

Capital Restructuring

Selective targeting

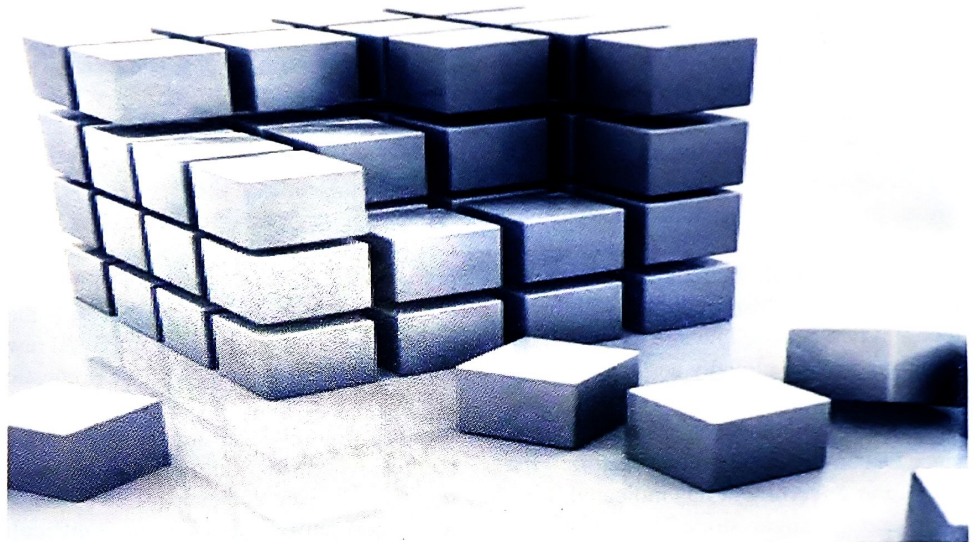
Many companies are using Section 100 of the Companies Act to squeeze out minority shareholders in the garb of reduction of share capital

Promoters have started using Section 100 to squeeze out minority shareholders from the company. Sections 100 to 105 of the Companies Act, 1956, contain provisions on reduction of share capital. The objective behind reduction of share capital is to give back to its shareholders the capital that cannot be optimally utilised for business purposes.

The whole process is divided into two stages. In the first stage, promoters opt for voluntary delisting of shares from the stock exchanges in accordance with the Sebi regulations, which require purchase of shares held by the public shareholders by the promoter group. Most of the public shareholders tender their shares to the promoters, fearing that they would be saddled with unlisted shares that cannot be traded on the stock exchanges.

The objective of delisting of shares, in most of the cases, is not only to avoid the compliances under the listing agreement with the stock exchanges and Sebi regulations but to acquire 100% control over the company so that the company is not required to make public any critical information or seek approval of the public shareholders at the annual general meeting or extra-ordinary general meeting. These objectives cannot be fully achieved through delisting of shares. Even after delisting, there are hundreds of small investors who may be collectively holding 5% to 10% of the paid-up equity capital of the company. This is the trigger point for the second stage to squeeze out such minority shareholders through whatever means possible. Such shareholders become the target of reduction of share capital under Section 100.

Section 100 requires the passing of a special resolution by the shareholders and its confirmation by the high court. The Act permits reduction of share capital by diminishing the nominal value of shares but is silent about the manner in which such reduction is to be effected. Normally, reduction of share capital is effected uniformly across all categories of equity shareholders by paying back, say, Rs 5 per share



Companies are choosing specific shareholders to eject after reduction of capital

(out of Rs 10 face value) so that the company's paid-up equity capital is reduced to half. Whether reduction of share capital can be done in a selective manner by targeting the non-promoter shareholders is a contentious issue.

The intention of the law is not to facilitate picking up or choosing specific shareholders who would cease to be the shareholders of the company after the reduction of capital. A surprising fact is that in almost all the cases that involve squeezing out of minority shareholders pursuant to Section 100, the amount of excess capital as determined by the company and its financial consultants is exactly equal to the shares held by the non-promoter shareholders and, thus, the shares held by the promoters need not be bought back. This leads to an obvious conclusion that the real intention of the promoter group is to squeeze out the minority shareholders and gain 100% control over the company in the garb of the reduction of share capital.

In a recent decision, the division bench of the Bombay High Court confirmed the special resolution passed by Sandvik Asia to reduce its share capital by an amount equal to the shares held by the minority

shareholders. As the special resolution sought to throw out only minority shareholders as a consequence of reduction of share capital, the single judge ruled that the proposal was inequitable. However, the division bench that dealt with the matter on an appeal filed by the company confirmed the special resolution and, thus, opened the doors for mandatory exit of minority shareholders.

