THE ISSUE OF PROTECTION OF MINORITY SHAREHOLDERS AT THE TIME OF AMALGAMATION: IS THE CURRENT LAW GOOD ENOUGH OR DO WE NEED TO LEARN FROM OTHER JURISDICTIONS?

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ABSTRACT

The protection of minority shareholders has always been one of the most important issues of corporate governance. These interests are especially very vulnerable during the time of amalgamation. The accusation that the current law too is inadequate has often been raised by the critics. This paper seeks to analyse this exact area. It traces the development of the law on this particular aspect from the Companies Act, 1956 to the Companies Act, 2013. It also tries to look into the criticism of the Companies Act, 1956 to better understand the reasons for development of law. This paper analyses the approach of the Companies Act, 2016 on this topic. It seeks to point out whatever loopholes exist in status quo from the critical analysis of the current law. It also studies the 2016 Rules on this topic and seeks to analyse their effectiveness. The paper also dwells into a cross-jurisdictional study of laws from the United States of America, United Kingdom and Canada on this particular topic in order to widen the perspective of the study and come up with potential suggestions for a better law. Lastly, the paper seeks to lay down a few suggestions in order to justify the intention of the legislature to better protect the interests of the minority shareholders during the time of amalgamation. This

Keywords *– Companies Act, Minority Shareholders, Amalgamation, Foreign Jurisdictions, Reforms, Corporate Governance.*

INTRODUCTION

Economic systems all throughout the world are becoming more powerful with the help of procedures like amalgamation and mergers. These procedures allow them to tackle various challenges that are posed by globalisation, a phenomenon that has channelled the integration of markets, both worldwide and national.

Although amalgamation is not defined in the Companies, the courts have stated that it happens when two or more companies are joined to form a third entity or one is absorbed into or blended with another.[i] Inferring from the context and from the reading of the marginal note of S. 394 of the Act, the main objective of amalgamation of two or more companies is to facilitate reconstruction of the amalgamating companies. Now, this process is largely dominated by majority shareholders.

One of the essential requirements of a sound corporate governance system is that rights of all shareholders shall be effectively protected and they shall be able to influence corporate decision making too.[ii]

It will be useful to note here that Company Law does recognize that at certain junctures, the majority stakeholders might be at an unfair disadvantage. This leads to an unfair disadvantage to the minority shareholders as their interests can often not align with that of majority shareholders and in that case, they have no recourse but that of law.

The Irani Committee Report[iii] clearly highlighted that this particular class of shareholders needs to be given special protection as there is a great likelihood of their interests being seconded to that of the majority. The consequence of this disability might be that the minority shareholders might not get returns on their investments or might possibly get "squeezed out" by the majority shareholders.

It is very much possible that the majority shareholders might use this vulnerability, since they are masters of this process of amalgamation, to force out or squeeze out the minority shareholders, under the garb of amalgamation. This worst and most likely consequence of this

squeeze out is that the minority shareholders get low prices during the buy-out by majority shareholders.[iv]

In this paper, I shall be discussing, both the Companies Act, 1956 (hereinafter, the 1956 Act) and the Companies Act, 2013 (hereinafter, the 2013 Act), and critically analysing the current position of law for the protection of minority shareholders during amalgamation. I shall be briefly discussing the legal position of certain countries on this particular topic. This shall be followed by me suggesting certain reforms in order to overcome whatever shortcomings that I have identified.

LEGAL POSITION UNDER BOTH THE STATUES

The principles of democracy have been the central ones in the corporate law jurisprudence. However, it has also been identified that this approach of can lead to subversion of the interests of the minority. Keeping this in mind, the framers of both the Acts have tried to give some kind of protection to the minority shareholders. Let us now critically analyse both the Acts:

The Companies Act, 1956

The 1956 Act had Section 395 that provided protection to the minority shareholders during the time of amalgamation and reconstruction.

