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Stake of Minority Shareholder during CIRP

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ABSTRACT

This paper aims at providing the readers a comprehensive understanding and a deep insight of minority shareholder rights during insolvency proceedings. It analyzes the current state of shareholders rights as under the Insolvency and Bankruptcy Code (IBC) and highlights it with the help of relevant landmark judgments. Additionally, it describes and talks about the guaranteed rights of minority shareholders under the Companies Act. By analyzing the various international perspectives on protecting minority shareholder rights, the authors have built a foundation for suggested policy implementations and concludes by emphasizing the urgent need to safeguard stakeholder interests during insolvency.

I. INTRODUCTION

Shareholders are the persons who form the integral part of any company as these are the persons, on whose money the company functions its business. In the light of said facts, it becomes necessary to protect the interest of the shareholders in a company as and when required, because of the very reason that if the interests of owners of the business will not be protected then how the owners of the business i.e. shareholders will protect the interest of the company. As, the interest of the company and the shareholders are mutually co-extensive with each other. Shareholders are further categorized into two categories i.e. Majority Shareholders and Minority Shareholders, though the Act doesn't make any distinction between the minority and the majority shareholders, but the value of the share one owns defines whether he is the minority or majority shareholder. Usually, a person who owns the 50% or more shares in the company is called the majority shareholder, whereas a person who owns the less than 50 % of shares is called as minority shareholder[2].

Minority shareholders in thousands of closing companies are contemplated as worthless and futile by the professionals of such companies. These minority shareholders are frequently being ignored and deprived of their rights at the time of initiation of resolution plan and for that matter at time of winding up of a company. Minority shareholders are often deprived of any income from the corporation either in the form of dividend or as salary, they are not being acknowledged and are not considered as an effective voice in the business when it comes to decision making.

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[2] Sikha Bansal, 'Minority Shareholders under IBC', Vinod Kothari Consultants, August 25, 2021,

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And on that account they are being eliminated from the company at a fraction of real value of their interest. The problem has eventually taken the shape of litigations as the last resort to ask for justice, time and again the amount of litigations has only increased from and out of minority shareholders.

However, since the implementation of IBC (Insolvency and Bankruptcy Code), 2016, a shift has been observed in the recovery mechanism in the country. IBC is creditor centric statute, hence from the initiation of the CIRP process, it is the committee of creditor (CoC) which handles and takes every decision relating to the corporate debtor. But the decision taken by the committee are expected to be wise enough that nobody can put any question against it and can only be questioned in case of deviation from the provisions of IBC or its objective. At times when any public company initiates an application for CIRP, the committee accepts the said application and tries to delist the company along with the writing off all its equity shares which notably impacts the minority shareholders and majority as well for that matter but the minority shareholders have to bear the brunt of the consequences or result of such decisions in most of the cases. Because, the Act has no where considered the interest of the minority shareholder. And, even in waterfall mechanisms also the shareholder are put at in the last. Therefore, in the light of such a prima facie discrimination, India needs a robust mechanism to safeguard the interests of shareholders especially minority shareholders.

- **Theoretical framework**

With the advent of IBC, 2016 in India, it has revolutionized the process of insolvency resolution via Corporate Insolvency Resolution Process. Since, the idea through which the Act was introduced to restructure the business of the company, which has become insolvent in order to increase its efficiency and protect the interests of all the stakeholders of the Company. However, it has been seen that during the entire CIRP process the interests of minority shareholders are not at all protected because of the mere reason that they have less equity in the company. A few are taking all the decisions just because they are owners of major equity of the company and these are none other than the promoters, key managerial personnels or the relatives of these persons, who has the significant control over the company. And, these persons often play a dominant role in the company.

II. CURRENT POSITION OF MINORITY SHAREHOLDERS UNDER IBC

The current IBC prevalent in India as of now doesn't make any distinction between the minority shareholders and majority shareholders. The instant Act puts both minority as well as majority shareholders on the same pedestal.

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"Sec. 21(2) states that COC should comprise of FC i.e, Financial Creditors as the corporate debtor". Here, also as such there is no say of minority shareholders.

Further, *Regulation 38(1A)* provides that the resolution plan must include the statement to the effect that how resolution plan will deal with the interests of all the stakeholders of the Company and that too shall be investigated by the NCLT.

Further, *"sec. 24(3) states that a resolution applicant has to a sent notice to the committee of creditors (COC) meetings of the members of the board of corporate debtor and operational creditors or their representatives*". Here also the minority shareholders have no say as the committees of creditors do not consist of minority shareholders.

Further, *"the sec. 30(2) the provision has specifically incorporated that the resolution plan must provide for resolution costs, and thereafter a minimal value to the operational creditors"*. But, as such there is no such stipulation has been provided by the Act for the minority shareholders.

