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PROTECTION OF MINORITY INTERESTS DURING AMALGAMATION

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I. INTRODUCTION

A company is essentially an association of persons coming together to make profit through systematic and organised business activity.[1] The concept of company came into existence because the structure of a company facilitates the ease of doing business.[2] As the most advanced and sophisticated form of doing business often involving a large number of stakeholders, it is imperative that a company follows a democratic process of functioning and decision-making. [3]

The structure of a company is democratised by diversifying and dividing its control among many people. This is done in a very interesting manner by dividing its capital (in case of a company with share capital) or liability (in case of a company without share capital) into parts and then allotting the ownership of those parts to different people.

Every democratic process by its very nature involves the presence of minority. Reconciling the interests of the minority with those of the majority is one of the biggest challenges faced by any democratic institution. And a company is no exception. Here, the majority and minority are decided and made on the basis of the proportion of shares held by the shareholders. This is because the major decisions in a company are taken through voting and the value of a voter is decided according to the proportion of shares held by him in the Company. If a person or an entity holds the majority of the shares in a company, then they arrive at a position to control the affairs of the company. In such a scenario, the rest of the shareholders come in a minority position.

But a democratic process means that there has to be a balance between the interests of both

[1] Institute of Company secretary of India, Study Material-Executive programme-part I, page no. 4, available at https://www.icsi.edu/Docs/Webmodules/Publications/1.%20Company%20Law-Executive.pdf

[2] Ibid

[3] Akshay Sulalit, Companies Act, 2013: Rise of Minority Shareholders, Indian Law Journal (Online), available at http://www.indialawjournal.org/archives/volume6/issue-2/article5.html

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the majority and the minority. Protection of the interests of the minorities is as important as the following the verdict of majority in order to successfully carry on the affairs of a company. [4]

This question of the protection of the interests of the minority becomes pertinent in certain junctures in the course of running of the business of a Company. One of them is when a Company starts a process of amalgamating itself with another entity.

The word amalgamation is a general word which means mixing of two different things to form one whole. [5]In the world of company law, the word amalgamation is connoted to mean different phenomenon in different jurisdictions. For the purpose of this project, the scope of the amalgamation would include all the transactions that were conceived under section 232 of the companies Act, 2013. It will include cases where one company merges into another big company losing its identity and becoming a part of the other. [6] It will also include cases where two companies come together to form a new entity where both the earlier entities lose their original identity. [7] The words 'amalgamation' is nowhere to be found defined in the Companies Act, 1956 or even in the Companies Act, 2013.[8] But its meaning has been developed by the Indian Courts through Judicial pronouncements.[9] For an amalgamation to happen there is a need of the presence of a transferor company and a transferee or acquirer company who will purchase the shares of the transferor company.[10]

This process of amalgamation is crucial from the point of view of the interests of the minority shareholders because the in most cases the terms of the contract of amalgamation are decided without taking into account the concerns of the minority shareholders.

III. NECESSITY OF THE PROTECTION OF MINORITY INTERESTS IN THE COMPANY

As discussed earlier, a company is a legal entity which is formed for the primary purpose of doing business and earning profit.[11] As an institution which has often more than one and occasionally many shareholders, it is imperative that a company runs in a democratic

[4] Ibid
[5] A Ramaiya, Guide to the companies act: Providing guidance on the Indian companies Act, 2013, New Delhi (2015) Lexis Nexis, page 3856
[6] Explanation, Section 232, companies Act, 2013
[7] Ibid
[8] Supra 5, page 3877
[9] Supra 5, page 3877
[10] Section 230, Companies Act, 2013
[11] Supra 1, page 33

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manner.[12]

A democracy necessitates protecting the interests of the minority on the same footing as accepting the verdict of the majority.[13] On the face of it, though it may seem that both are at loggerheads at each other, it is not so.[14] The scheme of our constitution places enough emphasis on the protection of the interests of the minority communities, be them socially, educationally, culturally or otherwise.[15] Though not completely accurate an analogy, the functioning of a company with shareholders can be compared with the functioning of a democratic country like India with citizen groups with different and sometimes conflicting interests.

