees One lakh. State Commission has jurisdiction when the claim is more than Rs.1 lakh but less than Rs.10 lakh and the National Forum has the jurisdiction when the claim is more than Rs.10 lakhs.

Complaints under the above Act can be filed by the individual in his personal capacity or through a voluntary Consumer Association.

The investors can write to SEBI in case of misleading advertisements, circulars or brochures. SEBI as part of its terms of authorisation of merchant bankers stipulate that the lead manager to the issue will ensure that publicity or advertisement materials in the brochures meet with the requirements stipulated in the relative guidelines/circulars issued by the Government of India or SEBI.
The investors can bring to the notice of the stock exchanges where the securities of the companies are to be listed, any misleading advertisements issued by the company or intermediary. The stock exchanges are empowered to take action for enforcement of guidelines and they can refuse listing of the securities of the company in the event of violation of Governments guidelines.\(^{13}\)

2. **MANIPULATIVE PRACTICES**

A broker executing a transaction with a client at a price different than the price at which it was executed by him will be committing an unfair trade practice.

"To pay money to any person for inducing another person to purchase or sell any security in order to inflate, depress or cause fluctuations in the market price" has been included in the purview of market manipulation.

Moreover, no person can, on his own behalf, or on behalf of any other person, knowledgeably buy or sell securities pending the execution of any orders of his client relating to the same security.

According to these guidelines, fraud, is any act committed with an intent to deceive somebody. It includes the deliberate suggestion of an untrue fact by someone, the active concealment of a fact by one having knowledge of the fact, a promise made without any intention of performing it, or any other act fitted to deceive.

\(^{13}\) Government of India letter NOS F1/1/SE/74 dated 9.10.75, F.14/3/SE/76 dated 12.3.76 and No.F.1/23/SE/86 dated 22.5.86.
On market manipulation, the norms stipulate that no person can take part in a securities transaction to artificially raise or depress prices for inducing sale or purchase by any person. "Purchase or sale of securities intended to only inflate, depress or cause fluctuations in the market price, and not to actually transfer beneficial ownership" is also market manipulation.

3. DELAY IN LISTING OF SECURITIES

Companies usually state prominently on the face of the prospectus that an application has been made to one or more stock exchanges for listing the shares or debentures offered for subscription. The object underlying this statement is to give an assurance to the investor that the shares or debentures will become marketable and to induce him to subscribe for them on that basis. Although there is no guarantee that the permission for listing will be granted by the stock exchange authorities, the public assumes that permission is likely to be granted.

Completion of the listing formalities is a pre-condition to the stock exchange granting permission for dealing in shares / debentures. Companies, on occasions, are unable to complete these formalities within the prescribed time.

Delay in allotment of shares and debentures and despatch of refund orders are invariably the cause of delay in the grant of permission in dealing by the stock exchanges. If the company is deprived the permission for dealing in securities by the stock exchange, this will adversely affect the investors as the allotment of shares or debentures made by the company becomes void.
4. **DELAY IN DESPATCH OF ALLOTMENT LETTERS / REFUND ORDERS**

Companies are required to finalise the basis of allotment of shares or debentures and despatch the allotment letters or refund orders within eight days on the basis of allotment or within 10 weeks of the closing of subscription, whichever is earlier.

Grievances arise when the time schedule given in the statute, the guidelines and the listing agreement of the stock exchange, is not adhered to.

5. **DELAY IN DESPATCH OF SECURITIES**

A share certificate under the seal of the company is prima facie evidence of the title of the share holder to the shares specified therein.

The investors grievance arise when there is delay in receipt of share or debenture certificate allotted to them.

6. **DELAY IN TRANSFER OF SECURITIES**

The share holders or debenture holders of the company, while selling their securities should also transfer them in the name of the person purchasing it (transferor). The transferee should be entitled as a matter of right to get the certificates transferred in his name expeditiously. When an inordinately long-time is taken by companies to transfer the shares or debentures lodged for transfer and registration, the transferee may lose certain benefits due to him in the intervening period like bonus, rights, dividends etc., and his name would not be entered as a "member" in the register of the company. This, then becomes the cause of the grievance.
7. TRADING IN ODD LOTS

Shares or debentures of the company are to be traded in stock exchanges in lots known as "tradeable lots". Investors sometimes own securities which are known as 'odd lots'. Odd lots generally result from factors like allotment of scrips by companies in lots smaller than marketable lots or multiples thereof, issue of bonus or rights shares of companies made pro-rata to the existing holdings, conversions of convertible debenture into equity shares, splitting of shares etc. On such cases, the liquidity of the securities of the investor is restricted and interest of the investors are impaired. Investor find it difficult to sell their odd lots and they normally receive 15 percent to 20 percent more than the market price when they buy odd lots for consolidation of holdings.

