

M&A Hotline

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MINORITY SQUEEZED, MAJORITY RULES

In a recent judgment passed by the two judge bench of the Hon'ble High Court of Bombay ("High Court"), in the matter of *Sandvik Asia Limited vs. Bharat Kumar Padamsi and Ors*¹ ("Appeal"), the High Court held that minority shareholders can be squeezed out if *inter alia* they have been offered to be paid fair value for their shares and the squeeze out is in accordance with the provisions of the Companies Act, 1956 ("Act").

Reduction of share capital is an effective mechanism for corporate restructuring of a company. This form of corporate restructuring is governed by Sections 100 to 105 of the Act and the procedure involves the approval of the capital reduction by a special majority (i.e. 75% or more) of the shareholders of the company, followed by the approval of such a resolution by the Indian judicial authority² having relevant jurisdiction to hear the matter.

FACTS

- Sandvik Asia Limited ("Appellant"), an Indian company, got delisted from the Indian stock exchanges on September 09, 2002. Pursuant to that, the Appellant's shareholding pattern was as follows: 95.54% of the equity share capital was held by the promoters of the Appellant and the remaining 4.46% was held by non-promoters.
- The Appellant passed a special resolution ("Resolution") at its general meeting, held on June 13, 2003 to return to the non-promoter equity shareholders INR 850 per equity share, thereby extinguishing all the non-promoter shares. During the general meeting, the Resolution received an overwhelming assent from 99.95% of the total shareholders of the Appellant, including both the promoters as well as the non-promoters.
- Thereafter, the Appellant filed a petition ("Petition") under Section 100 of the Act seeking sanction of the High Court for the same. Interestingly, the promoter shares were specifically excluded from the scheme of reduction of capital.
- Shareholders representing 0.05% of the total equity share capital who dissented the Resolution ("Respondents"), filed their objections to the Petition on the ground that the Resolution intends to wipe out the class of non-promoter shareholders, and is hence unfair and oppressive to the minority shareholders.
- The single judge bench of the High Court, after analyzing the submissions put forth by both the parties, rejected the Petition on the ground of protection of minority shareholders' interest, hence, forming the basis for filing of the Appeal with the two judge bench.

APPELLANT'S ARGUMENTS

The Appellant made the following submissions:

- The grounds for rejection of a scheme of reduction are restricted to non-compliance with the provisions of the Act, or if such scheme is unfair or inequitable. As per the Appellant, the scheme of reduction forming the basis of the Appeal was in compliance with the Act, and also provides for a fair and equitable exit price of INR 850 per equity share as against the book value of INR 687 per equity share.
- The Appellant's articles of association contained standard clauses on cancellation/reduction of shares as per Sections 100-104 of the Act and the Respondents were clearly aware of the power of the Appellant to proceed with the scheme of reduction in accordance with the Act.
- The Resolution received an overwhelming response from 99.95% of the total shareholders. Out of the total non-promoter shareholders of 4.46%, 4.41% voted in favour of the Resolution.

RESPONDENTS' ARGUMENTS

The submissions made by the Respondents were as follows:

- As the Appellant is organised as a public limited company, i.e. it invited public participation, it cannot extinguish the entire class of public shareholders (i.e. non-promoter shareholders) by a scheme of reduction of capital under Sections 100-105 of the Act in order to convert the Appellant into a wholly owned subsidiary of the promoters.
- The shareholders of a public limited company have the right to freely transfer their shares, which by interpretation also includes the right to retain or hold the shares. The Respondents' argued that a scheme of reduction that forcibly acquires the entire class of public shareholding would abrogate the above basic principle.
- By excluding the promoters shares from the scheme of reduction of capital, the interest of the minority non-promoter shareholders was compromised.

JUDGMENT

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The two judge bench of the High Court held that since the majority of the shareholders had approved the Resolution and that the price offered per share in the reduction of share capital exercise was fair, the decision of the single judge bench of the High Court which rejected the Petition, is erroneous. Hence, the Appeal was allowed.

It is also interesting to note that the High Court, while providing its judgment, relied on the cases *British and American Trustee and Finance Corporation Ltd.* and *Reduced vs. John Couper*³ and *Poole and Ors. v. National Bank of China Limited*. These cases, in spite of being decided by the House of Lords, U.K., were extensively relied upon and recognised by the Supreme Court of India previously⁴ and were by virtue of this fact considered relevant in the instant case.

IMPLICATIONS

- Section 395 of the Act mandates squeeze out of minority shareholders in the Indian company. However, use of this section and other sections of the Act for reducing the non promoter shareholding has been fraught with difficulties. Accordingly, the companies have been resorting to different modes of restructuring to achieve the same result as a squeeze-out. For e.g., instead of resorting to a buyback of shares which is optional at the option of the shareholder and is subject to various restrictions under the Act, companies may resort to a scheme of reduction of capital wherein the company can selectively force select minority shareholders to tender their shares to the company.
- This judgment would be favorable for those promoters who intend to delist their companies in the current market scenario since post delisting they should be able to squeeze out the minority shareholders in order to gain total control over the company.
- In the absence of certain contractually negotiated affirmative/veto rights, the private equity investors subscribing to small percentages of shares in Indian companies could face a potential risk of being squeezed out.

The Respondents may prefer an appeal to the Supreme Court of India against the order pronounced by the two judge bench of the High Court. We shall keep you updated on any future developments in this regard.

- Team M&A

1. Appeal No. 308 of 2004 in Company Petition No. 478 of 2003 in Company Application No. 290 of 2003, as decided on April 4, 2009.

2. The relevant judicial authority to hear such matters is the National Company Law Tribunal, which is yet to be established. In its absence, the High courts in various Indian states are empowered to hear these matters.

3. (1894) A.C. 399 (HL)

4. Ramesh B. Desai vs. Bipin Vadilal Mehta and Ors. (2005) 5 SCC 638

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