

## Pricing of shares offered by listed company on preferential basis – Special provision in AOA Vs. Pricing under SEBI (ICDR) Regulations



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The mandatory requirement of valuation of shares under different laws and regulations in India has always been a matter of interest for corporate law professionals. The requirement of valuation of shares is provided in Company Law, SEBI (ICDR) Regulations, Foreign Exchange laws, Income Tax laws. The requirement of valuation also depends upon the type of issue of shares – rights issue or preferential offer or ESOP, etc. In an interesting matter before SEBI (and then SAT), the issue was – whether mandatory requirement for valuation of shares of listed company by Registered Valuer under articles of association will prevail over the relevant provisions of Companies Act/Rules and SEBI Regulations.

**Brief facts of the case:** PNB Housing Finance Ltd. ('Appellant Company') is a registered housing finance company that is listed to stock exchange. The Appellant Company was seeking to raise its capital in the past two years but such efforts could not materialise. Punjab National Bank (largest shareholder in Appellant Company, holding 33%) informed the Appellant Company that it could not provide funding as regulatory approval from RBI was not obtained. On the other hand, some of the existing shareholders along with others jointly offered to pump in funds by way of preferential allotment of shares.

Based on the offer given by the said entities, the board of directors of Appellant Company passed a resolution on May 31, 2021 approving the raising of capital through preferential allotment of shares to the proposed allottees at Rs. 390/- per share. The board of directors resolved to call and convene an extraordinary general meeting on June 22, 2021 to consider the issue and allotment of shares by way of preferential allotment/private placement basis for cash consideration. The said resolution of the board of directors and subsequent issue of the notices to the shareholders were intimated to the stock exchanges, pursuant to which, the stock exchanges sought various information/responses from the Appellant Company which was duly provided/replied.

Based on the replies by the Appellant Company, the stock exchanges submitted a joint report to SEBI. SEBI (by its letter dated June 17, 2021) asked the Appellant Company to submit a para-wise comments to the joint report submitted by the stock exchanges especially on the issue whether all applicable methods of valuation were considered by the board of director while ascertaining the share price. The Appellant Company provided the requisite reply and, thereafter, the impugned communication was issued. By that communication, SEBI held that agenda no. 1 (i.e. issue and allotment of shares by way of preferential allotment) being ultra vires of Article of Association would not be acted upon until the Appellant Company obtained a report from the Registered Valuer as contemplated by Article No. 19(2) of the Articles of Association. SEBI mentioned that the resolution was ultra-vires since valuation by the Registered Valuer had not been factored while determining the price of the preferential issue and that the Articles of Association requires the board of directors to consider the valuation report of a Registered Valuer.

SEBI, by impugned communication, restrained the Appellant Company from holding the extra-ordinary general meeting with regard to the said agenda. The said communication by General Manger, SEBI was

challenged in appeal before SAT.

**Question before SAT:** For the preferential offer by Appellant Company (i.e. listed entity) is it required to get its shares valued from a registered valuer as required under the Articles of Association or whether the Appellant Company is required to get the pricing calculated in accordance with the pricing mechanism provided under Regulation 164 of SEBI (ICDR) Regulations?

