AN ANALYSIS OF MINORITY SQUEEZE-OUT IN CORPORATE AMALGAMATIONS: LEGAL FRAMEWORKS AND JURISDICTIONAL INSIGHTS

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ABSTRACT

This research takes a close look at "minority squeeze-out" methods used during company mergers. In these cases, major shareholders can force minor shareholders to sell their shares. The study carefully examines the legal issues and challenges with these methods. History shows that laws have often ignored the complex problems of minority squeeze-outs. Lawmakers have given major shareholders the controversial power to "buy out" minor shareholders' interests. Focusing on Sections 235-236 of the Companies Act 2013, this paper analyzes various legal cases that have shaped how these laws are interpreted and applied. It investigates how courts have defined the scope and enforceability of squeeze-out mechanisms, providing crucial judicial insights into the balance of power within corporate structures.

Further, the research transcends national boundaries to scrutinize comparable legislation in different nations. This cross-border examination aspires to unveil intricate revelations that could enlighten and potentially reshape the prevailing legislative terrain in India. The comparative analysis pursues not merely comprehending the legal machinery of minority exclusion, but also assessing its equity and efficacy in safeguarding minority shareholder rights while facilitating Merger and Acquisition. This study aims to make a major impact on the discussion about improving company laws. It suggests ways to create a fairer balance between the power of the majority and the protection of the minority during company mergers and takeovers.

Keywords: Minority squeeze-out, Major shareholders, Minor shareholders, Companies Act 2013, Corporate structures, Shareholder rights

1. Introduction:

1.1. Overview:

When a company merges with another firm, the controlling shareholders sometimes use their power to force minority owners to sell their shares at a set price. This is called a minority squeeze-out. Minority shareholders may feel this benefits the controlling owners more than themselves. Squeeze-outs let the controlling shareholders gain full ownership of the combined company. In India, common methods for squeeze-outs include mandatory buyouts, restructuring plans, and reducing a company's capital stock. Reducing capital is most widely used since it provides minimal protection for minority owners. To better safeguard minority shareholders' interests in India, policymakers could look at practices in the United States, Germany, and the United Kingdom. These nations have stronger regulations defending the rights of minority investors.[1]

Large companies sometimes join forces. There is a process called minority squeeze-out where the owners of a majority stake can make the owners of a minority stake sell their shares at a set price. This squeeze-out process is a significant part of corporate oversight and the balance of power among shareholders. In India, this practice presents both difficulties and opportunities for the legal system. It is a complex topic with crucial considerations for corporate laws.

People who own fewer shares in a company are called minority shareholders. The controlling shareholder has more shares. This makes it hard for minority shareholders to be part of decision-making. This is where the Rule of Majority comes in. The Rule of Majority means that the majority shareholders get to decide what's best for the company. This rule was first the term "squeeze-out" usually refers to the mandatory acquisition of the equity shares held by the minority in exchange for a "fair" price determined in accordance with the provisions of the Companies Act, 2013 read with the Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016.

A minority shareholder denotes an individual holding no more than 10% of a company's total shares. This threshold aligns with Section 235 of the Companies Act, 2013, which limits the

[1] The Law on Minority Squeeze-Out in India' Mondaq (06-05-2024) https://www.mondaq.com/india/shareholders/1199734/the-law-on-minority-squeeze-out-in-india.

definition of "dissenting shareholders" to those owning up to 10% of a firm's shares in cases of share acquisition.

Although this definition may seem to undermine minority shareholders' influence in corporate decision-making, the Companies Act, 2013 aims to safeguard their interests by curtailing the unchecked authority of majority stakeholders. The Act introduces measures to ensure minority voices are heard and their rights protected, fostering a balanced and equitable corporate governance framework.

The issue of whether an exchange of shares at a particular price could be deemed unjust or unequal emerged in the case of **Sandvik Asia Limited v. Bharat Kumar Padamsi**. In this case, it was observed that "once it is established that non-promoter shareholders are receiving a fair value for their shares, and they do not suggest that the amount being paid is insufficient, and the overwhelming majority of non-promoter shareholders have voted in Favor of the resolution, the Court would not be justified in withholding its sanction for the resolution.[2]

The Rule of Majority is a key legal concept established in the court case **Foss v. Harbottle**.[3] It states that decisions made by most shareholders must be respected. The court usually cannot interfere when the majority votes a certain way. This rule rests on a utilitarian view: that giving more power to the majority is best. However, lawmakers disagreed with this approach. To amend existing corporate laws, the Ministry of Corporate Affairs formed an Expert Committee in 2004. Their 2005 report aimed to better safeguard the rights of minority shareholders, among other goals. The Committee was headed by J.J. Irani and had pointed out the need to maintain a balance between the majority rule and the rights of the minority shareholders.[4]