Thus, the onus of maintaining the democratic nature of the functioning of a company generally rests on the domestic legislations regulating the affairs of the company. In the case of India, it was the Companies Act, 1956 till 2013 and it successor of 2013 after that. The Act of 1956 had made an attempt to protect the minority interests which can't be called to be sufficient. The safeguards were at a rudimentary level and had many drawbacks and lacunae in terms practical applicability. The Act of 2013 tried to fill many of those gaps and provide stricter safeguards. But taking into account the popularity of Companies as a form of business and coming into existence of more and more large-scale business conglomerates, even these safeguards can't be called adequate. A technical analysis of these assertions is offered in the following sections

IV. DEFINITION AND SCOPE OF MINORITY INTERESTS UNDER THE COMPANIES ACTS, 1956 AND COMPANIES ACT, 2013: A COMPARATIVE ANALYSIS

It cannot be argued in a straightforward manner that the Companies Act of 1956 didn't at all provide attention to the interests of the minority shareholders. The biggest manifestation of this assertion is sections 395, 397 and 398 of the Act. Section 397 of the Companies Act, 1956 deals with the concept of oppression and section 398 of the same Act deals with the concept of mismanagement.[16] Both the concepts of oppression and mismanagement basically

[12] Supra 3
[13] Adish C Agarwalla, Constitution of India, New Delhi, (2014) Amish Publications, page 344
[14] Ibid
[15] Ibid
[16] Section 397& 398, Companies Act, 1956

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deals with situation where the conduct of the affairs of the company is prejudicial to public interest or the interests any member or members.[17] In such a situation an application could have been made to the erstwhile company Law Board and if the Board found merit in the application could have passed and order as it deemed fit. [18]

One important aspect of these provisions is eligibility to file an application complaining against oppression and mismanagement. This is important for the point of view of this paper because the minimum eligibility to file an application under these sections is also generally used to define the concept of 'minority' under Indian company Law.[19] This is being dealt under section 399 of the Companies Act, 1956. According to this provision, one-tenth of the total number of shareholders or hundred shareholders (whichever is lesser) or member(s) holding one-tenth of the issued share capital is the minimum requirement for filing an application for oppression and mismanagement.[20] In case of a company which do not have a share, the minimum requirement is one-fifth of the total membership of the company. This criteria have been generally used the Court and scholars to define minority in the context of the company law.[21]Companies Act, 2013 lays down the provisions of oppression and mismanagement in section 241.

The provision concurring section 399 of the Companies Act, 1956 is section 244 which sets out the minimum eligibility criteria as provided in section 399 of the 1956 Act, to file an application for oppression or mismanagement.[22] However, the new act provides power to the Company Law Tribunal to waive the requirements under section 244 of the 2013 Act.[23] This means that if the Tribunal deems fit, it may allow any number of shareholders to file a claim of oppression and mismanagement.[24]

Another similar section which is much more relevant to the present topic is the section 395 of the Act of 1956 and the concurring section 235 of the 2013 Act.[25] These sections talk about the rights of the minority shareholders (referred to as the dissenting shareholders) at the time

[17] Ibid
[18] Ibid
[19] Supra 3
[20] Section 399, companies Act, 1956
[21] Ibid
[22] Section 244, companies Act, 2013
[23] Akshay Sulalit, Companies Act, 2013: Rise of Minority Shareholders, Indian Law Journal (Online), available at http://www.indialawjournal.org/archives/volume6/issue-2/article5.html
[24] Ibid
[25] Section 395, Companies Act, 1956 & section 235, Companies Act, 2013

