MINORITY SQUEEZE-OUTS OF INDIAN SHAREHOLDERS IN COMPANIES ABROAD DURING INCORPORATION

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ABSTRACT

Incorporation is a critical phase in the life of any company, that entails pivotal decisions impacting both majority and minority shareholders. Minority stakeholders, particularly those invested in foreign enterprises, encounter various risks, notably the looming threat of being forced out. This minority squeeze-out scenario unfolds when dominant shareholders or a parent entity coerce minority shareholders into selling their shares, typically at undervalued prices. Such occurrences transpire through diverse channels like mergers, compelled buyouts, or share amalgamations. The article delves into the obstacles confronted by Indian minority shareholders in international investments, specifically during the incorporation phase of companies. With Indian enterprises expanding their global presence, minority shareholders confront the risk of unfair squeeze-out situations orchestrated by majority stakeholders, particularly in foreign jurisdictions with weaker legal safeguards compared to India. Despite the protective measures stipulated in the Companies Act, 2013, including Sections 236[1], 241[2], and 242[3], Indian shareholders investing in foreign companies encounter additional hurdles due to diverse legal systems, regulatory constraints, and corporate governance norms. Furthermore, it scrutinizes significant legal precedents such as *Tata Sons v. NTT Docomo*[4], highlighting the enforcement difficulties minority shareholders encounter in foreign arenas.

[1] Companies Act, 2013, §236.
[2] Companies Act, 2013, §241.
[3] Companies Act, 2013, §242.
[4] Tata Sons v. NTT Docomo (2017) 7 SCC 1.

Introduction

As Indian businesses expand their involvement in cross-border investments and joint ventures, the concern about minority shareholders facing unjust squeeze-out scenarios intensifies. Minority squeeze-outs, entailing the coerced sale of shares held by minority stakeholders at potentially discounted rates, pose a significant threat to shareholder interests, particularly when such occurrences occur in the initial phases of company formation. This paper centers on the detrimental impact of minority squeeze-outs on Indian shareholders participating in overseas companies, particularly during the incorporation phase.

In the context of foreign investments, the risks faced by minority shareholders become more pronounced. Indian shareholders who invest in companies abroad encounter not only the inherent risks of having a minority stake but also the added complexities of dealing with unfamiliar legal systems, differing corporate governance practices, and regulatory frameworks that may provide them with fewer safeguards compared to those they are accustomed to under Indian law[5]. In such situations, minority shareholders are particularly vulnerable to being "squeezed out", a process wherein majority shareholders or parent companies compel minority shareholders to sell their shares, often at a price that does not accurately reflect their true worth[6].

Historical Context

Over the years, the rights of minority shareholders have undergone significant changes, primarily driven by the liberalization of economies and the increase in global investments. Previously, minority shareholders had limited protection and often had to comply with the decisions of majority shareholders without much recourse. In India, the Companies Act of 1956 established a basic framework for shareholder protection but lacked the necessary provisions to address the intricacies of minority rights, especially in the context of global investments[7].

The economic liberalization of the 1990s transformed India's business landscape, prompting Indian companies to attract foreign investments and engage in cross-border ventures. This shift highlighted the gaps in legal safeguards for minority shareholders, particularly during the

[5] Kohli, R., 2015. Financing strategies and shareholders' risk in cross border acquisitions in India. *International Journal of Commerce and Management*, *25*(3), pp.294-308.
[6] Van der Elst, C. and Van den Steen, L., 2009. Balancing the interests of minority and majority shareholders: a comparative analysis of squeeze-out and sell-out rights.
[7] *Id.*

incorporation phase when crucial decisions concerning governance are made[8]. To address these challenges, the Companies Act of 2013 was enacted, introducing various provisions to safeguard the interests of minority stakeholders. For instance, Section 236[9] was implemented to ensure fair compensation in squeeze-out situations, while Section 241[10] provided remedies for cases of oppression and mismanagement.

