ROLE OF JUDICIARY IN MONITORING REDUCTION IN SHARE CAPITAL

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INTRODUCTION

Share Capital Reduction is the process where the shareholder's equity is decreased by the way of share cancellations and share repurchase. Capital Reduction is also knowns as share buybacks. This reduction is done for various reason such as producing an efficient capital structure and increasing the shareholder value. After this reduction the number of shares will decrease in proportion to the reduced amount. This reduction is also done in response to a decline in the operating profits or in case of a revenue loss that cannot be recovered from the expected upcoming profits as well.

Generally, the need for capital reduction arises due to numerous reasons such as to distribute assets to the shareholders, reduce the basis for taxes, to compensate for deficit, to make up for heavy capital expenses etc. Moreover, sometimes the company has more capital and reserves than what they can profitably use, which is why they adjust the relation between capital and assets by this reduction of capital. However, the most common reason for reduction of share capital are, to increase the distributable reserves in order to enable future dividends to be paid to the shareholders, to return the excess capital to shareholders or to enable a share buyback or share redemption or as a part of scheme.

Share capital reduction is done under section 66. Initially civil courts looked after these reductions, however post amendment that is, Companies Act 2013 the National Companies Law Tribunal looks after the reduction of capital. This ensures that such reduction is done in consonance with law and that such reduction does not prejudicially affect any party. Under section 66 a sanction of tribunal is mandatory. However, there are other ways of reduction such as buy back, redemption of shares etc. where the assent of the tribunal is not required.

This paper aims to understand he types of share capital reduction, the judicial precedents regarding the same and also tries to understand the role of the judiciary in ensuring that the schemes laid out by the companies for the reduction does not adversely affect any party.

REDUCTION OF SHARE CAPITAL WITH THE SANCTION OF THE TRIBUNAL

According to section 66, a company may pass a specific resolution to reduce the share capital, subject to an order of the tribunal confirming the same, in any manner and may, either reduce the liability or cancel it on any of shares whose share capital is not paid up. For instance, when there is a share of Rs 10 and only Rs 6 is paid it will be taken as a share valued Rs 6 and fully paid up. This way even the shareholder is not liable for the uncalled capital; or either with or without reducing or extinguishing liability on any shares, (1) cancel any paid up share capital which is lost or a paid up share capital that is not represented.; or (2) return any paid up shared capital which is excess of what the company wants. For instance, if a share is fully paid up to Rs 10 and the share capital can be reduced to Rs 6 and Rs.4 can be paid back.

In the case of Tamil Nadu Newsprint and Papers Ltd. V. Registrar of Companies[i], the High Court of Madras permitted the company to reduce the capital which was in excess of what the company needed and directed it to pay partly in cash and partly in form of non- convertible debentures. In case of reduction of share capital, the company can alter its memorandum by the way of reducing the value of share capital and shares.

The procedure for reduction of share capital is given under section 66 of the Companies Act and can be given as follows,

1. Pass a special resolution for capital reduction.
2. Give an application to tribunal by the way of petition and confirm the aforementioned resolution.
3. The Tribunal shall give the notice of the application to Central Government, the registrar and the SEBI and in cases of listed companies to creditors.

