MINORITY SHAREHOLDER ACTIVISM AND THE CASE FOR THE APPLICATION OF THE BUSINESS JUDGMENT RULE IN INDIAN JURISPRUDENCE

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ABSTRACT

This paper examines the issue of minority squeeze-outs in the context of mergers with relevant legal provisions given in The Companies Act, 2013, where majority shareholders often seek to eliminate minority stakes to gain full control over a company. This paper further tells how the legal framework addresses or fails to address the issue, while also seeing the concept of Business Judgement Rule in India which gives the majority shareholders the wide stance of proving to be acting in good faith while making decisions for the company, while such transactions are often justified under business efficiency they frequently raise concerns about fairness and the protection of minority shareholder rights and also discusses how courts interpret prejudice and fair value. It further delves into a case study which specifically focuses on Section 66 of the Companies Act, 2013. The paper concludes by identifying legislative gaps in the provisions of the act and inconsistencies in the cases and finally proposes directions to reform.

Keywords: Minority Shareholders, Business Judgement Rule, squeeze outs, The Companies Act, 2013, National Company Law Tribunal.

I. INTRODUCTION

The Business Judgement rule is a concept given by the USA court. It is a concept to protect the directors of the company for the decisions made in good faith without any dishonest intention presuming it to benefit the members of the company in such a case they are protected by class suit actions filed against them by the members or shareholders of the company if they are not satisfied with the changes made. The rationale being that in an inherently risky global business environment, the Board should be allowed to take business risks without the constant fear of lawsuits. In the celebrated case of *Aronson v. Lewis*, the Delaware Supreme Court was of the view that:

"The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a). It is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[1]

While Section 245 of the Companies Act, 2013 talks about class action being filed by the members of the company if they think the decisions are taken in a manner prejudicial to the interests of the company or are outside the scope of its memorandum or articles of association they can file a suit before the National Company Law Tribunal on behalf of the members or depositors of the company.

Though there haven't been many cases where members or promoters have brought suit against the company but in the case of *Miheer H Mafatlal v. Mafatlal Industries 1996* the Supreme court said that they would not interfere in the decisions of the company provided that the board of directors have taken decisions acting in good faith and were just fair and reasonable taking a commercial decision for the company.[2]

II. MINORITY SHAREHOLDERS AND SHAREHOLDER ACTIVISM

A. Who Are Minority Shareholders?

The term "minority shareholder" is not defined under the Companies Act, 2013 and,

[1] Aronson v. Lewis, 473 A.2d 805 (1984).
[2] Bharat Vasani, The Business Judgment Rule: The Indian Context, India Corp. L. Blog (Dec. 20, 2023, 10:00 AM), https://corporate.cyrilamarchandblogs.com/2023/12/the-business-judgment-rule-the-indian-context/

accordingly, does not carry the status of a legislative term Minority Shareholders are people holding less shares in a company[3].

The closest legislative approximation appears in Section 151of the Companies Act, 2013, which, for the limited purpose of small shareholder director appointments, defines a "small shareholder" as a person holding shares of a nominal value not exceeding twenty thousand rupees[4].

Academic literature offers a broader characterisation. Gillan and Starks defined active shareholders as those investors who are dissatisfied with some aspect of a company's management or operations and try to bring about change within the company without a change in control[5].

B. Minority Shareholder Activism: Concept and Significance

Minority Shareholder activism refers to the collective opposition or proactive efforts taken by the shareholders of a company regarding new policy introduction or new changes brought by the promoters of the company which they percieve as contrary to their interest in the company's long-term value.

A notable illustration of the efficacy of minority shareholder activism in India arose in year 2014, when India's largest passenger car maker Maruti Suzuki faced pressure from minority shareholders. Maruti put forth the proposal to purchase vehicles from its related entity Suzuki Motor's Gujarat plant, however, the proposal was opposed by the minority shareholders as it would be detrimental to the interests of Maruti and eventually forced Maruti to change the terms of the proposal[6].

