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"SQUEEZING OUT OF MINORITY SHAREHOLDERS: A COMPARATIVE ANALYSIS BETWEEN COMPANIES ACT 1956 & 2013"

AUTHOR

APARNA PANDEY: NATIONAL LAW UNIVERSITY JODHPUR

EMAIL

aparnanluj@gmail.com

CONTACT

+91-7425818202

CORRESPONDENCE ADDRESS

Flat No. A/D., Ground Floor, Muskaan Apartments,

Gokhle Vihar Marg,

Lucknow (U.P.) -226001

ABSTRACT

Squeeze-out was legally recognized and addressed by the legal fraternity of the United States. The origin of the legal regime dealing with the validity of the squeeze out techniques can be traced back to 1920s. Florida, in USA, first codified the laws related to squeeze out in the mid- 1920, followed by the Delaware courts in the 1950s.[1] *The laws enacted, thereof, were aimed to codify the statutory merger mechanism for freezing out minority shareholders, also known as 'freeze out merger'. Such transactions are executed as a statutory merger under section 251 of the Delaware general corporation law (DGCL).*

This present paper aims to discuss the concept of squeeze-out and its genesis at Indian and international front. By virtue of squeeze-out, the majority shareholders are possessed with the power to oust the minority shareholders of a company. The concept originated from USA and is now very much embedded into the corporate jurisprudence of other nation, including India. The active role of Indian Judiciary effectively helped the minority shareholders to address this legal fiasco. Now the Companies Act, 2013 addresses this issue in greater detail than it previous counterpart. This project deals with the concept of squeezing out of minority shareholders under the Companies Act, 1956 and new Companies Act, 2013.

In India the term 'squeeze-out' has been widely used in both academic and professional practice. A 'squeeze-out' refers to a mechanism that effectively entitles the controlling block to acquire the shares held by the minority shareholders in a company.[2] Thus, Squeeze out is basically a way to oust the minority shareholders from their respective positions, being held in a public company. The Companies Act, 1956 provides for protection to minority shareholders against certain actions of majority shareholders, such as unfair dilution of shares, related party transactions, etc. However, the Act is silent with regards the protection of minorities in case of squeeze-outs.

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[1] Elliott J Weiss, *The Law Of Take Out Mergers: A Historical Perspective*, 56 NYUL Rev. 624, 627-29, 648 (1981)

[2] *Taxmann's Corporate Professionals Today,* Volume 28, Issue 2, page no. 131

I. MAJORITY RULE V. MINORITY RIGHTS: A NEVER ENDING DEBATE AT THE HEART OF SQUEEZE OUT

II.1. JUSTIFICATION OF MAJORITY RULE

Utilitarians have always justified majority rule in terms of the convenience in decision making. This theory is supported by the economic approach that higher rights and authority is directly proportional to percentage of ownership, giving the majority greater decision making power[3]. This would translate into a right of this majority beyond a specified threshold to decide whether it needs minority shareholders and if not the power to buy them out regardless. In terms of Squeeze out by third party bidders, Grossman and Hart[4] characterize minorities as free riders on investment risks thereby justifying the right of such bidders to squeeze out minority shareholders. The more legal justification often adopted by courts is based on the *Foss* v. *Harbottle*[5] rule that the majority proprietors are the beneficiary of a trust of the company and every person who enters the company, by the very terms of its incorporation, agree to be bound by the decision of the majority.

II.2. MINORITY RIGHTS - RIGHT TO ONE'S OWN PROPERTY

On the other hand, squeeze outs are considered as a depravation of property and when squeeze outs are enforceable under law, they amount to dispossession of property under the law. Under this approach dispossession of property must occur only in cases of

[3] Ataollah Rahmani, *A comparative Study of Justifications for majority rule in Corporations: The Case of England and Iran*, 282[I.C.C.L.R. 2007, 18(8) 279-294, (2007)]

[4] Grossman S. and O. Hart, *Takeover Bids, The Free Rider Problem and the theory of Corporation*, Bell Journal of Economics 11, 42-64.

[5] *Infra* Note **Error! Bookmark not defined.**

public or general interest[6] . However, this argument has been overturned by European courts by equating public interest with 'efficient management' of companies thereby justifying 'legal' provisions enabling squeeze out.

Another objection to squeeze out rights to the majority is based on grounds of fairness. Minority shareholders cannot be rendered powerless in terms of their shareholding in the company. However, Courts in India do not seem to support a right to be consulted unless statutorily provided for and have upheld majority attempts to cordon off minority rights through indirect squeeze outs[7].