According to this section, the acquirer company had to make an offer to the shareholders of the company that they plan on acquiring to sell their shares or class of shares under a contract or a scheme. This section mandated that shareholders that were holding 90 percent of the value of shares must then, within 4 months, accept that offer.

The total shareholders are divided into two kinds- majority shareholders i.e. the ones that accept the offer & the minority shareholders i.e. the ones that reject the offer.[v]
Once the offer is accepted, the acquiring company must, after the expiry of that period of 4 months, within another 2 months, send a notice to the shareholders that have dissented evincing interest to buy their shares.[vi] For the sake of clarity, dissenting shareholders include any

shareholder who has not assented to the scheme or contract and any shareholder who has failed or denied to transfer his shares to the acquirer company as per the contract or the scheme.[vii]
The dissenting shareholders then get a period of 1 month to approach the court/tribunal with any kinds of objections that they may have. This is the only chance that the minority shareholders get to challenge this process. If they fail to do so, the acquirer company gets the right to acquire their shares. If they do go to the tribunal, the success of the process becomes contingent on the tribunal's order. However, there might arise a situation where the company that is supposed to acquire already has one-tenth or more of the shares of the company that it is supposed to acquire. When this situation arises, the company that is supposed to acquire the shares has to take the consent of shareholders that hold more than 90 percent in value and more than 75 percent in the number of shareholders who hold the shares. In this situation, the minority shareholders are entitled to the same share price as other shareholders.[viii]

Criticism of the Companies Act, 1956

S. 395 only protects the right of the minority shareholders to approach the judicial forum only in the case of the contract or scheme being unfair and prejudicial. This however, does not exactly protect all the interests of the minority shareholders. A pertinent problem is that of the fair valuation of the price of the shares. There exists no procedure for the fair valuation of the shares of the minority shareholders in such cases.[ix]

There are instances where the price that was determined did not seem fair but after the process of amalgamation, the determined price seemed more than fair.[x]

This lack of proper procedure for valuation leaves the minority shareholders at the direction and will of the company that is supposed to acquire.[xi] There have been cases where the India Courts have held that the valuation procedure is fair as long as it is done by an "independent body" and in accordance with law.[xii] There have also been instances where the Court has itself appointed a valuer.[xiii]

This section of the 1956 Act is also restricted in the sense that it is only applicable where there is a transferor company and a transferee company, as has been stated in S. 394 of the 1956 Act. The Court, in *Pattrakola Tea Company Ltd.*[xiv], held that "only where there is a scheme or

contract involving the transfer of shares from one company to another company should S. 395 apply".

There have also been instances when S. 100 of the 1956 Act was used to circumvent this particular protection provision. This particular section discusses the reduction of capital. A special resolution needs to be passed to make the attempt of reducing the capital successful. The threshold for this process is 75 percent, which is a lot more relaxed than the 90 percent which has to be met under S. 395 of the 1956 Act. This way, it becomes earlier to get rid of the minority shareholders. It must be noted that the special resolution requires the assent of the court. The use of this particular tactic is however looked down upon.[xv] The Bombay High Court has opined that where a company seeks to resort to the reduction of capital to eliminate minority shareholders, the Tribunal must look into only two aspects before granting its assent, the aspects being 1) whether non-promoter shareholders are paid fair value; and 2) whether an overwhelming majority of the non-promoters shareholders voted in favour of the resolution.[xvi] The Andhra Pradesh High Court has, however, stated that where the reduction is done purely to deprive the minority shareholders of their rights, the Court may at its instance reject/modify the scheme in such a way that the minority shareholders get the benefits that they were expecting when they first purchased the shares.[xvii]

If this wasn't enough, there is still confusion as to whether the minority shareholders should be looked at as a class[xviii] or as an individual[xix].