1.2. Significance in merger and acquisition:

Minority shareholders, despite their smaller ownership stakes, play a critical role in maintaining corporate balance, ensuring ethical conduct, and supporting financial integrity. Their involvement is fundamental not only as a legal obligation but as an ethical cornerstone of corporate governance. Their protection is essential to avoid adverse consequences like eroded trust and reduced investment [5] Possible legislative changes are being suggested to give

[2] [1843] 67 ER 189.
[3] [1843] 67 ER 189.
[4] Ministry of Corporate Affairs, "Report of the Expert Committee on Company Law" (May, 2005).
[5] Arasi M and [K's last name], 'Protection of the Minority Shareholders in Company Law Regime' (2023) International Journal For Multidisciplinary Research https://doi.org/10.36948/ijfmr.2023.v05i06.9497.

more power to minority shareholders who have invested for the long term, in recognition of their part in promoting sustained concentration on corporate governance that will make management decisions to be in the best interest of the company over a long duration. This not just ensures equitability but also takes into consideration practical difficulties relating to equality among shareholders.[6] Ordinarily, although minority shareholders may be limited in their ability to influence company policy, they play a crucial part in corporate governance. Some of the statutory mechanisms, for example the right to disagree with some corporate moves, are meant for protecting these shareholders from some forms of tyranny that may be perpetrated by the majority and give them a chance to get a fair value for their investment during such times as when a company is making important decisions like mergers or acquisitions. [7]Also, enabling them exercise their voting power actively can lead to substantial decrease in agency costs as well as promote establishment of stronger financial markets.[8] In addition recent changes in legislation such as European Union laws on shareholders' rights seek to widen the role played by minority shareholders by doing away with barriers against activism on the part of shareholders generally while at once ensuring all shareholders are treated more equally which could potentially revolutionize how companies are run through increased activism by various groups of people holding parts of the share capital and different ideas on what should be done regarding this or that matter related to management and control of firms or businesses them further .[9]

2. Legal background:

Section 235 of the Companies Act, 2013 allows a company to buy shares from shareholders who do not support a plan or deal that most other shareholders agreed to. This rule works similarly to Section 395 of the old Companies Act from 1956. A company can purchase shares from shareholders who disagree with a scheme or contract if most of the other shareholders approved that scheme or contract.

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[6] Ginevri A, 'The Rise of Long-Term Minority Shareholders' Rights in Publicly Held Corporations and Its Effect on Corporate Governance' (2011) 12 European Business Organization Law Review 587-618 https://doi.org/10.1017/S1566752911400033.

[7] Wertheimer B, 'The Shareholders' Appraisal Remedy and How Courts Determine Fair Value' (1998) 47 Duke Law Journal 613-716 https://doi.org/10.2307/1372911.

[8] Solomon D, 'The Voice: The Minority Shareholder's Perspective' (2017) CGN: Controlling Shareholders (Topic)

[9] Rose C, 'The New European Shareholder Rights Directive: Removing Barriers and Creating Opportunities for More Shareholder Activism and Democracy' (2012) 16 Journal of Management & Governance 269-284 https://doi.org/10.1007/S10997-010-9140-7.

The law allows a process where one company (the transferee company) can acquire shares from another company (the transferor company). This process is initiated when the transferee company makes an offer to purchase shares from the transferor company's shareholders. If within four months, shareholders owning at least nine-tenths of the shares being transferred (excluding shares already owned by the transferee company or its subsidiaries) approve the offer, the transferee company can then give notice to any remaining dissenting shareholders. This notice, given within two months after the four-month period, informs the dissenting shareholders that the transferee company desires to acquire their shares as well. This legal provision facilitates consolidation of ownership when a substantial majority of shareholders have agreed to the transfer, while still protecting the rights of minority dissenting shareholde-rs.[10] Section 235, subsection 2 of India's Companies Act, 2013 states that if a notice is given, the acquiring company has one month to buy the dissenting shareholders' shares. However, the dissenting shareholders can apply to the National Company Law Tribunal to prevent this transfer.[11]

In the case of AIG (Mauritius) LLC v. Tata Tele Ventures, the court ruled that the 90% majority must consist of distinct individuals and different persons. This aligns with the law's purpose of overriding dissenting shareholders' interests only when the majority is truly separated from the offeror. The offeror and majority cannot be closely linked entities and should be substantially different.[12]

Shareholder activism is facilitated by Sections 235 and 236, which enable minority shareholders opposing a merger or takeover to get fair value for their shares through buyout. This approach may also be favourable to such investor groups since they can use it as an avenue for challenging strategic plans or blocking deals considered harmful. Furthermore, Section 230(11) combined with Regulations 3(5) & 3(6) gives more power to majority owners in private limited liability companies allowing them to undertake takeovers. However, activists may criticize this move as being undemocratic because they view it as a way through which those with financial muscle suppress others' voices in decision-making processes within organizations.