II. INDIAN POSITION ON SQUEEZE OUT

IV.1. DEFINITION OF 'MINORITY'

By virtue of Section 395 (*Power to acquire shares of dissenting shareholders*) and Section 399 (*Right to apply for Oppression and Mismanagement*) of 1956 Act minority can be defined. In case of a company having share capital, not less than 100 members or not less than 1/10th of total number of members, whichever is less or any member of members holding not less than 1/10th of issued share capital have the right to apply to the court in case of oppression and mismanagement.[8]

IV.2. Position Under Companies Act, 1956 ["1956 Act"]

The only provision which distantly deals with the squeeze out is Section 395 of the 1956 Act. Section 395 of the 1956 Act is a rarely used provision under which an acquirer company can make an offer to shareholder of a target company and if 9/10th of the

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6 *LKS's Corporate Amicus,* June 2013, Issue 3 available at <http://cn.lakshmisri.com/Uploads/MediaTypes/Documents/corporate-amicus-june-2013.pdf>

[7] *Sandvik Asia Ltd. In Re* [2009] 92 SCL 272 (Bom)

[8] Section 395 of the Companies Act, 1956

shareholders accept the offer, the rest of the shareholders can be squeezed out by serving them with a notice. There are two ways in order to squeeze-out the shares of minorities:

1. *Reduction of share capital*

Minority shareholders can be squeezed out of a company by reducing share capital through buy-back of specific shares. Buy-back of shares are generally done with the consent of the shareholders. Even in the Securities and Exchange Board of India (Buy-back) Regulations[9], it is mandatory that the shareholder has to specifically come forward and offer his shares in writing.

The phrase 'any shareholder' in section 101 of 1956 Act, indicates that a reduction of share capital need not necessarily be *qua* all shareholders of the company, but can take place from one or more amongst the body of shareholders.[10] Thus, an offer of buy-back of shares to any group of shareholders is possible under the said provision. If a resolution can be passed by the majority shareholders whose position will remain unaltered by the arrangement, as they constitute 3/4th of the shareholders and a fair value has been offered to the minority shareholders, then the minority shareholders can squeeze-out of the company.

In the case of *SEBI* v. *Sterlite Industries (India) Ltd.*[11] the company launched a buy-back offer, whereby, it was notified that the shareholders would be bought back, unless they specifically intimate the company otherwise in writing. The scheme was approved by the Single bench judge of the Bombay High Court. The SEBI and the central government filed an appeal before the division bench, wherein, the court held that SEBI did not possess the powers to challenge such scheme of arrangement and ruled in favour of the scheme. SEBI thereby amended the listing agreement and pursuant to that added sub clauses (f) (g) and (h) were to clause 24 to the same.

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[9] http://www.sebi.gov.in/cms/sebi_data/commondocs/bbreg_p.pdf

[10] *Elpro International Ltd. , In re.* [2008] 87 CLA 87 (Bom.)

[11] [2003] 53 CLA 41 (Bom.)

Similarly, in the case of *Elpro International Ltd., In re.*[12], the Bombay High Court approved the scheme of force reduction despite the objections of the Bombay Stock Exchange under clause 24(f) of the Listing Agreement[13]. Therefore, the judicial trend on this issue suggests that the court allows such schemes or contracts, if fairness standard is met; and the onus to prove otherwise lies upon the dissenting shareholders.

2. Scheme of takeovers

Another way by which the squeeze-out of minority shareholders can be made possible is through takeover of a company. Section 395 of the 1956 Act provides for compulsory acquisition of shares by the majority shareholders in certain circumstances. It is pertinent to mention that section 395 is the only provision in the 1956 Act that deals with the compulsory acquisition of shares of minority shareholders and there are no corresponding rules or guidelines available in relation to this. Under this provision, an acquiring company may make an offer to the shareholders of a target company of a scheme or a contract involving the transfer of shares of the target company. In the event that holders of the 9/10th of the value of the shares of the target company accept the offer of the acquirer company, the acquirer company shall have the right to give a notice to the dissenting shareholders to acquire their shares also despite their dissenting opinion. Once the resolution has been passed as per the requirements under section 395 of the 1956 Act i.e. resolution is passed by shareholders holding at least 9/10th of the values of the shares to be transferred ad are at least 3/4th in number of the holders of those shares, then the court usually does not interfere with such takeovers. The court is generally not concerned with the commercial decision of the shareholders until and unless it feels that the proposed merger is manifestly unfair and/or is being proposed unfairly and/or to defraud the minority shareholders.[14] Thus, section 395 of the 1956 Act allows squeeze-out of only the dissenting minority shareholders of the company. This provision does not allow

[12] [2008] 87 CLA 87 (Bom.)