There also exists no specification of any time period that has to be adhered to when the consideration received by the target company for the sale of such shares is to be paid to the shareholders. Lastly, the provision allowed even a single shareholder to challenge the contract or the scheme in the Court, thus opening up the amalgamation to a lot of unnecessary scrutiny.[xx]

The Companies Act, 2013

The 2013 Act has S. 235 which seeks to protect the minority shareholders. It corresponds to S. 395 of the 1956 Act. S. 235 mandates an offer may be made under a contract or a scheme by the company which seeks to acquire the shares of another company. Then, the shareholders holding 90 percent of the value of the shares must accept the proposed offer or scheme for it to

be valid. The acquirer company must make an offer to the minority shareholders for the purchase of their shares under a scheme or a contract within 4 months of its acquisition of 90 percent of the equity share capital of the company whose shares are to be transferred. The offer has to be made by way of notice.[xxi] The minority shareholders, in case of them objecting to the offer, may get a month's time to approach the Tribunal. In case the application to the Tribunal is not made or the Tribunal passes an order upholding the amalgamation, the company who seeks to acquire the shares may buy them at a price that is at par to the price paid to the shareholders who had approved to the process.

The majority shareholders often use a technique called "freeze out" to eliminate the consideration of interests of minority shareholders. This technique involves the incorporation of a new company by the majority shareholders simply to acquire the shares of the company whose shares are to transferred such that the minority shareholders are forced to sell their shares under S. 235 of the 2013 Act. The Courts have, however, read into S. 235 the requirement that both, the company that seeks to acquire and the company that is to be acquired, needs to be different entities.[xxii]

It must be noted that for any kind of challenge levelled against the contract or the scheme to succeed, the onus lies on the minority shareholder or the petitioner to show that the said contract or scheme is unconscionable i.e. it has been formed to simply force out the minority.[xxiii] The party that relies on the section has to dispel each and every doubt regarding the fact that there was fair play.[xxiv] The general rule is that the shareholders who dissent must not face any kind of disadvantage and must be offered a fair price.[xxv]

That being said, the framers of the 2013 Act did have in mind the lacuna that the 1956 Act left. This was cured by the addition of S. 236 of the 2013 Act. The primary reason for the inclusion of this section was the recommendation by the Irani Committee[xxvi].

S. 236 discussed a situation where the acquiring company has acquired 90 percent of the capital and makes an offer to the company whose shares are to be sold for the buy-out of the remaining shares of the minority shareholders. This section mandates that in such a case, the price at which the offer is made is to be calculated by a Registered Valuer as per the rules prescribed.

The rules for this are given under the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. Rule 27 provides that the valuation for a listed company has to be done in accordance with the procedure and terms as laid down by Securities Exchange Board of India[xxvii] and this has to be accompanied by a report that is submitted to the company that states the reasons that lead to the price so arrived at. For private companies and unlisted companies, the price of shares in to be decided by taking two factors into account: 1) highest price that has been paid for acquisition in the preceding 12 months to the company that seeks to acquire the shares[xxviii]; and 2) other relevant variables like return on net worth, book value of the shares, earning per share, price earning multiple vis-à-vis the industry average and other factors that are customary for valuation.[xxix]

It must be kept in mind that these factors are in no way exhaustive. This is implicit from the language that has been adopted in the section. It simply lays down a framework in order to facilitate the proper valuation of shares. This was something that was missing under the 1956 Act which lead to the minority shareholders being underpaid. Once the price is determined, the Registered Valuer must go ahead and submit its report to the company containing the price and the reasons behind it.[xxx]

S. 236 also grants the minority shareholder a right to make an offer to the company acquiring the shares of their company at the price that has been arrived at by the Registered Valuer.[xxxi] It also states that if the offer that is made either by the company acquiring or the minority shareholders of the company that is to be acquired is accepted, the majority shareholders must deposit the value of the shares in a separate bank account.[xxxii] This bank account should be operated by the transferor company and it must be made sure that this amount is disbursed to the minority shareholders within a period of 60 days from such acquisition. The shareholders, who do not get the disbursed amount or who do not claim it, may be entitled to claim it till a period of 3 years after which the amount should be deposited in the Investor Education and Protection Fund (IEPF) account.[xxxiii]

