

JUDICIAL INTERPRETATION OF MINORITY SHAREHOLDERS RIGHTS IN MERGERS AND ACQUISITIONS

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INTRODUCTION

Robert Rinder once said, “I propose that matchmaking should be approached like a corporate business venture. It can be risky but I have discovered that the potential profits from acquisitions and mergers cannot be underestimated”. Mergers and Acquisitions have become an essential part of the business world today. In order for a business or a company to survive and expand, it is necessary for them to be dynamic and make the necessary changes in their structure and work. Mergers, in simple terms, can be defined as a situation where two independently operating entities form a new entity. An acquisition is a situation where one company takes over and establishes control over another company. The process of a merger or an acquisition is a long one. It involves a lot of changes that takes place in the company as well as interested third parties. One issue that can arise over such a process is the protection of minority shareholders and their rights. Very often, whenever a certain proposal is made in a company, there is a certain minority that opposes it. Mergers and Acquisitions are no exception to this. However, it is important to strike a balance between protecting the company’s and majority’s general interest as well as the interest of the minority.

In this paper, the author has discussed five different cases where the minority questioned the proposed scheme of arrangement on various grounds, and how the court has interpreted their rights, keeping in view of the company’s general interests as well as the statutory provisions in place.

In Re: ITW Signodge India Ltd. ([2004]121CompCas66 (AP))

In this particular case, Mr. Praful Chavda opposed the entire scheme of arrangement that was set to take place. (99% majority approved this scheme.) The reasons for him opposing are as follows:

- i. He said that the scheme was not conducted in accordance with the law and the objections raised by some shareholders were not considered. He also said that some shareholders were not even allowed to speak.
- ii. He stated that the main motive behind such a scheme of arrangement was to increase the face value of each equity share to Rs. 20,000 as an act to eliminate the small shareholders of the transferee company under the pretext of this scheme.
- iii. He contended that the transferee and transferor companies are subsidiaries of a foreign company (M/s. Illinois Tools Works Inc., USA). This company holds 9696 shares in both companies, and that the present scheme of arrangement will cause harm to the interest of small shareholders.
- iv. He stated that the variation in the rights of the small shareholders under the proposed scheme without their written consent and sanction under special resolution is unconstitutional as per the provisions of Section 106 of the Companies Act, 1956
- v. He also raised a contention that the proposed scheme is not within the purview of the Memorandum and Articles of Association of the Transferee Company and the change of equity base of the Transferee Company with the Transferor Company, which is a non-listing company, is detrimental to the interests of the shareholders of the Transferee Company.

Based on all these grounds, he challenged the scheme and was his prayer to reject the scheme.

Along with Mr. Praful Chavda, Mr. Rajkumar, Mr. Rajkumar Khandelwal, Mr. Rahul Khandelwal and Mr. Ramesh Manguluri, shareholders of the Transferee Company, opposed the proposed scheme of arrangement with same set of allegations. They also contended that the proposed hike in the face value of the shares of the Transferee Company from Rs. 10 to Rs. 20,000 each is not justified and not in the interests of small and minority shareholders for it seeks to eliminate them.

Therefore, it can be clearly seen that one of the main reasons for opposing this scheme by the

above said people is because the scheme aims at increasing the face value of each share and this increase is detrimental to the minority shareholders.

However, the court held that in the management affairs of the company, the decision of the majority shareholders will prevail and will be binding on the minority shareholders, even if a single individual holds majority of the shares. The objection petitioners, holding comparatively very few shares, cannot object this scheme, especially when the voting of the scheme was conducted in a civilized and democratic manner. They also held that merely because by reason of increase in the face value of each share, the minority shareholders are eliminated, it cannot be said that a different class of shares have been created, and therefore, the provisions of Section 106 of the Companies Act are not applicable to the case on hand. By highlighting clause 6.5 of the scheme which provides for payment of monies to the shareholders representing the fractional entitlement at the rate of Rs. 80 per share, and once the Scheme of Arrangement is approved, the court said that the minority shareholders, if eliminated, will be compensated.

Thus, in conclusion, the court allowed the scheme of arrangement to continue as the scheme had been passed on valid grounds and the rights of minority shareholders were not violated.

Sandvik Asia Limited vs Bharat Kumar Padamsi and Ors. (2009(3) BomCR57)

This case is important because it deals with conducting separate meetings for two different groups in order to protect the rights of the minority shareholders. The case deals with the validity of reduction of shareholding under Section 100 of the Companies Act and the same was held for consideration.

The court observed that there were two distinct groups amongst the paid up equity shareholders, one belonging to the promoters and other of non-promoters and therefore separate meetings ought to have been convened of these two groups. The court stated that since a meeting of both groups was held together, the promoters could virtually bulldoze the minority shareholders and purchase their shares at the price dictated by them. The court found that therefore and also because the minority shareholders were not given any meaningful option, the reduction of share capital was

unjust and unfair.

Hoganas India Ltd. In Re ([2009] 148 Comp Cas Bom)

Hoganas India Limited had a shareholding pattern as follows: 96.15% was held by Hoganas AB Sweden, 01.82% was held by subsidiary of Hoganas AB Sweden named Hogana Hogaps AB and 02.01% was held by other shareholders.

