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# **REGULATING DELISTING PROCESS IN INDIA: BALANCING THE INTERESTS OF MINORITY AND MAJORITY SHAREHOLDERS DURING SQUEEZE-OUTS**

AUTHORED BY - ASHWIN

## **Abstract**

*Squeeze-outs are visible and physical expressions of a controlling shareholder's raw power within the corporate machinery—the ability to openly force minority shareholders to depart the company by accepting a fixed price for their shares. Squeeze-outs can paradoxically increase value since they allow the controlling shareholder to purchase the entire business, even as they serve as concrete and apparent signs of that shareholder's dominance over the corporate apparatus. This research paper scrutinises the regulatory landscape surrounding squeeze-outs during the delisting process, focusing on the equilibrium between the rights and interests of minority and majority shareholders. The author contends that existing regulations may inadvertently hinder the efficacy of squeeze-out processes, potentially due to the lack of balance between the impeding majority shareholders' ability to effect necessary corporate changes and the excessive protection granted to the minority shareholder in the name of interest protection. Through an in-depth analysis of case studies, comparative legal frameworks, and stakeholder perspectives, this paper advocates for a comprehensive reassessment and reformulation of delisting regulations to strike a harmonious balance between corporate democracy and minority shareholder rights. This paper aims to create a more equitable and efficient environment for all players participating in squeeze-out transactions in the Indian market.*

**Keywords:** *Squeeze-out, Minority shareholders, India, Corporate Democracy, Delisting*

## **Introduction**

On June 11, 2021, the Securities Exchange Board of India (SEBI) released the SEBI (Delisting of Equity Shares) Regulations, 2021 (the "Delisting Regulations, 2021") to strengthen, streamline, make transparent and better serve investors. Since then, numerous adjustments have been made to the delisting guidelines in response to changing market conditions and requirements. The Delisting Regulations were developed to reinforce and simplify the procedures that must be followed for delisting further. SEBI has implemented substantial policy reforms to better protect minority shareholders' interests. Though delisting a corporation is challenging in

the first place, after a successful delisting, minority squeeze-out is practically unattainable. Even after successfully delisting, the corporation may still have many public owners who own a few shares. To be delisted, a corporation must only acquire 90% of its holdings. This could mean that even after the delisting, some minority stockholders are left out. For the delisted corporations, this becomes costly and presents continuous compliance issues.

This paper seeks to comprehend the extant legal framework for delisting and analyse the impact of having a 'minority-centric' regulation framework that has slowed down the delisting process in India.

### **Background**

The ability to easily sell and transfer shares to new owners is arguably their greatest advantage. However, there are instances where a company chooses not to continue to list its share on the stock exchange; in these cases, the share must be delisted. This indicates that trading of the company's shares on the stock exchange's trading platform will cease. Businesses choose to list to get access to a wider range of investors, reduced capital expenditures, simpler share trading, elevated status, and other advantages. Nonetheless, the companies must contend that listing benefits exceed listing costs, that compliance requirements do not burden the companies, and that listing does not put them at risk of disciplinary action.<sup>1</sup>

Typically, during the delisting process, a squeeze-out is transacted to consolidate ownership of the company and remove the administrative burdens associated with having minority shareholders.

### **Squeeze out (Definition)**

The term "squeeze-out" usually refers to the mandatory acquisition of the equity shares held by the Minority in exchange for a "fair" price determined by the provisions of the Companies Act, 2013 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.<sup>2</sup> When a majority shareholder wishes to consolidate their ownership of the firm, delist it from a stock exchange, or take the company private, they frequently employ squeeze-outs. *For instance, if AU Ltd. has a 55% controlling stake in ABC Ltd., the target firm, and AU were to gain total control over ABC, a squeeze-out would occur. Most of the time, this results in the non-AU shareholders—who, in this example, represent the minorities receiving a monetary sum for their 45% stake in ABC. If all minority shareholders are eventually squeezed out, then it is highly*

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<sup>1</sup> Shreya Masalia and Anushka Vohra, Easing Delisting of Equity Shares

<sup>2</sup> William T. Allen, Reinier Kraakman & Guhan Subramanian, Commentaries and Cases on the Law of Business Organization (4th edn, 2012) 496-497.

