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# **REGULATORY FRAMEWORK OF PROSPECTUS:** **CRITICAL ANALYSIS**

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## **ABSTRACT**

The paper will provide insights into the procedure, types, and modes of the prospectus with an in-depth focus on the eligibility, limitations, and risk associated with the issuing of the prospectus. It focuses on the principles of capital restructure, investment, and management in the corporate sector. The prospectus is an essential document issued by a company to raise its capital further. The paper shall clarify the process of filing a prospectus in accordance with the Companies Act, 2013, and the regulations by Securities Exchange Board of India, especially SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018. It also covers how false statements in a prospectus could be held liable. The different types of prospectus include the shelf prospectus, red herring prospectus, deemed prospectus, and the abridged prospectus. Delving into different modes through which they can be made, including the public offer, rights issue, private placement, and the bonus issue. Emphasising on different modes having different eligibility criteria, advantages, limitations and risks associated via SEBI regulation.

By thoroughly analyzing case studies and legal precedents, the paper offers insights into how businesses maneuver the regulatory environment while ensuring transparency and accountability. The results highlight the significance of a properly organized prospectus in building investor trust and enabling informed investment choices. This study ultimately acts as a significant resource for legal professionals, business organizations, and regulatory bodies in comprehending and implementing the stipulations of the Companies Act of 2013 within the framework of capital markets.

## **INTRODUCTION**

When a company is incorporated and registered, a comprehensive capital is invested in the form of equity, also specified in the memorandum of association of the company. However, over time, due to circumstances such as increased competition or to facilitate the financial and operational management of the company, or otherwise, the company may prefer to increase its

capital. The corporate sector provides a broad platform for such companies to raise the capital of the company by providing access to various options such as private placement, bank loans or rights issue. This can be done by filing a prospectus with the registrar of the company. The prospectus is a medium through which the interested public is informed about the venture of the company.<sup>1</sup> It is mandatory for the company issuing securities to the public to issue a prospectus, which not only discloses the essential information and circumstances but also ensures nothing about the company is hidden from the investors, and therefore, it is also called golden legacy.<sup>2</sup> This aforementioned rule has been reflected under various provisions of the Companies Act, 2013, which seeks to protect the interests of investors by providing comprehensive and elaborative guidelines and requiring relevant disclosure of material facts to ascertain the financial soundness of a company. There are four main types of prospectuses: shelf prospectus, red herring prospectus, deemed prospectus, and abridged prospectus. A company interested in raising capital may issue a prospectus via public offer, private placement, rights issue, or bonus issue. Public offers can be made by the existing public companies who issue shares on a recognized stock exchange or the company that has just been listed and is issuing shares for the first time via further public offer and initial public offer respectively. A private placement is done by the issuer company to only a selective group of people already registered with the company. Rights issue is the issuance of shares that are first offered to the already existing shareholders of the issuer company and then the general public. However, a bonus issue is the issuance of shares to the shareholders without any consideration. The Security Exchange Board of India (herein after SEBI), specifically by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the Companies Act of 2013, regulates and governs the entire process. SEBI provides regulations to be followed and ensured by the companies making public offers, whereas the Companies Act defines and provides a mechanism that guides. This paper will delve into a comprehensive understanding of various ways a company can issue a public offer, private placement, rights issue, and bonus issue, different types of prospectus, regulations to be followed, benefits and challenges faced during the public offer, along case studies.

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<sup>1</sup> The New Brunswick Railway Company v. Muggeridge (1859) (62 E.R. 263)

<sup>2</sup> Pagewood in Henderson v. Lacon (1865)

## PROSPECTUS AND ITS REGISTRATION

A prospectus, as defined under the Companies Act, 2013, means a document that is issued as a prospectus by a company, including red herring and shelf prospectus, through advertisement, media, notices, etc.<sup>3</sup> A prospectus is an invitation to offer to the general public to subscribe or purchase the listed securities of the company on the recognised stock exchange. Any document through which an offer to subscribe or sell the securities to the public is made shall be considered to be a prospectus issued by the company, and the content requirements and liabilities of the prospectus shall be implied upon such offer.<sup>4</sup> The prospectus shall, before being issued to the public, be registered with the registrar of the company and a copy shall be signed by the directors of the company. For a prospectus to be registered, it shall comply with the requirements mentioned below.