[10] The Companies Act, 2013 (Act 18 of 2013) s. 235(1).
[11] The Companies Act, 2013 (Act 18 of 2013) s. 235(2).
[12] 43 SCL 22943 Del 2003

Section 395A was added to the Companies (Amendment) Bill in 2003. This law aimed to control the process of buying up any leftover shares in a company. Although this law was never put into practice, it was suggested by the J.J. Irani Committee. The Committee said it should be used to create rules for buying shares owned by a small number of people. The Companies Act 2013, Section 236. It says if an acquirer gets 90% or more shares, they must tell the company they want to buy the remaining shares. If this happens through an amalgamation, share swap, converting securities, or any other way, the acquirer has to offer a price to minority shareholders. That price will be decided by a registered valuer as per the Companies (Compromises, Arrangements, and Amalgamations) Rules 2016.[13]

This rule ensures fairness for minority shareholders. When a company is taken over, the majority owner must give remaining shareholders a fair chance to exit at a proper value. The valuation is done independently to prevent exploitation. Such provisions protect small investors' interests when control of a company changes hands.

The Indian government has introduced a fresh approach for bigger shareholders in unlisted firms to acquire minority stakes. As per the notification on February 3, 2020, Section 230(11) together with Rules 3(5) and 3(6) of the Companies Rules allow majority holders with at least 75% shares to make an offer to buy out remaining shareholders. They can do so by filing an application with the National Company Law Tribunal.

Rule 80A lays down the process for such applications. It mandates submitting a registered valuer's report, safeguarding the minority investors' rights. This valuation ensures fair treatment and prevents exploitation of the minority shareholders at any cost. Further, subsection (12) of Section 230 attempts to balance this power of the majority by providing the party, aggrieved by the takeover offer, a remedy to make an application to the Tribunal. The ability of dissenting shareholders to seek redress from the NCLT provides a crucial check against potential mismanagement and oppression. This is particularly important in cases where the transaction might not adequately reflect the interests of all shareholders.

The case Cadbury answered one of the most important factors which is to be considered while acquiring minority shareholding is whether such shares are being purchased at a fair and equitable price and if not, can it be held to be in contravention with the right of minority and

[13] The Companies Act, 2013 (Act 18 of 2013) s. 236(1).

while answering this question the court established important guidelines for assessing whether a proposed scheme is acceptable. In considering approval, the court must verify that: (1) the scheme does not harm public interests; (2) the scheme is fair and reasonable; and (3) the scheme does not unfairly discriminate against or “prejudice” any shareholder group.[14]

"Prejudice" in this context means more than simply a shareholder receiving less than desired. It signifies a concerted effort to force a shareholder class to divest their holdings at an unreasonably low rate. Prejudice here implies discrimination, a strategy forcing an entire class to accept something inherently unjust. This oversight by the courts is crucial. It helps guarantee that situations where minority shareholders are forced out do not lead to biased results. These biased results could unduly benefit the majority group while harming the minority group.

Sections 235, 236, and 230 give more control to majority shareholders. They let these groups combine their shares to make company choices simpler. But the law also protects minority shareholders. They must get a fair price for their shares. And they can go to court if needed. Keeping a balance between small and large shareholders is important. This makes sure no group has too much power over the company.

The section 236 about minority shareholder rights during mergers and acquisitions. Sections 236(1) and 236(2) use the word "shall," making it mandatory for a person acquiring a 90% majority stake to offer to purchase the remaining shares. However, Section 236(3) uses the word "may," giving minority shareholders the choice to sell their shares at a fair price. This provides them with a reasonable opportunity to exit while balancing the interests of both majority and minority groups. Section 236 promotes transparency and fairness in corporate transactions by highlighting the majority shareholder's obligation to extend this offer to minorities.