*probable that ABC would no longer be available for public trading and would, in effect, be transformed into a private enterprise.*<sup>3</sup>

## **Present Legal Framework**

In this section, we look at the current Indian legislation on squeeze-outs and assess how well it safeguards minority rights while considering squeeze-outs potential advantages. Three different transaction structures can be used in India to accomplish a squeeze-out: compulsory acquisition mechanism, arrangement scheme, and capital reduction.

### **1. Compulsory Acquisition**

Only a single statutory provision expressly contemplates a compulsory acquisition of shares held by minorities.<sup>4</sup> It is governed by Section 235 of the Companies Act, 2013<sup>5</sup>. Under this provision, a company can compulsorily acquire the shares of minority shareholders if it holds at least 90% of its voting power. The company must pay a fair price for the shares, which an independent valuer determines. Dissenting minority shareholders who are not willing to sell their shares can approach the National Company Law Tribunal (NCLT) for relief.<sup>6</sup>

Although the compulsory acquisition mechanism explicitly permits a squeeze-out with minimal court involvement, one might expect it to be widely used. Still, in reality, it hasn't been applied very often. The requirement that the Acquirer obtain acceptance from shareholders who hold 90% of the shares to whom the offer has been made is the main cause of this. As we can see from an example, this can be challenging to accomplish. Suppose a controller or other Acquirer owns 70% of the company's shares and wants to buy out the remaining owners. In that case, it must first make an offer to the minority shareholders who own 30% of the shares.<sup>7</sup> For the Acquirer to be

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<sup>3</sup> Vikramaditya Khanna & Umakanth Varottil, "Regulating Squeeze-Outs in India: A Comparative Perspective." *The American Journal of Comparative Law*, vol. 63, no. 4, 2015, pp. 1009–51. JSTOR,

<sup>4</sup> See, Shaji Vikraman, Reverse Book-building for Delisting Price, *THE ECONOMIC TIMES* (Aug. 22, 2007); Ashish Rukhaiyar & Ashley Coutinho, Small Companies Hop on to Delisting Bandwagon, *THE INDIAN EXPRESS* (Jun. 8, 2013)

<sup>5</sup> The Companies Act, 2013 (Act 18 of 2013) s. 235

<sup>6</sup> Dissenting shareholders must approach the court (or the NCLT, as the case may be) within one month of receipt of the notice for compulsory acquisition. Companies Act, 1956, §395(1), (3); Companies Act, 2013, §235(2). In considering such applications, courts or the NCLT may either refuse to interfere, in which case the compulsory acquisition may proceed, or they may restrain the compulsory acquisition. Based on the practice hitherto followed by the courts, it is not likely that the courts or the NCLT will alter the terms and conditions of the offer.

<sup>7</sup> Khanna, Vikramaditya S. and Varottil, Umakanth, *Regulating Squeeze Outs in India: A Comparative Perspective* (July 30, 2014). *American Journal of Comparative Law*, Vol. 63(3), pp. 1009-1051, 2015, NUS - Centre for Law & Business Working Paper No. 14/06, NUS Law Working Paper No. 2014/009, NUS - Centre for Asian Legal

able to carry out a squeeze-out, the offer must be accepted by shareholders holding at least 27% of the firm (i.e., 90% of 30% shares).

## 2. Scheme of the arrangement

A company may make agreements and compromises with its creditors or shareholders under the specific provisions of the Companies Act. In the context of squeeze-outs, a business may suggest a plan that enables a controller or the business itself to buy minority shareholders' shares, thereby completing a squeeze-out. Section 230 of the Companies Act of 2013<sup>8</sup> governs it. A business may purchase minority shareholder shares under this clause if the NCLT and its shareholders approve of the transaction. Conflicting minority shareholders may file a relief request with the NCLT, and the company must offer a reasonable share price.

