Permissibility of Selective Capital Reduction Under the Companies Act, 2013 and the Wider "Take Private" Question

In a departure from existing precedents, the National Company Law Tribunal, Kolkata bench ("**NCLT**"), pursuant to its order dated September 19, 2024, rejected a petition for reduction of capital[1] under Section 66 of the Companies Act, 2013 filed by Philips India Limited ("**Philips India**"), an unlisted company, to cancel and extinguish the equity shares held by the non-promoter shareholders.

The rejection was on the basis that the company's main objective was a buy-back of equity shares from the minority public shareholders and that the reduction of share capital was only incidental to the company's main objective.

FACTS OF THE CASE

The promoters of Philips India, Koninklijke Philips N.V. and Philip Radio B.V., held 96.13% of the shareholding in Philips India. The remaining shareholding was held by 25,000 public shareholders (3.16%) and the Investor Education Protection Fund (0.71%).

Philips India sought to reduce its issued and paid-up equity share capital by cancelling and extinguishing 3.87% shareholding held by the non-promoter shareholders on the basis that *firstly*, the public shareholders were inconvenienced as there was no liquidity for their shareholding after the delisting of the shares of Philips India in 2004 and *secondly*, the proposed capital reduction would enable the company to save administrative and other costs associated with a very small percentage of shareholding held by a large number of public shareholders. Philips India stated that the capital

[1] CP/312(KB)2023

reduction was aimed at providing an exit to the public shareholders in a fair and transparent manner.

Philips India appointed KPMG Valuation Services LLP ("**KPMG**") as the registered valuer for determination of the fair value of shares, which was assessed at INR 740 per equity share based on the discounted cash flow method. The board of directors of Philips India accepted such valuation and decided to pay a premium of INR 175 per equity share (approximately 24% over the fair value) in the proposed capital reduction. ICICI Securities Limited issued its fairness opinion confirming the valuation.

The proposed capital reduction was approved by 458 shareholders representing 99.58% shareholding of Philips India by way of a special resolution. 161 shareholders voted against the resolution.

Certain minority shareholders objected to the proposed scheme for capital reduction before the NCLT as unjust, unreasonable and unfairly discriminatory to a class of shareholders on the basis that the promoter shareholders were attempting to gain complete control over the company by ousting the non-promoter shareholders at a "throw away price". Such minority shareholders objected to the valuation determined by the registered valuer (KPMG) on the basis that the valuer was appointed solely by Philips India and they relied on separate valuation reports independently obtained by them to contend that the valuation of shares of Philips India was substantially higher than the price determined by the registered valuer appointed by Philips India. They also submitted that Philips India had made a similar attempt to reduce its share capital previously in 2018, which had to be withdrawn due to protest/objections made by the public shareholders.

The NCLT dismissed Philips India's petition on the ground that Section 66 of the Companies Act, 2013 cannot be invoked under the facts and circumstances of the case as it did not involve the circumstances mentioned in Section 66(1)(a) or 66(1)(b) of the Companies Act, 2013. Essentially, the NCLT observed that Section 66(1)(a) of the Companies Act, 2013 relates to extinguishment or reduction of the share capital that had not been paid-up, which was not the case in the Philips India capital reduction nor did the reduction of capital of Philips India involve cancellation of paid-up capital lost or unrepresented by available assets or paying off any paid-up capital which was in excess of wants of the company as contemplated under Section 66(1)(b) of the Companies Act, 2013.

The NCLT was of the view that while the provisions of the erstwhile Companies Act, 1956 were wide enough to permit a buy-back of shares from minority shareholders though capital reduction and there was no specific bar against it, Section 66 of the

Companies Act, 2013 provides that "*nothing in this section shall apply to buy-back of its own securities by a company under Section 68*" and this language should be read as a specific bar against a selective capital reduction which results in a buy-back of shares from minority shareholders.

While the NCLT agreed that the discounted cash flow method may be the more appropriate method of valuation (in contrast to the comparable companies method) in the context of the specific business of the company, it observed a "huge difference" between the valuation determined by the valuers appointed by Philips India and the minority public shareholders even though both valuers had used the discounted cash flow method. However, the NCLT did not issue any specific directions with respect to valuation parameters on the basis that the petition was being dismissed in any event on the ground that Section 66 of the Companies Act, 2013 cannot be invoked in the facts of the case.

ANALYSIS

Reduction of capital has typically been permitted by the NCLTs in the past in identical facts. The NCLT order in Philips India, while deviating from existing precedents, has failed to appreciate that the circumstances specified in Section 66(1)(a) and Section 66(1)(b) of the Companies Act, 2013, which were relied on by the NCLT to dismiss the petition by Philips India, are only illustrative and the lead-in of Section 66 of the Companies Act, 2013 permits a company to reduce its share capital "*in any manner*" after obtaining approval of its board of directors, shareholders and the NCLT.

Further, Section 66(6) of the Companies Act, 2013 which states that "*nothing in this section shall apply to buy-back of its own securities by a company under Section 68* " is only clarificatory in nature and intends to explain that the provisions applicable to a capital reduction under Section 66 of the Companies Act, 2013 will not apply to a buy-back of shares, which is separately governed under Section 68 of the Companies Act, 2013.

THE WIDER 'TAKE PRIVATE' QUESTION

The 'take private' transaction, not an unusual transaction in other jurisdictions, has been difficult to achieve in India for two reasons:

1. Delisting within the applicable framework in India has been challenging on various counts. The Securities and Exchange Board of India ("**SEBI**") has recently amended the delisting regulations to address some of the issues, including through the introduction of a delisting at a 'fixed price' in addition to the earlier approach of

delisting at a price discovered through 'reverse book building'. However, difficulties persist. This is a subject for another note which will follow separately.

2. If delisting is achieved, public shareholders may remain on the shareholder register. One of the methods successfully used in India to purchase the shares held by the minority shareholders in such situations is a selective capital reduction of the nature presented before the NCLT in the Philips India matter. While the Companies Act, 2013 presents other alternatives in Sections 235 and 236, these provisions are framed in ambiguous language and are largely untested in courts. It is therefore important that the NCLT's decision in Philips India is considered an aberration that does not influence the prevailing established judicial position.

*This insight has been authored by **Rajat Sethi** (Partner) and **Raya Hazarika** (Partner). They can be reached on rsethi@snrlaw.in and rhazarika@snrlaw.in, respectively, for any questions.* *This insight is intended only as a general discussion of issues and is not intended for any solicitation of work. It should not be regarded as legal advice and no legal or business decision should be based on its content.*

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S&R ASSOCIATES ADVOCATES

NEW DELHI
Max House
Tower C, 4th Floor
Okhla Industrial Estate Phase III
New Delhi 110 020
Tel: +91 11 4069 8000

MUMBAI
One World Center
1403 Tower 2 B
841 Senapati Bapat Marg, Lower Parel
Mumbai 400 013
Tel: +91 22 4302 8000