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of merger, amalgamation and reconstruction.[26] Both these sections mandate that such a transaction scheme has to be approved by the shareholders holding at least nine-tenth of the total value of shares.[27] Thus, under these sections, emphasis is laid not on the numerical strength but on the value of the shares.[28] For these cases, the minority or the dissenting shareholders as they are called constitute the leftover shareholders who hold shares whose value amounts to ten-percent or less of the total share value.[29]

V. PROTECTION OF MINORITY INTERESTS DURING AMALGAMATION UNDER THE COMPANIES ACT REGIME

Companies Act, 1956 had some safeguards for the protection for minority shareholders, which was improved upon by the 2013 Act. Under the 1956 Act, Chapter V was dedicated to the concepts of amalgamation, arrangement or reconstruction. Under the Companies Act, 2013 these concepts were dealt with by chapter XV, but in a much broader way. The sections of chapter V of the 1956 act, which are relevant to us are sections 391 and 395. In case of the 2013 Act, the sections are 230, 232, 235 and 236.

The most important safeguard provided in section 391 of the 1956 Act and the concurring sections 230 and 232 of the 2013 Act is the approval of the scheme by the Courts.[30] According to the sections, when a company wants to undergo any scheme of arrangement, then it has to approach the Company Law Tribunal (Company Law Board under the 1956 Act0.[31] The Tribunal and is then required to call for a meeting of the stakeholders, where the scheme has to be approved by shareholders who hold three-fourth of the total value of the shares. Moreover, an opportunity is provided for the minority shareholders to voice their objections. These sections define minorities as shareholders who hold not less than ten percent of the total value of the shares or not less than five percent outstanding debt to the company. [32]Thus, if a group of shareholders or even a single shareholder fulfils the above

[26] Sachin Mehta, Minority shareholders and the threat of squeeze outs, available at http://www.livemint.com/Money/dfzhNnJ17ARJB5lcAmTMEI/Minority-shareholders-and-the-threat-of-squeezeouts.html
[27] Ibid
[28] Ibid
[29] Ibid
[30] A Ramaiya, Guide to the companies act: Providing guidance on the Indian companies Act, 2013, New Delhi (2015) Lexis Nexis, page 3856
[31] Section 230, Companies Act, 2013
[32] Section 230, companies Act, 2013

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mentioned criteria, then he is allowed to voice his dissenting opinion with the tribunal in the form of written objections.

Thus, it can be noticed that the criteria for passing of the scheme in the meeting and the criteria for voicing dissent are very different. Though the minimum eligibility for approval of the scheme is three-fourth of the total value of the share, i.e. seventy-five percent, it requires only shareholders holding ten-percent of the total share value or five-percent of the outstanding debt to file their objection.

The legislative intent behind these different thresholds can be claimed to be quite novel and altruist. The legislature wanted ease of business and recovery of sick business on one hand, but didn't want to disregard the concerns of the minority shareholders on the other. Thus, to foster ease of business they didn't keep the threshold for approval too higher. But, they also provided the minority shareholders an opportunity to voice their objections, even if they constitute a percentage as minuscule as ten or five.

After the minority shareholders have provided their objections to the tribunal, and if the tribunal considers that there is merit in their submissions, it will provide directions as deemed fit by it. It is decided after a catena of case laws that the mere fact that the scheme has been approved in the meeting doesn't prohibit the Court from passing an order contrary to it.[33] Thus, the tribunal is a supervisory court and can't be designated as a court of appeal.[34] It gives a final seal on the scheme by deciding on it by taking all the relevant factors into consideration.[35] And it is undeniable that the concerns and objections of the minority shareholders is definitely one of them.[36]

Another important aspect that was developed in by the Act of 2013 was that the disclosures that are supposed to be made by the companies to the Tribunal as well as to the shareholders, which was not mandatory under the 1956 Act.[37] These disclosures by the Company help the minority shareholders to better gauge the service of their interests and the Tribunal to see if the scheme is blatantly detrimental towards the interests of the minority shareholders.[38]

Section 230 of the 2013 Act also provides exit option to the shareholders who doesn't find the scheme beneficial to their interests and whose exit will be proved beneficial to the