Further, if we look at explanation to sec. 30(2), it states, if in any case the approval of shareholders as provided, under the Companies Act, 2013 and for that matter under any law for the very purpose to implement the actions of the resolution plan, in such scenarios the consent of shareholders shall be deemed to be approved by virtue of the explanation provided given sec. 30(2) of the code. And, it shall not be considered in contravention of any law for the time being enforce. Bare reading of the instant provisions clearly signifies that the interest of minority shareholders are completely ousted and that too including the promoters.

The Act further talks about the initiation of CIRP as per sec. 10 by the such corporate applicant, which also includes the corporate debtor, whenever there is a default committed by the corporate debtor. Here, the majority shareholders by passing a special resolution *"as mentioned in the sec. 10(3) (c)*[3] *of IBC, 2016 they can initiate the CIRP that often causes the potential harm to the minority shareholders by way of reducing the value of the investments, dilution of their ownership stake or sometimes the complete loss of their holdings can also be seen, when the CIRP results in liquidation".* And, once CIRP has been initiated the ball is put into the court of NCLT will decide that whether the CIRP is in the interest of the stakeholders or not. But, anyway the action of majority shareholders itself, not only undermines the financial interests of the minority shareholders but also in the shadows their voices and rights within the company. Therefore, the cumulative effect of all the provisions make the shareholders vulnerable, because they neither have representation before Committee of Creditors nor there is any consent required to be taken for the implementation of any act or action taken by the CoC therefore, in the light

[3] Insolvency and Bankruptcy Code, 2016, Section 10, cl.3. sub.cl.(c).

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of aforesaid facts it becomes necessary to protect the interest of minority shareholders at any cost. Now, the very important question arises here is:-

- **"Whether the minority shareholders genuinely need any protection?"**

If we see some examples, of recently concluded CIRP process then, the answer to the question will become easy. And, the best example for this situation is the recently conducted CIRP in the a publicly listed company named DHFL. In that the value of the share was deducted in such a manner that its value went down and the paid up capital of such company will come to zero. The another example could be the CIRP in the "*Jaypee Kensington Boulevard Apartments Welfare Association and Ors v. NBCC (India) Ltd and Ors."* Here, also similar situation can be seen as we have seen in the DHFL case, and in this case the a resolution plan was suggesting the almost reduction of the paid up share capital which is very negligible and ultimately that resolution plan was also approved by the Hon'ble Supreme Court. Because of the reductions of the paid up share capital in both the examples, the minority shareholders loose everything because of such an unfair treatment. This is the very reason which warrants the protection of the rights of minority shareholders as their huge investments went into vain. And, to address this problem of minority shareholders for the recognition of their interests, they have approached the SC, whereby the SC also felt that there is the unfair treatment of minority shareholders during the CIRP. But, it failed to recognize such interest as valid because of the reason that the provisions of IBC doesn't provide any such scheme for the redressal of such grievances. And, therefore it is for the legislature to formulate such policies to redress the grievances of minority shareholders and the court cannot step into the shoes of the legislature for which it is not empowered. Which is evident from the below discussed case in detail:-

III. CASE LAWS

1. *Jaypee Kensington Boulevard Apartments Welfare Association and Ors v. NBCC (India) Ltd and Ors. (2022)*[4]

The issues in the present before the apex court were that:

a. Can the resolution plan be executed and put an end to the security interest of third party secured creditors without assigning any value to them?

b. What is the treatment of minority shareholders of the corporate debtor at time of CIRP?

c. The Resolution Plan as approved by the NCLT was not in accordance with the

[4] *Jaypee Kensington Boulevard Apartments Welfare Association and ors v. NBCC (2022) 1 SCC 401 (India)*

Resolution Under section 38 (1) A, however the power and jurisdiction of NCLT was questioned while dealing with the resolution plan.

Held: To which the apex Court stated that the grievance in the present suit cannot be considered and recognized as a legal grievance and they don't have any cause of action to maintain such disagreements between the COC and minority shareholders on the ground as specified under:

a. that the shareholders would stand at the end in the queue of priority under *section 53* at the time of winding up and liquidation, hence it cannot be termed as unfair when the promoters are extinguished and canceled in total without considering them.

b. While dealing with the minority shareholders under IBC is a completely different and structured process which provides supreme rights to the COC as described under section 30(2)(e).

c. However as far as the powers and jurisdiction of NCLT is concerned, under the Act only COC is the only authority entrusted to deal with and approve the resolution plan and no shareholder can be part of this process.