4. Within 3 months of the receipt of such notice, the Central Government, registrar and the SEBI must make representation. If they fail to do so they it will be presumed that they do not have any objections to such reduction.
5. The tribunal shall then make an order confirming such reduction of share capital if it is satisfied that the debts or claims of every creditor has either been discharge or is secured or his consent for such reduction has been obtained.
6. The application cannot be sanctioned by the tribunal if the accounting treatment given by the company for such reduction unless it is consonance with the accounting standards given under section 133 or any other provision of the act and a certificate is to be provided by the company's auditor to that effect.
7. The order of such confirmation by the tribunal must be published by the company in a way directed by the tribunal.
8. The company shall then deliver the certified copy of the order of the tribunal and of minute approved by the tribunal comprising of the amount of share capital, the number of shares to which it is to be divided, the amount of each share and the amount to be paid up on each share on the date of registration. The copy of the order should be delivered to the registrar within 30 days of receipt of copy of such order and on receipt of such order the registrar shall register the same and furnish an order to that effect
9. A member of the company will not be liable for any call or contribution with respect to any share held by him which exceeds the difference between amount paid on for procurement of such share or the amount which is deemed to be paid and the amount that is fixed for the reduction.
10. If the name of any creditor, who is entitled to object to such reduction by the reason of his ignorance of the reduction proceedings or of its nature and effect to his claim or debt is not entered into the list of creditors and post reduction the company is not in a position to pay his debt or claim,
    (1) Then every person that was a member of such company on the date of the registration of the order of the tribunal with the registrar shall be liable to contribute an amount which he would have been liable to contribute if the company would have started winding up on the said date.
    (2) If the company has wound up, then upon the application of the creditor along with the proof of his ignorance the tribunal may prepare a list of people who shall be

liable to contribute and enforce calls and orders on such persons as if they were the ordinary contributors to the aforementioned process.

(3) This shall not affect the rights of the contributors among themselves

11. If any of the officers of the company, conceals the name of the creditor, who is entitled to raise objection, on purpose or knowingly misrepresents the nature and the amount of such debt of any creditor or abets or is privy to any such misrepresentation or concealment, he shall be liable under section 447.
12. The company shall publish the order of the tribunal as directed by the tribunal or shall be liable to pay a fine of not less than 5 lakhs but may exceed to 25 lakh.

In the case of Tamil Nadu Newsprint and papers Ltd. v. Registrar of Companies[ii], the company issued share capital worth 98,18,00,000 which consisted of 9,81,80,000 equity shares having the value of Rs 10 each. The company passes a resolution via general meeting, proposed to reduce the capital to Rs. 50 crore which would consist 5 crore equity shares having value of Rs 10 each by returning Rs 48.18 crore divided into 4,81,80,000 equity shares of Rs 10 each to the shareholders proportionately. This payment was to be made partly in cash and partly by the issue of non-convertible debentures. Most of the creditors approved the aforementioned proposal. Madras High Court approved the reduction and also approved the procedure followed by the company. In another case, In Re OCL India Ltd[iii], the company wanted to reduce the capital based on a special resolution passed. The Orissa High court held that in order to permit the reduction it is the duty of the court to see if the procedure through which the resolution is to be passed is formally correct and that no prejudice is caused to the creditors. It is also the responsibility of the court to see if the scheme is fair or not. The court should first protect the interest of the creditors, then the interest of the shareholders and should also take public interest into consideration.

REDUCTION OF SHARE CAPITAL WITHOUT THE SANCTION OF THE TRIBUNAL

Reduction of share capital can be done without the sanction of the tribunal in the following ways,

1. **Buyback of Shares**

   According to section 67(1) a company cannot buy its own shares, however, section 68 is an exception to this and states that a company can buy back its shares or other securities which is subject to certain conditions. A company can buy its shares out of its free reserves or the securities premium account or the proceeds of any shares or other securities. However, buyback is not possible with the proceeds of a previous issue. Moreover, according to section 69 if the shares are bought back from free reserves then a sum equal to the nominal value of the shares bought back will be transferred to a Capital Redemption Reserve account and such transfer is to be disclosed in the balance sheet of the company.

2. **Forfeiture of Shares-** The company can forfeit its shares in pursuance of its articles, for non-payment of calls
3. **Surrender of shares-** Under certain circumstances where the forfeiture is justified, it has the effect of releasing a shareholder whose surrender is accepted from liability on the shares.
4. **Diminution of Capital-** Diminution of capital is given under section 61(2). This is reduction of issued capital instead of paid up capital like in case of reduction of capital. Moreover, this can be affected by the way of ordinary resolution.
5. **Redemption of shares-** According to section 55, companies that are limited by shares cannot issue preference shares that are irredeemable. Moreover, if they are authorized by the article, they can issue shares which are to be redeemed within a period of 20 years.