### *Procedure for filing a prospectus*

Every public company issuing a prospectus shall ensure that the prospectus contains the following<sup>5</sup>:

1. A resolution has been passed for such an issue with its details and the authority concerned for it,
2. It shall be dated and signed by all the persons named in the prospectus
3. The details (mainly the names and addresses) of the Company Secretary, legal adviser, registered office of the company, Chief Financial Officer, banker, and others as shall be prescribed,
4. The details containing the appointment and remuneration of the directors of the company,
5. The accurate date of the opening of the issuance of the securities, followed by the closing time, along with the details of procedure, allotment, and refunds,
6. A separate bank account shall be opened wherein all the money received by the issue shall be transferred, and a statement about the same shall be made by the Board of Directors,
7. The information about the underwriting of the issue,
8. The Directors, auditors, bankers, and other persons as prescribed shall sign the consent,
9. The capital and the objective of the Company,

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<sup>3</sup> § 2(70) of the Companies Act, 2013

<sup>4</sup> §28(2) Companies Act, 2013

<sup>5</sup> Regulation 3 of SEBI (Prospectus and allotment of securities) Rules

10. The objective of the issue and its terms,
11. Documents concerning the management of the risk to the project, gestation period, progress report along with the time limit for completion of the project, and any pending proceedings or legal actions against the promoters of the company in the past five years from the issuing of the prospectus.
12. The source of contribution of the promoters.
13. A report for the financial information containing<sup>6</sup>:
  - i) The report on the profit and loss in the preceding five years from issuing of prospectus with the auditors of the company,
  - ii) The report of assets and liabilities of the company not more than one hundred eighty days prior to issuing the prospectus. However, if a company is incorporated in less than five years from the issuing of the prospectus, the profit and losses of the company in the preceding financial year shall be stated.
  - iii) The report of the company and its subsidiaries preceding five years relating to the profit and losses. However, if a company or its subsidiaries is incorporated in less than five years from issuing of the prospectus, the profit and losses of the company in the preceding financial year shall be stated.
  - iv) Reports of the proceeds of the securities,
14. The provisions of the Companies Act, 2013, Securities Contracts (Regulation) Act, 1956, and the Securities and Exchange Board of India Act, 1992, shall be complied with, and a declaration about the same shall be made.
15. A statement that the copy of the prospectus is registered with the registrar of the company.
16. Any other report as may be prescribed.

To make it more convenient for the investors, the prospectus shall contain the following at the beginning of the prospectus:

- a) Documents such as red herring prospectus,
- b) Name, logo, address of office, contact details along with the date of incorporation of the company,
- c) Details of the promoters of the company,
- d) Quantum, price, and other information about the issued securities,
- e) The expected raised amount by this offer made through shelf prospectus,

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<sup>6</sup> Regulation 4 of SEBI (ICDR) Regulations

- f) Name, logo, address of office, contact details of the registrar of the company,
- g) Date of opening and closing of the issue,
- h) Rating of credit,
- i) Grades issued by Initial Public Offer,
- j) The recognised stock exchange where the issued securities are listed,
- k) Eligibility criteria of the investors,
- l) Coupon payment, rate, redemption amount and date, and debenture trustee (in case of debt securities).

The prospectus shall be issued in not more than ninety days from being registered with the registrar; else it shall be not valid. Also, if the prospectus is issued while violating the provisions as stated, the issuing company shall be fined up to three lakh rupees, and the offenders shall be imprisoned or fined up to three lakh rupees or both.

#### *Modification in terms of the prospectus*

The issuing company shall not alter the terms of the contract or the object of the issue as referred to in the prospectus unless a special resolution is passed by the company to do so. Such details of the special resolution shall be published in a newspaper in the area where the company has its registered office, one in English and one in the local language. The company shall not use the money raised by the issue for buying or trading in the equity shares of another company. However, the shareholders against such variation in the terms of contracts or the objects of the company shall be granted an exit offer by the promoters or the shareholders in a manner prescribed by the regulations of SEBI.

#### *Advertisement of prospectus*

The contents of the memorandum, including the objective of the company issuing the prospectus, the liability, capital, and the address of the registered office along with the number of shares subscribed by the members who have signed the memorandum of the company, shall be published in the advertisement done for the prospectus.