[13] http://www.sebi.gov.in/cms/sebi_data/pdffiles/21169_t.pdf

[14] Miheer H. Mafatlal v. Mafatlal Industries, IT 1996 (8) 205

squeeze-out of minority shareholders when the takeover offer is not accepted by the majority of the minority shareholder block of a company.

IV.3.Position on Squeeze-out under Companies Act, 2013 [“2013 Act”]

The Companies Act, 2013 (2013 Act) received the presidential assent on 29th August 2013. The 2013 Act has streamlined lot many provision of the company law. With special reference to squeeze-out, the 2013 act refreshed provisions relating to squeeze-out of minority shareholders by forming new clauses for the purchase of shares of minority shareholders and also relating to the reduction of shares. Section 395 of the 1956 Act deal with the ‘power to acquire shares of the dissenting shareholders’ which has been drastically moulded and introduced under section 235 of the 2013 Act. In addition to that, the 2013 Act also provides for the procedure to be followed to give effect to the purchase of shares of the shareholders under Section 236 of the 2013 Act. Furthermore, the section 66 of the 2013 Act has replaced section 100 of the 1956 Act which deals with ‘reduction of capital’, introducing a whole new procedure to give effect to the scheme.

V.1.SECTION 66: REDUCTION OF SHARE CAPITAL

Under sub-section (1) of section 66 of the 2013 Act a condition has been added that the capital reduction will be disallowed if the company has in arrears repayment of any deposits or interests payable thereon.

Sub-section (2) of section 66 mandates the tribunal to give a notice of the proposed capital reduction scheme to the central government, Registrar of Companies, SEBI and creditors, and to the representative, if any, within the deadline of 3 months from the date of receipt of the scheme. If no representation is made by any of the above named, then the scheme shall be deemed to have been accepted

V.2.ANATOMY OF SECTION 236: PURCHASE OF MINORITY SHAREHOLDING.

The newly introduced section 236 of the 2013 Act seeks to put an end to the Squeeze-out fiasco and enables the acquirer who holds 90 percent or more of the issued share capital of the company to squeeze-out the minority shareholders. Section 236 of 2013 Act is a blend of section 395 and section 100 of the 1956 Act.

1. Notification of intention to the company

According to Section 236(1) , in the event of an acquirer, or the person acting in concert with such an acquirer, becoming registered holder of ninety percent or more of the issued equity share capital of a company, or in the event of any person or group of persons becoming ninety percent majority or holding ninety percent of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, shall notify the company of their intention to buy the remaining equity shares.

2. Pricing mechanism of shares so acquired

Sub-section (2) of section 236 provides for the pricing mechanism of the acquired shares. The acquirer, person or group of persons under sub-section (1) shall offer to the minority shareholders of the company for buying the equity shares held by such shareholders at a price determined on the basis of valuation by a registered valuer[15] in accordance with such rules as may be prescribed.

3. Minority may offer to the majority shareholders

An interesting part of section 236 is that the sub-section (3) allows the minority shareholders to offer to the majority shareholders to purchase the minority equity shareholding of the company, at a price to be determined under sub section (2) of section 236.

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[15] *Infra* Note 17

4. *Deposit of value of shares in separate bank account.*

According to sub-section (4), the majority shareholders shall deposit an amount equal to the value of shares to be acquired by them under sub-section (2) or sub-section (3), as the case may be, in a separate bank account to be operated by the transferor-company for at least one year for payment to the minority shareholders and such amount shall be disbursed to the entitled shareholders within sixty days, provided that such disbursement shall continue to be made to the entitled shareholders for a period of one year, who for any reason had not been made disbursement within the said period of sixty days or if the disbursement had been made within the aforesaid period of sixty days, they failed to receive or claim payment arising out of such disbursement.

5. *Transferor-company to act as transfer agent*

It can be deciphered from sub-section (5) that in the event of a purchase under section 236, the transferor-company shall act as a transfer agent for receiving and paying the price to the minority shareholders and for taking delivery of the shares and delivering such shares to the majority, as the case may be.