8. STOCK MARKET TRANSACTIONS

If an investor wants/desires to sell or acquire any security in the secondary market on the floor of the exchange, he has to necessarily avail of the services of a broker recognised by the stock exchange. Disputes frequently arise between the investor and his broker or sub-broker. The complaints relate to non-receipt of or delay in receipt of securities even after payments have been made, excess brokerage charged, short or delayed payments, non-furnishing of contract notes, selling of securities which have forged signatures or are counterfeits or the validity of the transfer form has expired.

9. SUB-BROKERS

A grievance regarding sub brokers arise because investors very often enter into transactions with sub-brokers under the impression that they are authorised to give contract notes. Such notes are valid only if the sub-broker concerned is authorised by the member broker of the stock exchange to act on his behalf. The stock exchange on its part take cognisance of only such contract notes which are signed by the member - broker.
10. **BAD DELIVERY**

When transfer of securities take place sometimes the company returns the securities with relative transfer deeds as being defective without registering the transfers. A major portion of bad deliveries are due to differences in the signature of the transferors. The investor approaches the broker, who further gets in touch with the introducing broker in his stock exchange. The seller-broker takes 3 to 4 months to remove the defect and deliver the securities to the investor. The time taken for removal of the defect is another cause of grievance.

11. **DEFAULT BY A BROKER**

If a broker is unable to meet his financial liabilities, the stock exchange may be constrained to declare the member broker a defaulter. A member who is declared a defaulter shall at once cease to be a member of the exchange and consequently also cease to enjoy any of the rights and privileges of membership but the rights of his creditor members against him remain unimpaired. Once a broker is declared a defaulter he may lose his securities and incur financial loss. Where a broker is declared a defaulter the investors are put to a disadvantage because after such declaration, they will not be in a position to receive the securities purchased through such broker or receive the money in respect of the securities sold through him, even though the broker might have executed the contract notes in his behalf.
investors against a repetition of the practices that had led to the enormous losses which they had sustained. As the 1934 report of the House of Representatives put it:

'As a complex society diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position. Unless constant extension of the legal conception of a fiduciary relationship a guarantee of "straight shooting" - supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system...

...As management became divorced from ownership and came under the control of banking groups, men forgot that they were dealing with the savings of men and the making of profits became an impersonal thing. When men do not know the victims of their aggression they are not always conscious of their wrongs'.

The Congress correctly concluded that no one can safely buy or sell securities without having an intelligent basis upon which to base his / her judgement as to their value:

Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy. Delayed, inaccurate, and misleading reports are the tools of the unconscionable market and the recreant corporate official who speculate on inside information.

The Congress also concluded that it was necessary to place certain restrictions on the activities of corporate insiders and to impose upon them affirmative duties of disclosure so that investors would have a better idea of factors that might affect the value of their investments. Members of Congress concluded that the right of corporate suffrage should be extended, because insiders having little or no substantial interest in the properties they manage have often retained their control without an adequate disclosure of their interest and without an adequate explanation of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights.

Although management is most often eager to suppress bad news, it is probably not correct to assume that management is eager to suppress only bad news. Under some circumstances, the selfish interests of management are

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16Ibid

18Ibid. 13f
probably, at least as well, served by suppressing good news as, for example, when an existing new product is about to be introduced into the market. It is far better, under such circumstances, to keep the news away from potential competitors, even though stock prices may suffer temporarily.

Management and big investors and bankers failed to disclose vital facts pertaining to the life savings of millions of citizens. They manipulated the news and the markets for their own benefit. Theoretically, management was entrusted with the duty to run a corporation for the benefit of its shareholders. In reality, they often run it for their own benefit and concealed their operations from the shareholders.

