Page 1829 - 1839 **DOI:** *http://doi.one/10.1732/IJLMH.25912*

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 4 | Issue 1

2021

A Comparative Analysis of Minority Squeeze-Outs

ARUSHI MALIK MEHTA [1]

ABSTRACT

Squeeze-out implies compulsorily acquiring the equity shares of a company from the minority shareholders by giving them compensation in cash. Squeeze-outs are both visible and palpable manifestations of a controlling shareholder's raw power within the corporate machinery- the ability to openly force minority shareholders to exit the company by accepting a certain price for their shares. Yet, squeeze-outs can be value enhancing at times due to the benefits of enabling the controller to acquire the entire company. Perhaps due to this rather conflicted and dramatic background, squeeze-out regulation takes on varying hues across multiple jurisdictions.

In India, the concept of squeezing-out minority shareholders has always existed but it was explicitly introduced in the Companies Act, 2013. The mechanism for minority squeeze out in India is quite similar to that in UK. In India, the controllers can choose among several available transaction structures to implement a squeeze-out. These include the compulsory acquisition mechanism, scheme of arrangement, and reduction of capital. Unsurprisingly, the structure most commonly used by controllers is the reduction of capital, which provides the least protection to minority shareholders.

Since, the structure or mechanism for squeeze-out in India is quite similar to that of UK it becomes important to analyse the system in UK. The regulation of squeeze-outs in jurisdictions apart from UK i.e. USA, Germany, Singapore will also be analysed. The objective is to examine which approach or combination of approaches will be best suited for India. But the basic aim of suggesting the reforms will be protection of minority shareholders which is currently missing in India

I. INTRODUCTION

The unleashing of the business economy has opened up a lot of lucrative options for the business community as a whole. The absence of any restrictions as such has encouraged the business to expand using both organic and inorganic means of growth. Mergers and

[1] Author is Assistant Professor at School of Law, Sushant University, Gurugram, India.

amalgamations have become the symbol of new economic order.[2]

The business combinations be it in any form – takeovers, mergers or amalgamations, the interest of the individual and the entire community who are involved from different angles has to be seen. Combining social interests in the economic activities involves the application of law in such a manner that the economic activities are regulated to safeguard the interest of the general public. Provision for mergers and takeovers do exist which try to ensure that public interest is not jeopardised either by squeezing or exploiting the interest of minority shareholders or the interests of investors and creditors of the company or the end users of the company's products and services.[3]

For these reasons it is important to understand the provisions relating to mergers and takeovers. Therefore, in this article one of the important aspects of takeovers i.e. minority squeeze-outs is being analysed. The objective is to critically analyse the provisions relating to squeeze-outs.

The controlling shareholders have always been the centre point of discussion on various issues emerging under Company law ranging from the leadership and vision they provide to the company to the misery of minority shareholders in case of an acquisition where the acquirer probably just wants to benefit himself than the company. Corporate laws across various countries have tried to maintain a balance in the interests of the controlling shareholders.[4] But mostly it has been observed that in trying to maintain a balance of interest's decisions are taken supporting the majority and overshadowing the concerns and issues faced by the minority. One such area in the competing interests of majority and minority shareholders has been squeeze-out transactions.

Squeeze-out implies compulsory acquisition of equity shares of a company from the minority shareholders by providing them compensation in cash. So basically, it allows the majority shareholders to acquire control over the remaining shares of the company.[5] Squeeze out transactions can be carried out through various methods such as reduction of share capital, consolidation, acquisition and cash payment to minority shareholders under a scheme of amalgamation. It is not surprising at all that out of all these methods the reduction of share capital method is most commonly used and it is also the method which provides least protection

[2] N.R. Sridharan & P.H. Arvind Pandian, Guide to Takeovers and Mergers 1 (LexisNexis Butterworths Wadhwa 2010)
[3] J.C Verma, Corporate Mergers Amalgamations & Takeovers 88 (Bharat Law House 2009)
[4] Vikramaditya Khanna & Umakanth Varottil, Regulating Squeeze-Outs in India: A Comparative Perspective, 63 AM. J. Comp. 1009, 1052 (2015)
[5] Kirthana Singh, Squeezing Out Minority Shareholders – An Indian Perspective, The World Journal on Juristic Policy (2018), (August 5 2018, 2:05 PM), http://jurip.org/wp-content/uploads/2018/01/Kirthana-Singh.pdf

to the minority shareholders.[6]

In India, the concept of minority squeeze-out always existed but never really became part of any of the laws regulating companies in India. But now this concept has garnered interest as well as intense scrutiny. The Companies Act, 1956 did not explain the concept of squeeze-out but after the amendment in 2013 this concept got a place in our company law.[7]

This article will first explain the concept of squeeze-out and the concerns surrounding it. It will then move on to explaining the Indian regulation with respect to squeeze-outs and finally the regulation regarding squeeze-out in various other jurisdictions. The purpose of studying regulations in various other jurisdictions is to try to carve out some possible reforms for the squeeze-out transactions in the Indian context.

