SQUEEZING OUT MINORITY SHAREHOLDERS- AN INDIAN PERSPECTIVE

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INTRODUCTION

Squeezing out the minority shareholders implies the compulsory sale of shares of minority shareholders of a Joint Stock Company for which they receive compensation. It allows shareholders who hold the majority shares to gain ownership of remaining shares. Even though this practice had been taking place in the corporate sector around the world for a long time, there was an absence of a specific statute to address the same in India till the year 2013.

The Companies Act, 2013 ('Act') introduced the concept of squeezing out by introducing Section 236, which elaborates different situations in which minority shareholders can be bought out by the majority shareholders. According to this provision, majority shareholder of a company, who holds at least 90% of the equity shareholding, has the right to notify its intention to buy-out the minority shareholders and the minority shareholders may in turn sell their shares to the majority shareholders at a price to be determined in accordance with the Act. Even though there are specific provisions of the Act, which deal with the concept of squeezing out minority shareholders, the main issue that arises here is whether such provisions (as construed by the Courts) provide legality to this act of squeezing out minority shareholders by the shareholders in majority? The term 'Minority Shareholding' has not been specifically defined under the Act; however, section 236 of the Act uses the word Minority shareholding in respect of registered holders of the issued equity shares of the company not exceeding ten percent. Various methods for the implementation of the squeezing out of the minority shareholding as introduced by the Act include:

CONSOLIDATION OF SHARE CAPITAL UNDER SECTION 61 OF THE ACT

When a company selects this option, it consolidates and divides its share capital into shares having face value larger than the existing shares. However, such a step requires authorization in accordance with the Articles of Association of the company and a sanction at a general meeting. Post the consolidation, the minority shareholders receive fractional shares as per the new face value and these fractional shares, as sanctioned by the Articles or by the terms of the resolution authorizing consolidation, stands transferred to the board or a person appointed by the board, who holds them in trust for such members. Typically, this option can be completed in a very short time frame, as it requires a mere shareholder approval. However, it may give rise to the following issues:

1. As per a new *proviso* which has been inserted under Section 61(1)(b), which states that if a consolidation and division results in changes in the voting percentages or shareholders then it shall not take effect unless it is approved by the Tribunal. This may act as a potential roadblock.
2. Further, Regulation 4 of Table F of schedule I of the Act provides that the company is entitled to refuse recognition of 'any interest in any fractional part of a share'. This is however limited to those companies to which either Table F applies or which has a provision in its Articles similar to Regulation 4.
3. Another possible outcome is that minority shareholders who fulfill the requisite number as required by the Act could file an action for oppression under section 397 of the Act.

REDUCTION OF CAPITAL IN ACCORDANCE WITH SECTION 66 OF THE ACT

The paid-up capital of a company can be reduced under Section 66 of the Act by paying off the minority shareholders. This reduction requires to be authorized by special resolution approving the reduction and then subsequently, it needs to be confirmed by the National Company Law Tribunal ("NCLT") of the relevant jurisdiction.

For e.g.: In **Sandvik Asia Ltd. v Bharat Kumar Padamsi (Bombay HC 2009)[1],**

- The issue was whether a special resolution, which proposed to wipe out a class of shareholders after paying them just compensation, can be termed as unfair and inequitable?
  - It was held that once it is established that non-promoters are being paid fair value of their shares and an overwhelming majority of non-promoter shareholders have voted in favour of the resolution, court would not be justified in withholding sanction. Therefore, minority shareholders can be squeezed out even without consent.

The High Court of Bombay in this case laid down tests, which appear to be the guiding principles under this option:

(i) whether non-promoter shareholders are paid fair value; and

(ii) whether an overwhelming majority of the non-promoter shareholders voted in favour of the resolution.

In *Re Organon (India) Limited v. Unknown*[2], the Hon'ble Bombay High Court stated about the fair valuation that the court's obligation is to be satisfied that the valuation was

[1] *Sandvik Asia Limited v. Bharat Kumar Padamsi and Ors.,* 2009 (3) Bom CR 57 (Div bench)
[2] *Re Organon (India) Limited v. Unknown* (2009) 92 SCL 272 (Bom).

in accordance with law, and it was carried out by an independent body. The Act provides for the 'independent body', which is prescribed under Section 247 of the Act and is known as a registered valuer. Similar lines of reasoning were provided in *Wartsila India Limited v. Janak Mathuradas & Ors*[3]. In particular cases where this option has been successfully expended for selective reduction, after the business justifications for reduction of capital (such as reduced capital requirements and absence of alternatives for utilization of capital), reasons for such selective reduction include:

(i) Due to de-listing and consequent loss of tradability, reduction provides an opportunity to public shareholders to liquidate their shareholding at an attractive price and realize a return on their investment.

(ii) Company has received requests from non-promoters to provide them with an exit opportunity (in the context of loss of liquidity and tradability of the shares).

(iii) Due to large promoter coming through takeover offers, to protect minority shareholders from impairment of assets and changes of business by promoters, the capital of minority shareholders is being returned.