A kind of financial cannibalism took place on a massive scale. Promoters of essentially worthless stock made promises of vast wealth and employed all the means of high pressure salesmanship at their command. Pool operators manipulated the prices of such stocks as AT & T, American Tobacco, Gimbel Brothers, RCA and Safeway. They subsidized financial writers who touted the stocks in which they were interested. The writers not only received payment for their services, but also participated in the scheme. Market letters, publicity agents and tipster sheets helped further to wet the public's appetite for the stock, driving the prices up. Participants in the scheme then liquidated their holdings, the prices dropped, and the public was left holding the bag.

J.P. Morgan & Company set aside blocks of securities it was underwriting for leading political figures. Once the price had risen, the recipients could purchase them at the low offering price. It was, however,
expected that these politicians would express their gratitude to Morgan in appropriate ways 17.

Such abuses led Congress to pass the securities laws which still control the markets. These laws, passed in the early 1930s, have since been supplemented by additional legislation and by court decisions that have broadened their reach. Among other things, they set standards for fiduciaries18 who were involved in the securities markets.

SECURITIES AND EXCHANGE COMMISSION

The SEC was created to serve as the enforcement agent for security laws.

SEC investigations are generally fact-finding inquiries. If it is determined that the law has been violated, the Commission can pursue several courses of action. It can seek a civil injunction by applying to U.S. district court for an order restraining the acts in violation. The Commission contacts the grand jury and institute criminal proceedings. The SEC can also impose administrative remedies by denying, suspending or revoking registration of brokers and dealers or suspending or expelling members from exchanges or from the National Association of Security Dealers.

The Securities Act, 1933, often referred to as the 'Truth in Securities Act' has two objectives: to provide investors with financial and other information concerning securities offered for public sale and to prohibit

18 The duties of fiduciaries are described later in this chapter.
misinterpretation, deceit and other fraudulent acts and practices. The basic provisions of the 1933 Act are as follows:

(i) To protect investors by requiring that key information be disclosed to investors.

(ii) To require corporations wishing to sell securities in the interstate commerce to file a registration statement containing extensive information concerning both the issue and the corporation.

(iii) To subject all corporate officers and directors, attorneys' appraisers and accountants associated with the undertaking (i.e. as signers of the registration statement) to the provision of the Act.

(iv) To hold all these responsible individuals liable for any material mis-statements or omissions of material facts.

The SEC determines the kind of information that must be given to the public by an enterprise that seeks to obtain public investments. Although SEC does not make judgements on the merits of the securities, it does see to it that the firm floating a new issue of stock does not mislead the investor. SEC has the responsibility of taking appropriate action to stop and to punish those who attempt to avoid furnishing information or who attempt to sell securities on the basis of mis-interpretation or mis-information.

The philosophy of the 1933 Act was extended to the secondary market to ensure the purchasers and sellers that the market is free from manipulative schemes or fraudulent practices, by the Securities Exchange Act of 1934.
The basic purpose of this Act is to protect investors by curbing excessive speculation and eliminating unfair practices in security exchanges. It regulates the buying and selling of existing securities on the exchanges and over-the-counter markets. The Act requires that all exchanges be licensed by the SEC and that all securities sold on the exchanges be registered both with the SEC and with the listing exchange. Reports must be filed annually and quarterly with the SEC in order to keep the exchanges, the SEC, and the investors informed.

DUTIES OF FIDUCIARIES

Investment advisor is a fiduciary under the law. He has an affirmative obligation not to remain silent, but reveal material information. Thus, in applying the common law principle that a person's failure to disclose material information prior to the consummation of a transaction is not fraud unless he is under a duty to make such a disclosure, American Securities law does not recognise that there is a relationship of trust between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their positions with that corporation. This relationship gives rise to a duty to disclose because of the "necessity of preventing a corporate insider from ... taking unfair advantages of the uninformed minority stockholders". Although the legislation was prompted by abuses against unsophisticated small investors, neither the Congress nor the SEC has ever indicated that the securities laws protected only such investors. Fraud may also be perpetrated upon powerful and experienced investors.

20Lehigh Valley Trust Co, V. Central National Bark, 409 F. 2d, 989, 992, (5th Cir - 1969).
The fact that advice given by an investment adviser is completely truthful is not necessarily sufficient, either in law or in ethics, to establish that it is not fraudulent. Suppose a securities analyst's newsletters are completely accurate and the given advice is quite sound. But suppose, finally, that he had purchased large blocks of shares in the corporations he recommends to his clients and fails to disclose his financial interest in the stock, such a course of action would constitute fraud.