To start the process, the company applies with the High Court to call meetings of the different shareholder classes. The scheme must be adopted by a majority of shareholders representing 75% of the total value of each class at separate meetings attended and voted on by each class. After receiving approval, the business must reapply to the High Court to approve the plan. After hearing arguments from interested parties in person, the High Court will rule on the matter and, if satisfied, will issue an order approving the plan.

## 3. Reduction of capital

The Companies Act provides for reducing the share capital of a company under Section 66.<sup>9</sup> Under this provision, a company can reduce its capital by cancelling the shares of its shareholders. This can be done if the company has a surplus of capital or if it needs to reduce its liabilities. Dissenting minority shareholders can approach the NCLT for relief. Such a reduction involves a repurchase of some (not all) shares by the company and a consequent cancellation of those shares. A reduction of capital may be effected on several grounds,<sup>53</sup> of which are only illustrative, and companies possess sufficient flexibility to reduce share capital for other reasons.

A reduction of capital is an attractive method of accomplishing a squeeze-out. First off, the least onerous majority of votes needed to approve a proposal from shareholders is only 75% of all votes cast by shareholders, unlike a scheme of arrangement, which requires the approval of 75% of the votes cast by each class of shareholders, or a compulsory acquisition, which requires the consent of 90% of the Minority.<sup>10</sup> Therefore, without needing any support or agreement from the

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Studies Working Paper No. 14/11,

<sup>8</sup> The Companies Act, 2013 (Act 18 of 2013) s. 230

<sup>9</sup> The Companies Act, 2013 (Act 18 of 2013) s. 66

<sup>10</sup> *Supra* Note 7

minorities, a major controller can secure enough support for a squeeze-out. Second, the company's funds compensate shareholders whose shares are being purchased under duress. The controllers do not suffer any direct financial cost, although they benefit from obtaining full ownership rights of the company. Given the lower standards imposed on the reduction of capital as a method of squeeze-out, it is being increasingly employed by controllers such that an overwhelming number of the reported squeeze-outs in the last decade in India have followed this method.<sup>11</sup> Presently, a delisted company's only chance to achieve Minority squeeze out is by going through a capital reduction procedure. The NCLT has given its approval for this. This option is very complex, costly, and time-consuming. As a result, very few businesses choose this choice.

Using the Minority Squeeze-out provisions outlined in Section 236 of the Companies Act of 2013<sup>12</sup> might be a preferable course of action. Although a similar provision is widely recognised and adhered to worldwide, our legislation is unclear. The prevailing view is that the current interpretation does not require minority shareholders of Section 236<sup>13</sup> to sell their shares even if the majority shareholder makes an offer.

### **Minority Protection**

In each squeeze-out strategy, the law seeks to balance the interests of controllers and minorities. Indian courts frequently allow squeeze-outs when they find satisfaction in two areas: (i) pricing fairness and (ii) process fairness. To understand the need for minority protection, we must first examine the majority rule derived from the *Foss v. Harbottle* decision. This rule would prevent individual shareholders from pursuing legal action for any damages caused by the company; only the corporation or a derivative action would be allowed to do so.

Although majority rule is frequently followed, minority shareholders' rights may occasionally be obscured. The legislature held a different opinion, despite the utilitarian approach's support for this rule, which maintains that decision-making authority always belongs to the majority and that this automatically confers a greater degree of decision-making power. Indian company law has established special mechanisms to protect minority rights and strike an equilibrium between the interests of majority and minority shareholders. These measures are listed below:-

#### **1. Fair Value Mechanism**

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<sup>11</sup> *Supra* Note 7

<sup>12</sup> The Companies Act, 2013 (Act 18 of 2013) s. 236

<sup>13</sup> *Id*

The price at which minority shareholders are being squeezed out, which varies depending on the procedure used, is a major factor in determining how fair a squeeze-out transaction is for them. While a scheme of arrangement or a reduction of capital requires expert valuation reports to justify the price offered, compulsory acquisition guarantees equal treatment. There is no chance that minority shareholders who disagree with the arrangement will suffer consequences for declining the initial offer. As a result, the controller cannot force them to accept his offer.