#### *Liability for false statements in the prospectus*

**Criminal liability:** When a company issues a prospectus that involves any statement that is not true or is misleading, and the person had no reasonable grounds to believe it to be true, then the person responsible for this act shall be liable for fraud as under section 447 of the Companies Act, 2013. This shall include the omission or concealing of information to gain

undue advantage by neglecting the public interest. Which states that the person guilty of fraud shall be punished for six months to ten years and fined of amount equivalent to or any amount not less than up to three times the amount of fraud.

*Civil liability:* When a company issues a prospectus that involves any statement that is not true or is misleading, and people have subscribed to the securities by believing the false statement in the prospectus and has sustained loss, in such a case the company and its directors, person signed as director in the prospectus, and its promoters shall be liable to compensate for such losses. However, if any person who consented to become a director later withdraws his consent before the issuing of the prospectus or gives a public notice that his consent was not taken before the issue, he shall not be liable<sup>7</sup>.

## TYPES OF PROSPECTUS

As described in the definition of the prospectus in the Companies Act, 2013, under sub section 70 of section 2, it states that a prospectus includes shelf prospectus and a red herring prospectus. However, the deemed prospectus and abridged prospectus are also their kinds.

### *Shelf prospectus*

Drafting a prospectus is a time-consuming process, especially for a company that issues securities multiple times in a year. In such a scenario, it is nearly impossible to keep drafting prospectus every time. Therefore, SEBI allows such companies or classes of companies, via regulations, to issue shelf prospectus. The shelf prospectus is filed with the registrar of the company when a company issues securities for more than one round. However, the validity of such prospectus is not more than one year. An information memorandum shall be filed with the registrar of the company within three months to the subsequent issue, containing information including any new charge, financial updates of the company from the previous issue, etc.<sup>8</sup>

### *Red Herring prospectus*

One of the ways to invite the public to subscribe to issued securities is via a red herring prospectus. A red herring prospectus does not contain detailed particulars about the issue, such as the quantity or the price. A company may issue a red herring prospectus soon before the

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<sup>7</sup> Mohandas Shenoy Adige v SEBI

<sup>8</sup> §31 of Companies Act, 2013

issue of a prospectus. The red herring prospectus does not provide or contain information about the quantum of the securities or the price of each security. However, a rough span of the price is provided. Such a prospectus shall be filed within three days from the opening of the offer with the registrar of the company. Even though it is different than a usual prospectus, it carries the same obligations, and all the rule and procedures of the prospectus applies to the red herring prospectus. The details not specified in the red herring prospectus and other details, such as the capital, by debt or share capital, raised, closing price of the securities shall, after the closing of the issue, be registered with the registrar and SEBI. This is generally used by the companies making an Initial Public Offer wherein they discuss and consult with the investors and underwriters to determine a price to bid for the listed securities for bidding.<sup>9</sup>

#### *Deemed prospectus*

Any document published by which an offer to the public is made to purchase or subscribe to the listed securities of the company is deemed to be a prospectus as if it is issued by the company.<sup>10</sup> Therefore, the rules, procedures, and liabilities of a prospectus shall apply to it in the same manner. It shall be considered that the allotment of securities was made to invite offers for purchase from the public if it is proved that:

- a) an offer to subscribe or sale of securities was made within six months after the allotment,
- b) the company has not received the consideration with respect to the securities on the date of offer.

The documents issued by the company or firms that are deemed to be prospectus shall be signed by at least two directors of the company or not less than one-half of the partners of the firm.

#### *Abridged prospectus*

A prospectus is a lengthy document that contains a lot of details about the company, including its memorandum of association and details about the securities being listed. Hence, the investors can't go through hundreds of pages to get to know about the offer. Therefore, a prospectus having all the salient features of the issue of the securities is issued, which is known as an abridged prospectus. It is also mandated that a company issuing shares shall accompany an abridged prospectus with the application for the subscription or purchase of securities. A

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<sup>9</sup> Book building method

<sup>10</sup> § 25 of the Companies Act, 2013

company shall be held liable to pay a fine of up to Rs fifty thousand if it does not comply.<sup>11</sup>.

