

# Reliance Retail's Capital Reduction: The Position of Minority Shareholders

In July 2023, Reliance Industries Limited announced that the board of directors of its indirect subsidiary, Reliance Retail Limited ("**Reliance Retail**"), has approved a proposal to reduce its share capital by canceling the shareholding of its minority shareholders. Reliance Retail is an unlisted public limited company. As of July 10, 2023, its promoter and holding company (i.e., Reliance Retail Ventures Limited ("**RRVL**")), held 99.91% of the share capital of Reliance Retail, while the remaining 0.09% was held by 13,509 minority shareholders.

The petition for reduction of share capital filed by Reliance Retail with the National Company Law Tribunal, Mumbai bench ("**NCLT**"), proposes that the share capital held by all shareholders other than RRVL will be canceled. Following the implementation of the capital reduction, Reliance Retail will become a wholly-owned subsidiary of RRVL.

## BACKGROUND

A company may decide to reduce its share capital by way of share cancellation or through other methods such as a buy-back. For a discussion on the tax implications of such capital reduction, please see our note [here](#).

Section 66 of the Companies Act, 2013 ("**Companies Act**"), read with the National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016, provides for the reduction of share capital of a company. To undertake a capital reduction, *inter alia*, a special resolution must be obtained from shareholders (i.e., at least 75% of shareholders must vote in favor of the capital reduction) and an approval from the jurisdictional NCLT is required.

The application filed by Reliance Retail with the NCLT states that the capital reduction has been approved by 99.99% of Reliance Retail's shareholders. Of the minority shareholders, 84.65% by value and 51.57% by number have approved the capital reduction.

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Reliance Retail's shares have been valued by two independent registered valuers – Ernst & Young Merchant Banking Services LLP and BDO Valuation Advisory LLP. Based on the valuation reports issued by the valuers and tax considerations, Reliance Retail has proposed a consideration of INR 1,380 per extinguished share.

## **POTENTIAL OBJECTIONS BY MINORITY SHAREHOLDERS**

News reports state that certain minority shareholders (presumably those which did not approve the capital reduction) may have objections to the capital reduction on the basis that the consideration being offered by Reliance Retail is lower than the price of the equity shares being traded in the unlisted market. Note that no formal documentation in this regard is currently publicly available.

In fact, the application for reduction of share capital filed by Reliance Retail states as follows: “*It has been observed that the equity shares of the Applicant Company are being traded privately at random prices quoted by some brokers / intermediaries on their websites without any fair price discovery and the number of equity shares traded are increasing month-on-month.*”

A brief summary of the judicial precedents in relation to the views of Indian courts in relation to valuation in the context of a capital reduction is set forth below:

- The Supreme Court of India in *Reckitt Benckiser v. Unknown* (122 (2005) DLT 612) observed that when (i) an independent valuer has determined the fair value of shares in accordance with accepted valuation principles, and (ii) a lucrative price has been offered for such shares, it may be concluded that the necessary share valuation has been arrived at in a reasonable manner if accepted by the shareholders.
- Relying on *Hindustan Lever Employees' Union v. Hindustan Lever Limited* (AIR 1995 SC 470), the Supreme Court has held that it would not interfere with the value arrived at only because a better value could have been obtained through the use of an alternative method. Further, in *Re: Cadbury India Limited* ([2015] 125 CLA 77 (Bom)), the court held that the objecting shareholder should prove that the valuation arrived at was apparently unreasonable, implying that such valuation ought to be manifestly wrong from the perspective of a reasonable person.
- Another factor considered by courts in connection with matters related to reduction of share capital is the motive behind such reduction. For instance, in *Reckitt Benckiser*, the court was of the opinion that the majority shareholders had the right to decide the manner of share reduction only if it was not unfair or inequitable to the minority. Therefore, if there is a ploy in the context of a scheme of share reduction to oust a particular group of shareholders that may be deemed inconvenient by the majority,

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such scheme may be considered unfair or inequitable, and consequently, the proposed reduction may be rejected by the court.

- In *Cadbury*, the court held that the scheme of reduction (i) should be just and fair, (ii) should not be contrary to public interest, and further, (iii) no prejudice or discrimination should be caused to a particular class of shareholders on account of such reduction. In this context, 'prejudice' may refer to more than just the case of a specific shareholder getting what it wants; rather, it relates to a coordinated effort to persuade a group of shareholders to sell their shares at a price substantially below what is just, fair and reasonable.
- *Reckitt Benckiser* also stated that the reduction of share capital is purely a 'domestic' matter, and the decision of the majority will prevail. This includes the manner in which such reduction takes place, where the underlying assumption remains that no unfair or inequitable transaction has occurred in the context of such reduction.
- In *Sandvik Asia Limited v. Bharat Kumar Padamsi* (2009 (3) Bom CR 57), the judicial pronouncement remarked, among other things, that the court could not withhold its approval in a scheme of reduction unless (i) the non-promoter shareholders are not paid in terms of a fair valuation for their shares, or (ii) there is a lack of an overwhelming majority among non-promoter shareholders voting in favor of the resolution. In this regard, in *Cadbury*, too, the court emphasized the importance of the views of the majority among non-controlling shareholders before the court approves a scheme of reduction based on views of the aggregate majority.

## **TRADING OF EQUITY SHARES OF UNLISTED COMPANIES**

Unlike for listed companies, the Indian securities regulator, the Securities and Exchange Board of India, has not prescribed rules on the trading of equity shares of unlisted companies. Unlisted public limited companies are governed primarily by the Companies Act, and there are limited rules and regulations governing the offer and sale of equity shares of such companies. Currently, applicable regulations include, among others, the Companies Act requirement on a public offering (the invitation or offer to more than 200 persons in a financial year, subject to certain exceptions, constitutes a public offer and the requirement to issue a prospectus), the Indian exchange control regulations and organizational documents of the relevant companies.

Investors trading shares in unlisted companies have access to limited information in relation to such companies. For example, unlisted companies are required to mandatorily release their financial statements on an annual basis (and not on a quarterly basis, as is required of listed companies). Therefore, an investor trading in equity shares of such companies may have dated financial information at the time of making an investment decision to purchase, sell or hold equity shares. Investors also purchase shares in unlisted

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companies which are either in the pre-IPO stage or likely to be proceeding for an IPO, which may be based on public speculation.

The application filed by Reliance Retail states that “*The Applicant Company does not have any plan to list its equity shares on the stock exchanges.*” The application also states that the capital reduction is an exit opportunity being provided to the minority shareholders, who currently hold an illiquid stake.

The price of Reliance Retail as mentioned on an unlisted market trading website (unlistedzone.com) on July 7, 2023 (i.e., the date on which the proposed capital reduction was announced) was INR 2,600. This price is significantly higher than the consideration being offered by the company as part of the NCLT process. However, as described in the judicial precedents above, the NCLT is not obligated to use this price as a reference point to determine the appropriateness of the valuation reports issued by the independent valuers of Reliance Retail.

## CONCLUSION

Investors trading in unlisted equity shares on platforms are unlikely to receive the same protections as investors trading in listed securities (i.e., those to which the SEBI regulations and the protections thereunder apply).

As the valuation report has been obtained from two independent valuers and given that the majority of the minority shareholders have approved the capital reduction, *prima facie* the proposed capital reduction of Reliance Retail satisfies the criteria required for the approval of the NCLT. It will be interesting to note whether the NCLT handles any objections from the minority shareholders with the background that the equity shares of Reliance Retail were traded in the unlisted market.

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