One of the most significant issues to evaluate when obtaining such minority shareholdings is whether they are obtained at a fair and equitable price and, if not, whether they violate the Minority's rights.

This question was answered in the Cadbury case, where it was stated that "In considering the application for sanction, the Court must ensure that (1) the scheme is not against the public interest; (2) the scheme is fair and just, and not unreasonable; and (3) the scheme does not unfairly discriminate against or prejudice a class of shareholders."

*"Prejudice" here must mean something more than just receiving less than what a particular shareholder may desire. It means a concerted attempt to force a class of shareholders to divest themselves of their holdings at a rate far below what is reasonable, fair and just. Prejudice in this context must connote a form of discrimination, a stratagem by which an entire class is forced to accept something inherently unjust."*<sup>14</sup>

## **2. Class Action Suit**

Section 245 of the Companies Act 2013<sup>15</sup> provides minority shareholders the right to file a class action suit against the company in NCLT if their rights are being oppressed or their interests are being prejudiced. The section allows a group of minority shareholders with similar complaints against the company to file a single lawsuit collectively.

The right to file a class action suit by minorities under the Companies Act, 2013 of India is an important safeguard to protect the interests of minority shareholders. It provides a mechanism for minority shareholders to come together and collectively raise their grievances against the

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<sup>14</sup> Cadbury India Limited, In re, 2014 SCC OnLine Bom 4934.

<sup>15</sup> The Companies Act, 2013 (Act 18 of 2013) s. 245

company, which would otherwise be difficult for them to do individually. This helps to ensure that the company operates fairly and transparently and that the interests of all shareholders are protected. The provision has helped to strengthen corporate governance in India and promote greater shareholder democracy.

### **3. Appointment of Small Shareholders Directors**

According to Section 151 of the Companies Act<sup>16</sup>, small/minority shareholders of a listed company have the right to appoint a shareholder of their choice to the board as a 'Small Shareholders Director'. At least one thousand small shareholders, or one-tenth of the total number of such shareholders, can apply for the appointment. The appointed director must meet the criteria of an independent director under Section 149(6) of the Act.<sup>17</sup> However, this provision should not be misused by large institutional investors, as it may compromise the interests of passive retail shareholders. It is important to note that this right is available only to the listed companies.

### **4. Minority Takeover**

Section 236 of the Companies Act of 2013 states that if the Acquirer becomes a registered holder of 90% or more share capital or if the majority acquires 90% or more share capital in the company through an amalgamation, share exchange, securities conversion, or for any other reason, the Acquirer must notify the company of their intention to purchase the remaining equity shares.<sup>18</sup> In the event of such an acquisition, the Acquirer will offer to the minority shareholders at a price set by a registered valuer by the Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016.<sup>19</sup>

In a notification dated February 3, 2020, the government announced a new procedure for unlisted corporations to acquire shares of the Minority. Section 230(11)<sup>20</sup>, read with Rules 3(5) and (6) of the Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016, allows the majority of shareholders holding at least 3/4th of the shares to make an offer to acquire the remaining shares by applying with the National Company Law Tribunal.