III. MINORITY SHAREHOLDER RIGHTS AND THE BUSINESS JUDGMENT RULE IN THE CONTEXT OF MERGERS

A. The Legal Grey Area: Section 245 vis-à-vis the Business Judgment Rule

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[3] Shashank Chaddha, Merger and Acquisition in India: Trends on Squeeze outs and the Rights of Minority Shareholders, 2 J. ON GOVERNANCE 42 (2017)

[4] Companies Act, 2013, § 151 (India)

[5] Gillan and Starks (2007, p. 55)

[6] Souvik Ganguly, Impetus to Shareholder Activism in India – Invesco v. ZEE Case, ACUITY LAW (Apr. 21, 2022), https://acuitylaw.co.in/impetus-to-shareholder-activism-in-india-invesco-v-zee-case/.

While a merger is in process the majority can choose to squeeze out the minority by justifying that this helps the business to function efficiently, this typically occurs when retaining minority shareholders is seen as a barrier to operational decisions, strategic changes or complete control, while this may disregard the rights of minority shareholders but because of the Business Judgement Rule the promoters are immune to any such class suit being filed by the minority. This brings in confusion among the people as there is a legal grey area which gives rights to minority under Section 245 of The Companies Act, 2013 while also the majority's decision is shielded by the Business Judgement Rule, courts may be hesitant to entertain challenges from minority shareholders, unless there's evidence of fraud, bad faith, oppression or mismanagement. Though class suits are available it is very hard to prove that the promoters acted otherwise.

The case of *Dale and Carrington Investment (P) ltd. v. R.K. Prathpan 2004* was a landmark judgement which dealt with oppression and mismanagement and also highlighted the importance of fiduciary duties and the need for adherence to proper procedures in corporate actions. It serves as a reminder that directors must act in good faith and in the best interests of the company and its shareholders, ensuring transparency and fairness in their decisions and actions.[7]

B. Squeeze-Outs in the Context of Mergers

A merger within the meaning of Section 233 of the Companies Act, 2013 talks about merger or amalgamation of certain companies. Merger of a company means when two companies of similar size come together to form one legal entity. When two companies merge, the majority shareholders often squeeze out the minority shareholders in order to gain full control of the business not wanting to deal with the minority and for effective and smooth functioning of the company.

Shareholder Squeeze Out is a process where the majority shareholders force the minority shareholders to give up or sell their shares. This is given in Section 235, 236 and Section 66 of The Companies Act, 2013. Section 236 of The Companies Act, 2013 was incorporated under the recommendation of *Dr. J.J. Irani Committee Report on Company Law*, *2005* for the reason being that the law should enable companies to purchase the stake of minority

[7] Dale & Carrington Inv. (P.) Ltd. v. P.K. Prathapan & Ors., AIR 2005 S.C. 1624; (2005) 1 S.C.C. 212 (India) (Sept. 13, 2004)

shareholders in order to prevent exploitation of such shareholders where a promoter has bought back more than 90% of the equity. Such purchase should take place on the basis of a fair offer. Appropriate valuation rules for this purpose should be prescribed, or, the last known price prior to delisting, could be made the benchmark for such acquisitions[8]. While it talks about rights of majority it also says to provide appropriate value to the minority.

i. Section 235: Compulsory Acquisition of Dissenting Shareholders

Section 235 of The Companies Act, 2013 talks about *power to acquire shares of shareholders dissenting from scheme or contract approved by majority*. [9]It allows a compulsory acquisition from minority shareholders during a merger, when a company makes an offer to buy shares of another company and if 9/10th or 90% of the shareholders or more agree within four months then the transferee can force the minority shareholders to sell their shares. After these four months have passed and within the next two months the transferee company can send a notice to those who did not agree to sell their shares, asking them to sell their shares too. Once the notice has been given the shareholders have the right to object and go to the tribunal within one month of receiving notice. If the National Company Law Tribunal does not interfere or if shareholders do not object, the transferee has the right to acquire the shares of them as they did previously.

