

# Discussion Paper on “Review of policy relating to forfeiture of partly paid-up shares - Amendments to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011”

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## Background

1. Forfeiture of shares is a process specified under Table-F (Articles of Association of a Company Limited by Shares) of Schedule I of the Companies Act, 2013. The standard procedure to be followed in case of forfeiture of partly paid-up shares is as follows:
  - i. If a member fails to pay any call, or instalment of a call, on the day appointed for payment, the Board of Directors of the company may, at any time thereafter during such time as any part of the call or instalment remains unpaid, serve a notice on him requiring payment of such amount, together with any interest which may have accrued.
  - ii. If the requirements of any such notice are not complied with, any share in respect of which the notice has been given may be forfeited by a resolution of the Board of Directors of the company.
2. The manner of exercising voting rights on partly paid-up shares as per the Companies Act, 2013 has been specified as hereunder:
  - i. As per clause (b) of sub-section (1) of section 47 of the Companies Act, 2013, voting rights on a poll shall be proportionate to the paid-up equity share capital of the company. Therefore, voting rights on partly paid-up shares may be considered to be in proportion to the actual amount paid on these shares.

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- ii. Further, sub-section (1) of section 106 of the Companies Act, 2013 allows the articles of a company to provide that no member shall exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid.
  3. However, the increase in voting rights on the expiry of call notice period may not be everlasting and some shareholders may pay up the calls even after the expiry of call notice period and there would be uncertainty in this respect till the time the shares are forfeited by the company. Since the actual increase in voting rights is evident only on forfeiture of shares, the open offer obligations in such cases would trigger on the date of forfeiture of partly paid-up shares. However, the same is not explicitly provided for.
  4. With regard to the issue of incidental increase in voting rights without a positive act of an acquirer, Hon'ble SAT vide order dated November 21, 2011 in the matter of Mr. Raghu Hari Dalmia and others vs SEBI had ruled that the increase in the voting rights of the appellants was not by reason of any act of theirs but was incidental to the buyback of shares of other shareholders by the company and such a passive increase in the proportion of their voting rights would not attract regulation 11(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. It may be noted that open offer obligations arising as a result of buyback were subsequently brought under the scope of exemptions through the automatic route in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred to as the "Takeover Regulations, 2011").
  5. The increase in the shareholding due to the expiry of call notice period and forfeiture of shares may be treated as a passive acquisition due to the following reasons:
    - i. Increase in voting rights of any shareholder as a result of forfeiture of partly paid-up shares held by some shareholders is passive in nature as the process is initiated due to non-payment of call money by defaulting shareholders.

- ii. Similarly, accrual of voting rights to the remaining shareholders, computed on pro rata basis, upon the expiry of call notice issued to the shareholders holding partly paid-up shares is also passive in nature.
- iii. Forfeiture is undertaken by the company as per the provisions of the Companies Act, 2013 where it is at full liberty to undertake this to remove defaulting shareholders from the Register of Members.

### **Need for regulatory amendment**

6. Regulation 10 of the Takeover Regulations, 2011 provides general exemption from the obligations to make an open offer for certain acquisitions, subject to fulfillment of the conditions specified therein.
7. Increase in voting rights arising out of actions undertaken by the companies under the Companies Act, 2013 such as rights issues, buybacks and schemes of arrangement are exempt from the open offer obligations under regulation 10 of the Takeover Regulations, 2011.
8. Further, accrual of voting rights on preference shares where dividend has not been paid for two years or more as per sub-section (2) of section 47 of the Companies Act, 2013 are exempt from the open offer obligations under regulation 10 of the Takeover Regulations, 2011.
9. Currently, there is no provision for increase in the voting rights of a shareholder due to the expiry of call notice period and forfeiture of partly paid-up shares to be exempt under regulation 10 of the Takeover Regulations, 2011 and an application needs to be filed with SEBI for seeking exemption from the open offer obligations in this regard under regulation 11 of the Takeover Regulations, 2011.
10. It may be noted that the facts of these cases with respect to these applications are quite similar. However, a reasoned order must be passed by SEBI in each such case which may take enormous amount of time and effort.

11. Further, increase in the voting rights of a shareholder due to the expiry of call notice period and forfeiture of partly paid-up shares is undertaken under the Companies Act, 2013 and is passive in nature.
12. Therefore, it is proposed that the Takeover Regulations, 2011 may be amended suitably for providing general exemption from the open offer obligations in the cases of increase in voting rights as a result of the expiry of call notice period and the forfeiture of shares in line with general exemptions available with respect to rights issues, buybacks etc.

### **Proposed Amendment**

13. Accordingly, it is proposed to insert the following as clause (j) under sub-regulation (1) of regulation 10 of the Takeover Regulations, 2011:

*“Increase in voting rights arising out of the operation of sub-section (1) of section 106 of the Companies Act, 2013 or pursuant to forfeiture of shares by a company undertaken in compliance with the provisions of the Companies Act, 2013 and articles of association of the company.”*

### **Public comments**

14. Considering the implications of the said matter on the market participants including listed companies, promoters/promoter group of the said companies and investors, public comments on the amendment proposed above at paragraph 13 are solicited. Specific comments/suggestions as per the format given below would be highly appreciated:

<b>Name of entity / person / intermediary:</b>		
<b>Name of organization (if applicable):</b>		
<b>Sr. No.</b>	<b>Proposed / suggested changes</b>	<b>Rationale</b>



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15. Such comments may please be e-mailed on or before September 30, 2015, to [anupamk@sebi.gov.in](mailto:anupamk@sebi.gov.in) or [sk Singh@sebi.gov.in](mailto:sk Singh@sebi.gov.in) or sent by post, to:-

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