[33] Supra 30
[34] Kirloskar Elecric Co Ltd. Re, (2003) 116 Com cases 413
[35] Mafatlal Industries Ltd. Re (1995) 84 Com cases
[36] Consolidated Coffee Ltd. Re (1999) Com cases 97 1
[37] A Ramaiya, Guide to the companies act: Providing guidance on the Indian companies Act, 2013, New Delhi (2015) Lexis Nexis, page 3851
[38] Ibid

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interests of them as well as the companies in question. [39]Section 230 (7) (e) lays down this provision. This is a major departure from the 1956 Act which didn't have provisions for any exit option of the dissenting shareholders. Any valuation of shares in such cases has to be in consonance with the accounting standards prescribed in the Companies Act. This is to ensure that the outgoing shareholders get a fair price and are not discriminated against for going against the majority in the company.

Another provision for protection of the interests of the minority shareholders is laid down in the form of section 232 (3) (h) of the companies Act, 2013.[40] There is a qualification in its application. It is applicable only in cases where the transferor company is a listed company and the transferee company is an unlisted company.[41] If some shareholders of the transferor company decide not to join the transferee company, then there shall be options for them to leave the scene after getting payment worth the value of the shares held by them, which shall be determined on the basis of previously determined formula or a valuation by accredited accountants.[42]

Another section which deals with the interest of the minority shareholders during amalgamation is section 395 of the 1956 Act and its concurring section 235 of the 2013 Act. [43]These sections deal with squeezing out minority shareholders also known as compulsory acquisition of minority shares, which is a concept which, prima facie, goes against the interests of the minority shareholders.[44]

To illustrate, the sections say that in case of transfer of shares, if more than nine-tenth of the shareholders of the transferor company agree to transfer within four months of making of the offer, the transferee company becomes eligible to provide notice to the rest of the shareholders to acquire their shares at the rate agreed to by the majority of the shareholders.[45]The same section also gives the dissenting shareholders the right to file an objection with the Company Law Tribunal, after which the onus rests upon the tribunal decide whether the transferee company can acquire the shares of the dissenting shareholders.[46] Section 236 of the companies Act, 2013 is an extension to section 235 and an

[39] Institute of Company Secretary of India, Corporate Restructuring and Insolvency, page 21, available at https://www.icsi.edu/portals/0/CORPORATE%20RESTRUCTURING.pdf
[40] Ibid
[41] Section 232 (3) (h), Companies Act, 2013
[42] Ibid
[43] Supra 39
[44] Umakanth Varottil, Squeezing out the minority: Is it a viable option?, Indian CorpLaw Blog, available at https://indiacorplaw.in/2008/09/squeezing-out-minority-is-it-viable.html
[45] Section 235, companies Act, 2013
[46] Ibid

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addition in comparison to the 1956 Act. It lays down detailed procedure regarding the following of the substantive guideline given in the previous section, i.e. section 235.

As argued by Umkanth Varottil, section 395 of the Companies Act, 1956 have a lot of lacuna in applying it and those gaps have not been completely filled by the 2013 act.[47] The author of this paper makes an attempt to argue that section 395 of the Companies Act, 1956 is actually a safeguard to the interests of the minority shareholders. This is specifically because the responsibility of the majority shareholders to implement this provision.[48] The legislators must have realised that an unrestrained power on the majority shareholder to squeeze out the minority shareholders would lead to a total deprivation of their property rights, over their shares. Thus, they preferred a section which is strongly worded in favour of the minority shareholders. Under the section, if the minority or the dissenting shareholders do not agree to the terms of share transfer, they can file a petititon in the Company Law Board (Today's Company Law Tribunal). If the CLT decides in their favour, then they can retain their shareholder ship in the Company. If the CLT decides against them, then they have no option other than sell their shares to the acquirer on the terms and conditions approved by the majority shareholders. A scenario where the CLT refused to accept the offer of the acquiring company is when upon careful inspection it found that the acquiring company is virtually the same as the majority shareholders. This was held by the Delhi High Court in AIG (Mauritius) v Tata Televentures Holdings Ltd. [49]

