



On August 26, 2015, SEBI floated a Discussion paper for reviewing the policy relating to forfeiture of partly paid-up shares, requiring an amendments to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('Takeover Code, 2011'). SEBI in its Board meeting held on November 30, 2015, approved the proposal to amend the Takeover Code for providing general exemption from open offer obligations arising due to 'passive increase' in voting rights as a result of expiry of call notice period and forfeiture of shares.

#### General Exemptions under Takeover Code, 2011:

Regulation 10 of Takeover Code, 2011 relates to 'General Exemption', wherein certain acquisitions are exempt from the obligation of making an open offer under Regulation 3 ('Substantial acquisition of shares or voting rights') and Regulation 4 ('Acquisition of control'), subject to fulfillment of certain conditions. These acquisitions include:

- (i) Inter-se transfer of shares amongst qualifying persons,
- (ii) Acquisition in the ordinary course of business by SEBI registered underwriter (by way of allotment pursuant to an underwriting agreement),
- (iii) Made by Stock broker (on behalf of his client in exercise of lien over the shares purchased on behalf of the client),
- (iv) Made by Merchant banker (in the process of market making or subscription to the unsubscribed portion of issue),
- (v) Any person acquiring shares pursuant to a scheme of safety net,
- (vi) Made by SEBI registered Merchant Banker acting as a stabilising agent or by the promoter or pre-issue shareholder,
- (vii) Made by Market-maker of a stock exchange (in respect of shares for which he is the market maker during the course of market

making),

- (viii) Scheduled Commercial Bank (acting as an escrow agent),
- (ix) Invocation of pledge by Scheduled Commercial Banks / Public Financial Institutions as a pledgee,
- (x) Acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement,
- (xi) Acquisition pursuant to a scheme made under section 18 of SICA,
- (xii) Acquisition pursuant to a scheme of arrangement involving the target company as a transferor company / transferee company, or reconstruction of the target company, including amalgamation, merger or demerger;
- (xiii) Acquisition pursuant to a scheme of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger,
- (xiv) Acquisition pursuant to a scheme to SARFAESI,
- (xv) Acquisition pursuant to a scheme to Delisting Regulations,
- (xvi) Acquisition by way of transmission, succession or inheritance,
- (xvii) Acquisition of voting rights or preference shares carrying voting rights arising out of the operation of Section 87(2) of Companies Act, 1956.

#### Case Laws on Triggering of Open Offer due to



### share forfeiture:

With respect to 'incidental increase' in voting rights without a positive act of an acquirer, SAT (in the matter of Mr. Raghu Hari Dalmia and others Vs SEBI) had ruled that increase in voting rights of 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 Reg. 11(1) of the SEBI Takeover Code, 1997.

In the SAT ruling in the matter of Luxury Foams Ltd & others Vs SEBI, it was held that "In the light of the legal position regarding voting rights attached to the partly paid shares in terms section 181 and 87 of the Companies Act, it is difficult to subscribe to the Appellants version that 440 lakh X equity shares of Rs.10 each issued but partly paid, have no voting rights and as such should be excluded for the purpose of computing the percentages prescribed in regulation 10 etc., is not tenable."

With respect to the general exemptions as prescribed in Regulation 10 of Takeover Code, 2011, SC in Swedish Match AB & Anr. Vs SEBI had held that "...Indisputably, the purport and object of which a regulation is made must be duly fulfilled. Public announcement is at the base of Regulations 10, 11 and 12. Except in a situation which would bring the case within one or the other 'exception clause', the requirement of complying with the mandatory requirements to make public announcement cannot be dispensed with..."

In a recent ruling in the matter of Emmons International Limited, SEBI held that share forfeiture is not a 'passive acquisition' like buyback of shares, since forfeiture of shares is orchestrated by the management / promoters of the company and can be made only by the Board of Directors by passing resolution. The management / promoters are very well aware of

the forfeiture proceedings since they have access to the records of company.

### Reasons for proposing the amendment to Takeover Code, 2011:

The reasons for floating the Discussion Paper to amend the Takeover Code, 2011 are as follows:

- (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) 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 in accordance with Companies Act, 2013 where it is at full liberty to undertake this to remove defaulting shareholders from Members' Register.

SEBI noted that increase in voting rights arising out of corporate actions such as rights issues, buybacks, schemes of arrangement, accrual of voting rights on preference shares where dividend has not been paid for 2 years or more as per Section 47(2) of Companies Act, 2013 are exempt from the open offer obligations under Reg. 10 of Takeover Code, 2011. SEBI observed that, presently, 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 Reg. 10 of the Takeover Regulations, 2011 and an application needs to be filed with SEBI for seeking exemption from the open offer obligations. The facts in the application under Reg. 11 would be quite similar. However, SEBI observed that a reasoned order must be in each such case, which may take enormous amount of time and effort. SEBI acknowledged the fact that



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.

**Proposed amendment to Takeover Code, 2011:**

SEBI had proposed in the Discussion Paper, which has been approved in its Board Meeting held on November 30, 2015 to amend the Takeover Code, 2011 by inserting clause (j) under sub-regulation (1) of Reg. 10 of the Takeover Regulations, 2011 as follows:

“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.”

**Conclusion:**

Finally, SEBI has acknowledged the fact that increase in shareholding / voting rights due to share forfeiture is a 'passive' activity. The exemption from the mandatory requirement of making an open offer will be a great relief to listed companies, as it's sometimes difficult for the company management to quantify such forfeited shares and make an open offer. There will also be a reduction in the litigation on the issue. Now, in the due course SEBI will issue a Notification for amending the Takeover Code, providing an effective date for its applicability.