The duty, both moral and legal, to refrain from committing fraud either by speech or by silence, is clear. The duty to speak out is less clear when one becomes aware of another person's fraudulent behaviour.

ETHICAL ISSUES IN THE SECURITIES INDUSTRY

The ethical problems presented by the modern securities industry are novel only in the specific forms they take and the instruments to which they must be applied. The problems themselves, however, are probably as ancient as human society, and the ethical and legal principles that might appropriately be applied to them were well formulated many centuries ago.

Concern about economic crimes extended throughout the history of ancient Israel, from the earliest biblical period through the later prophets and the period of the Talmud (ending about the seventh century). In denouncing the worst offenses he could think of, the prophet Ezekiel wrote, in the early sixth century B.C.E., "The people of the land have practiced fraud and committed robbery: they have wronged the poor and the needy, and have
defrauded the stranger without redress." The Talmud and the various codes of Jewish law deal with such economic offenses at great length, both as civil and as criminal wrongs.

These ancient principles are not significantly different from those that Congress applied to the securities industry. In essence, they can be reduced to the following:

1. Buyers and sellers are bound both to speak truthfully concerning the transactions in which they engage and not to conceal material facts from one another.

2. So far as is reasonably possible, buyers and sellers are obliged to disclose all of the material facts to those with whom they deal.

3. A person who is in a position of trust should avoid self-dealing and conflicts of interest, and where he has any personal interest in the transaction, he should reveal it to the other party.

4. Misappropriation of the property of others is always, wrong. This principle applied not only to tangible personal property but also to such intangible, intellectual property as information and trade secrets.

5. People should deal fairly and equitably with one another. The principle of fair and equitable dealing may appear to be too vague and general to be of any use, since scholars generally demand clear and distinct

\textsuperscript{21} Ezekiel 22:29 Old Testament, International Version
statements with unequivocal terms and precise criteria for their application to particular cases. Courts recognise, however, that the world does not always lend itself to neat categorisation. The conditions of human behaviour and human ingenuity are so complex and so variable that they cannot be compressed into the narrow molds of precise legal terminology. Therefore, such terms as fairness and equity, with all their seeming ambiguity, are essential to the governance of human behaviour.\footnote{Ethics and the Investment Industry - op.cit. p.158}

Thus, truthfulness, full disclosure, scrupulous conduct when in a position of trust, respect for property rights - including those involving intellectual property - and fair and equitable dealing are the principal rules of conduct governing persons involved in the securities markets.

The following cases illustrate some of these rules and will be useful in drawing some important ethical distinctions.

Feit V. Leasco Data Processing Equipment Corp.\footnote{332. F Supp. 544 (E.D.N.Y. 1971). Quoted in Olivier F.Willeams, et.al. op.cit.} is an illustrative case in which this principle has been applied. Leasco, desiring to purchase Reliance Insurance Company (Reliance), offered Reliance shareholders a package of preferred shares and warrants in exchange for their common stock.

Like all insurance companies, Reliance was required to maintain a certain surplus to guarantee the integrity of its insurance operations. However, Reliance had built up cash and other liquid reserves far in excess of those legal
requirements, amounting to about a hundred million dollars. In its prospectus, Leasco made no direct reference either to the amount of these excess cash reserves or even to their very existence. The prospectus said only that Leasco intended to establish a holding company that would provide "more flexible operations, freedom of diversification and opportunities for more flexible operations, freedom of diversification and opportunities for more profitable utilization of financial resources. It added that Leasco would have Reliance provide the holding company with the maximum amount of funds legally available which is consistent with Reliance's present level of net premium volume.

Those words meant that Leasco planned to drain Reliance's cash reserves into its holding company. Obviously, however, only a very astute investor would have understood that.

The court found that this was an example of a literary art form "calculated to communicate as little of the essential information as possible while exuding an air of total candor." "Masters of this medium", the court went on, "utilize turgid prose to enshroud the occasional critical revelation in a morass of dull and - to all but the sophisticates - useless financial and historical data."

The court noted that the legal standard was that all material facts must be disclosed. It was crucial, however, to determine the persons to whom the facts were intended to have significance. The court concluded that the prospectus must communicate the material facts to the average common shareholders as well as to the sophisticated investor and securities
professional. The less experienced investor is "entitled to have within the four corners of the document an intelligible description of the transaction. "Consequently, the court held that the plaintiffs - investors who had exchanged their shares of Reliance for the Leasco package - were en-titled to money damages because they were misled by the omission of a material fact. The court, in light of these findings, imposed of liability both upon Leasco and upon some of its principal officers.

