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MINORITY SQUEEZE OUT UNDER THE COMPANIES ACT, 2013

On December 7, 2016, the Indian government notified several provisions of the Companies Act, 2013 (the "**2013 Act**"), including provisions on variation of shareholders' rights, reduction of capital, mergers and amalgamations, winding up by the National Company Law Tribunal, and appointment of official liquidators, all effective from December 15, 2016. With this, Sections 235 and 236 of the 2013 Act, dealing with the purchase of minority shareholding in a company, have also come into effect.

This note discusses the provisions on purchase of shares of dissenting shareholders under the earlier Companies Act, 1956 (the "**1956 Act**") and the 2013 Act, as well as the new process for minority squeeze out under Section 236 of the 2013 Act.

Purchase of shares of dissenting shareholders under the 1956 Act

Under the 1956 Act, there was no provision for purchase of minority shareholding, other than in case of acquisition of shares of dissenting shareholders under a scheme or a contract approved by the majority shareholders as per Section 395 of the 1956 Act. Under Section 395 of the 1956 Act, if a scheme or a contract involving the transfer of shares of the transferor company to the transferee company was approved by holders of $9/10^{ths}$ in value of the shares whose transfer was involved, the transferee company could give a notice to the dissenting shareholders to the effect that it proposed to acquire the shares held by the dissenting shareholders. Thereafter, unless the concerned High Court ordered otherwise, on an application made by a dissenting shareholder, the transferor company was entitled and bound to acquire the shares from the dissenting shareholder on the same terms as the shares of the approving shareholders under the scheme or contract for transfer of shares.

Section 395 was the only provision under the 1956 Act that dealt with compulsory acquisition of shares of minority shareholders, and there were no rules or guidelines in respect of the procedure for such an acquisition. Also, the concerned High Court was empowered to give directions on any application made by even one dissenting shareholder, and therefore, exit offers were open to time-consuming scrutiny. This Section did not prescribe valuation guidelines for the purchase of the shares and did not increase the threshold of holders of $9/10^{ths}$ value of the shares in case a related party of the transferee company held shares of the transferor company.

Given the foregoing loopholes, the majority shareholders rarely resorted to Section 395 of the 1956 Act and used selective buy-backs or reduction of share capital to give an exit to dissenting shareholders. Considering that Section 235 of the 2013 Act continues to incorporate the same provisions on acquisition of shares of dissenting shareholders as under Section 395 of the 1956 Act, it is unclear what purpose it will serve.

Minority squeeze out under the 2013 Act

Section 236 of the 2013 Act provides that an acquirer or a person acting in concert with such acquirer, or any person(s) holding 90% or more of the issued equity share capital of a company (the "**Acquirer**"), by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, shall notify the company of its intention to purchase the remaining equity shares. The term "acquirer" and "person acting in concert with the acquirer" has the same meaning as under the Securities and Exchange Board of India (Substantial Acquisition of Takeovers) Regulations, 1997. While the ambit of a majority shareholder is much wider under Section 236 of the 2013 Act as compared to the 1956 Act (which restricted the meaning to companies incorporated under the 1956 Act only), it is unclear why the definition of "acquirer" and "person acting in concert with the acquirer" is as per the Securities and Exchange Board of India (Substantial Acquisition of Takeovers) Regulations, 1997, which have been replaced by the Securities and Exchange Board of India (Substantial Acquisition of Takeovers) Regulations, 2011. Additionally, it must be noted that Section 236 of the 2013 Act only permits acquisition of equity share capital of a company and not preference share capital.

An offer for purchase of shares of the minority shareholders can be made by an Acquirer, or alternatively, the minority shareholders may offer the shares to the Acquirer at a price determined on the basis of valuation by a registered valuer in accordance with prescribed rules. However, Section 236 of the 2013 Act does not clarify whether upon receiving such an offer the minority shareholders or the Acquirer (as the case may be) is obligated to sell or buy the shares, and no specific timelines have been prescribed for acceptance of such an offer or for the tender of shares. In our view, unless this is clarified, majority shareholders looking to consolidate their shareholdings will not benefit from this Section.

Note that the concept of registered valuer under the 2013 Act has not been made effective as yet, and therefore, any chartered accountant or SEBI registered merchant banker can undertake the valuation. The concerns on who controls such a valuation will continue to remain under the 2013 Act until the notification of the rules for registered valuers.

Section 236 of the 2013 Act also provides that the purchase price for the purchase of shares must be deposited by the Acquirer with the transferor company in a separate bank account, and the transferor company must ensure that the minority shareholders are paid the purchase price within sixty (60) days. Further, the bank account must remain operational for at least one (1) year as a precautionary measure in case any minority shareholder(s) does not receive the purchase price. This requirement is beneficial to the minority shareholders.

The transferor company is also required to act as the transfer agent and ensure that the minority shareholder delivers the physical share certificate, which must then be endorsed in favour of the Acquirer. This Section, however, does not cover instances where the shares are held in a dematerialized form.

In addition, if prior to the date of transfer of the shares from the minority shareholders to the Acquirer, 75% or more of the 10% minority shareholders are able to negotiate a better purchase price with the Acquirer (which the Acquirer agrees to pay), the additional consideration must be distributed among all of the minority shareholders on a *pro rata* basis. This condition is not applicable where the transfer of a part of the minority shareholders is completed and, thereafter, the remaining minority shareholders are able to negotiate a better purchase price with the Acquirer.

In conclusion, although Section 236 of the 2013 Act is a welcome move towards establishing a regime for minority squeeze out in India, its workability is uncertain in the absence of mandatory timelines within which the minority shareholders must sell their shares.