**Discussion on relevant provisions & Observations of SAT:**

- (1) **For listed companies, Chapter III of Companies Act falls under SEBI's jurisdiction:** According to section 24 of the Companies Act, all the provisions in Chapter III (relating to 'Prospectus and Allotment of Securities'), Chapter IV and section 127 of the Act in so far as they relate to issue or transfer of securities and non-payment of dividend by listed companies and companies that intend to get their securities listed would be administered by SEBI. SAT observed that pursuant to section 24 of the Companies Act, virtually all the provision of Chapter III that are connected with securities of listed companies stand covered by SEBI so long as there is a connection with issue and transfer of securities. The provision, in fact, enhances the powers of SEBI in relation to listed companies in as much as everything related to raising capital out of issuance of securities and transfer of securities is now explicitly in SEBI's domain.
- (2) **Companies Act to override Memorandum & Articles of Association of company:** Section 6 of the Companies Act provides that the provisions of the Act shall have effect notwithstanding anything to the contrary contained in the Memorandum and Articles of Association of the company or where there is a provision in the Memorandum or Articles of Association which is repugnant to the provisions of the Act, in which case, the Act will prevail in the face of competition between the two. Thus, there can be no provision in the Memorandum or Articles of Association which could grant any authority to the company which is contrary to the provisions of the Act. Therefore, any clause in the Articles of Association which is repugnant to the Companies Act would be void and the Act shall prevail as held in *Madanlal Fakirchand Dudhediya v. Shree Changdeo Sugar Mills Ltd.* [1962] 32 Comp. Case 604 (SC). SAT noted this important and relevant judgment. It was noted that the statute is to be considered as paramount and no action of the company based on the provisions contained in the Articles of Association which runs contrary to the Act shall not sanctify such action.
- (3) **Issue of shares under section 62(1)(c) of the Act:** Section 62 of the Act relates to 'further issue of share capital'. Pursuant to section 62(1)(c) of the Act, the shares shall be offered to any persons if it is authorised by a special resolution either for cash or for consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to the compliance with the applicable provisions of Chapter III of the Companies Act and any other conditions as may be prescribed. Therefore, under section 62(1)(c) of the Act, the price of the share is required to be determined by the valuation report of a registered valuer. SAT noted that to this extent there is no conflict with Article 19(2) of the Articles of Association of Appellant Company and, consequently, there is no repugnancy. However, the determination of the price of the shares by the valuation report of a registered valuer is subject to compliance with the applicable provisions of Chapter III of the Companies Act and which requires that SEBI will administer this provision in accordance with the SEBI Act and the Regulations framed therein. In this regard, the Regulations framed is SEBI (ICDR) Regulations and the pricing mechanism has been prescribed under Regulation 164. SAT further noted that section 62(1)(c) of the Act provides that the determination of the price of the shares by the valuation report of the registered valuer would also be subject to any other conditions as may be prescribed. According to Rule 3 of the Companies (Share Capital and Debentures) Rules, 2014, the said Rules shall apply to all unlisted public companies and listed companies so far as they do not contradict or conflict with any other Regulations framed in this regard by SEBI.

- (4) No mandatory requirement of valuation report for preferential offer of shares by listed company:** The second proviso to Rule 13(1) of Companies (Share Capital and Debentures) Rules, 2014 makes it explicitly clear that the price of shares to be issued on preferential basis by listed company shall not be required to be determined by valuation report of Registered Valuer. Rule 13(2) of the said Rules amplifies that where a preferential offer of shares/other securities is made by a company whose shares/other securities are listed on a recognised Stock Exchange, such preferential offer shall be made in accordance with the provisions of the Act and Regulations made by SEBI (i.e. Regulation 164 of SEBI (ICDR) Regulations). If the shares/securities are not listed, then preferential offer shall be made in accordance with Companies Act and Rules made thereunder. SAT also noted that Rule 3 of Companies (Share Capital and Debentures) Rules, 2014 provides that the provisions of SEBI Regulations would prevail in the event there is any contradiction or conflict with the said Rules.

Taking into consideration the above points and remarks, SAT (Presiding Officer) observed that in a case of a listed company, the stipulation contained in Article 19(2) of Articles of Association of Appellant Company requiring valuation of shares through registered valuer is dispensed with in view of Rule 13 of Companies (Share Capital and Debentures) Rules, 2014. It was observed that "*Further, in view of Section 24 of the Companies Act read with rule 3(c) and 13(2) of the Rules of 2014, the pricing of the shares of a listed Company is required to be determined in accordance with the Regulations framed by SEBI, namely, Regulation 164 of the ICDR Regulations. Further, in our view there is no repugnancy of any provision of the Companies Act, Rules of 2014 with the SEBI Act and Regulation 164 of the ICDR Regulations.*"

However, SAT (Judicial Member) disagreed with the reasoning recorded and conclusion drawn by SAT (Presiding Officer) and observed as follows:

- (1) While Memorandum of Association is recognised as company's constitution, it's Articles of Association provide the mechanism for implementation of the constitution along with defining the internal relationship between shareholders inter-se and between company. The Article of Association in a way is a contract between the shareholder and company (*Naresh Chandra Sanyal v. Calcutta Stock Exchange Association Ltd.* AIR 1971 SC 422). Once it is found that Articles of Association forms a contract between the shareholders and company/association it would follow that the contract will have to be performed by the parties thereto unless the contract – agreement is void being unlawful or not enforceable by law as provided by the Indian Contract Act or Section 6 of Companies Act;
- (2) Article 19 of the Articles of Association of Appellant Company affirmatively prescribes that preferential shares can be allotted as per other terms and conditions if authorised by special resolution and if the price of such shares is determined by a registered valuer. Taking into consideration Article 19 of the Articles of Association and Regulation 164 of SEBI (ICDR) Regulations, it was observed that "*A provision can be said to be repugnant with other provision if both the provisions are irreconcilable and cannot stand together. I do not find any repugnancy between Article 19 of the Articles of Association and the pricing method provided by Regulation 164 of the ICDR. Article 19 is an agreement between the shareholders and the Company that in the cases where allotment of preferential shares is being made the price of the shares shall be determined by a registered valuer. Regulation 164 of ICDR simply provides for a floor price i.e. a price that shall not be less than the price arrived at by the mechanism provided by it. Both the provisions can stand together.*"
- (3) The SAT (Judicial Member) finally concluded by stating "*In the present case in order to safeguard the interest of the investors, the impugned order was passed by SEBI on the line of the provisions made in Article 19(2) by the Appellant Company and its shareholders, at the time the Company was to be listed on the Stock Exchanges. Therefore, in my view the same cannot be called as illegal or unjustified.*"

**SAT's conclusion, Supreme Court appeal and further observations:** The final order was pronounced by SAT on August 9, 2021<sup>1</sup> wherein SAT (Presiding Officer) allowed the company's appeal and quashed SEBI's Letter, whereas SAT (Judicial Member) dismissed the company's appeal. In view of the difference in opinion between the members of the bench, SAT has directed the interim order passed in the matter to continue until further orders and the Appeal papers to be placed before the Presiding Officer on the administrative side for appropriate orders. SEBI appealed against the SAT order in the Supreme Court. However, in the meantime, the Appellant Company decided not to proceed with the preferential issue. The Supreme Court<sup>2</sup> dismissed the appeal filed by SEBI stating that the appeal has become infructuous due to subsequent developments. The Appellant Company and its directors paid approximately Rs. 73 lacs to SEBI to settle the case w.r.t. preferential allotment of shares to a group of investors<sup>3</sup>.

**Conclusion:** This SAT order is quite interesting as it interprets section 62 of the Companies Act along with Companies (Share Capital and Debentures) Rules, 2014, Companies (Prospectus and Allotment of Securities) Rules, 2014, Regulation 164 of SEBI (ICDR) Regulations and most importantly the Articles of Association of the company. If the matter would have been heard and decided by the Supreme Court (or had it not been the split decision of SAT), the interpretation would have helped in addressing challenging situations where the provisions of the articles of association provided an additional requirement over and above the SEBI Regulations / Company Rules.

Consequent to this case, SEBI amended Regulation 164 of SEBI (ICDR) Regulations, 2018 which now provides that if Articles of Association of the issuer company provide for a method of determination which results in a floor price higher than that determined under ICDR Regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue<sup>4</sup>.

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<sup>1</sup>. *PNB Housing Finance Ltd. v. SEBI* [2021] 129 taxmann.com 136 (SAT - Mum.).

<sup>2</sup>. Civil Appeal No. 5052/2021, October 20, 2021.

<sup>3</sup>. Settlement Order No. SO / EFD-2 / SD/ 413 / JULY / 2022, dated July 18, 2022.

<sup>4</sup>. Amendment inserted by the SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022 w.e.f. January 14, 2022.