The Misappropriation Theory: The decision in the case of R. Foster Winans, who wrote the "Heard on the Street" column for the Wall Street Journal, might seem to be a repudiation of Dirks because the Court upheld the convictions of Winans and his co-conspirators. However, there were crucial legal and ethical distinctions between the two cases.

Knowing that the column's comments were taken seriously by investors and often had a swift impact on share prices, Winans conspired with several friends to buy and sell shares of corporations that would be the subject of future columns. He and his co-conspirators were prosecuted for violations of the securities law by misappropriating material, non-public information from the Wall Street Journal in connection with the purchase and sale of securities, and of mail and wire fraud. The defendants argued that because they were not corporate insiders and had not misappropriated the information they used from such insiders, they had violated no fiduciary duty that would fall under Rule 19(b)-5"24 and that they were therefore not guilty of any violation of the securities laws.

24 United States V. Carpenter. 791. F.2d, 1024 (2d Cir 1986).
As Lord Hardwicke said, "Fraud is infinite," and however we may legislate against it, our efforts will be "perpetually eluded by new schemes which the fertility of man's invention would contrive."\(^{25}\) Neither legislation nor education will eradicate the tragedies that befall the victims of such scandals as Equity Funding and the Affiliated Ute Citizens, or for that matter, the tragedies that befall the perpetrators of such schemes. We can do no more than reiterate that - ancient principles that have been handed down to us - principles that have not lost their vitality over the centuries, and that continue to inspire our legislators and, we would hope, our citizens. It is still true that the world rests upon three foundations; justice, truth and peace,\(^ {26}\) for where there is peace, there is no need for courts of law; and there is peace wherever truthfulness reigns. And therefore, all three of these foundations rest ultimately upon truthfulness.

Donald Shriver, (President, Union Theological Seminary, New York City) discusses the affairs of Wall Street in the light of Christian faith.

As a theologian, Shriver argues that a religious vision can be the horizon of human judgement and valuation. Given his background and professional commitment, there is little here that should be surprising. He advocates some criteria for the investment industry that grew out of this religious perspective. According to him an investment is good:


\(^{26}\) Rabban Shimeon ben gamliel, Pirke Avot (Ethics of the Fathers) I.
-when it increases the ability of the weakest people of society to meet their basic needs,

-when profit from the investment has its origin and benefit in the work of the spectrum of people... who use the investment... and

-when the investment offers individuals and groups incentive to serve some social good beyond themselves.

Likewise, his religious vision provides indices of mis-service to the social and common good;

-when it inflicts large penalties on any group of people without providing them either direct or indirect rewards ...

-when its long-range harms to majorities outweigh its short-range benefit to a minority...

-when the major result of the investment is to make the rich richer and the poor no better or worse off...

Both the above positive and negative criteria are the essence of what he characterizes as "moral capitalism". Shriver believes that the religious person cannot settle for anything less, even if there is risk to profits and personal gain.
Sometimes a wrong idea prevails about the small investor and it is said that a large number of small investors jam the system of raising capital from the public. It is suggested by SEBI that for reducing the marker of small investors the minimum application amount should be increased to a face value of Rs.5000 from the present amount of Rs.1000. (Minimum 100 shares of Rs.10 each). There is also a government directive that preference in allotment must be given to small investors. One guideline that must be followed is that there must be atleast 20 allottees for every Rs.1,00,000 of issued capital. An important objective of public issue is the widening of the shareholder base of the issueer by attracting a range of new shareholders. Therefore, a minimum of 50% of net offer to the public out of the public issue amount has to be reserved for individual investors applying for securities not exceeding 1000 securities in each case.27 Several arguments have been put forward opposing the suggestion of SEBI. This is seen as a move to shut out small investors from the primary market. FICCI has opined that this will inhibit the development of the capital market, since the small, investors are the back bone of a strong market.

It is said, “Leave the decision to the individual, big, medium, small or tiny. If he knows not let him go to the mutual funds. If he thinks he knows or knows he knows, don't keep him out just because his financial resources are small”28. It is also seen that the system gets clogged not because of the large


number of small investors but because the banking system is not able to process the application cheques faster.