Even with these reforms in place, Indian minority shareholders who invest abroad encounter distinctive challenges. The initial incorporation phase poses a significant risk for them, as dominant shareholders typically wield influence over the company's framework and conditions, potentially marginalizing the interests of minority stakeholders[11]. This historical context highlights the persistent necessity for enhanced, internationally harmonized safeguards for minority shareholders, especially in transactions spanning across borders.

Legislative Provisions – National or International

The safeguarding of minority shareholders, especially during the initial stages of incorporation, is overseen by national laws and international legal frameworks. Each jurisdiction provides different levels of protection, significantly impacting minority shareholders, particularly in cross-border investments.

National Legislative Frameworks

In India, the Companies Act of 2013 is the principal legislation governing corporate operations and includes provisions for protecting minority shareholders. Section 236[12], a crucial provision, addresses the compulsory acquisition of shares, allowing majority shareholders to acquire minority shares in specific situations, such as restructuring or mergers, at a "fair price". However, determining what constitutes a "fair price" can be vague, placing minority shareholders in a precarious position[13]. During the incorporation phase, majority shareholders might exploit this provision to enhance their control, potentially disregarding minority interests.

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[8] Bertrand, O. and Zitouna, H., 2006. Trade liberalization and industrial restructuring: The role of cross-border mergers and acquisitions. *Journal of Economics & Management Strategy*, *15*(2), pp.479-515.
[9] Companies Act, 2013, §236.
[10] Companies Act, 2013, §241
[11] Tarunya Krishnan, New provision on minority buy-out: Is the buy-out a squeeze-out? Lexology (2014), https://www.lexology.com/library/detail.aspx?g=76064aa9-4fd5-4a9c-9430-be50e6fbd796.
[12] Companies Act, 2013, §236.
[13] Bhardwaj, S. and Dasgupta, A., Critical Analysis of Section 236 of the Companies Act, 2013.

While Section 241 of the same act offers a recourse mechanism for minority shareholders in cases of oppression and mismanagement, its effectiveness during the incorporation phase is limited, exposing minority shareholders to potential exploitation.

International Legislative Frameworks

Various jurisdictions offer diverse protections for minority shareholders, often superior to those in Indian law. For example, the UK Companies Act of 2006 enables minority shareholders to petition courts in instances of unfair prejudice under Section 994[14]. This provision safeguards minority shareholders from unjust treatment during significant corporate events like incorporation, restructuring, or share consolidations. It provides a robust remedy allowing minority shareholders to challenge decisions unfairly impacting their interests, positioning the UK as a protective jurisdiction for minority shareholders.

Similarly, the Delaware General Corporation Law (DGCL) in the United States grants minority shareholders appraisal rights under Section 262[15], particularly in mergers and acquisitions. These rights empower dissenting shareholders to demand the fair value of their shares, safeguarding them during substantial transactions that may result in a squeeze-out. Delaware's favorable corporate laws make it a preferred choice for incorporation, offering legal protection to minority shareholders who believe their shares have been undervalued[16].

Bilateral Investment Treaties (BITs) and International Arbitration

When it comes to international investments, Indian shareholders venturing into foreign companies can also leverage Bilateral Investment Treaties (BITs) for protection[17]. These treaties, agreements between two nations, aim to support and safeguard investments made by one country's investors in another. They typically contain clauses safeguarding against expropriation, ensuring that investors, including minority shareholders, are compensated if their investments are seized by the host country[18]. Moreover, many BITs incorporate investor-state dispute settlement (ISDS) mechanisms, enabling investors to file complaints against host