## MODES TO ISSUE PROSPECTUS

### *Public offer*

A company not limited by liability where listed or intending to get listed may offer to issue securities to the public via prospectus, which is known as a public offer. The securities issued by the issuer company making a public offer shall be in dematerialised form in compliance with the Depositories Act, 1996<sup>12</sup>. The company making a public offer and issuing the securities for subscription or purchase shall make an application to one or more recognized stock exchanges to obtain the permit for the securities to be issued in such stock exchange. The prospectus shall state the name of the recognised stock exchange where the securities shall be issued.

The public offer is of three types

#### a) Initial Public Offer

The initial public offer is an invitation to offer specific securities by an unlisted company for subscription or purchase. The conditions provided by SEBI in the Issue of Capital and Disclosure Requirements shall be complied with by the issuer while filing the offer document.

### *Eligibility to make an initial public offer*

- i) The company shall have *net tangible assets* of a minimum of three crore rupees in every three preceding years, calculated on a consolidated basis. Fifty percent of which shall be in monetary form.
- ii) The *average operating profit* of the issuer company shall be at least fifteen crore rupees during the preceding three years, calculated on a consolidated basis.
- iii) *Net worth* shall be at least of one crore rupees in the previous three years, calculated on a consolidated basis
- iv) If the name of the issuer company has been changed in the last a year, then it shall, a least, have a revenue of fifty percent for that year earned with the new name.

If the issuer company does not satisfy any of these conditions, it can still make an initial

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<sup>11</sup> § 33 of the Companies Act, 2013

<sup>12</sup> § 29 of the Companies Act, 2013

public offer via book building process, and the issuer agrees to allot at least seventy-five percent of the net offer to qualified institutional buyers<sup>13</sup>.

*Non-eligibility for a company to make an initial public offer*

- i) If the board has barred any of the issuers, promoters, directors, or shareholders.
- ii) If the board has debarred any of the issuers, promoters, directors, or shareholders of any other company.
- iii) If the issuer or its promoters or directors are defaulters.
- iv) If they are economic defaulters.<sup>14</sup>

*Essential conditions to be followed<sup>15</sup>*

- i) An application shall be made to stock exchange(s) for approval to list the securities on that stock exchange
- ii) The securities shall be in the dematerialized form before filing the offer document, and for the same, it shall have entered into an agreement with the depository.
- iii) All the party-paid equity shares shall be fully paid or forfeited
- iv) The financial arrangements are made through verifiable sources of around seventy-five percent of the finances for the project to fund the issue.
- v) The amount for corporate purpose shall not exceed twenty five percent as specified in the draft offer document and the draft document.
- vi) The amount for general corporate and the purposes where the company has not yet identified the target amount shall not exceed thirty five percent, as per the offer document.
- vii) No amount of more than twenty five percent received from the issue shall be utilised for the purposes where the company has not yet identified the target amount.

b) Further Public Offer:

The further public offer is an invitation to offer of specific securities by an unlisted company for subscription or purchase. It includes an offer for sale of these securities by the existing holders to the public.

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<sup>13</sup> Regulation 6 of SEBI (ICDR) Regulations

<sup>14</sup> Regulation 5 of SEBI (ICDR) Regulations

<sup>15</sup> Regulation 7 of SEBI (ICDR) Regulations

*Eligibility to make a further public offer*

- i) The issuer company shall not have changed its name in the preceding one year of making a further public offer. If it has, then at least fifty percent revenue is generated in the new name
- ii) If the issuer company does not satisfy any of these conditions, it can still make an initial public offer via book building process, and the issuer agrees to allot at least seventy-five percent of the net offer to qualified institutional buyers.

*Non-eligibility for a company to make an initial public offer*

- i) If the board has barred any of the issuers, promoters, directors, or shareholders
- ii) If the board has debarred any of the issuers, promoters, directors, or shareholders of any other company
- iii) If the issuer or its promoters or directors are defaulters.
- iv) If they are economic defaulters<sup>16</sup>

*Essential conditions to be followed<sup>17</sup>*

- i) An application shall be made to stock exchange(s) for approval to list the securities on that stock exchange
- ii) The securities shall be in the dematerialized form before filing the offer document, and for the same, it shall have entered into an agreement with the depository.
- iii) All the party-paid equity shares shall be fully paid or forfeited
- iv) The financial arrangements are made through verifiable sources of around seventy-five percent of the finances for the project to fund the issue.
- v) The amount for corporate purpose shall not exceed twenty five percent as specified in the draft offer document and the draft document.
- vi) The amount for general corporate and the purposes where the company has not yet identified the target amount shall not exceed thirty five percent, as per the offer document.
- vii) No amount of more than twenty five percent received from the issue shall be utilised for the purposes where the company has not yet identified the target amount.