II. What is a Squeeze-out and what are the issues surrounding it?

The term squeeze-out refers to a transaction where the acquiring party is the controlling shareholder of the firm to be acquired i.e. the target firm. This can be explained through an example: the target firm is XYZ Ltd. and it's controlling shareholder is VU Ltd. having 55% shares. A squeeze-out will result when VU Ltd. decides to acquire 100% shares in XYZ ltd. This will often result in the minorities of XYZ ltd. getting compensation for their 45% shares in the firm.[8] This example demonstrates just one way through which squeeze-out can be carried out but there are other ways as well as mentioned above in the introduction.

The important point to be seen is that squeeze-out happens through whichever way it will raise concerns for the minority shareholders because the controlling or majority shareholders can easily divert the entire transaction in their favour at any given point of time being in majority. There can be various examples where the majority shareholders use different phases and circumstances in a company's life to their advantage for carrying out squeeze-out transaction.

The different situations where the majority shareholders can be opportunist are that they can time the squeeze-out around that point when they know that the company is about to receive a profitable opportunity, so that they don't have to share the profits with the minority shareholders. Then they can also take advantage of the decline in prices in the stock market in a similar fashion as above, even though the decline might be temporary. Further, the majority shareholders can also deliberately take decisions which reduce the value of the company for a certain time period so that they do not have to pay more compensation to the minority

[6] Rajiv Luthra et al., Minority Squeeze Out, Companies Act 2013 – Key Conceptual Transformation, 25 (August 5 2018, 4:10 PM), http://www.luthra.com/admin/article_images/minority-squeeze.pdf
[7] Khanna, supra note 4
[8] Khanna, supra note 4

shareholders. If the controlling shareholders behave in such a manner then the minority shareholders definitely need protection and it can also have an effect on the capital formation.[9]

Seeing such examples, one might think that there should be total prohibition on squeeze-outs but that is not possible as squeeze-outs do have some benefits as well. So, a well-balanced approach is required in tackling minority squeeze-out.

III. REGULATION IN INDIA REGARDING SQUEEZE-OUT:

The regulation of squeeze-out in India is governed by delisting regulation of Securities and Exchange Board of India (SEBI) and the statutory provisions which are given under the companies Act.

Coming to the companies act it was mentioned above there are various forms through which squeeze-out of minority shareholders can happen. The Companies Act, 1956 (hereinafter called as the Act) did not explicitly have any provision relating to the same. The only section which can be related to it was section 395 of the Act, which explained the acquisition transaction which is considered as one of the forms of minority squeeze-out.

Section 395 of the Act stated "*that transfer of shares or any class of shares of a company (transferor company) to another company (transferee company), has to be approved by holders of at least nine-tenths in value of shares whose transfer is involved within four months after the offer has been made by the transferee company. After the lapse of two months out of the four months mentioned above, the transferee company shall give a notice to the dissenting shareholders (left 10% of the shareholders) to acquire their shares*." Through this provision the minority is eliminated from the company.

But it is also mentioned that sec 395 was seldom used and instead recourse was made to sec 100 of the Act to eliminate the minority. According to sec 100 the capital of the company could be reduced in any manner just by passing a special resolution which required the assent of 75% of the shareholders present and voting. This was subject to the approval of the court. This section completely ignores the intention of minority shareholders altogether.[10] It should be noted that reduction of capital is another form or way of enforcing minority squeeze-out.

