



Corporate Law Update: New M&A Rules affect Minority Shareholders

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The Ministry of Corporate affairs has recently notified Sections 230(11) and 230 (12) of the Companies Act, 2013 (“**Companies Act**”) and certain amendments to the Companies (Compromises, Arrangements and Amalgamation) Rules, 2020 (“**M&A Rules**”)² (together, the “**Amendments**”).

The Amendments provide that a member holding not less than three-fourths of the shares in the company (“**Majority Shareholder**”) can file an application for acquiring the shares held by the other shareholders, i.e. shareholders holding the other one-fourths of the shares in the company (“**Minority Shareholders**”). However, the application for buying-out the Minority Shareholders should be made under a ‘compromise’ or an ‘arrangement’ under Section 230 of the Companies Act, 2013 (the “**Companies Act**”).

Background: Compromise or an arrangement under Section 230 of the Companies Act

Section 230 of the Companies Act enables the National Company Law Tribunal (“**NCLT**”) to sanction a compromise or an arrangement proposed between the company and its members, or a compromise or an arrangement between the company and its creditors, if majority of members or creditors representing three-fourths in value have consented to the compromise or an arrangement. The ‘explanation’ to Section 230(1) of the Companies Act provides that “arrangement” includes a reorganization of the company’s share capital by the consolidation of shares of different classes or by the division of shares into shares of different class, or by both of those methods. Section 230 of the Companies Act is broad enough to include various types of corporate restructuring like mergers, amalgamations and demergers.

While the new regime of corporate reorganization / restructuring under the Companies Act, 2013, is a marked improvement over the erstwhile regime under the Companies Act, 1956, certain questions remained unanswered. One such question was whether shares held by the Minority Shareholders can be compulsorily acquired by the Majority Shareholder in a ‘compromise’ or an ‘arrangement’ under Section 230 of the Companies Act.

Acquisition from Minority Shareholders: The new regime

¹ Views expressed are personal and do not necessarily reflect the views of the Firm.

² Notification dated February 3, 2020, read with the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2020.

The Amendments now provide that a 'takeover offer' can be included in a 'compromise' or an 'arrangement' under Section 230 of the Companies Act. While the expression 'takeover offer' has not been defined in the Companies Act, the Amendments indicate that it would refer to the acquisition of shares held by the Minority Shareholders.

The proviso to Section 230(11) provides that in case of listed companies, the requirements of the Securities and Exchange Board of India will apply. Readers will be aware that listed companies are required to comply with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Regulations**") in case of takeover offers. The Takeover Regulations contemplates a mandatory open offer to be made to public shareholders in case of acquisition of shares, voting rights or control in certain circumstances.

The Amendments further provide the following procedural rules / aspects as far as a 'takeover offer' is concerned:

- The Majority Shareholders proposing a "takeover offer" should file an application with the NCLT for sanctioning the "takeover offer". The "takeover offer" may be approved by the NCLT as part of the 'compromise' or 'arrangement' under Section 230 of the Companies Act.
- A report of the 'registered valuer' should be furnished. The report shall mandatorily consider certain parameters as regards the valuation aspects of the target company. It should consider the highest price paid by any person or group of persons for acquisition of the target company's shares during the last twelve months. It should also consider other relevant valuation parameters like return on net worth and parameters customary for valuation of shares of such companies.
- The acquirer/ Majority Shareholder should open a bank account and deposit a sum of not less than one-half of total consideration of the "takeover offer" in the bank account

Please note that the requirements stated above do not apply in case of acquisition of shares pursuant to contract, arrangement or succession or any transfer made in pursuance of any statutory or regulatory requirement. Such arrangements are kept outside the ambit of the Amendments as they would be governed by applicable contractual arrangements.

An "aggrieved party" is entitled to object to the "takeover offer" by filing an application. The Amendments do not propose any shareholding threshold in order to file the application.

Comments / Observations

The introduction of the valuation requirement and the deposit of consideration in a separate bank account are important procedural safeguards for Minority Shareholders. However, the Majority Shareholder could argue that valuable funds is locked up in the judicial system till the closure of the 'takeover offer'.

In addition to the above, certain key issues regarding the implementation aspects of the Amendments remain. These are briefly enumerated below.

- There is considerable overlap in the various provisions of the Companies Act dealing with minority squeeze out. For example, what happens to Section 236 of the Companies Act which already

provides for minority squeeze out in certain situations? The answer seems to be in the wording of the sections. While Section 236 does not indicate whether the minority shareholders are required to tender their shares or not, Section 230(11) appears to indicate that the shares of the Minority Shareholders can be compulsorily acquired. A Majority Shareholder may now look to implement a minority squeeze out through the recently introduced Amendments rather than through Section 236 of the Companies Act. Therefore, these issues regarding regulatory overlap will have to be addressed.

- Minority shareholders could argue that the Amendments do not really protect them. They are in fact quite onerous compared to the other sections as they can be forced to give up their shares. Minority shareholders are bound to resist the application of these Amendments / the “takeover offer”.

Given the above issues, one will have to wait and see how these provisions play out in real life situations. We may have to wait for more clarity from the regulatory authorities and perhaps the courts as regards the implementation aspects of these Amendments.