[14] UK Companies Act of 2006, §994
[15] Delaware General Corporation Law, §265
[16] Welch, E.P. and Saunders, R.S., 2008. Freedom and its limits in the Delaware General Corporation Law. *Del. J. Corp. L.*, *33*, p.845.
[17] Kerner, A., 2009. Why should I believe you? The costs and consequences of bilateral investment treaties. *International Studies Quarterly*, *53*(1), pp.73-102.
[18] *Id.*

governments in international arbitration tribunals. Organizations like the United Nations Commission on International Trade Law (UNCITRAL) establish frameworks that offer legal channels for resolving disagreements that may arise in cross-border investments, especially those involving minority shareholders. For example, the UNCITRAL Arbitration Rules provide a structured procedure for resolving disputes, providing an impartial platform where shareholders can seek justice. Nevertheless, the efficacy of these international measures significantly relies on their enforcement and the legal landscape of the host nation. While BITs and arbitration frameworks can offer a level of protection, the ability of Indian shareholders to assert their rights successfully often depends on the legal framework of the investment location[19]. Some countries may possess weak enforcement mechanisms or legal systems skewed towards local majority shareholders, posing challenges for minority shareholders to achieve equitable outcomes.

Gaps in International Protections

There are gaps in international protections that can impede minority shareholders in cross-border investments. While national and international frameworks exist, they may not seamlessly function for these shareholders. Indian shareholders may encounter challenges in utilizing the protections provided by international treaties or arbitration bodies, as these mechanisms often demand substantial financial and legal resources[20]. Moreover, not all foreign jurisdictions provide the same level of safeguard as India or Western jurisdictions such as the UK or the U.S. For example, in countries where corporate laws are less developed or skewed in favor of majority shareholders, Indian minority investors may face difficulties in contesting squeeze-outs or other actions that undermine their interests.[21]

Legal Ambiguity in Jurisdictional Protection

The involvement of companies in foreign jurisdictions introduces considerable legal uncertainties for Indian shareholders, particularly concerning their entitlements and safeguards as minority investors. In India, the Companies Act of 2013 establishes robust protections to shield minority shareholders from unjust practices like oppression and mismanagement.

[19] Bodea, C. and Ye, F., 2017. Bilateral investment treaties (BITs): The global investment regime and human rights. *British Journal of Political Science, Forthcoming*.
[20] Zhang, S., 2019. Human Rights and International Investment Agreements: How to Bridge the Gap?. *The Chinese Journal of Comparative Law*, *7*(3), pp.457-483.
[21] *Id.*

Specifically, Sections 241[22] and 242[23] grant minority shareholders the authority to recourse to the National Company Law Tribunal (NCLT) if they perceive that the company's operations are detrimentally impacting their interests. Remedial actions under these provisions encompass overseeing the company's operations, dismissing directors, or awarding compensation for losses incurred due to oppressive behavior[24].

Nevertheless, when a company is registered overseas, Indian shareholders often confront foreign regulations that may not offer equivalent levels of protection. This situation gives rise to a legal void in which Indian shareholders might encounter the threat of being marginalized by majority shareholders without ample legal avenues for redress.[25] In jurisdictions outside India, such as the U.S. and certain European nations, mechanisms for squeezing out minority shareholders can be activated with limited shareholder safeguards. For instance, despite Section 236 of the Companies Act, 2013 ensuring that minority shareholders receive equitable compensation if a majority shareholder secures 90% or more ownership, foreign statutes could permit such squeeze-outs with compensation mechanisms that devalue minority interests, thereby exposing shareholders to risk[26].

The legal ambiguity presents a significant challenge due to the diverse corporate governance standards prevailing in different jurisdictions. In certain regions, dominant shareholders enjoy significant flexibility to enforce decisions that might compel minority shareholders to divest their holdings at a reduced valuation. Contrasts between the corporate regulations in India and those in other countries emphasize the necessity for alignment. Indian investors risk losing the safeguards provided by Sections 241 and 242 of the Companies Act when engaging in enterprises established in nations with less robust protections for minority stakeholders[27]. This discrepancy exposes a lacuna in global corporate legislation, where the rights of minority shareholders lack consistent safeguarding beyond national boundaries.