Rule 80A of the Rules above specifies how such an application should be made. It requires the report of a registered valuer to be submitted along with it, guaranteeing that the Minority's rights

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<sup>16</sup> The Companies Act, 2013 (Act 18 of 2013) s. 151

<sup>17</sup> The Companies Act, 2013 (Act 18 of 2013) s. 149(6)

<sup>18</sup> The Companies Act, 2013 (Act 18 of 2013) s. 236(1)

<sup>19</sup> Richa Bhandari and Praneet Kaur India: The Law On Minority Squeeze-Out In India

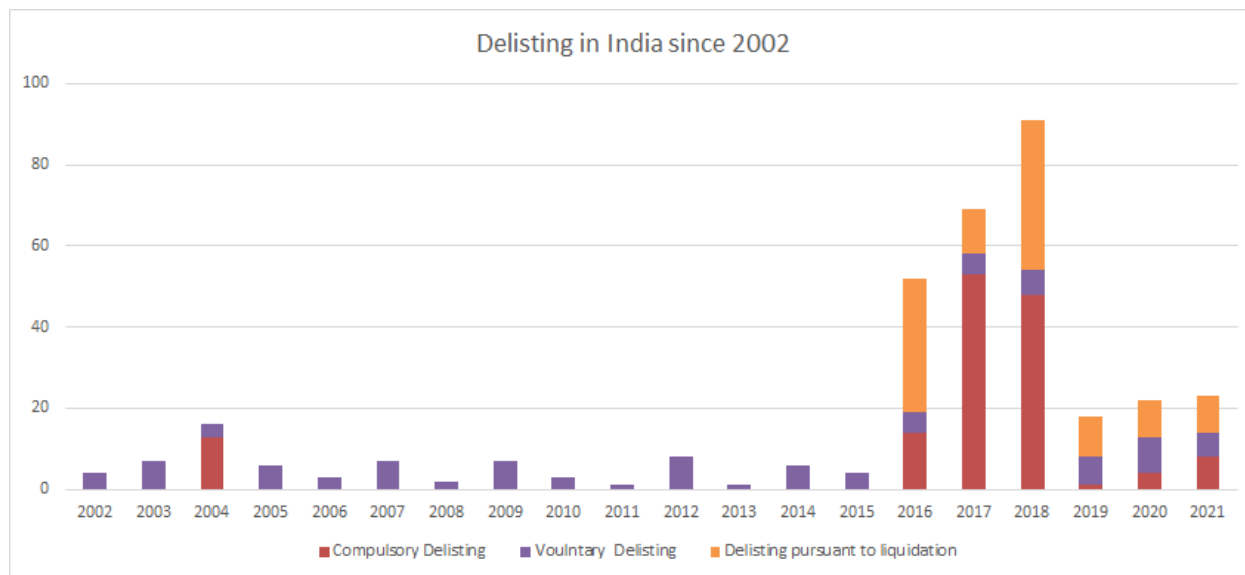
<sup>20</sup> The Companies Act, 2013 (Act 18 of 2013) s. 230(11)

are maintained at all costs.<sup>17</sup>

Furthermore, sub-section (12) of Section 230 seeks to balance the majority's power by allowing the party aggrieved by the takeover offer to apply with the Tribunal.<sup>18</sup>

### **Case of Excessive Minority Protection**

Despite the implementation of various reforms by SEBI, a downward trend exists in the successful delisting of companies in India.



(Source: NSE)

The protracted and complex delisting process in India is the cause of this decrease. The purpose of this section of the paper is to analyse the squeeze-out clause and identify the shortcomings that have led to a convoluted delisting process to craft a law that is Minority shareholder-friendly.

#### 1. **Reverse Book building process**

For the Acquirer's total shareholding to reach 90% of the company's issued capital, the Companies Act of 2013 stipulates a precondition threshold of 90% of the total issued share capital when the shares are tendered through qualified bids. Reverse book building, or "RBB," is the name of this bidding procedure. Delisting occurs when the Acquirer pays all public shareholders whose bids were accepted in the RBB and accepts the discovered price.