(iv) Other reasons include that the company finds it administratively prohibitive to service small shareholders and it is not cost effective.[4]

However, ***In re Cadbury India Ltd.***[5]***;***

Cadbury India was a public listed company, being a subsidiary of Cadbury Plc, UK. As a result of several takeover offers made by Cadbury Plc and buyback offers by Cadbury India, the public shareholding of the company fell below the minimum required for continued listing. Hence, the company was delisted from the stock exchanges. At a time when the Cadbury Group held 97.583% of the equity share capital of Cadbury India, with the remaining 2.417% held by the minorities, the company initiated a capital reduction scheme to buy out the minorities. The price offered was supported by the reports of two independent valuers, M/s. Bansi S. Mehta & Co. and M/s. SSPA & Co., which both valued the shares of Cadbury India at Rs. 1,340 per equity share. The special resolution required for such a reduction scheme under the Companies Act, 1956 was duly passed, and the company sought the sanction of the Bombay High Court to the same. It was then duly subjected to challenge by the dissenting minorities. The uniqueness of *Cadbury case* lies in the fact that the court first ordered the appointment of another valuer to conduct the valuation afresh (albeit with the parties' support) and then proceeded to announce a legal standard that made it difficult for the minority to challenge this valuation.[6] Although the result appears somewhat curious, the High Court's order appointing the valuer suggests it arose out of a compromise whereby the company was keen to "cut short the controversy"

[3] *Wartsila India Limited v. Janak Mathuradas & Ors*. (2010) 101 SCL 270 (Bom).
[4] http://www.luthra.com/admin/article_images/minority-squeeze.pdf
[5] Company Petition No 1072 of 2009, Decided on 25th February. 2014 (Bombay High Court).

[6] https://indiacorplaw.in/2014/08/squeeze-outs-analyzing-cadbury-decision.html

so long the independent valuation was to be treated as binding. However, the court retained some leeway to interfere with such report in case of "any grave infirmity in it". Accordingly, Ernst & Young (E&Y), the court-appointed valuer, returned an initial valuation of Rs. 1,743 per equity share, which was subsequently revised upwards to Rs. 2,014.50 per equity share. The objecting minorities who demanded a price of at least Rs. 2,500 per share too challenged this. It was held that it is the court's duty to ensure that the scheme is not against public interest, is fair and just and not unreasonable, doesn't unfairly discriminate against or prejudice a class of shareholders. Before a court can decline sanction to a scheme on account of valuation an objector must show that valuation is ex-facie unreasonable, or discriminatory or has not been approved by sufficient majority. However, in this case, an overwhelming majority approved it. Given these circumstances, the court approved the capital reduction at the price of 2,014.50, based on the revised EY report. Similarly, in the *Rockwool*[7] case, the Hon'ble High Court of Andhra Pradesh went on to observe that a company that achieved high growth and high net-worth and is in a position to share its profits among all the small investors can go into the hands of a few individuals or a group helping them to amass wealth, using the procedure of reduction.

ACQUISITION OF SHARES UNDER SECTION 235 OF THE ACT

In this, a 'transferee company' may under a scheme or contract make an offer to the shareholders of another company, termed as the 'transferor company' to acquire their shares. If the offer is approved by shareholders holding 90% of the shareholding (excluding shares already held by the transferee company or its subsidiary or nominee), within 4 months, then the transferee company may within 2 months after expiry of the above 4 months, give a notice to any dissenting shareholders that it desires to acquire their shares.

Unless any of the dissenting shareholders makes an application to the NCLT within 1 month of receipt of such notice and the NCLT orders otherwise, the transferee company shall be entitled to acquire the shares of the dissenting shareholders on similar terms of the scheme or contract. In *AIG (Mauritius) LLC V. Tata Televentures (Holdings) Ltd. and Anr.*[8]*,* it was observed by the Delhi High Court that it is extremely important that the 90% majority should comprise of different and distinct persons since this would then fall in line with the rationale of the section and justify overriding the rights and interests of the dissentients. It is also imperative that this majority should not be the same as the party seeking to acquire the shares.

PAYMENT OF CASH AS CONSIDERATION TO MINORITY SHAREHOLDERS UNDER A SCHEME OF AMALGAMATION

Under this method, the company can be amalgamated with some other entity and in consideration to this amalgamation; minority shareholders can be paid in cash instead of

[7] *Chetan Cholera v. Rockwool*, [2010] 155 Comp Cas 605 (AP).
[8] *AIG (Mauritius) LLC V. Tata Televentures (Holdings) Ltd. and Anr.,* 2003 II AD (Delhi) 672

shares in the transferee company. This can be done in two ways- either by paying the minority shareholders only cash (as per the terms of the scheme) or by giving them an option to have the consideration paid to them in either cash or shares of the transferee company.

PURCHASE OF MINORITY SHAREHOLDING UNDER SECTION 236 OF THE ACT

Section 236 (which corresponds to Section 395 of the Companies Act, 1956) elaborates on the purchase of minority shareholding by the majority shareholding; it says that if an acquired has 90% or more of the issued equity share capital of a company, he can make an offer to the company by a notification to purchase the remaining shares. Section 236 has to be read with Rule 27 of the Companies (Compromise, Arrangement and Amalgamation) Rules, 2016 to determine the price for purchase of minority shareholding. This section also provides a chance to the minority shareholders to offer to the majority shareholders to purchase the minority equity shareholding of the company. This provision thus, helps the minority shareholders in exercising exit rights from the company.

CONCLUSION

The main issue that needs to be addressed here is whether such minority squeeze-outs are legal and are explicitly permitted under the Act. A certain and strict interpretation of the provisions which allow the companies to take such steps will indeed augment promoters and acquirers to structure mergers, acquisitions and various forms of corporate restructuring.