Forfeiture & Lien – inherent powers of a company having share capital

Two of the powers available to the Company in respect of shares is forfeiture and lien.

1. **Forfeiture of shares:**
   Forfeiture of shares is a way of cessation of membership in the company. This is an act on the part of company. The reason for forfeiture is generally non-payment of calls. This is a very harsh action as it results in ouster of shareholder. The provisions relating the same are stated in Regulation 28 to 34 of Table F of Schedule I.

2. **Effect of forfeiture on shares:**
   The effect of forfeiture was held as "The reason why it was held that the forfeiture was valid was that on such forfeiture all that happened was that the right of the particular shareholder disappeared but the share considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it: Naresh Chandra Sanyal v. Ramani Kanta Bay [1945]2 I.L.R. Cal. 105. [1963] 33 Comp Cas 862 (SC)."
   It was however observed in one case that the company may provide for grounds other than non-payment of call. "Examining the provisions of the Companies Act, 1913 reviewed the decisions of the Courts in England and of the High Court of Calcutta and observed that the Indian Companies Act as well as the English Companies Act contemplate, recognize and sanction forfeiture generally and not for non-payment of calls only; that a company may by its Articles lawfully provide for grounds of forfeiture other than non-payment of call, subject to the qualification that the Articles relating to forfeiture do not offend against the general law of the land and in particular the Companies Act, and public policy; and that the forfeiture contemplated does not entail or effect a reduction in capital or involve or amount to purchase by the Company of its own shares nor does it amount to trafficking in its own shares" [The Calcutta Stock Exchange Association Ltd. v. S.N. Nundy & Co. I.L.R. [1950] 1 Cal. 235. As quoted in Naresh Chandra Sanyal vs Calcutta Stock Exchange Association Limited 1971 SCR (2) 483]

3. **Strict compliance with the procedure required**
   Procedural aspects assume most significance in giving effect to a valid forfeiture. "It is also clear that forfeiture is treated very strictly by the courts, and the directors seeking to enforce it must exactly pursue the course of procedure marked out by the articles. A slight irregularity is as fatal as the greatest. Thus if the call, in respect of which the forfeiture is made, was not validly made or if the notice on which the forfeiture is founded is inaccurate in requiring payment of interest from a wrong

date, e. g., the date of the call instead of the date appointed for payment, the forfeiture may be held invalid". [Karachi Oil Products Ltd. vs Kumar Shree Narendrasinghji AIR 1950 Bom 149 referring to Palmer's Company Law, p. 136]

4. Effect of forfeiture on liability of shareholder

It should be noted that the shareholder continues to remain liable to the company for the amount due from him which is not paid. "The position in law on forfeiture is quite clear. As is stated in Palmer's Company Law, dn. 17, p. 138, forfeiture of shares prevents prima facie any action by the company for past calls, Once there is forfeiture, the only liability which the shareholder would have to pay the monies would arise by reason of the articles of association, and the articles commonly provide that where a share has been forfeited the member shall be liable for payment of the call with interest, and this creates a new obligation which can be enforced by action at law." [Karachi Oil Products Ltd. vs Kumar Shree Narendrasinghji *ibid.*]

Regulation 32 of Table 'F' of schedule I, also provides that a person whose shares have been forfeited shall cease to be member in respect of the forfeited shares, but shall, notwithstanding the forfeiture, remain liable to pay to the company all monies which, at the date of forfeiture, were presently payable by him to the company in respect of the shares. The liability of such person shall cease if and when the company shall have received payment in full of all such monies in respect of the shares.

5. Re-issue of forfeited shares

The Company may re-issue the forfeited shares to any willing buyer after having specific powers to thateffect in the Articles. The shares are generally issued at a price on par with other shares as reduced by amounts already received in respect of the said shares. "If, therefore, the shares which the Company forfeited have to be considered as shares already created and as continuing in existence as such in spite of the forfeiture, obviously they could not be allotted in the sense in which that word is understood in the Company law as we have earlier stated. In Morrison v. Trustees etc Insurance Corporation [1899] 68 L.J. CH 11, the articles of the Company gave power to forfeit shares for non-payment of calls -and further provided that "any share so forfeited shall be deemed to be the property of the Company 'and the directors may sell, reallot or otherwise dispose of the same in such manner as they think fit". It was held that the Company could re-issue the forfeited shares giving credit for the money already received in respect of them. The contention that the transaction amounted to the issue of a share at a discount was rejected. Vaughan Williams L. J. observed, "I do not like the use of the word 'issue' with reference to the transaction with regard to these shares. If they were being issued, the argument for the appellant might possibly be right; but they are not being issued. When we look at the articles we see that what takes place on a forfeiture of shares is that the power of transferring them passes from the original shareholders to the company and the company can then transfer the shares subject to the same rights and liabilities as if they had not been forfeited". [Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association *supra*]. It should be noted that

although the re-issue is not allotment of shares, section 53 prohibits issue of shares at discount. In terms of Para 6.1 of the Secretarial Standard – 9 issued by ICSI (not mandatory) a forfeited share may be reissued or otherwise disposed of on such terms and in such a manner as the Board may think fit.

Reissue of forfeited shares is a sale of shares and it does not amount to an allotment. The company should duly record the particulars of the members who acquire those shares as if it were a transfer of shares.

The directors would fix a price for the forfeited share that should not be lower than the amount of the call(s) due and unpaid on the share at the time of forfeiture.