After the amendment, the Companies Act, 2013 specifically introduced the concept of squeeze-out under section 236, which elaborates various situations under which minority shareholders can be bought out by the majority shareholders. The term Minority Shareholding has not been

---

[9] Ibid

[10] Akshat Sulalit, Companies Act, 2013: Rise of Minority Shareholders, ILJ Vol. 6 Issue 2, (July 25 2018, 11:30 AM), http://www.indialawjournal.org/archives/volume6/issue-2/article5.html .

specifically defined under the act of 2013 however, sec 236 uses the word minority shareholding in respect of equity shareholders not exceeding 10% of shares in the company.[11]

The various methods for the implementation of the squeezing out of minority shareholding as introduced by the Companies act of 2013 are:

A. Consolidation of Share Capital –

Through this option the company the company consolidates and divides its share capital into shares having face value larger than the existing shares.[12] However, such a step cannot be taken without the authorisation as per the articles of association as well as sanction in a general meeting of the company. Post the consolidation, minority shareholders receive fractional shares as per the new face value and these fractional shares are transferred to the Board who holds such shares as a trustee. The board is also authorised to consolidate these fractions and sell the resulting shares to any person whom it deems fir for the same and at a price that seems appropriate to the board. The proceeds from such a sale is then transferred to those members with fractional entitlements in proportion to what they are entitled to, thereby effectively cashing them out.[13]

Normally, this process can be completed within short time frame as it requires just an approval from the shareholders. But it is also possible that this process might have to go through certain hiccups in the form of opposition or resistance. This can be in the following forms:

- Any consolidation or division which results in a change in voting percentage of the shareholders then it shall take effect only if the approval of the Tribunal has been obtained in the prescribed manner.[14]
- The company is also entitled to refuse recognition of any interest in any fractional part of a share. This applies to only those companies which are mentioned in Table F of the act and those companies which have in their articles provisions similar to that given in regulation 4 of the act.[15]
- The minority shareholders can file for an action of Oppression (earlier sec 397 of the Companies Act, 1956).[16]

B. Reduction of Capital:

[11] Singh, supra note 4
[12] The Companies Act, 2013, sec 61(1) (b) (India)
[13] Luthra, supra note 5
[14] The Companies Act, 2013, sec 61(1) (b) Proviso (India)
[15] The Companies Act, 2013, Regulation 4 of Table F of Schedule I (India)
[16] The Companies Act, 2013, sec 241 (India)

The paid-up capital of the company can be reduced by paying off the minority shareholders. For this a special resolution has to be passed in the meeting of the company and it has to be approved by the Tribunal as well.[17]

In the case of *Sandvik*[18] the issue was whether a special resolution, which proposed to wipe out a class of shareholders after paying them just compensation, can be termed as unfair and inequitable? It was held that once it is established that non-promoters are being paid fair value of their shares and an overwhelming majority of non-promoter shareholders have voted in favour of the resolution, court would not be justified in withholding sanction. Therefore, minority shareholders can be squeezed out even without consent.

The High Court of Bombay in this case laid down tests, which appear to be the guiding principles under this option:

(i) whether non-promoter shareholders are paid fair value; and

(ii) whether an overwhelming majority of the non-promoter shareholders voted in favour of the resolution.

In the case of *Re Organon*[19], the Hon'ble Bombay High Court stated about the fair valuation that the court's obligation is to be satisfied that the valuation was in accordance with law, and it was carried out by an independent body. The Act provides for the 'independent body', which is prescribed under Section 247 of the Act and is known as a registered valuer.

In cases where this option has been successfully expended for selective reduction, the reasons cited for such selective reduction can be:

(i) Due to de-listing and consequent loss of tradability, reduction provides an opportunity to public shareholders to liquidate their shareholding at an attractive price and realize a return on their investment.

(iii) Company has received requests from non-promoters to provide them with an exit opportunity (in the context of loss of liquidity and tradability of the shares).

(iv) Due to large promoter coming through takeover offers, to protect minority shareholders from impairment of assets and changes of business by promoters, the capital of minority shareholders is being returned.

[17] The Companies Act, 2013, sec 61 (India)
[18] Sandvik Asia Ltd. v Bharat Kumar Padamsi and Othrs., (2009) 3 Bom CR 57 (Div Bench)
[19] Re Organon (India) Limited v Unknown (2009) 92 SCL 272 (Bom)

(v) Other reasons include that the company finds it administratively prohibitive to service small shareholders and it is not cost effective.[20]

The decision of the Bombay High Court in *Re Cadbury India Ltd.*[21], is of utmost importance. The facts: Cadbury India was a public listed company, being a subsidiary of Cadbury Plc, UK. As a result of several takeover offers made by Cadbury Plc and buyback offers by Cadbury India, the public shareholding of the company fell below the minimum required for continued listing. Hence, the company was delisted from the stock exchanges. At a time when the Cadbury Group held 97.583% of the equity share capital of Cadbury India, with the remaining 2.417% held by the minorities, the company initiated a capital reduction scheme to buy out the minorities. The price offered was supported by the reports of two independent valuers, M/s. Bansi S. Mehta & Co. and M/s. SSPA & Co., which both valued the shares of Cadbury India at Rs. 1,340 per equity share. The special resolution required for such a reduction scheme under the Companies Act, 1956 was duly passed, and the company sought the sanction of the Bombay High Court to the same. It was then duly subjected to challenge by the dissenting minorities.[22]