Sandvik Asia's equity shares were voluntarily delisted from the stock exchanges in September 2002. But there were still many public shareholders who were collectively holding 4.46% of the equity share capital. The company's proposal to reduce the share capital was in effect a proposal to squeeze out the public shareholders by paying them Rs 850 per share. The matter of concern is that the minority shareholders were not given any option to retain their shares. The proposal was framed in such a manner that a cut-off date was decided by the company and the minority shareholders, whether they were willing to sell their shares or not, were proposed to be paid Rs. 850 per share. This, according to the single judge, was unfair and inequitable as the majority shareholders cannot bulldoze the minority in this manner. In

the appeal filed by the company against the verdict of the single judge, the division bench of the high court, however, allowed the reduction of share capital.

The point to ponder is whether it fair and ethical to throw out the minority shareholders in such a manner. In the past, Reckitt Benckiser India had also used the Section 100 route to squeeze out the minority shareholders. These judgments have set a precedent, which is likely to be followed by other companies. At its EGM held on 16 November 2009, Cadbury India passed a special resolution to pay off around 8,000 shareholders, holding around 2.4% of the equity capital, at a price of Rs 1340 per share. The shareholders of Cadbury are preparing to contest the case in the Bombay High Court. But as the division bench has already delivered the judgment in the matter of Sandvik Asia, the chances of success of Cadbury India minority shareholders are doubtful.

In delisting of shares, the open offer has to be given by the promoter group. The company's funds are, thus, not utilised. For reduction of share capital, the promoters' shareholding increases to 100% through utilisation of company's funds as the public shareholders are paid the fair value of the shares by the company. It is more or less unjust enrichment of the promoters at the cost of the minority shareholders.

Another issue that needs to be addressed



The intention is to acquire 100% control

is the valuation of shares. Most of the companies' offer price is based on the price determined by the valuers or financial consultants appointed for this purpose. The price is fixed by valuers after taking into account several parameters including the book value of shares. The issue is that in case of delisted shares there is no known market price and, therefore, the price may not be fair in most of the cases. In the absence of stock price quotation, the minority shareholders do not know whether the offer price is reasonable.

Sebi recently substituted Sebi (Delisting of Securities) Guidelines, 2003, with the Sebi (Delisting of Equity Shares) Regulations, 2009, which are far more

stringent than the earlier guidelines. The new regulations expressly provide that the promoter shareholders cannot cast their vote on the proposal for delisting and only public shareholders can decide, through postal ballot, whether they would like the company to remain listed on the stock exchanges. Unfortunately, at the immediate next stage, that is for passing of the special resolution under Section 100, there is no such safeguard as all the shareholders including the promoter shareholders are allowed to cast their vote and, thus, influence the final outcome of the poll. Passing of a special resolution under Section 100 is a mere formality as the promoters already hold more than 90% shares. The only stumbling block in the whole process is the requirement of confirmation of the special resolution by the high court, which is also not difficult since high courts also allow such proposals due to the fact that Section 100 is silent on the manner in which share capital of a company can be reduced.

The million-dollar question is how can the majority shareholders snatch the right of the minority shareholders to retain their shares and that, too, in a legally permissible manner? The decision of the Bombay High Court is definitely in accordance with the letter of the law since Section 100 is silent on the manner of reduction of share capital. The spirit of Section 100 is to restructure the share capital of the company for genuine business reasons. In many cases, the intention of the promoters was not to restructure the share capital but to acquire 100% control over the company.

The only foreseeable solution to this problem lies in the amendment of Section 100 so that it explicitly provides that reduction of share capital has to be done uniformly across all categories of equity shareholders. Such an amendment will ensure that the minority shareholders are fairly treated by the promoters even after the delisting. The ministry of corporate affairs ought to propose such an amendment to plug the loophole in Section 100 that facilitates forceful exit of the minority shareholders by the promoters in the garb of reduction of share capital. The ministry can also make necessary amendments in the corresponding Clause 59 of the Companies Bill, 2009, that was introduced in Lok Sabha on 3 August 2009.

—Rajesh Relan

The squeeze

Companies that have reduced their equity capital

COMPANY NAME	EFFECTIVE DATE NO-DEALING/	BEFORE REDUCTION SHARE CAPITAL (RS CR)	AFTER REDUCTION SHARE CAPITAL (RS CR)	PUBLIC SHARE- HOLDING(%)	SHARE HOLDING AS ON
Polygenta Technologies	19/11/09	19.43	1.94	2.902	30/09/09
Modern Malleables	19/05/09	11.53	1.15	3.306	30/09/09
Remi Metals Gujarat	16/12/08	75.61	7.56	7.855	30/09/09
JIK Industries	01/10/08	30.44	3.04	8.124	30/09/09
India Foils	08/09/08	28.34	2.83	7.337	30/09/09
Singer India	05/08/08	15.65	1.56	7.590	30/09/09
Hindustan Copper	13/05/08	768.21	384.11	0.284	30/09/09
Regency Hospital	09/05/08	8.04	0.80	3.381	31/03/09
Kesar Petroproducts	03/04/08	26.73	0.27	3.079	30/06/09
Millennium Beer Inds	29/03/08	54.80	5.48	8.703	30/09/09
Andrew Yule & Co	28/03/08	58.27	11.66	0.869	30/09/09
Surat Textile Mills	21/02/08	67.07	6.70	7.719	30/09/09