In the case of a company whose shares are listed in a recognized stock exchange, re-issue of forfeited shares shall be as per Guidelines for Preferential Issue of the Securities and Exchange Board of India and the listing agreement.

6. Lien on shares

Lien is the right to retain the property. "Legal right or interest that a creditor has in another's property, lasting usually until a debt or duty that it secures is satisfied. Typically, the creditor does not take possession of the property on which the lien has been obtained." [Black's Law Dictionary, 9th Edition, Page 1006]. It is not a distant possibility that a member might owe some money to the company in some capacity and the same needs to be enforced. There are no statutory provisions which deal with enforcing a lien. The same needs to be specifically provided in the Articles of Association of the company. Clause 9 to 12 of the Model Articles of Association as contained in Schedule I, Table F deal with the lien. It specifies right of lien only for shares which are not fully paid. It further provides for enforcement of such lien by the Board. Such lien is exercisable only in that debt which is undisputed. In lien also, 2 types are to be considered: lien on shares and lien on other amounts due to the member. While the former implies the right to sell the shares held by a shareholder, the latter is a right to withhold the sum due to a shareholder from a company in cases like dividend.

However, it should be noted that the Articles of a company may provide for lien in any shares, whether fully or partly paid and for any debt, whether in capacity as members or otherwise.

While talking about the nature of liability, it was held that "Liability or responsibility is the bond of necessity that exists between the wrongdoer and the remedy of the wrong. This 'vinculum juris' is not one of the mere duty or obligation; it pertains not to the sphere of ought but to that of must. It has its source in the supreme will of the state, vindicating its supremacy by way of physical force in the last resort against the unconforming will of the individual. A man's liability consists in those things which he must do or suffer, because he has already failed in doing what he ought. It is the 'ultimatum' of the law." [Salmond on Jurisprudence, Tenth Edition, Pg 364 quoted in Amar Nath And Anr. vs Karnal Electric Supply Co. Ltd. AIR 1952 P H 411]. Hence, the liability is enforceable by force of law and not because of any particular clause.

7. Amount on which lien may be exercised

It was held in one case that for trade debt due from a member, a company can exercise lien. "One Easby held some sharesin Briggs Son & Co. Ltd. The articles of Briggs Son and Co. Ltd. contained a provision, being Article 103, similar to Article 39 in the defendant company's articles before me. Briggs Son & Co. Ltd., carried on business as coal proprietor while Easby was a coal merchant. Easby purchased coal from Briggs Son & Co. Ltd., and became indebted to it for the price of coal purchased. It was held by the House of Lords that Briggs Son & Co. Ltd., had a lien on Easby's shares of the amount due to it from Easby. Lord Blackburn in his speech put the position in these words at pp. 33-34: "John Faint Easby, a coal merchant, became a proprietor of a number of shares in the respondent company, and obtained certificates for them. This property in the shares was, by virtue of the 16th section of the Act already quoted, I think, bound to the company as much as if he had (at the time he became holder of these shares) executed a covenant to the company in the same terms as Article 103, but I do not think it was bound any further. John Faint Easby filed a petition for liquidation on the 31st of December 1883, being then indebted to the company. He had been a customer of the respondent company, and owed them a considerable sum at that date. He still continued the registered holder of the shares, and, if there had been no more in the case, it is not now at least disputed that the respondent company would have had a first lien on the shares." [Bradford Banking Co. Ltd. v. Briggs Son & Co. Ltd., (1886) 12 AC 29 (C) quoted in Kanhaiyalal Jhanwar vs Pandit Shirali And Co. And Ors. AIR 1953 Cal 526]

The principles of unjust enrichment will be applicable in these cases also. Hence, the excess amount needs to be returned to the shareholder. "We are of the view that the balance on hand after satisfying the liability of the defaulter must still be returned to the defaulting shareholder. The power to forfeit does not imply authority to appropriate the balance, remaining in hand after satisfying the liabilities and obligations of the defaulter to the Exchange and its members. Any such implication would be contrary to the intendment of s. 74 of the Contract Act.... The legal theory of forfeiture is that a share forfeited is only taken over by the Company with the object of disposing it of to satisfy its claim to enforce which the share was forfeited and all other obligations arising against him out of his membership. The Company is given this right to recover the loss suffered by it by reason of the breach of contract committed by the shareholder. If the Company is permitted to retain the balance of the amount after satisfying the debts, liabilities and engagements of the shareholder, the transaction would not be different from one purchasing the share of the defaulting shareholder for a value equal to the amount of his obligations." [Naresh Chandra Sanyal vs Calcutta Stock Exchange Association Limited 1971 SCR (2) 483].

Other principles of equity will be equally applicable. Hence, when the company had notice of the charge being created and did not take any action, the same will not be enforceable as "first and paramount" charge. 'If before the lien becomes effective by the holder of the share becoming indebted to the company, it has notice of an equitable interest already created out of the shares, the company cannot claim priority for its line' [Pennington 4th Ed. 316, quoted in Shyama Prasad Murarka vs Calcutta Stock Exchange Association 2002 108 CompCas 703 CLB]

8. Procedure for exercise of lien

Article 10 of Table F of Schedule I provides that such sale shall be made only after expiry of 14 days of notice after following such procedure as may be decided the Board. The only fetter for changing this procedure is principles of natural justice shall be followed. The innocent buyer will be protected by doctrine of indoor management.

9. Effect of other provisions

It should be noted that the definition of 'charge' as defined in Section 2(16) of the Act, contains the word 'lien', the same shall be registrable when one company holds shares in another company.