If the tribunal does not stop and if one month has passed the transferee company must send a copy of notice and a share transfer form to the transferor company. The transferee company must also pay the price for those shares to the transferor company. Then the transferee company is officially registered as the new owner of those shares by the transferor company. The transferor company must inform the dissenting shareholders that their shares have been transferred and the payment for their shares has been received and is available for them this should all be done within a month. Dissenting shareholders can approach the National Company Law Tribunal using Section 235(2) and section 235(3) of The Companies Act, 2013.

ii. Section 236: Purchase of Minority Shareholding

Section 236 (1) says that if a person or group of people owns 90% or more of a company's

[8] Vinod Kothari Consultants, MCA Issues Rules to Squeeze Out Minority Shareholding Held in Dematerialized Form, VINOD KOTHARI CONSULTANTS (Dec.2020), https://vinodkothari.com/2020/12/mca-issues-rules-to-squeeze-out-minority-shareholding-held-indematerialized-form/#_ftn1.

[9] Companies Act, 2013, § 235 (India).

shares whether by buying, merging, exchanging shares, converting other securities or any other reason they must inform the company that they plan to buy remaining shares from the minority shareholder.

Section 236(2) of The Companies Act, 2013 says the majority owner must make a formal offer to buy the shares of minority price of which would be decided by the registered valuer who follows legal rules to ensure that the price remains fair.

Section 236(3) of The Companies Act, 2013 says that minority shareholders also have the right to approach to the majority and ask them to buy their shares at that same value price of the shares, whether the company is listed or unlisted the price must be determined by Rule 27 of The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The valuation must be done by a registered valuer under Section 247 of The Companies Act, 2013 and as per The Companies (Registered Valuers and Valuation) Rules, 2017[10].

iii. Section 66: Reduction in share capital

Section 66 of the Companies Act, 2013 allows a company with share capital to reduce its share capital, but only by following a specific legal process. This reduction can be done in different ways, such as canceling unpaid share capital that cannot be recovered due to loss, or returning excess capital that the company no longer needs.

To begin the process, the company must pass a special resolution and then apply to the Tribunal for approval. The Tribunal will notify the Central Government, the Registrar of Companies (ROC), the Securities and Exchange Board of India (SEBI) in the case of listed companies, and the company's creditors, giving them three months to raise any objections. Additionally, the company must ensure that the accounting treatment of the capital reduction follows the accounting standards prescribed under Section 133 of The Companies Act, 2013 a certificate from the company's auditor confirming this must be submitted. Only after the Tribunal is satisfied that the reduction will not harm the public or creditors it will approve the reduction.

Once approved, the company must file a certified copy of the Tribunal's order and the approved minute with the ROC within thirty days, after which the ROC will register it and

[10] Anu Tiwari et al., Minority Squeeze-Out Under Our Company Law – Is It a Legislative Policy Dilemma?, Cyril Amarchand Mangaldas (Dec. 13, 2021, 9:30 AM),Minority squeeze-out under our Company Law – Is it a legislative policy dilemma? | India Corporate Law

issue a certificate. However, any company that has defaulted in repaying deposits or interest on those deposits is not allowed to apply for reduction of share capital under this section.[11]

Case Law - Obo Bettermann case

S. Gopakumar Nair & Anr. vs Obo Bettermann India Pvt. Ltd. & Anr., 2014

In the Obo Bettermann case, the majority shareholders (who held 99.64% of the shareholding of the company) tried to compulsorily acquire the shares of the minority, by issuing notices under Section 236 of The Companies Act, 2013.

The National Company Law Appellate Tribunal held that Section 236 of the said act can be invoked by the majority shareholders only if either of the 'events' specified under Section 236(1) of The Companies Act, 2013 have taken place, which implies that the majority shareholder should hold or acquire minimum of 90% of the shareholding "by virtue of an amalgamation, share exchange, conversion of securities or for any other reason".

It was held that the words "for any other reason" should be read ejusdem generis (of the same kind) with the preceding words and would only include 'events' that are similar to an amalgamation, share exchange and conversion of securities. The National Company Law Appellate Tribunal had also observed that while Section 235 of The Companies Act, 2013 deals with the acquisition of shares from dissenting shareholders in certain specified situations, Section 236 of the Companies Act, 2013 deals with the acquisition of shares from assenting shareholders, if either of the 'events' specified in Section 236(1) of the said act have taken place[12].

