M&A Hotline

March 11, 2010

COURTS RECONFIRM: SELECTIVE SQUEEZE OUT IS PERMISSIBLE

The Bombay High Court ("**Court**") in its recent decision in the case of Elpro International Limited, in re, (2009 4 Comp LJ 406 (Bom)) has reaffirmed that a selective reduction of share capital is permissible and not an act which is extraneous to the provisions of section 101 of the Companies Act, 1956 ("**Act**"). The Court held that there is no legal requirement for the scheme of reduction of capital to be applicable to all shareholders and the scheme can be made applicable to a select group of shareholders so long as the prescribed consents under the Act have been procured.

FACTS

Elpro International Limited ("**Company**"), a company listed on the Bombay Stock Exchange ("**BSE**") proposed to extinguish and cancel 8,89,169 shares held by shareholders constituting 25 per cent of the issued and paid up share capital at a price of Rs. 183 per equity share in accordance with section 100 of the Act.

· On January 27, 2006, a board resolution for effecting the reduction of the issued and paid up share capital was passed seeking shareholder approval for the scheme ("Scheme") for reduction of capital by postal ballot. The scheme propounded that the reduction of share capital would take place from amongst shareholders who either vote in favour of the Scheme or do not object to the same.

· The Scheme was approved by more than 95% shareholders and creditors, and a petition was proposed to be filed with the Court under section 102 of the Act seeking an order for confirmation of the reduction of share capital. On July 25, 2006, a copy of such petition was filed with the BSE as prescribed under Clause 24(f) of the Listing Agreement.

· On August 22, 2006, BSE issued a letter to the Company stating that the Scheme should be made applicable either to all the shareholders of the Company or only to those shareholders who have furnished a positive assent to the special resolution. The Company was also advised not to file the Scheme with the Court unless a no-objection is granted by BSE.

The petition was filed with the Court and the arguments made by the Company and the BSE were as follows.

BSE'S ARGUMENTS

BSE contended that out of 3,835 shareholders only 112 shareholders voted in the course of the postal ballot and 3,723 shareholders did not even cast a ballot. To that extent, balance shareholders who did not cast their votes were also being treated as if they had accepted the proposed Scheme. Besides, the promoters held 60% of the issued share capital, which made the resolution a foregone conclusion. Other arguments emphatically put forth were with respect to pricing, (a) there had been a substantial increase in the prices of the shares since the date of the board meeting held for reduction – the price of the shares as on August 22, 2006 (date when the letter was issued by BSE); and (b) the promoters of the company would have the benefit of realizing a higher market value, if there is a need to increase the non-promoter shareholding to comply with the minimum public float of 25%.

Thus the reduction ought to be effective only if the Scheme allows the surrender of shares of only those shareholders who have specifically agreed to a reduction of their capital or otherwise said Scheme shall be applicable across the board.

COMPANY'S ARGUMENTS

The Company argued that selective reduction of capital is permissible and lawful and there is nothing provided under the Act which prohibits such selective reduction. The Scheme was approved by more than the required majority of shareholders and provided an exit opportunity to all the shareholders who made a positive act of casting a ballot in favor of the scheme. Further, the Company also averred that the price at which share capital was proposed to be returned to the shareholders was the highest of the parameters taken into consideration by the valuers in preparing the weighted average value of the shares and was at a premium over the weighted average value of each share as determined by the valuers as well as the current market value of the shares immediately before the meeting of the Board of Directors.

Accordingly, there was no requirement for the Scheme to be extended to all the shareholders of the Company and the procedure stipulated under section 101(3) of the Act was duly followed.

THE LAW

Section 100 of the Act authorizes a Company to reduce its share capital and lays down the procedure which is required to be followed. Sub-section (2) of Section 101 then provides that where the proposed reduction of share capital involves either a diminution of the liability in respect of unpaid share capital or the payment to "any shareholders" of any paid up share capital and in any other case, if the Court so directs, then the provisions which

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have been made thereunder shall have effect. The adoption by Parliament of the words "any shareholders" in Section 101 of the Companies Act, 1956 indicates that a reduction of share capital need not necessarily be qua all shareholders of the company, but can take place from one or more amongst the body of shareholders.

THE JUDGMENT

The Court held that a classification of shareholders for the purposes of effecting the reduction of capital is, therefore, not an act which is extraneous to the provisions of Section 101. Court further noted that effect must be given to the plain meaning and intendment of the provisions of Section 101, and corporate autonomy must have a wholesome recognition in law and unless the law circumscribes it by a clear provision, courts would not read limitations where the Legislature has not imposed them.

The Court relied on a recent decision of the Delhi High Court in the case of Reckitt Benckiser (India) Limited [MANU/DE/1174/2005] where it underlined the following principles which emerge from the law relating to a reduction of share capital:

(i) The question of reduction of share capital is treated as a matter of domestic concern, i.e., it is the decision of the majority which prevails;

(ii) If a majority by special resolution decides to reduce share capital of the company, it has also the right to decide as to how this reduction should be carried into effect;

(iii) While reducing the share capital the company can decide to extinguish some of its shares without dealing in the same manner as with all other shares of the same class. Consequently, it is purely a domestic matter and is to be decided as to whether each member shall have his share proportionately reduced, or whether some members shall retain their shares unreduced, the shares of others being extinguished totally, receiving a just equivalent;

(iv) The company limited by shares is permitted to reduce its share capital in any manner, meaning thereby a selective reduction is permissible within the framework of law;

When the matter comes to the Court, before confirming the proposed reduction the Court has to be satisfied that (i) there is no unfair or inequitable transaction; and (ii) all the creditors entitled to object to the reduction have either consented or been paid or secured.

In light of the above, the Court held that since the majority of the shareholders had approved the resolution and that the price offered per share in the reduction of share capital exercise was fair, selective reduction of share capital was permissible.

Negating BSE's argument that shareholders abstaining from voting on the resolution should not be counted as consenting, the Court noted that that the touchstone laid down by the Act is votes by persons who are entitled to vote and who in fact cast their votes at the meeting. The fact that some shareholders may decide to abstain from the meeting will not dilute the efficacy of the resolution, general or special, provided the requisite statutory majority is found to exist. The Court also confirmed that the price being offered to the shareholders was fair and in accordance with the statutory provisions.

ANALYSIS

This is the second judgment delivered by the Court after the Sandvik Asia Limited vs. Bharat Kumar Padamsi and Ors wherein the Court had also held that selective reduction of capital is permissible under the Act. Such cases are building up strong jurisprudence in favour of selective reduction of capital. Selective reduction of capital may prove to be an important tool in the hands of the promoters to manage the shareholding structure of the company as per their comfort.

The Sandvik Asia case as well as current case is similar to the extent that the resolution was passed by more than 95% of the shareholders. However, if the resolution is passed only by 90% shareholders' votes and rest 10% alleges oppression and mismanagement, it would be interesting to see if the outcome of such a case would be any different.

- **Vedant Shukla, Ruchir Sinha & Nishchal Joshipura**

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