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<sup>16</sup> Regulation 102 of SEBI (ICDR) Regulations

<sup>17</sup> Regulation 104 of SEBI (ICDR) Regulations

c) Offer to sale-

The members of the issuer, after consulting with the board of directors and in accordance with the regulations and laws, may offer to sell whole or part of their shares. Any document providing information of such an offer is deemed to be a prospectus and shall hold the content and liabilities of a prospectus<sup>18</sup>.

*Private Placement*

Unlike a public offer, a private placement is an offer to subscribe or purchase securities by selective persons as prescribed by the regulation in SEBI.

Before making a private placement, the issuer shall ensure that

- i) The offer in the special resolution is passed by the shareholders where the price of the same was disclosed<sup>19</sup>.
- ii) The value of such an offer shall not be less than the face value of rupees twenty thousand per person. However, this does not apply in the case of non-banking financial companies and housing finance companies registered under the RBI Act, 1934, and the National Housing Bank Act, respectively<sup>20</sup>.

If the offer is made to more persons than prescribed it shall be considered a public offer in whatever circumstance, for example, if the company has received the payment or it wanted to list those shares. The offer shall be made to the persons who are on record with the company before such invitation to offer. The offer shall be received by the person accompanied by an application form in a prescribed manner. A private placement offer letter is issued by the company making a private placement in the form PAS-4<sup>21</sup>. The securities shall be allotted within sixty days from the date of receipt of money. In case it is not complied with, it shall repay within fifteen days the money received, and if not then it shall be liable to repay with an interest of 12% interest per annum. Until the allotment of the said securities is completed, the issuer shall not make any fresh offer.

The issuer shall keep the money received from the issue in a different account, and all the payments with respect to the securities shall be done via cheque or demand draft but not through cash<sup>22</sup>. Such an offer shall not be socially announced through

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<sup>18</sup> § 28 of the Companies Act, 2013

<sup>19</sup> Rule 14(2) of SEBI (ICDR) Regulations

<sup>20</sup> Regulation 14(5) of SEBI (ICDR) Regulations

<sup>21</sup> Regulation 14(1) of SEBI (Companies Prospectus and Allotment) Rules

<sup>22</sup> § 42 of the Companies Act

media, advertisement, or marketing.<sup>23</sup> A return of allotment shall be filed with the registrar of the company including the list containing details of the securities holders. However, any offer to private placement is not in compliance with the Companies Act, 2013, and the regulations of SEBI, and the Securities Contracts (Regulation) Act shall be deemed to be a public offer.

The entire record shall be maintained by the issuer in Form PAS-5.

The issuer may issue further shares to increase the capital by offering to:

- i) Existing shareholders of equity share by sending them an offer letter, which shall include the quantum of shares being issued, and he shall have the right to reject or renounce such an offer.
- ii) Employees or any other person, by passing a special resolution.

Such notice shall be provided within three days before the opening of the issue via registered post. This does not apply to increasing the capital by converting the debenture or loan into shares. However, if such a loan or debenture is issued by the government, then it may directly be converted to shares, if the government orders. However, if the company is not satisfied, then it may file before the tribunal within sixty days<sup>24</sup>.

### *Rights issue*

The securities are offered to the existing shareholders in the same proportion to the existing holding in the capital. It is the discretion on them to accept completely or partially, or reject or renounce the offer to another existing shareholder. The conditions of Chapter II of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 shall be satisfied while filing a draft and final letter of offer if the issuer has issued securities of more than fifty crore rupees.

Such securities may be issued to:

- i) Equity shareholders, by sending an offer letter that shall specify the quantum of shares. The offer shall be accepted within fifteen to thirty days, else it shall be deemed to be declined. It shall also include the rights of the offeree to renounce the offer to another existing equity holder.

