

## A New Method of Minority Squ(ease) Out

On February 3, 2020, the Ministry of Corporate Affairs notified sub-sections (11) and (12) of section 230 of the Companies Act, 2013 (the “**Companies Act**”) along with also notifying the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2020 and the National Company Law Tribunal (Amendment) Rules, 2020 (collectively, the “**Takeover Notification**”), which would enable shareholders of unlisted companies holding at least 75% securities (including depository receipts) with voting rights (the “**Acquiring Shareholder**”) to acquire the remaining minority shareholders (the “**Minority Shareholders**”) pursuant to a court-approved compromise or arrangement that includes a takeover offer.

Certain other methods that are generally considered for buying-out minority shareholders, often termed as minority squeeze-outs, include undertaking a selective reduction of share capital under section 66 of the Companies Act and the purchase of minority shareholding by a majority shareholder holding 90% or more of the share capital under section 236 of the Companies Act.

This note briefly discusses the new method of minority squeeze-out introduced by the Takeover Notification and considers whether the Takeover Notification makes it easier to squeeze out the minority shareholders as compared to the other available options mentioned in the paragraph above.

### TAKEOVER NOTIFICATION

The Takeover Notification permits the Acquiring Shareholder to make a takeover offer for acquisition of any part of the remaining shares in such company pursuant to an application of compromise or arrangement (“**Takeover Application**”) to be filed before the National Company Law Tribunal (“**NCLT**”) under section 230 of the Companies Act. The Takeover Application will also need to be approved by creditors of the company. Once the Takeover Application is approved by the NCLT, the order of the NCLT would be binding on all the Minority Shareholders who would mandatorily be required to sell

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their shares to the Acquiring Shareholder. This method of minority squeeze-out is only available to unlisted companies and listed companies will be subject to the regulations prescribed by the Securities and Exchange Board of India.

### ***Valuation***

The Takeover Notification provides that in addition to the other information/documents required to be filed for compromises and arrangements under section 230 of the Companies Act, the Takeover Application filed with the NCLT is also required to enclose a registered valuer's report in respect of shares proposed to be acquired which must take into account: (i) the highest price paid by "any person or group of persons" (which may also include any price paid by the Minority Shareholders) for acquisition of shares during the preceding 12 months, and (ii) the fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple *vis-a-vis* the industry average, and such other parameters as are customary for valuation of shares of such companies.

Courts in India have generally not questioned independent valuation reports to determine fair value in schemes of compromise or arrangement. The approach of the courts is typically to examine whether or not a valuation report is demonstrated to be so unjust, so unreasonable and so unfair that it could result only in a manifest and demonstrable, inequity or injustice. Accordingly, a detailed report from a registered valuer which considers the above-mentioned parameters for share valuation and forms the basis of the Takeover Application may make it difficult for the Minority Shareholders to raise objections to the Takeover Application.

### ***Deposit of funds in escrow***

The Acquiring Shareholder is required to deposit at least 50% of the total consideration of the takeover offer in a separate bank account. However, the Companies Act and the Takeover Notification does not specify details regarding restrictions on withdrawal and/or procedure of disbursement of funds from such escrow account. This may be more of an issue in the event the Acquiring Shareholder making the takeover offer is a non-resident person and the Minority Shareholders are persons resident in India, since such transfer of shares would have to be reported to the Reserve Bank of India by filing Form FC-TRS within 60 days from the receipt of funds in India and it is unlikely that the NCLT approval for the Takeover Application will be received in such period. With such ambiguity in procedure, strict implementation of this requirement for an effective escrow mechanism may be difficult and may require further amendment or clarifications to the Companies Act and certain other applicable law and regulations.

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## ***Minority shareholder protection***

In the event any Minority Shareholders are not satisfied with the takeover offer from the Acquiring Shareholder, pursuant to section 230(12) of the Companies Act they may approach the NCLT by way of an application reporting their grievance against a Takeover Application and include documents supporting such grievance. In any such application, the NCLT will have the power to consider the merits of the grievance and pass such orders as it may deem fit. While the Companies Act does not prescribe a time frame for resolution of such grievance, a grievance application by a Minority Shareholder may impact timelines for acquisition of shares from Minority Shareholders.

To the extent possible, Minority Shareholders should also include contractual protection to block any such takeover offers. Although most investment/shareholders' agreements include certain veto rights for investors against the company, a Takeover Application made by the Acquiring Shareholder may not be within the scope of such veto matters and may have to be specifically included in investment/shareholders' agreements and the articles of association of the company to prevent a minority squeeze-out.