There is also an additional protection granted under S. 236 of the 2013 Act. The protection is that the shareholders that hold 75 percent or more of minority equity shareholding may negotiate or try to reach an understanding on a higher price for any transfer, proposed or agreed

upon, the majority shareholders shall share the additional compensation so received by them with other minority shareholders on pro rata basis.[xxxiv] This protection allows the minority shareholders to receive the renegotiated price even after the sale has already been given effect to.[xxxv]

There is also a protection in the sense that if some shareholders are left out i.e. the acquiring company did not acquire their shares, the left out shareholders still protected under S. 326 of the 2013 Act even if their shares have been delisted or if the period of 1 year that is mentioned in the Securities Exchange Board of India's regulations had lapsed.[xxxvi]

LOOPHOLES THAT EXIST IN STATUS QUO

There is no doubt that the 2013 Act did try and plug a lot more holes through S. 235 and S. 236 than the 1956 Act did through S. 395. However, there are still a few loopholes left.

Firstly, S. 236 of the 2013 Act fails to specify whether the offer that is made by the majority shareholders optional or compulsory.[xxxvii] On the contrary, we see that S. 235 of the same act does specify that the company should acquire the shares within a period of 1 month if there is not application that is made to the Tribunal or if the Tribunal does not pass an order to the contrary.[xxxviii] This is exactly where S. 236 falls short in the sense that it only specifies that a notice may be sent to the minority shareholders which shall then be followed by the procedure of depositing money in a separate bank account.

We can, however, judge from the usage of the phrase "in the event of purchase" that the offer may or may not be accepted. This makes it look more like an option. Even sub-section 9 of S. 236 of the 2013 Act states that "where a shareholder fails to acquire". The use of this particular phrase further makes it look like an option. This makes it fairly clear that while there is clarity as to the fact that the majority shareholders are required to make an offer and send a notice to the minority shareholders, there exists no such clarity as to whether or not there exists an obligation on the minority shareholders to accept such an offer that is made to them under S. 236.

Secondly, we see ambiguity with regards to the timeline under S. 236 of the 2013 Act. This particular section does not specify in how much time should the offer be made by the majority shareholders.[xxxix] S. 235 of the 2013 Act is however very clear on this timeline point. Not just this, S. 236 of the 2013 Act is also ambiguous on the question of how much time does a minority shareholder has to respond to an offer and the exact time period during which the minority shareholders are supposed to or rather expected to transfer their shares to the majority shareholders. The only clarity that we have is that the time period for the dispersion of the money to the minority shareholders.[xl] This particular lacuna may further lead to different practices in various companies and this may later become a point of dispute.

We also see that there can be some shareholders from the majority shareholders, whose shares are not being purchased back, have a right to vote for approving the contract or the scheme. This part needs to be cured for ensuring that the the buy-back of shares does not occur where there is no consent of the shareholders whose shares will be purchased in the event of a merger.[xli]

Another point of concern is that there exists no provision in the 2013 Act that provides for a separate meeting of minority shareholders to against the proposed buy-out.[xlii] This may lead to a situation where the decision makers would not be affected by their own decisions. This is so because the shareholders that would be approving that particular proposed contract or a scheme won't be the ones who would be directly affected by it. This is because the question does not involve their shares. This defect needs to be cured at the earliest. It can be cured by a simple amendment that states that the concerned shareholders or the minority shareholders should be allowed to have their own meeting so they can alone decide on matters that pertain to their shares.

It is also seen that even though the 2013 Act does specify the requirement of giving a notice to the minority shareholders by the majority shareholders, the requirements of the notice often seem insufficient to explain to the minority the effect of the restructuring activity, as in the case of amalgamation.