EVOLUTION OF THE CONCEPT OF REDUCTION OF SHARE CAPITAL

One of the landmark cases that have been used by the Indian Courts is the case of British and American Trustee and Finance Corporation Ltd v. Couper[iv]. In the aforementioned case the House of Lords held that the question to reduction of share capital is the internal concern of such company and when the legislation does not provide for a particular method it necessarily means that such the intention of the makers was to let the majority shareholders decide the method of reduction. The same was affirmed and brought in India by the Supreme Court in the case of Ramesh B. Desai v. Bipin Vadilal Mehta.[v]

Justice Chandrachud in the case of *Re: Elpro International*[vi] *has laid down certain principles to be followed by the courts,*

1. The share reduction is an internal matter of the company.
2. The majority shareholders can decide to reduce the capital and can pass a special resolution to that effect. They can also decide the way by which reduction is to be done.
3. Selective reduction is permissible for same class of shares and since it is a domestic matter the company can decide if share of members are to be reduced in proportion or if shares of certain members are to be cancelled entirely while others share remain unaffected.
4. It is the duty of the court to ensure that such transaction is fair or equitable and all creditors have been paid or given the right to object or are secure or have consented to such reduction.

REDUCTION OF SHARE CAPITAL AND SCHEMES OF A COMPANY

In the case of Sandvik Asia v. Bharat Kumar Padamsi[vii], it was contended that the schemes wherein all the entire shareholders except for the promoters are wiped out is in contradiction to intention of Legislation as well as public policy. The Bombay High Court accepted this contention and held that a separate meeting should be held for non-promoting shareholders in order to ensure that the minorities have a say in the reduction. Moreover, in the instant case the shareholders were not given the option to keep their share which according to the court was not fair as it led to the minority shareholders being forced to give up their shares. This decision of the court was appealed against and went to the division bench of the high court for an appeal. This decision was reversed and the court held that under the Companies act reduction can be done in any manner, it held the reduction to be valid. Moreover, the court also observed that fair price was given to the shareholders and the resolution for reduction of share capital in this case was supported by the majority of non-promoter holders and hence could not be struck down.

In Re Organon (India) Ltd[viii], the court observed that the valuation must be carried out by an independent body for it to be fair. In the instant case one of the shareholders who held 0.002 percent of the total capital raised an objection to the reduction. However, the court applied the principle in the Sandvik case and stated that since a majority supported the decision it was fair held the valuation and reduction to be valid.

In the case of Chetan G Cholera v Rockwool (India) Limited[ix] the court allowed the reduction taking the facts of the case into account. However, it also gave certain insights pertaining to the rights of the minority shareholders. The court took the Preamble and Directive Principles of State Policy into account which essentially state that India is a socialist state into account and held that courts have the power to strike down any scheme of reduction which were not in the interest of the minority.

In the case of In Re: Cadbury India Limited, the company passed a resolution for reduction of share capital which was supported by 99% of the shareholders. This resolution was challenged by a minority shareholder on the ground of determination of fair price of such shares. An independent valuer was hired by the court. Principles were laid down which were to be followed while exercise of discretion by the courts. First, that such scheme must not be against the public interest. Two, that such reduction must be fair, just and reasonable and third that such scheme must not be prejudicial to a certain class of shareholders.

REGULATORY BODIES AND SCHEMES OF COMPANY

It is the duty of the regulatory bodies to ensure that the schemes are in interest of the shareholders and do not exploit the minority shareholders. In the case of ***SEBI v. Sterlite Industries****, SEBI filed a petition before the Bombay High Court stating that the buybacks must be done in accordance with section 77 of the Companies Act, 1956 and not section 100-104 which dealt with reduction of capital. Moreover, silence of the shareholders does not amount to their consent and that it is necessary for the shareholders to positively agree. The court first held that SEBI did not have locus standi in that case and that if the shareholders did not object to the reduction the court could not disallow such reduction. However, this judgement of the court has been rendered invalid and according to section 66(2) of the amended act the SEBI can object to schemes of reduction of the company*.