An opposing viewpoint suggests that minority shareholders ought to be cognizant of the

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[22] Companies Act of 2013, §241
[23] Companies Act of 2013, §242
[24] Calori, R., Lubatkin, M. and Very, P., 1994. Control mechanisms in cross-border acquisitions: An international comparison. *Organization studies*, *15*(3), pp.361-379.
[25] Why we need to protect minority shareholders, World Economic Forum, https://www.weforum.org/agenda/2015/10/why-we-need-to-protect-minority-shareholders/.
[26] Vikramaditya S. Khanna & Umakanth Varottil, Regulating squeeze outs in India: A comparative perspective SSRN(2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2479678.
[27] Dahiya, S.B. and Gupta, D., 2001. Foreign investment and issues of corporate governance in India.

associated risks when investing in foreign entities. Shareholders are expected to undertake thorough research and grasp the legal structure governing the corporation within its incorporating jurisdiction. Advocates of this perspective contend that if minority shareholders opt to invest in overseas ventures, they should anticipate encountering legal landscapes that might not offer the same level of protection as Indian statutes. However, this argument oversimplifies the intricate nature of international corporate governance and fails to acknowledge the power disparity between majority and minority shareholders. The nuances of corporate law in foreign jurisdictions can be opaque, leaving minority shareholders, especially those not well-versed in foreign legal systems, unaware of the potential risks involved. Legal frameworks governing corporations can vary significantly, making it unrealistic to expect minority shareholders to navigate these complexities independently without proper alignment of international standards. The robust protections offered by Indian law under Sections 241, 242, and 236 signify an acknowledgment of the vulnerability of minority shareholders. Such safeguards should be extended to cross-border investments to ensure that minority shareholders receive adequate protection beyond national boundaries[28]. While investing in foreign firms entails risks, the absence of harmonized international legal standards places minority shareholders in a precarious position. Without universal legal safeguards, majority shareholders may exploit legal loopholes to sideline minority interests without offering fair compensation, compromising the fundamental principles of fairness and justice crucial to effective corporate governance.

Lack of Uniform Standards

One critical challenge in safeguarding minority shareholders in cross-border investments lies in the lack of consistent international standards. The expansion of businesses into global markets leads to operations and establishment in various legal systems, each governed by distinct laws. This diversity can greatly impact minority shareholders, especially when investing in foreign firms subject to governance regulations that may lack strength or exhibit partiality towards majority stakeholders. The decentralized legal landscape globally, lacking a universally acknowledged and enforceable framework, exposes minority shareholders—like Indian investors—to the risk of unjust actions, like squeeze-outs.

[28] Daude, C. and Fratzscher, M., 2008. The pecking order of cross-border investment. *Journal of International Economics*, *74*(1), pp.94-119.

The OECD Principles of Corporate Governance are widely recognized as a leading framework for promoting transparency, fairness, and accountability in corporations[29]. However, it is important to note that these principles are not legally binding and are intended to serve as guidelines rather than enforceable rules. They aim to encourage corporate governance reforms at a national level, but they do not have the necessary legal authority to ensure adequate protections for minority shareholders in cross-border situations.Similarly, regional treaties that focus on fostering investment and trade cooperation may also fall short when it comes to providing specific and enforceable safeguards for minority shareholders, despite their aim of promoting investor rights. This is particularly evident in countries with emerging markets, where minimal corporate governance standards may be adopted to attract foreign investment. In such environments, majority shareholders often hold significant power, while protections for minority shareholders may be lacking or ineffective.

Without internationally harmonized standards, minority shareholders in India, for example, may find themselves subjected to corporate laws that prioritize the interests of majority shareholders, leaving them with limited options to challenge decisions that negatively impact their own interests.