Observations of Supreme Court: that the initiation of insolvency proceedings should be last resort possible to save the company and IBC should come only after all possible attempts done to resolve and negotiate the conflict between the debtors and creditors, however the law is of such a nature that resolution plan under section 230 of IBC is a method or process to provide protection to the creditors and shareholders (including minority shareholders), hence are made to be forced on them. But despite these above mentioned observations there is no bar on minority shareholders to propose any sort of resolution under section 230 of Companies Act when the CIRP proceedings have already been initiated, therefore if the proposal of minority shareholder is in the interest of the company as well as its members and is better than the Resolution plan it can be presented before the National Company Law Tribunal.

2. ***Diwan Housing Finance Limited's Case (2021)***[5]

In the instant case the decision of the NCLT was challenged before the Hon'ble supreme court by the minority shareholders of the company. The trading of DHFL's shares was ceased and PCHFL was authorized to takeover the insolvent company , however the resolution plan suggested that the company (PCHFL) will purchase the equity shares owned by other shareholders through reduction in the paid up capital which will be almost up to zero. Hearing this the retail investors rushed to purchase such shares in the hope to have gains of winding up

[5]Anirudh Laskar, DHFL investors to move Supreme Court against plan to delist stock, Hindustan Time, Jun 18,2021

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as the new management takes over companies management, but this could not last for a long time and the shares were to be delisted according to the resolution plan and in that the retail investor or minority shareholders were not recognized and will receive nothing in exchange of their shares after the process of winding up.

These minority shareholders include both investors who were present in the workings of DHFL's management day and night as well as those who recently bought and became a part of the Company. In response to the resolution plan and to protect the rights of minority shareholders the case was filed challenging the decision of NCLT. However, the case is yet to be decided and is pending before the Supreme Court and minority shareholders are in hope that their rights will be recognized this time by the Hon'ble apex court.

In pursuance of the observations by the courts in above two case, the Securities and Exchange Board of India suggested certain policy implications for the protection of the rights of minority shareholders in November, 2022. Following are certain suggestions, which were made by the SEBI[6]:-

a. To offer an opportunity to the minority shareholders to acquire the share in restructured company to the maximum cap of 25%, whereby at least they should acquire 5% shares mandatorily by the resolution applicant. And, this offer shall be mandatorily open for all the minority shareholders[7].

b. Further, the listing of the entity shall be permissible only upon providing the 5% of shares after completion of CIRP.

c. And, if in case the company is not able to achieve minimum cap of 5% of acceptance, then such companies to be delisted.

d. Further, the regulation provided that, regulations to be undertaken in order to ensure that exemptions shall be given to only those entities, where either the entities go into liquidation or when public shareholdings remains below 5%.

This proposal of SEBI was very apt in protecting the interests of minority shareholders. SEBI came up with all the proposals by virtue of sec. 11 of SEBI ACT, 1992[8]. where, sec. 11(1) of the Act empowers SEBI to make regulations, in order to protect the interest of the investors in Securities and Capital Markets and to take any such steps which helps in overall development

[6] Framework for Protection of Interest of Public Equity Shareholders in case of Listed Companies Undergoing CIRP under IBC, Jan 22, 2023
[7] Report of Bankruptcy Law Reforms Committee, Pg. No. 10
[8] The Securities and Exchange Board of India, 1992 Sec 11

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of Securirities market. Therefore, when we read such proposals in the light of sec. 11 of SEBI Act, 1992 then we come to the conclusion that SEBI was right in proposing such policies in order to protect the interest of publicly listed company's minority shareholders. However, the proposals was not accepted because of the very reason that the IBC, 2016 doen't have any such provisions. And, in order the proposal to be accepted it has to be in consonance with, the IBC, 2016 since the modification doen't only bring change into the SEBI Act but it is equally going to affect the IBC. And, therefore to check, whether such material changes are feasible? The IBC in its framework has contained sec. 238 of IBC[9], which runs with a non-obstante clause, which means in the event of conflict between two statutes , the former will prevail over latter. Therefore, a very important question arises whether the protection for minority shareholders as envisaged by SEBI is in line with the IBC. To this it is crystal clear from the schemes of IBC that there is no place of minority shareholders in the schemes of IBC, and if the policy proposed by SEBI is implemented than it is going to be in direct contravention of the Sec. 238 of IBC. And, both being the special laws, which will prevail over whom was the question, if there is no possibility of reconciliation between the two. Therefore to resolve this issue the SC relied on the judgement in the ***case of*** *"Maharashtra Tubes Limited v State Industrial and Investment Corporation of Maharashtra"*[10]**.**

In this case the court settled the issue that when there is a conflict between two special statutes with no possibility of reconciliation, then the latter in law shall prevail over the former statue. Therefore, in the matter at hand IBC, 2016 being latter in law shall prevail over the SEBI Act, 1992. And, therefore in the light of said judgment, the proposed policy implication shall not be taken into consideration.