Moreover, in the In Re: Elpro International Ltd[x], the Bombay Stock exchange (BSE) contended that the scheme of reduction that regards silence as equivalent to consent should not be allowed and a positive agreement of the shareholders must be taken into account. While in this case the court allowed the scheme it also stated that the BSE has the power to take an action in case there were violations of security laws,

Hence from the aforementioned precedents it is quite evident that the SEBI as well as stock exchanges have the ability to protect the interests of the minority shareholders in case the reduction share capital is being forced. However, SEBI has such power only in cases where such companies are listed.

ANALYSIS

With the aid of the aforementioned precedents it can be understood that more often than not the courts abstain from intervening in cases of share capital reduction. Their duty is to only ensure that the according to the scheme proposed the shareholders are getting a fair price. Moreover, it is also their duty to ensure that schemes for such reduction is not against the public policy and is fair just and reasonable. The courts have time and again upheld that the making of such scheme is a domestic affair and the court shall not interfere except for the aforementioned circumstances.

Furthermore, the courts also take into consideration if the majority of the minority is in support of such schemes that is most of the minority shareholders approve of the scheme of the reduction proposed by the company. Most experts in the field are of the opinion that the majority of minority rule helps in ensuring that the scheme proposed is fair. It is pertinent to note that a scheme can be approved even without even without the aforementioned rule by the way of a court ruling, it is always better to ensure such rule is complied with to ensure fairness and safeguard the interests of the shareholders. In order to safeguard the interests of the public the company, a prior approval of the independent directors must be made mandatory. This is because the independent directors are aware of the affairs of the company and their input for the same would help in protecting the company as well as protecting the interests of the minority shareholders.

CONCLUSION

Reduction of share capital is generally done under section 66 of the Companies Act 2013. As established above, for reduction of share capital under section 66, the tribunal must sanction it. The Judiciary usually does not interfere in the scheme under which such reduction is done, as it considers it to be a “domestic affair”. In most cases mentioned above whenever the court or the tribunal was of the opinion that majority of the minority gave the assent for such reduction it refused to interfere.

However, sometimes when the court feels that such a scheme does not provide for fair pricing or is against the public policy, it has the authority to interfere and strike down such scheme or the part that is in conflict with, law. Moreover, Companies Act, 2013 enables the, regulatory bodies such as SEBI and other stock exchanges to raise objections in the interests of public. However, this power is only limited to the listed companies. It is also suggested that when such proceedings in tribunal are going on the tribunal must also take the opinion of Independent directors in order to ensure that this step is in the best interest of the company as well as the shareholders.

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ENDNOTES

[i] Tamil Nadu Newsprint and Papers Ltd. V. Registrar of Companies, 1995 (4) TMI 222

[ii] Tamil Nadu Newsprint and Papers Ltd. V. Registrar of Companies, 1995 (4) TMI 222

[iii] In Re OCL India Ltd, AIR 1998 Ori 153

[iv] British and American Trustee and Finance Corp v. Couper [1894] A.C. 399.

[v] Ramesh B. Desai v. Bipin Vadilal Mehta, (2006) 5 SCC 638

[vi] In Re: Elpro International Ltd 2008 (86) SCL 47 (Bom).

[vii] Sandvik Asia v. Bharat Kumar Padamsi, 2009 (3) Bom CR 57.

[viii] In Re Organon (India) Limited, (2010) 98 CLA 480 (Bom.).

[ix] Chetan G Cholera v. Rockwool (India) Limited, (2010) 155 Comp Cas 605 (AP).

[x] In Re: Elpro International Ltd 2008 (86) SCL 47 (Bom).