## **COMPARISON WITH OTHER EXISTING METHODS OF MINORITY SQUEEZE-OUTS**

### ***Selective reduction of share capital***

Section 66 of the Companies Act permits a company to reduce its share capital in any manner, including by cancellation of shares held by the minority shareholders and altering its memorandum of association by reducing the amount of its share capital with the approval of shareholders by special resolution (three-fourth of shares, present and voting) and the NCLT. Such reduction of capital is subject to *inter alia* the company not being in arrears in repayment of any deposits accepted by the company or any interest payable on such deposits. If the NCLT is satisfied that the reduction of share capital is fair and equitable and debt or claim of every creditor of the company has been discharged or determined or has been secured or its consent is obtained, the NCLT may issue an order confirming the reduction of share capital on such terms and conditions as it deems fit.

The process for reduction of capital does not require active participation from minority shareholders, but could be challenged by them. However, courts in India have frequently upheld selective reduction of capital. To determine whether a selective reduction of share capital is fair, just and reasonable, courts have generally held that the motive of the company behind the given extinguishment and the fairness of valuation of the shares have to be considered. Indian courts have typically refrained

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from undertaking a detailed examination of the valuation reports and the processes or methodologies followed in cases of capital reduction and have held that as long as the minority shareholders are being paid fair value of their shares, the special resolution to sanction the scheme for reduction of share capital should be approved.

Unlike a selective reduction of capital where the majority shareholders require the cooperation of the company to undertake a reduction of its capital as the onus is on such company to demonstrate that the reduction is fair to minority shareholders, the Takeover Notification expressly recognizes the right of the Acquiring Shareholder to make a takeover offer pursuant to a compromise or arrangement for buying out the Minority Shareholders. It enables the Acquiring Shareholder to use its own funds to make a fair and reasonable offer to the Minority Shareholders as opposed to utilization (or lack thereof) of funds from the company.

### ***Purchase of minority shareholding***

Under section 236 of the Companies Act, an acquirer, or a person acting in concert with such acquirer, who becomes registered holder of 90% or more of the issued equity share capital of a company, or any person or group of persons becoming 90% majority or holding 90% of the issued equity share capital of a company, has a right to buy-out the minority shareholders by notifying the company of its intention to purchase the remaining shares held by the minority shareholders at a price determined on the basis of valuation by a registered valuer, which takes into account (i) the highest price paid by such acquirer, person or group of persons for acquisition during the preceding 12 months, and (ii) the fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple *vis-a-vis* the industry average, and such other parameters as are customary for valuation of shares of such companies.

Further, the acquirer is required to deposit an amount equal to the value of shares to be acquired by them in a separate bank account to be operated by the company for at least one year for purposes of payment of consideration to the minority shareholders and such amount is required to be disbursed to the minority shareholders within 60 days. The Companies Act does not provide any time limit within which the offer under section 236 of the Companies Act has to be accepted by the minority shareholders and the time limit for transfer will have to be specified by the company.

The qualifying threshold to purchase the minority shareholding is lower in case of a takeover offer pursuant to the Takeover Notification, i.e., 75% as compared to 90% in case of an acquisition under section 236 of the Companies Act. Additionally, the

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framework under section 236 of the Companies Act does not expressly cast an obligation on the minority shareholders to sell their shares. However, courts in India have observed that “section 236 has drastic nature of forcibly transferring the shares”. Section 236(9) of the Companies Act further provides that in case majority shareholders fail to acquire all shares of minority shareholders, the residual minority shareholders will continue to be governed by the relevant provisions of the Companies Act and in the absence of a court order (unlike sanction from the NCLT as in the case of a Takeover Application), any aggrieved minority shareholders may have to approach courts to seek appropriate relief.

## CONCLUSION

All methods for minority squeeze-out discussed above have certain peculiarities and which option best fits may have to be evaluated in view of the circumstances and the desired objective. In any event, irrespective of the level of participation required by the minority shareholders in implementing any of the above-mentioned methods, the minority shareholders will continue to have the right to approach the NCLT to seek appropriate remedies under law, including on grounds of oppression and mismanagement. However, the Takeover Notification does open another option for corporate restructuring and is an attempt to provide a new method for completely squeezing out minority shareholders in Indian unlisted companies. It provides a feasible option for buying-out the minority shareholders as it introduces a direct binding mechanism for the Acquiring Shareholder to buy out the Minority Shareholders without requiring active participation by the Minority Shareholders or any contribution of funds from the company, which may or may not be available for minority squeeze-out. As a balancing factor, requirements of an independent valuation and deposit of 50% purchase consideration have been included which are intended to protect the interests of the Minority Shareholders. The Takeover Application which will necessarily have to be approved by the NCLT is likely to be a time-consuming process, however, the approval by the NCLT may help in ensuring that the interests of the Minority Shareholders are adequately safeguarded and also provide certainty of completion of the share transfer in favor of the Acquiring Shareholder.

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