Given that delisting requires passing the 90% criteria, a few public shareholders retain disproportionate power over the result of the RBB process. Transaction data shows that this small percentage of public shareholders seek an absurd delisting price, which the Acquirer regularly rejects. The company's wider public shareholder base, who tendered their shares at a fair price and hoped for a possible departure, is harmed by the delisting offer's failure. This is demonstrated

by the fact that the majority of delistings have failed under both the 2009 and current delisting regulations.

RBB is the main reason for most unsuccessful or nonexistent delisting initiatives in India. This makes successful delisting uncommon, although it shouldn't be the case. Delisting should be free, and the outdated method should be eliminated, such as listing a firm as free (as long as there is a good cause to go public).

#### 1. *Compulsory buyout of residual shareholders*

After a successful delisting, a significant portion of the public shareholders of the privately owned company are often retained. Collectively, these stockholders typically own up to 7% of the share capital of the unlisted business. When examined quantitatively, this amount appears huge, although it may appear little when viewed in percentage. Many delisted companies are, therefore, forced to incur substantial costs for shareholder-related events such as meetings and notices. Furthermore, the remaining public shareholders are not involved in the management or day-to-day activities of the unlisted company and thus stand to lose nothing by keeping an illiquid stock.

### Reforms

The delisting procedure is ineffectual after examining the rights of minority shareholders in India and the rules governing minority squeeze-outs and takeovers. The law must strike a compromise between allowing for effective consensus-based decision-making and prohibiting the majority from obstructing their wrongdoings from being addressed. Given this, the following possible changes could be made to the existing laws.

It is possible to suggest forming a special committee of independent directors to examine the deal in a way that mimics an arm's length transaction. The committee would have to be knowledgeable, free from coercion, and able to choose independent legal and financial counsel and act independently of the majority shareholder. The primary concern with this approach is that the committee may be selected by the controlling shareholder, which raises the concern of the committee voting in favour of the party who appointed them.

Another reform that can be included is the mandate for the Acquirer to forcibly purchase the remaining shareholders within 30 days of the end of the statutory one-year exit offer following a successful delisting at the delisting price paid to the remaining owners. The Indian legal framer may borrow inspiration from jurisdictions like the EU, which provide minority shareholders with a "two-tier" option: accepting the delisting price or selling shares back to the company.

Ultimately, whether the delisting is attempted under Regulation 5A of the Takeover Regulations or the Delisting Regulations, the RBB process is now antiquated and ought to be eliminated. SEBI should implement a "fixed price" system in place of the RBB procedure. The fixed price should be made clear in the initial public announcement for delisting. According to the SEBI Takeover Regulations, the SEBI may establish a methodology for establishing a fixed delisting price comparable to the minimum pricing structure that applies to an open offer. If the Acquirer thinks it to be commercially appropriate, they ought to be able to offer a higher delisting price.

This eliminates subjectivity in the delisting process for both public shareholders and acquirers. This will also prevent a tiny minority of shareholders from hijacking the delisting process at the expense of the greater public shareholder base seeking an exit.

### **Conclusion**

India has had relatively little success with the "Delisting" process compared to the international market. Unquestionably, the new regulations address some fundamental issues and emphasise gradual improvements by filling in some of the gaps in the previous regulations.

The cautious approach taken by the SEBI in the New Regulations may still limit its applicability, given the concerns expressed by the authors. Thus, some of the more important reforms still need to be described to address the problems caused by squeeze-outs in India; eventually, legislative intervention will be required to simplify this area of the law. India's legal system regarding squeeze-outs is fragmented.

Squeeze-outs have instead been accomplished by using different transaction structures intended for different purposes, such as schemes of arrangement and capital reduction. As we have tried to demonstrate, the laws regulating these various transaction structures have evolved independently and do not have anything in common. Controllers can now easily capitalise on this tactical advantage by choosing from a menu of options to achieve squeeze-outs through structural arbitrage. Ultimately, a well-regulated delisting process fosters a vibrant capital market. By ensuring fairness for all shareholders, India can attract investment while protecting the interests of those who keep the market functioning.

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