Statistics show that small investors formed nearly 85 to 90 percent of the applicants in an average public issue during 1995-97. In future, it is quite possible this will be substantially decreased because the small investors have started to shift to other safer investments like participating in mutual funds.

After SEBI activated the Investor Grievance Cell, representatives of many companies have started collecting investor complaints against their names personally from SEBI, for quicker redressal. Some companies have informed SEBI that they have created a special investors’ cell to look into their grievances.

The complaints received by SEBI from investors have been categorised as under:

Type I : Non-receipt of refund orders, allotment letters, stock invest.
Type II : Non-receipt of dividend
Type III : Non-receipt of share certificates, bonus shares
Type IV : Non-receipt of debenture certificates, interest on debentures, redemption amount on debenture.
Type V : Non-receipt of Annual reports, right forms, interest on delayed receipt of refund order, dividend.
Type VI : Complaints related to plantation schemes etc.
The grievance redressal rate of SEBI has been increasing through the years as can be seen from the following Table.

**INVESTOR GRIEVANCES - YEAR-WISE**

<table>
<thead>
<tr>
<th>Year</th>
<th>Complaints Received</th>
<th>Complaints Resolved</th>
<th>Percentage of complaints Resolved</th>
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<tr>
<td>Upto 1991</td>
<td>18,794</td>
<td>4,061</td>
<td>21.61</td>
</tr>
<tr>
<td>1992-93</td>
<td>1,10,317</td>
<td>22,946</td>
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<td>1993-94</td>
<td>5,84,662</td>
<td>3,39,517</td>
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<td>5,16,080</td>
<td>3,51,842</td>
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<td>1996-97</td>
<td>5,69,231</td>
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<td>1,59,670</td>
<td>6,10,247</td>
<td>NA</td>
</tr>
</tbody>
</table>

The grievances received during the year 1997-98 were substantially lower than those received in the earlier years. The average receipts consequently declined to around 450 per day. The decline was pronounced with regard to non receipt of refund orders, allotment order, and share/debenture certificates on allotment. The reasons for the improvement in the rate of investor grievances redressal in the year under review included effective follow
up with the companies, tightening of the procedure for issuing the No
Objection Certificate for release of the 1 per cent security deposits kept by the
companies with the stock exchanges and periodic meetings held with the
recalcitrant companies. Further, the SEBI also sent reply paid post cards to
those investors whose complaints were pending as per the SEBI database
asking them to confirm whether the resolution as reported by the companies
is correct or not. Based on the confirmation received, SEBI updated the
Investor Grievances Database. SEBI has formulated an Investor Complaint
Format by which the investors can bring their grievances to the notice of SEBI.

SEBI has been unable to bring offenders to book. The Indian Judicial
system, is both expensive and time consuming. 29 SEBI is also handicapped by
the fact that it is still an evolving organisation; there is no sufficient clarity on
the extent of its powers and responsibilities. The many regulatory authorities
like the Reserve Bank of India, the Department of Company Affairs, the Stock
Exchanges and the Public Sector Banks all have to work in coordination to
make the regulatory framework successful.

When SEBI was set up the prime responsibility was to take care of
investors and look into public-issue-related problems. Once the investor
becomes a shareholder, the responsibility of ensuring fair play was with the
Department of Company Affairs.

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Subsequently SEBI was given additional functions which included ensuring that companies transferred share in the stipulated time and paid declared dividends. Such additional responsibility did not come hand in hand with greater authority. While SEBI has the overseer’s role, it does not have power to take action against companies in case of default. It has to either urge the stock exchanges or to use the DCA. SEBI does not have the power of search and seizure; it cannot act against companies; it cannot bar an individual for life from the securities market or make high profits.

While SEBI does not have specific powers it can invoke section 11(B) of the SEBI Act which empowers it to issue directive in the interest of investors. But that doesn’t take it very far. When SEBI had ordered NEPC Paper and Boards to refund the application money because of inadequate disclosures in the offer documents, the Finance Ministry revoked the order.  

Finally, it may be concluded that the SEBI regulations are in effect intended to enable the investors to make well informed decisions, not necessarily the best decisions. Information no doubt enables rational decision making but one has to foresee about the future which if turns out to be real, the decision ends successfully - the investment bears fruit.