Although the result appears somewhat curious, the High Court's order appointing the valuer suggests it arose out of a compromise whereby the company was keen to "cut short the controversy" so long the independent valuation was to be treated as binding. However, the court retained some leeway to interfere with such report in case of "any grave infirmity in it". Accordingly, Ernst & Young (E&Y), the court-appointed valuer, returned an initial valuation of Rs. 1,743 per equity share, which was subsequently revised upwards to Rs. 2,014.50 per equity share. The objecting minorities who demanded a price of at least Rs. 2,500 per share too challenged this. G.S Patel, J stated *"that court has a right to decline the scheme on the account of valuation but the person objecting the scheme should show that the valuation was unreasonable. This was not demonstrated in the case."*

The court found out that a majority of minority non-controlling shareholders had voted in favour of reduction of capital. The court further set a high standard for the objecting shareholders who were challenging the valuation. They had to prove that the valuation was unreasonable and just because they prefer one valuation method over the other was no answer to the problem. Therefore, in this case the court held that in this case the objecting shareholders were miniscule in number and they were not able to discharge the burden of overturning the

[20] Singh, supra note 4
[21] Company Petition No 1072 of 2009, Decided on 25th February. (2014) (Bombay High Court)
[22] Umakanth Varotill, Squeeze-Outs: Analyzing the Cadbury Decision (August 20 2018, 6.00 PM), https://indiacorplaw.in/2014/08/squeeze-outs-analyzing-cadbury-decision.html.

valuation.[23]

It was feared after the decision of this case that it might not confer enough protection to the minority shareholders and as it is the law for the protection of minorities in case of squeeze-outs is pretty weak.

C. Acquisition of shares –

If there is a scheme or contract under which transfer of shares from a transferor to a transferee company has been approved within 4 months by shareholders holding 90% of shareholding then the transferee company can within 2 months after the expiry of the above mentioned 4 months make an offer to the dissenting shareholders to acquire their shares. Unless the dissenting shareholders do not agree and make an application to the Tribunal and the Tribunal orders otherwise, the transferee company can acquire the shares of the dissenting shareholders.[24]

This concept is somewhat similar to the concept of 'freezing-out' where the majority shareholders incorporate a second corporation, which initiates a merger with the original corporation. So, the majority shareholders using the merger plan force the minority shareholders in original corporation to sell their shares.[25]

D. Payment of Cash as Consideration to Minority Shareholders Under a Scheme of Amalgamation –

Under a scheme of amalgamation, the minority shareholders can be paid in cash instead of giving them shares in the transferee company.[26]

E. Purchase of Minority Shareholding –

If any acquirer has acquired 90% of the equity share capital of a company by virtue of amalgamation, share exchange, conversion of securities or any other reason, then he can make an offer to the company to acquire the remaining shares as well.[27] The price to be paid to the minority shareholders has to be determined in accordance with Rule of the Companies (Compromise, Arrangement and Amalgamation) Rules, 2016.

It was mentioned in this section above that we also have a delisting regulation of SEBI. The SEBI (Delisting of Equity Shares) Regulation, 2009 can be considered as a prequel to squeeze-

---

[23] Ibid
[24] The Companies Act, 2013, sec 235(1), (India)
[25] Luthra, supra note 5
[26] Singh, supra note 4
[27] The Companies Act, 2013, sec 236 (India)

out. As per these regulations the promoters of a company can delist it from the stock exchange by offering to purchase the shares of public shareholders. Upon the company being delisted, the shareholders will lose the liquidity attached to their shares and their exit option becomes weak which pressurises them to accept the offer of the promoters.[28]

Delisting is beneficial for the promoters because it removes the company from the ambit of SEBI (as SEBI deals with only listed companies) due to which the company is subject to a less strict legal regime. The delisting proposal must be approved by a 75% majority of the votes cast by all shareholders through postal ballot after disclosure of material facts. In addition, the delisting proposal must obtain at least a two-thirds majority of the public shareholders. But this delisting process has often turned out to be cumbersome for the promoters hence, it has been used less and the promoters have resorted to other mechanisms for squeeze-out instead of going through delisting first.[29] It has also been argued that the delisting procedure does not produce the same results as are produced by the squeeze-out provisions under the companies act.