Exploitation of Legal Loopholes

The lack of consistency in legal frameworks across different jurisdictions presents opportunities for dominant shareholders to take advantage of legal loopholes. In regions with less stringent corporate governance regulations, majority shareholders can employ squeeze-out tactics to compel minority shareholders to sell their shares below market value.[30] While these actions may be rationalized as enhancing corporate efficiency or facilitating restructuring, they ultimately diminish the rights of minority shareholders, often leaving them with limited legal recourse in such environments. In contrast, Indian legislation, specifically Section 236 of the Companies Act, 2013, mandates that if a majority shareholder holds 90% or more of a company, minority shareholders must be offered a fair value for their shares in any squeeze-out situation[31]. This statutory provision acts as a crucial safeguard against the exploitation of minority shareholders within the Indian context. Nevertheless, when these same shareholders

[29] Gordon, K., 2001. The OECD guidelines and other corporate responsibility instruments: a comparison.
[30] Vikramaditya S. Khanna & Umakanth Varottil, Regulating squeeze outs in India: A comparative perspective SSRN(2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2479678.
[31] Bhardwaj, S. and Dasgupta, A., Critical Analysis of Section 236 of the Companies Act, 2013.

invest in foreign entities, they may forfeit these protections and become subject to systems where majority shareholders can impose terms with minimal supervision. Some argue that each country has the right to establish its own corporate laws based on its unique economic, political, and social context. According to this view, imposing uniform international standards on shareholder rights would infringe upon national sovereignty, limiting a country's ability to regulate its own corporate environment and prioritize local economic interests.

Respecting national sovereignty is paramount; however, the growing global interconnectedness of business underscores the importance of establishing fundamental international safeguards to promote equity in transnational investments. Absence of these safeguards exposes minority shareholders, especially those hailing from developing nations such as India, to potential exclusion or oppression by dominant shareholders in regions with less robust corporate governance structures. It is imperative to harmonize national sovereignty in corporate legislation with the adoption of universal norms that safeguard minority shareholders from exploitation.

The Tata Sons v. NTT Docomo[32] (2016) case is significant concerning minority squeeze-outs in cross-border investments, demonstrating the intricate challenges Indian minority shareholders may confront when asserting their rights internationally. NTT Docomo, a minority shareholder in Tata Teleservices, invoked its exit option from the joint venture due to Tata Teleservices' failure to meet specified performance targets. Despite a favorable arbitration decision, Tata Sons invoked Indian foreign exchange regulations to stall the payment, highlighting the obstacles encountered by minority shareholders in enforcing agreements across borders. This case unveils the broader issues of jurisdictional conflicts and regulatory hurdles that complicate the rights of Indian shareholders in foreign companies. Moreover, the case emphasizes the necessity of having robust contractual safeguards, including exit clauses and equitable valuation mechanisms, crucial for shielding minority shareholders from unjust exclusion. NTT Docomo's pre-arranged exit plan underscores the significance of establishing these mechanisms proactively, especially in engagements involving foreign jurisdictions where local laws may not provide equivalent protections. For Indian shareholders entangled in squeeze-out situations overseas, the Tata-NTT Docomo case serves as a model of how contractual provisions and legal

[32] Tata Sons v. NTT Docomo (2017) 7 SCC 1.

battles could be impeded by regulatory landscapes, necessitating meticulous planning and legal foresight.

The Need for Harmonization

The absence of coordinated international standards leads to uneven protection for minority shareholders based on the incorporating jurisdiction. In nations with strong corporate governance frameworks like the UK or the U.S., minority shareholders enjoy more avenues to contest injustices, including resorting to legal channels within well-established judicial systems[33]. Conversely, in other regions, especially in emerging economies, minority shareholders may encounter substantial obstacles in challenging squeeze-outs due to underdeveloped legal structures or bias favoring majority stakeholders.