However, the promoter group shall not renounce the offer if the director, issuer, or

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<sup>23</sup> Vijay Kumar Gupta v Eagle Paint and Pigment Industries Ltd. ([1999] 95 COMPCAS 810 (CLB))

<sup>24</sup> § 62 of the Companies Act, 2013

promoters are willful offenders.

- ii) Employees or any other person, by passing a special resolution.

Such notice shall be provided within three days before the opening of the issue via registered post. This does not apply to increasing the capital by converting the debenture or loan into shares. However, if such a loan or debenture is issued by the government, then it may directly be converted to shares, if the government orders, considering the financial position of the company. However, if the company is not satisfied, then it may file an appeal before the tribunal within sixty days.

The changes shall be registered with the registrar of the company and alteration shall be done in the MOA of the company accordingly<sup>25</sup>.

#### *Eligibility to make rights issue<sup>26</sup>*

- i) An application shall be made to the stock exchange or exchanges for approval to list the securities on that stock exchange.
- ii) All the party-paid equity shares shall be fully paid or forfeited
- iii) The financial arrangements are made through verifiable sources of around seventy-five percent of the finances for the project to fund the issue.
- iv) The amount for corporate purpose shall not exceed twenty five percent as specified in the draft offer document and the draft document.
- v) The amount for general corporate and the purposes where the company has not yet identified the target amount shall not exceed thirty five percent, as per the offer document.
- vi) No amount of more than twenty five percent received from the issue shall be utilised for the purposes where the company has not yet identified the target amount.

#### *Non- eligibility to make rights issue:*

- i) If the board has barred any of the issuers, promoters, directors, or shareholders
- ii) If the board has debarred any of the issuers, promoters, directors, or shareholders of any other company
- iii) If they are economic defaulters.

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<sup>25</sup> § 64 of the Companies Act, 2013

<sup>26</sup> Regulation 62 of SEBI (ICDR) Regulations

A date shall be announced to the eligible shareholders to apply for the proposed securities in a manner prescribed by SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

### *Bonus issue*

Similar to the rights issue, shares are issued for the existing shareholders in the proportion of their existing shares. However, unlike the rights issue, the bonus issue is done without consideration.

### *Eligibility for bonus issue<sup>27</sup>*

- i) The issuer has specified in the articles of association about the bonus issue
- ii) The issuer shall pass a resolution to make such alteration in the articles of association if it was not specified earlier
- iii) Approval from the recognized stock exchange for listing such securities
- iv) No default in the payment of principal or interest of deposits or debts
- v) No default in the payment towards contribution in funds or bonus
- vi) The partly paid-up shares are fully paid
- vii) The issuer, its director, or promoters are not economic offenders.

### *Limitations on bonus issue<sup>28</sup>*

- i) Reservations of equity shares are made for shareholders of convertible debts
- ii) Such reservation shall be issued to the warrant or debt instrument holders on the same proportion at which the bonus share is issued
- iii) The bonus issue shall be made of free reserves, or premium account, build b profits
- iv) If SR equity shares are issued, then they shall carry the same voting rights as ordinary shares
- v) The issue shall be done in a dematerialized form.
- vi) A bonus issue, once declared, cannot be withdrawn.

## **CONCLUSION**

It can, therefore, be concluded, a prospectus serves as a vital document in the corporate field, which creates an equilibrium between the transparency of the company and the interest of the

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<sup>27</sup> Regulation 293 of SEBI (ICDR) Regulations

<sup>28</sup> Regulation 294 of SEBI (ICDR) Regulations

investors. The Companies Act and SEBI provide a legal pathway for the issuer by establishing general guidelines for this process. The provisions to disclose the memorandum and other details of the company, liability for false statements in prospectus, advertisements, etc, help promote accountability. The various types of prospectus are discussed in the paper, namely, shelf prospectus, red herring prospectus, deemed prospectus, and abridged prospectus, along with the eligibility, limitations, and other procedures to prevent the misuse of capital market. Therefore, it can be said that a transparent system is followed to raise the capital. This paper acts as a crucial tool for stakeholders aiming to understand the intricacies of prospectus issuance, highlighting the importance of ethical financial conduct and adherence to legal regulations.