6. *Cancellation of share certificates*

Sub-section (6) stipulates that in the absence of physical delivery of shares by the shareholders within the time specified by the company, the share certificates shall be deemed to be cancelled, and the transferor company shall be authorized to issue shares in lieu of the cancelled shares and complete the transfer in accordance with law and make payment out of deposit under sub-section (4) by the majority in advance to the minority by dispatch of such payment.

7. *Offer to the shareholders who have died or ceased to exist.*

In the event of a majority shareholder or shareholders requiring a full purchase and making payment by deposit with the company for any shareholder or shareholders who have died or ceased to exist, or whose heirs, successors, administrators, or assignees have not been brought on record by transmission, the right of such shareholders to make an offer for sale of minority equity shareholding shall continue and be available for a period of three years from the date of majority acquisition or majority shareholding.Sub-section (7).

8. *Sharing of additional compensation with minority shareholders.*

Where the shares of minority shareholders have been acquired in pursuance of this section and as on or prior to the date of transfer following such acquisition, the shareholders holding seventy-five percent or more minority equity shareholding negotiate or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement, the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a *pro rata* basis.[sub- section (8)]

9. *Majority equity shareholder fails to acquire full purchase of the shares*

It is embodied under sub-section (9) that when a shareholder or the majority equity shareholder fails to acquire full purchase of the shares of the minority equity shareholders, the provision of this section shall continue to apply to the residual minority equity shareholders, even though,-

a. The shares of the company of the residual minority equity shareholder had been delisted; and
b. The period of one year or the period specified in the regulations made by the SEBI under the Securities and Exchange Board of India Act, 1992, had elapsed.

10. The expression 'acquirer' & 'person acting in concert'

For the purposes of section 236, the expressions 'acquirer' and 'person acting in concert' shall have the meanings respectively, assigned to them in clause (b) and clause (e) of sub-regulation (1) of Regulation 2 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.[16]

It is pertinent to note here that in the 2013 Act, Section 236 uses term the 'acquirer' which is defined under the Takeover Regulations. It provides that the acquirer should be that registered holder of the 90% of the shares along with the person acting in concert.

It is further pertinent to note here that the scheme of things as provided, shall be initiated only when the shares have been acquired, whereas in the 1956 Act once the scheme had been approved by the 9/10th of the shareholders of the company, the transferee-company could serve notice to the dissenting (minority) shareholders for acquiring their shares.

In order to ensure that the scheme is fair to the minority (dissenting) shareholders, 2013 Act provides that the shares are to be valued by the 'registered valuer' as defined under section 247 of the 2013 Act.[17] This would ensure that the minority shareholders are not squeezed out of the company without being given fair value of their shares.

Conclusion

Upon careful examination of the provisions of the 2013 Act it can be ascertained that legislative intent in 2013 Act is to safeguard the minority interest in a more comprehensive manner. However, the provisions of 2013 Act not only requires proper implementation upon addressing the present lacunas but also requires instilling

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[16] http://www.sebi.gov.in/acts/act15a.pdf (last accessed on 23rd March,2017).

[17] Section 247(1) of the 2013 Act reads as :

"Valuation by Registered valuers: Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company."

confidence in the minority shareholders with respect to the institutional and regulatory mechanism which ensures that interest of minority shareholders shall be given due consideration. This dual approach towards enforcement of minority rights shall only guarantee proper administration of the corporate activities.

Section 66 of the 2013 Act, though provides for a detailed procedure, yet it has a few shortcomings such as it will result in the increase of the overall timeline due to the mandatory three months period. The provisions for accounting will restrict the planning opportunities for the unlisted companies, since auditor's certificate is required upfront. It also creates additional pressures on public companies to settle any outstanding public deposits.[18]

The provisions for both the reduction of capital and purchase of shares of dissenting shareholders have been changed in consonance with the recent judicial trend. Section 295 of the 1956 Act only enable a squeeze-out of dissenting minority shareholders. However, section 236 of the 2013 Act provides for fair exit to the minority shareholders, as the value of their shares is ascertained by the 'registrar valuer' and it also provides for the opportunity to the minority shareholders to offer their shares to the majority shareholders. It is only a matter of time that the entire 2013 Act will be enforced, but despite the judicial intervention will be utmost necessity in order to increase the effectiveness of the 2013 Act to address the concerns of the minority shareholders.

The provisions barring a few glitches seem to be comprehensive but it cannot be said with certainty that they will yield good results. Now that they have been enacted they will be put to test, therefore with the judiciary implementing the newly formed provisions, a decision can be arrived at regarding its effectiveness.

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[18] *Supra* Note 2

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