Standardizing shareholder rights globally could mitigate these disparities. A consistent international framework establishing minimum safeguards for minority shareholder interests, irrespective of the incorporating jurisdiction, could ensure equitable treatment and adequate compensation for minority shareholders in squeeze-out scenarios. This framework might encompass enforceable guidelines preserving minority shareholders' rights to equitable valuation, voting privileges, and the capacity to contest decisions favoring majority interests disproportionately. Furthermore, such a framework could facilitate international arbitration or accessible legal avenues for minority shareholders, enhancing the efficacy and affordability of dispute resolution mechanisms currently in place[34].

Detractors of harmonization frequently argue that global standards could impose rigid regulations that hinder innovation and adaptability in corporate governance. They posit that businesses across different nations encounter diverse obstacles, suggesting that universal regulations may lead to inefficiencies or excessive control[35]. While acknowledging the uniqueness of governance challenges in each country, proponents of harmonization emphasize that the advantages outweigh the potential drawbacks. Establishing a foundational level of safeguards would not necessarily impede national governance advancements but rather ensure that all shareholders, irrespective of origin or registration jurisdiction, receive essential

[33] Martinez, I. and Serve, S., 2011. The delisting decision: The case of buyout offer with squeeze-out (BOSO). *International Review of Law and Economics*, *31*(4), pp.228-239.
[34] *Id.*
[35] Calori, R., Lubatkin, M. and Very, P., 1994. Control mechanisms in cross-border acquisitions: An international comparison. *Organization studies*, *15*(3), pp.361-379.

protections. Moreover, standardized norms could still permit leeway for domestic laws to tackle local issues, if they uphold essential values such as equity, openness, and safeguarding minority shareholders. This strategy presents a wellrounded approach, fostering both global investor trust and the robustness of indigenous corporate governance frameworks.

Suggestions for Strengthening Protections

To enhance safeguards for minority shareholders in cross-border investments, a series of pivotal reforms are imperative. Initially, the standardization of global corporate governance norms is crucial to guarantee that all jurisdictions uphold fundamental protections, such as equitable valuation in squeeze-outs and the ability to contest corporate resolutions. This objective could be realized through the implementation of mandatory international agreements or regulations overseen by entities like the WTO or IOSCO. Furthermore, Bilateral Investment Treaties (BITs) should be broadened to explicitly safeguard minority shareholders, granting them easier and more cost-effective avenues for resolving conflicts. The establishment of a specialized international arbitration institution dedicated to handling disputes involving minority shareholders, characterized by reduced expenses and simplified processes, would greatly enhance the accessibility of legal recourse for minor investors.

In addition, emerging markets should consider revising local corporate governance laws to boost transparency, reinforce voting rights, and guarantee fair treatment for minority shareholders. Oversight by independent watchdogs could effectively supervise corporate activities to prevent any misconduct. Enhancing education and raising awareness about shareholder rights would further empower minority investors to safeguard their interests and identify infringements on their rights. These comprehensive reforms aim to bridge existing international protection loopholes and secure equitable treatment for minority shareholders, irrespective of the company's jurisdiction. Implementing these strategies would enable India to cultivate a more just environment for minority shareholders, safeguarding their rights and interests.

Conclusion

The protection of minority shareholders, particularly in cross-border investments, is a crucial concern in today's global business environment. While the Companies Act, 2013, offers significant safeguards for minority shareholders in India, these protections may not always apply in foreign jurisdictions, exposing Indian shareholders to potential exploitation during the company formation stage. Case studies like Tata Sons v. NTT Docomo underscore the legal and regulatory hurdles that minority shareholders could encounter when asserting their rights overseas. Harmonizing international corporate governance standards is vital to ensuring consistent protection for minority shareholders worldwide. Implementing reforms such as expanding Bilateral Investment Treaties (BITs) and establishing specialized arbitration mechanisms are crucial steps toward achieving fair outcomes for minority shareholders on a global scale. Furthermore, educating minority shareholders about their rights and the associated risks of foreign investments will empower them to protect their interests effectively in an interconnected global economy.