It should be noted that though there is provision in respect to protection of minorities under section 235(2) and section 235(3), of the said act they should not be left stranded. They should be given fair value of shares which they invested for, squeezing out the shareholders might also mean denying them the right to their property.

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[11] Taxmann, Restructuring Share Capital: Understanding Section 66 of the Companies Act, 2013 | Experts' Opinion, Taxmann (June 26, 2023),Restructuring Share Capital: Understanding Section 66 of the Companies Act, 2013 - Taxmann

[12] Anu Tiwari et al., Minority Squeeze-Out Under Our Company Law – Is It a Legislative Policy Dilemma?, Cyril Amarchand Mangaldas (Dec. 13, 2021, 9:30 AM), Minority squeeze-out under our Company Law – Is it a legislative policy dilemma? | India Corporate Law

The Question of Prejudice and Fair Value

In *Cadbury India Limited* judgment, certain principles had been established to ascertain whether a selective share capital reduction would be fair. These principles made it necessary to fairly evaluate share prices, by taking into account previous share prices and offers. Nonetheless, the same judgment also stated that simply receiving a smaller monetary compensation, than what a shareholder may want, would not constitute "prejudice." Only forcing "a class of shareholders" to sell their shares at a price which is far lesser than what would be considered reasonable and just would constitute prejudice.[13]

Definition of prejudice is very subjective and may vary from shareholder to shareholder. As a result companies are not required to give their shareholders the highest return on their investment as long as they ensure that the amount doesn't amount to legal prejudice. This allows companies to offer payouts, that while technically fair may still be short of what shareholders expected. It creates disadvantage for the minority shareholders in receiving the maximum return depriving them of their fair share of value. The fact that companies are merging and the majority shareholders want to acquire the whole company does not exempt the majority from offering the minority shareholders compensation that barely meets the minimum standard requirement.

IV. CASE STUDY- PHILIPS CO-OPERATIVE GROUP HOUSING VS D.S. KUNDU

On 19th September 2024, the Kolkata Bench of the National Company Law Tribunal (NCLT) rejected a request made by Philips India Limited to reduce its share capital under Section 66 of the Companies Act, 2013. Philips has two majority shareholders *Koninklijke Philips N.V. and Philips Radio B.V.* who together own about 96.13% of the company. The remaining 3.87% is held by public shareholders, and 0.71% of that is owned by the Investor Education

Protection Fund (IEPF). Philips was delisted from the Bombay Stock Exchange on February 16, 2004, and at that time, it offered its shareholders a chance to exit by selling their shares at INR 105 per share within a year. However, some public shareholders chose to keep their shares even after the delisting.

[13] Souvik Ganguly, Impetus to Shareholder Activism in India – Invesco v. ZEE Case, ACUITY LAW (Apr. 21, 2022), https://acuitylaw.co.in/impetus-to-shareholder-activism-in-india-invesco-v-zee-case/.

In the current situation, Philips filed a request under Section 66 of the Companies Act,2013 to cancel and remove the 3.87% shares that are not held by the majority shareholders, trying to remove the remaining public shareholders. According to Philips, the minority shareholders who continued to hold their shares even after the company was delisted in 2004 have been stuck with an investment that they can't easily sell, this is called holding an illiquid asset. Philips said that these shareholders had sent many requests to the company, saying that they were facing problems because they couldn't sell their shares and wanted a way to get money for them. To help these shareholders and give them a chance to get liquidity for their shares, Philips proposed a capital reduction plan where it would cancel the remaining public shareholding and pay the shareholders a good price. The company even offered to pay more than the fair market value of the shares. As per a valuation report and a fairness opinion, Philips' board calculated the fair value of each share to be INR 740, and they proposed to pay INR 915 per share, which is a 24% premium over the fair value.