In this particular case, the company, under the proposed scheme of arrangement, had decided to reduce its shareholding of all shares except those held by its holding Company Hoganas. It offered the following options to the shareholders:

- i. The shareholders could sell their shares for a consideration of Rs. 177/-;
- ii. That the shares could be exchanged for an unsecured fully paid debenture of Rs. 177/-
- iii. If the shareholders did not opt for the above two, he would be paid a sum of Rs. 177/- in lieu of share, which would then be deemed, vested in the Company's name.

The two objections to the scheme were as follows:

- i. The three options that were provided were not fair as they had no choice but to give up the shares.
- ii. The requested majority of 3/4th was achieved by the improper inclusion of Hoganas Hogap AB which held 1,00,000 shares aggregate value of Rs. 10,00,000.

The court said that while it agrees that the (first) contention of the shareholders was true. It held that if such a clause, if not shown to be contrary to any provision of law and if applied uniformly, is within the power of the company, particularly when taken by the majority of the members of the company present for voting as required in law.

Regarding the second objection, the objectors further stated that the Company ought to have obtained appropriate directions from this Court for convening separate meetings of Hogana Hogaps AB which is a subsidiary of Hoganas AB Sweden, which held 1.82% shares and a separate meeting of other shareholders who held 2.01% shares because according to the petitioners Hogana Hogaps would be inclined to allow its shareholding to be extinguished according to the wishes of

the company and therefore constitute a separate class from the other shareholders, who would not have wanted their shareholding to be extinguished.

However, the learned judge in this case stated that all shareholders who were offered the same terms would have to be treated as a same class and this was the case in the present matter. If different terms had been offered to different groups of shareholders, then they would've been treated as a different class, which is not the case here. He further stated that all these shareholders (Hogana Hogaps AB, which held 1.82% of the shares and other members of the public who held 2.01%) were to be relieved of their shareholdings on the same terms, and therefore it was necessary on the part of the company to treat all the shareholders as one class.

In conclusion, the judge said that it does not appear that the proposed action is manifestly unfair or is being proposed to defraud other shareholders. The decision to reduce the shareholding of the company since shares became untradeable in the market and the corresponding decision of the shareholders to accept payment in such shares and relinquish their shareholding could be well said to be commercially correct and acceptable decision. The judge rejected the objections made and sanctioned the scheme of arrangement.

In Re: Organon (India) Ltd. ([2010]157CompCas287(Bom))

In this case, a particular scheme of arrangement was proposed. The scheme would lead to a reduction of the share capital as well as paying off the public shareholders, excluding the promoter shareholders. The promoter shareholders held 98.43% of the paid up equity share capital.

Mr. Lakhani, a shareholder, submitted that such reduction of the share capital proposed by the petitioner-company, by paying off the public holders of equity shares, other than the promoter-shareholders and giving them certain compensation, amounts to a forceful acquisition of the shares held by them. He stated that such action on the part of the petitioner-company is against the principles of natural justice, corporate democracy and corporate governance. He further stated that such reduction tantamounts to a sophisticated corporate mafiaism.

However, the court rejected the various contentions made by Mr. Lakhani, and allowed the scheme to take place.

Ram Kohli Vs Indrama Investment Pvt. Ltd. Select Holiday Resorts Ltd.
([2014]186CompCas358(Delhi))

In this particular case, the scheme of arrangement was passed with a 99% majority. The appellant filed an application under Section 394(2) and 395(1) of the Companies Act, 1956, questioning the validity of the scheme.

Mr. V.N. Kaura, learned Senior Advocate appearing on behalf of the appellant contended that the appellant and other shareholders whose shareholding was being treated as fraction under the scheme should be treated as a separate class and a separate meeting qua them should have been held. However, in response to this particular contention, the court held that under Section 391 of the Companies Act, here is only one class of equity shareholders. The decisive factor for determining the class of shareholder is not the shareholding pattern but the category of shares that one holds. All equity shareholders constitute the same class of shareholders. It also held that merely holding a fraction of shares would not make them a separate class and that all equity shareholders (irrespective of their shareholding pattern) would constitute one class.

The court finally upheld the decision of the Company Court and stated that the scheme is fair and reasonable and didn't call for any interference in the same.

CONCLUSION

Through the above cases, the court has laid down the following two points:

1. If a resolution for scheme of arrangement has been passed in a justified and legal manner and in accordance with the statutory provisions, the even if a single shareholder holding a majority of the shares supports the resolution, it will be considered valid. The decision of

the majority shareholders will prevail and will be binding on the minority shareholders.

2. Separate meetings should be conducted for different classes or groups of shareholders. However, if shareholders are offered the same terms, then they will be treated as belonging to the same class. It also said that merely holding a fraction of shares would not make these shareholders a separate class and that all equity shareholders (irrespective of their shareholding pattern) would constitute one class.

This is the judicial interpretation of minority shareholder's rights in mergers and acquisitions, when there have been opposition to schemes on various grounds.