IV. RIGHTS OF MINORITY SHAREHOLDERS AS PER COMPANIES ACT[11]:

1. Right to be heard

As soon as the minority shareholders get recognized under provisions of the Companies Act they have the right to be heard and the company needs to ensure and place an appropriate mechanism to ensure that no such right doesn't obstruct the management from performing their functions in the interest of the company. However the management should act in a just and reasonable manner free from unscrupulous acts.

[9] The Insolvency and Bankruptcy Code, Sec 238
[10] 1993 SCC (2) 144
[11] Manjeet Kumar Sahu, Rights of minority shareholder in India Under the Companies Act

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2. Right in case of mismanagement

Since the minority shareholders have a considerable amount of equity share capital and have representation in the company there are certain provisions in the Act to prevent mismanagement but in case of any conflict they are entitled to approach the appropriate court, tribunal or forum to protect their interest.

3. Right of minority shareholders at the time of mergers/ amalgamation/takeover

"Under section 395[12] of the Act, a transferee company, which has acquired 90% shares of a transferor company by means of a scheme or contract, will be entitled total sum of shares of remaining 10% shareholders". The minority shareholder has vested with a power to approach appropriate authority in case the scheme appears to be unfair. In case of takeover by SEBI, SEBI has the power to investigate any matter reported by any such investor or minority shareholder or any other person raising the question of substantial acquisition of shares and takeovers, the investigation will be by an investigating officer appointed by SEBI.

4. Fair valuation of shares

The principle of valuation should be recognized in the Company and should be done through an independent valuation process to ensure the means of safeguarding the interest of minority shareholders. An Audit committee needs to be set up to proceed with valuation, and in case it is observed that the process of valuation is not up to the mark or is unfair, the shareholders have the right to approach the appropriate Court or Tribunal.

V. RELEVANCE IN INDIA & WORLD

In the growing economies like, the business needs a healthy credit flow and the generation of new capital are essential. But the problem arises when the business or the company turns insolvent. So, to restructure their business and make good the creditors money the Act at hand came into being. The bare reading of the objective of IBC, 2016 makes it clear that, the objective of the legislation was to make alive by restructuring its business. The impact of this legislation can be seen through the various companies which were earlier unable repay their debt have no option but to go into liquidation but with the advent of IBC, 2016. Even if they are unable to repay their debt still their business can be restructured and can be made it alive again. But, earlier it had no option but to go into liquidation. And, now the creditors also have more faith than earlier that their money will be recovered easily since once the company becomes insolvent, the power stands transferred into the hands of committee of creditors.

[12] The Companies Act, 2013, Section 395

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And, the relevance of the Act which we see in India, is almost similar relevance in other world countries like, UK, US, Canada etc too.

VI. SUGGESTED POLICY IMPLICATION

Here, the protection of interest of minority shareholders doesn't signify that, the protection of interest of minority shareholders at the cost of the interest of majority shareholders. Unlike what has been provided under IBC, the approach should be to balance the interests of both the minority and majority shareholders. And, for recognising such interests the approach of the legislature should be to first bifurcate in clear terms that who are the minority shareholders and who are the majority shareholders. And, this clear bifurcation is needed, so that if the legislature makes any provision for the protection of interests of minority shareholders then the benefit will reach directly to the intended persons. And, the objective of the legislation will be fulfilled.

Further, to provide a fair share holdings in the newly structured business of the corporate debtor with a minimum of at least 10% share holdings, with a cap of maximum 40%. And, it should be made mandatory for all the businesses post CIRP. In case of non-compliance the stringent punishment to be made in order to follow the regulation in strict adherence.

These all the aforementioned changes should be brought through the Insolvency and Bankruptcy Code because of the reason that IBC is latest in law as well as latter in law. So, that if in case of conflict with no possibility of reconciliation, the provisions can be implemented in its strict sense. And, by these provisions the interest of minority shareholders is going to be protected.

VII. CONCLUSION

After, going through the bare perusal of the provisions of the IBC, 2016 it has been realized that the scheme of the Act, doesn't provide the protection of interests of minority shareholders. And, the same has also been unequivocally accepted by the SC, in the case of Jaypee Keingston. But, the SC failed to recognise it as legal grievance, in the absence of limited power of rule making meaning thereby, the court doesn't want to step into the domain of legislature and violate the specific power, that has been provided to the legislature unless it violates the fundamental rights of the people. Further, the court impledly also want to tell that had there been any intention of the legislature to address the grievance of the minority shareholders then, they would have specifically included such specific provisions. Hence, in the light of such observation, it can be said that any changes to be brought out for the protection of rights of minority shareholders will have to come from the legislature and not from the court. Further, that recognition by way of

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modification should be included in IBC and not in the SEBI Act, 1992. Because of the very reason that both being the special legislation, latter shall prevail over the former.

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