The value was determined using a method called the Discounted Cash Flow (DCF) approach, which looks at the company's expected future earnings to estimate today's value. After getting approval from 99.58% of its shareholders, Philips filed an application with the NCLT (Kolkata Bench) to approve the capital reduction. However, some minority shareholders disagreed and filed formal objections with the National Company Law Tribunal against this proposal under Section 66 of The Companies Act, 2013. The NCLT (Kolkata Bench) looked at Section 66 of the said Act which allows a company to reduce its share capital only in specific cases like when shares are not fully paid, when the company has lost capital that's not backed by assets, or when it has more capital than it needs.

But in this case, Philips wanted to reduce its capital by removing minority shareholders mainly to give them cash (liquidity) and to save on administrative costs. The NCLT said these were not valid reasons under Section 66 of The Companies Act, 2013. *It also pointed out that Section 66 does not allow capital reduction if it amounts to a buy-back,* and what Philips was doing was basically buying back shares from minority shareholders, which isn't allowed here.

On the matter of how the shares were valued, NCLT said that although Philips used the DCF (Discounted Cash Flow) method which made sense for a company like Philips', the minority shareholders' valuation didn't clearly explain which companies were being used for comparison, and also Philips' unique business model made DCF more suitable than comparing with other companies. Finally, although the NCLT noticed a big difference between the valuations given by the two sides, it didn't dig deeper into that issue because the main reason for rejecting the application was that Philips' proposal didn't fit into any valid ground under Section 66 of the said Act.

V. LEGISLATIVE GAPS AND INCONSISTENCIES

A critical analysis of the existing statutory framework reveals several significant lacunae that operate to the detriment of minority shareholders.

Absence of a Clear Benchmark for Fair Value -While Section 235 and 236 of The Companies Act, 2013 allows majority shareholders to acquire minority shares there is no clear benchmark on fair value given to the minority even when premium may be given as seen in case of Philips cooperative. Terms like prejudice are very subjective and can cause problems to minority shareholders proving oppression or undervaluation.

Asymmetric Access to the NCLT-Section 235 of The Companies Act, 2013 while talking about majority shareholders being able to acquire shares from minority shareholders, Section 236 of The Companies Act, 2013 talks about minorities being able to decide whether or not to give up their shares but does not give any way to the minority to approach the NCLT.

Overly Broad Application of the Business Judgment Rule-The Business Judgement Rule further discourages courts from interfering in matters of company unless there is fraud making it harder for the minority to prove otherwise.

Misuse of Section 66- The company can misuse Section 66 of the said act as in the case of Philips, the court rejected their application under Section 66 as the company was buying back the shares from the minority which is not in accordance with capital reduction given. The minority, post delisting are often left with illiquid assets which traps their investment for years.

VI. CONCLUSION

The Business Judgment Rule protects directors when they act in good faith and make decisions in the interest of the company. However, Section 245 of The Companies Act, 2013 empowers shareholders to file class action suits if such decisions are prejudicial. Minority shareholder activism, though not legislatively defined, plays a very important role holding companies accountable. The Maruti Suzuki case highlights how shareholder pressure can influence and reshape corporate decisions. While the Business Judgment Rule offers protection to promoters, it must not overlap the legitimate concerns of minority shareholders. While the Companies Act, 2013 provides mechanisms like Sections 235, 236 and 66 for mergers and share acquisitions, they often favor majority shareholders. Although provisions exist to protect minority interests, proving unfair treatment remains difficult.

The Cadbury and Obo Bettermann case shows that fairness is often measured by minimal legal standards rather than equitable outcomes. This creates a grey area where minority shareholders may be forced out with compensation that feels inadequate or less than what they expected. Therefore, stronger enforcement of fair valuation and fiduciary duties is important to ensure true protection of minority rights.

The NCLT's rejection of Philips India's capital reduction proposal under Section 66 of the said act highlights that liquidity concerns or administrative convenience do not qualify as valid grounds for share capital reduction. The Tribunal emphasized that Section 66 of the said act cannot be used as a means for buying back minority shares. Despite Philips offering a premium price using the DCF method, the motive behind the reduction was found inconsistent with the intent of the law. The judgment protects minority shareholders from forced exits under the form of capital restructuring. It reinforces the need for companies to strictly adhere to statutory grounds when attempting such reductions.