VI. SEBI TAKEOVER REGULATIONS: ANOTHER WAY OUT FOR THE PUBLIC LISTED COMPANIES

In case of public listed companies, an amalgamation can be done in three ways.[50] It can be done either through a contract, arrangement scheme provided under the Companies Act or a takeover regulated by the Security and Exchange Board of India.[51] The form of business sale is not that profitable to the minority shareholders because the criterion for the completion of

[47] Supra 44
[48] Umakanth Varottil, squeezing out Minority Shareholders: A recent judgement, Indian CorpLaw Blog, available at https://indiacorplaw.in/2009/05/squeezing-out-minority-shareholders.html

[49] Ibid
[50] Umakanth Varottil, Minority shareholder Protection in M&A, Indian CorpLaw Blog, available at https://indiacorplaw.in/2012/02/minority-shareholder-protection-in.html
[51] Ibid

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the transaction is the approval from those present and voting.[52] Even there is no quorum requirement in this case. The second option is available under the Indian companies Act, which have the safeguards for minority interest protection as discussed above. The third option which is available is under the SEBI takeover regulations.

The Securities and Exchange Board of India is a security markets regulator of India, formed in 1992.[53] Under the parent act, SEBI is authorised to frame regulations form time to time to effectively regulate various aspects of the securities markets.[54] Pursuant to this, SEBI framed takeover regulations in 1992, famously known as the takeover code.[55] But, taking into account the coming into existence of the companies Act, 2013 and the changes in the markets, it framed a brought into effect a new set of takeover regulations in 2011.[56] The advantage which is available under these regulations is that it provides the minority shareholders an opportunity to exit on same terms as promoters or controlling shareholders.[57]Under these regulations, the acquirer needs to make an offer to buy from the public shareholders share worth twenty six percent.[58] Moreover, there are extensive disclosure requirements prescribed under the regulations.

Indian public listed Companies have the above-mentioned three options to choose from when they want to merge and amalgamate with other companies. And it is completely left to the company which route they want to take. As elaborately discussed Courts generally do not interfere in the decisions of the company until it becomes blatantly unjust for one of the parties. But as argued by Umakanth, a scheme under the SEBI takeover regulations is the most beneficial for minority shareholders basically due to the structure which provides a cluster of rights including the exit rights

VII. CONCLUSION

The primary motive of a shareholder buying a share in a company is to earn profit. Thus, more is the risk of not earning profit through shares; the lesser will be the interest of the investors to put their hard-earned money in buying shares. The result will be no different

[52] Ibid
[53] Investopedia, Securities and Exchange Board of India, available at https://indiacorplaw.in/2009/05/squeezing-out-minority-shareholders.html
[54] Ibid
[55] PwC, Referencer on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, available at https://www.pwc.in/assets/pdfs/services/m-a-takeover-book-final-lowres.pdf
[56] Ibid
[57] Ibid
[58] Ibid

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even if this risk arises from the consequences of being a minority shareholder. It can't be emphasised more that the creation of a such an atmosphere will not only be detrimental to the economy of a country but also will significantly reduce the credibility of company as the most sophisticated, modern and democratic form of doing business. Thus, it is imperative that the interests of the minority are taken care of through systematic legal sanctions. In case of the minority interests during amalgamation, the company Act, 2013 has effective provisions like sections 230, 232 and 235. The Courts and tribunals have also done a commendable job by interpreting these provisions in a balanced manner yet catering to the interests of the minority interests. The SEBI takeover regulations also offer another amalgamation regime for public listed companies; which is considered safer for the minority shareholders. But, keeping in mind the rise of conglomerates and the increasing amalgamation of smaller business into it, stricter provisions for the protection of minority interests are expected from the legislators and the regulatory authorities.