Furthermore, Section 236(9) ensures that if the majority shareholder fails to acquire all minority shares, the rights of the remaining minority shareholders remain protected. This provision safeguards small investors, even when larger entities seek complete control. Additionally, Section 236(3) begins with "without prejudice to," suggesting it is an independent provision that potentially grants any minority shareholder—not just those holding 10% or less—a continuous 'put option' on the majority shareholder. This broadens the scope of

[14] Cadbury India Limited, In re, 2014 SCC OnLine Bom 4934.

protection and leverage for minority shareholders in corporate governance matters.[15] In this situation, we can also look to the Supreme Court's decision in A.P. State Financial Corporation v. Gar Re-Rolling Mills[16] for guidance. The Court noted that using the phrase "without prejudice to" in a law implies that the other provisions still apply. This phrase should not be used to make the other provisions unnecessary. The wording of Section 236(3) and the intent behind the law suggest that it is closely linked to the previous sections. A minority shareholder can only make a binding offer to sell their shares if the requirements in Sections 236(1) and 236(2) are met first.

3. Regulatory framework for minority squeeze in different jurisdiction:

3.1. United Kingdom:

In the United Kingdom, a buyer has some rights after making an offer to take over a company. One of these is the "squeeze-out" rule. If the buyer gets 90% or more of the shares, they can force the remaining shareholders to sell their shares. This gives the buyer full control of the company. It also makes it easier to manage and make decisions. Another right is selective capital reduction. This means the new owner can reduce the share capital. They might do this to give money back to shareholders or to cover losses. This changes how power is shared in the company and affects profits. [17]The legal framework, including the EU's Takeover Directive, ensures that these processes are conducted fairly, protecting minority shareholders through mechanisms like the squeeze-out and sell-out rights, which require fair compensation. This structure aims to balance efficient corporate control transfers with equity among shareholders.[18]

3.2. United States:

In the U.S., there are big differences between short-form and long-form mergers after a company makes a tender offer. If a bidder gets at least 90% of the target company's shares, they can do a short-form merger without needing more shareholder approval. This fast process allows for quick consolidation. But it raises worries about protecting minority shareholders.

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[15] Parliamentary Standing Committee on Finance, '57th Report on The Companies Bill, 2011' (15th Lok Sabha) 73.
[16] (1994) 2 SCC 647
[17] Alqobali H and Li D, 'The Consequence of Takeover Methods: Schemes of Arrangement vs. Takeover Offers' (2022) International Journal of Financial Studies https://doi.org/10.3390/ijfs10030069.
[18] Elst C and Steen L, 'Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-Out and Sell-Out Rights' (2009) 6 European Company and Financial Law Review 391-439 https://doi.org/10.1515/ECFR.2009.391.

They have limited options, like seeking appraisal rights if they think the merger terms are unfair.[19] On the other hand, if the 90% threshold is not met, a long-form merger is needed. This requires approval from most of the remaining shareholders. This method offers greater protection for minority interests. It involves them in the approval process and ensures more rigorous procedural fairness. Both approaches balance efficiency in corporate restructuring with the need for shareholder protection, impacting governance and shareholder value differently.[20]

3.3. European Union

The regulatory framework for mergers and Acquisition in European union is given in various directives including the third council directive on merger and acquisition and thirteen council directives on takeover.

1-The Third Council Directive's Articles 3 and 4 on Merger Regulations outline specific requirements for shareholder treatment in corporate consolidations. Whether through an acquisition or the formation of a new entity, these provisions mandate that all shareholders involved receive shares according to an exchange ratio approved by the boards and shareholders of each participating company. This legal safeguard ensures equitable equity distribution among all parties based on the mutually agreed-upon terms, fostering a fair and transparent merger process.

2- A takeover bid is a formal process where one company aims to gain control over another. The Thirteenth Directive has rules about this. Article 5 says that if a company wants to take control of a listed company, it must make an offer to buy shares from all the shareholders of the target company. This gives investors a fair chance to sell their shares if they want to. Article 15 goes further. If a company buys 90% or more of the voting shares through tender offers, it can force the remaining shareholders to sell their shares for a fair cash price. This helps create a clear ownership structure after the takeover. It may also help the new owner run the company more efficiently.

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[19] Steinberg M, 'Short-Form Mergers in Delaware' (2003) 27 The Delaware Journal of Corporate Law 489

[20] Iacono C, 'Tender Offers and Short-Form Mergers by Controlling Shareholders Under Delaware Law: The "800-Pound Gorilla" Continues Unimpeded - in Re Pure Resources, Inc., Shareholders Litigation' (2004) Corporate Governance: Actors & Players eJournal

The implementation of these directives is aimed at harmonizing the practices around mergers and acquisitions across the EU, creating a more integrated market. However, the actual application can be a bit contrasting due to the differing legal and corporate environments in the member states, which occasionally leads to critiques regarding the protection of minority shareholders and the effectiveness of these directives in maintaining a true single market for corporate control. [21]

[21] Papadopoulos T, 'The European Union Directive on Takeover Bids: Directive 2004/25/EC' (2008) Corporate Law: Practitioner eJournal (forthcoming)