IV. Regulation of Squeeze-Outs in other jurisdictions:

It has generally been observed that the laws in India generally have been borrowed from some other jurisdiction. The case of squeeze-out is not different at all. The provisions in India with respect to squeeze-out are a mixture of laws in U.K, USA, Germany, Singapore. In this segment an overview of the laws in other jurisdictions regarding squeeze-outs will be discussed.

A. United Kingdom (U.K) –

U.K also has several mechanisms or procedures for carrying out squeeze-outs. These procedures include: Compulsory Acquisition, Scheme of Arrangement and Reduction of Capital.

Under the compulsory acquisition method, following a takeover offer, the bidder has a right to acquire the minority shares compulsorily if it has acquired at least 90% of the shares which also carry voting rights.[30]

The scheme of arrangement under U.K law follows an all or none approach which means that either the acquirer acquires everything or nothing at all. The minorities in such a situation are provided with a very basic level of protection like considering them as a separate class, disclosing them every detail before taking their approval and the court also supervising their

[28] Sachin Mehta, Minority shareholders and the threat of squeeze-outs, The Livemint (2008), (August 20 2018, 6.00 PM), https://www.livemint.com/Money/dfzhNnJ17ARJB5lcAmTMEI/Minority-shareholders-and-the-threat-of-squeezeouts.html
[29] Khanna, supra note 3.
[30] Luthra, supra note 5.

interests.[31]

The reduction of capital method is also used to squeeze-out the minorities but it is not a preferred approach. The courts in such a method have argued that the controllers and minorities should be construed as separate classes as they have competing interests involved.[32]

B. United States (USA) –

In general, the process of squeeze-out simply requires majority vote in favour of a squeeze-out merger. There are two types of mergers which can happen in this process, long-form merger and short-form merger.[33]

When an acquirer has acquired 90% of shares of the target company it can implement short-form merger and acquire the balance shares through that process only. But if the acquirer has not obtained the target number of shares in the target company it can acquire them through a long-form merger by paying consideration for the same followed by an approval of the shareholders.[34]

The protection of shareholders comes in two forms: (i) Statutory appraisal rights: wherein the dissenting shareholders can demand that they should be paid fair value of their shares determined by the court. (ii) Fiduciary duty class actions: wherein the dissenting shareholders together can file a class action showing fraud or overreach by the controllers thereby stating a breach in the fiduciary duty by them. The burden in such cases is on the controller to show that the entire process was fair.[35]

C. Germany –

In Germany, controllers use three mechanisms for squeezing out minorities.

(i) General squeeze-out mechanism: under this mechanism the controller has to take approval of the shareholders in their meeting. The price to be given to them is determined through a written report of the controller supported by report of an independent auditor. The squeeze-out has to be filed in the commercial register.[36]

(ii) Takeover squeeze-out: under this mechanism the when a controller reaches a shareholding of 95% of the total voting share capital of a company it can acquire

[31] Ibid
[32] Khanna, supra note 3.
[33] Ibid
[34] Luthra, supra note 5
[35] Khanna, supra note 3
[36] The German Stock Corporation Act, 1965, sec 327a-327f

 [ISSN 2581-5369]

the remaining shares. The price of shares will be determined in accordance with the consideration paid in the takeover offer. It does not require shareholder approval as in the above mechanism.[37]

(iii) Merger-specific squeeze-out: this new squeeze-out mechanism enables a controller holding at least 90% of the shares in the target to merge the target with itself. Since the target will be wound up in the process, its shareholders (i.e., the minorities) must receive appropriate value for their shares from the controller. It is necessary to obtain shareholders' approval of the target within three months from the date of signing of the merger agreement.[38]

V. CONCLUSION

In India as mentioned previously in the article, there was no specific provision relating to squeeze-outs in the Companies Act, 1956. It was introduced under sec 236 of the Companies Act, 2013. The aim of specifically introducing squeeze-out as a provision under the new act was to align the Indian and global corporate scenario. However, in the effort of explicitly including the provision for squeeze-out by taking reference from various other jurisdictions but still the minority shareholders do not get proper protection.

*****

[37] The German Securities Acquisition and Takeover Act, 2006. sections 39a and 39b
[38] Third Act of Amendment for The German Reorganization Act, 2011