COMPARATIVE ANALYSIS OF INDIAN LAWS AND THEIR FOREIGN EQUIVALENTS

Let us briefly look into the position of law with reference to the protection of minority shareholders with regards to amalgamation and merger in three different jurisdictions, the United States of America, the United Kingdom and Canada and compare them with the Indian laws.

The United States of America

The federal law of the U.S. provides for two types of mergers that can be used by the majority shareholders to "squeeze out" the minority shareholders. There are:

- Long-form merger: In case the company that seeks to acquire another company fails to acquire a minimum of 90 percent share of the company that it seeks to acquire, a special meeting is called in order to get the votes of the residual shareholders.
- Short-form merger: When the company that seeks to acquire another company gets 90 percent or more shares of the company that it seeks to acquire, it does not need to call any special meeting for getting the shares of the remaining shareholders.[xliii]

This is a distinct feature of the U.S. legal system. In India, we do not have any such divisions. The federal law also has two types of protective mechanisms for the minority shareholders. These are:

- Appraisal rights: This right ensures that the minority shareholder gets a fair valuation of their share.
- Fiduciary Duty Class Action: This basically shifts the onus of proving that the contract or the scheme does not have any unfair content that might harm the minority shareholders.

In India, we see that unlike the U.S, the onus is on the person who alleges that there is unfairness. While one can say that S. 236(2) may give the minority shareholder a right to have a fair valuation of their shares, this is just not enough. In the U.S. the entire burden is shifted from the aggrieved shareholder to the company.

The United Kingdom

Like almost every other law, the laws of the U.K. are quite similar to that of India. One of the prominent points of divergence in the U.K. law is that the Courts of the U.K. have actually held

certain mergers to be invalid when they were prejudicial to the interest of the minority shareholders.

The United Kingdom law mandates the company making the proposal to clearly specify in the notice that they are sending to the company that they seek to acquire, the impact of the scheme or the contract on the minority shareholders.[xliv]

In India, we see that the guidelines for the notice are very vague and clearly not sufficient enough to protect the interests of the minority shareholders. This draws in favour of the company that seeks to acquire another company.

Canada

The CBC Act states that every such class of shareholders is required to approve the scheme or the contract.[xlv] The Indian law, however, does not draw any such distinctions between different classes that might be impacted by this process.

RECOMMENDATIONS BASED ON THE COMPARATIVE ANALYSIS

After having analysed the foreign laws, I shall now attempt to give a few recommendations to increase the protection of the interests of the minority shareholders during amalgamation. These recommendations might allow us to overcome the shortcomings of the Indian law.

- Mention of the impact of the scheme or the contract on the minority shareholder in clear and precise terms in the notice that is to be sent to the minority shareholders. This will enable the minority to take an informed decision.
- Courts should increase the threshold for approval of such schemes or contracts. They should be subjected to greater scrutiny. They should reject the scheme or the contract if it is detrimental to the interest of the minority shareholders.
- The burden to show that the scheme is fair should be pushed to the company that seeks to acquire another country.
- The approval of minority shareholders as a class much be made mandatory to proceed with amalgamation.

CONCLUSION

The intention of the legislature has always been to protect the interest of the minority shareholders. However, we see that their legislative actions have not done justice to their intention.

We see that the 2013 Act did try and remedy and few shortcomings of the 1956 law. However, there are still a few loopholes or shortcomings left. These were identified as confusion regarding the nature of notice being compulsory or optional, the lack of a provision for a meeting with the minority shareholders, etc. and their relation to the detriment of interests of the minority shareholders has been shown.

We also saw the laws for the protection of the minority shareholders during amalgamation in foreign jurisdictions. We saw how there exists a few laws that can be adopted by India too in order to improve the protection enjoyed by the minority shareholders.

We have come a long way from where we started but there is still a long way to go. We must always make an active attempt to foster an environment in the company where corporate democracy is respected and a balance is struck between it and the rights of the minority shareholders.

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