

# Critical Analysis of Section 236 of the Companies Act, 2013

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## ABSTRACT

*The controversy relating to the rights of Minority shareholders and the Majority rule has been the epicentre of discussion since ages. Foss v. Harbottle has marked the intrusion of Majority Rule i.e. the majority shareholders has the control over the decision of the Board. But this rule has time and again challenged the rights and interests of the minority shareholders. Though the concept of 'squeezing out' of the minority shareholders has always been prevalent, but it lacked a backing statute under Companies Act, 1996. Under Section 236 of the new Companies Act 2013, the concept has been specifically introduced, but is to-some-extent partipris in its approach. In this paper, we would focus on analysing the existing scenario of the minority rights and compare the same with the 'concept of squeezing out' prevailing in various countries and thereby suggest what can be implemented to fill-up the shortcomings of Section 236.*

**Keywords:** majority rule, minority shareholder's right, squeezing out

## Introduction

### Minority Shareholders

Companies Act 2013 does not explicitly define the term 'shareholders' but under Section 2 (55), the term 'member'<sup>1</sup> has been defined which includes subscribers to the memorandum of the company. Thus, we can derive the meaning of the term 'shareholder' as the person who holds the shares of a company.

Usually, the majority shareholders own more than 50% of company's shares, whereas the minority shareholders hold less than 50% of the shares of the company. But as per Section 236 of the Act, 'minority shareholding' has been referred to shareholders holding not more than 10% of the shares of the company. So technically, the majority shareholders majorly influence the decision-making process of the company.

As per Black Law's Dictionary, minority shareholder means "Equity holder with less than 50% ownership of the firm's equity capital and having no vote in the control of the firm"<sup>2</sup> But the term "minority shareholding" has usually been used in respect of shareholders holding shares of the company not more than 10%.

Under Companies Act, 2013, Section 151<sup>3</sup> defines the term "small shareholders". It means that the shareholders holding shares having nominal value of not more than Rs. 20,000 or as may be prescribed. So, small shareholders can also be considered as minority shareholders.<sup>4</sup>

### Concept of 'Squeeze Out'

Squeeze out implies the acquisition of minority shareholders by majority shareholders through cash compensation. It is a mechanism where the shareholders holding 90% or more shares of a company have the power or ability to acquire the shares of the minority shareholders. It is a mechanism to lower down the power of the minority shareholders.

Though the concept of 'squeezing out' was practically prevalent in the corporate sector throughout the world, but under Companies Act, 2013, Section 236 introduces the concept explicitly. This was enforced by the Ministry of Corporate Affairs vide notification dated December 7, 2016<sup>5</sup>.

<sup>1</sup>The subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members.

<sup>2</sup><https://thelawdictionary.org/minority-shareholder/>

<sup>3</sup>A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

<sup>4</sup>P.B. Jayakumar, Business Today, A Board Seat, (URL - <https://www.businesstoday.in/magazine/focus/a-board-seat/story/258715.html>)

<sup>5</sup>[http://www.mca.gov.in/Ministry/pdf/commencementnotif\\_08122016.pdf](http://www.mca.gov.in/Ministry/pdf/commencementnotif_08122016.pdf)

### Majority Rule

The concept of 'majority rule' had its genesis in *Foss v. Harbottle*<sup>6</sup>. In the case, the two minority shareholders<sup>7</sup> of Victoria Park Company<sup>8</sup> filed a suit against the five directors of the company alleging that the company's property were misused and misapplied and mortgages over the property were given improperly. They requested for a receiver to be appointed. The Court held that the plaintiffs were not competent enough to bring such proceedings against the company or its representatives. Added to this, the court also held that the minority shareholders are bound by the decision of the majority shareholders. The 'Majority Rule' was thus established.

Four exceptions<sup>9</sup> to the rule were made to shield the rights of the minority shareholders.

- a. Any transaction or action which is illegal or ultra vires the company, the rule shall not be applicable as the majority shareholders cannot approve to or decide such action
- b. To apply ordinary resolution i.e. simple majority for any corporate act where the constitution of the company mandates special resolution<sup>10</sup>
- c. When the act by the company against which complaint has been made by the shareholders infringes their personal right as an individual<sup>11</sup>
- d. Where directors fail to take appropriate action against any wrongdoing or fraud committed against the shareholders. In *Pavildes v Jensen*<sup>12</sup>, it was held that actual fraud should be caused in order to bring action against the company and not mere negligence. But *Daniels v Daniels*<sup>13</sup> came up with a more liberal approach i.e. if shareholders had no other option but to sue the directors, they can. Where the directors act in such a manner that benefits them at the cost of the company, then the shareholders having no remedy to it, shall be able to file a suit against the directors.

### Rights of Minority Shareholders under Companies' Act 2013

#### 1. **Right to appoint Small Shareholders' Director**

The question of appointment of small shareholders director was first raised by the minority shareholders of the oldest drug company in India, Alembic Ltd.<sup>14</sup>

Section 151 of the Companies' Act 2013 empowers the listed companies to *suomotu*<sup>15</sup> or on application by at least one thousand small shareholders or one-tenth of such shareholders having shares less than Rs. 20,000 in value<sup>16</sup> to appoint a director representing small shareholders.

#### 2. **Right to apply to NCLT in case of Oppression and Mismanagement**

The Board of Directors are responsible for acting to maximize value of shares held by the shareholders. It's a fundamental rule that the majority shareholders enjoy the maximum power in controlling the affairs of the company than the minority shareholders. Though there is a high chance that the decisions of the majority shareholders are not in favour of the minority shareholders, in that case, they can take the issue up or approach the National Company Law

<sup>6</sup>1843 67 ER 189

<sup>7</sup> Richard Foss and Edward Starkie Turton

<sup>8</sup>Set up September 1835, near Manchester

<sup>9</sup>Ezeanya Ann Ugonna, The Department of Private and Business Law, University of Ibadan, *Exception to the rule in Foss v Harbottle: Comparison of the decisions in Daniels v. Daniels and Pavildes v. Jensen* (URL – [https://www.academia.edu/13600514/Exception\\_to\\_the\\_rule\\_in\\_Foss\\_v\\_Harbottle\\_Comparison\\_of\\_the\\_decisions\\_in\\_Daniels\\_v.\\_Daniels\\_and\\_Pavildes\\_v.\\_Jensen](https://www.academia.edu/13600514/Exception_to_the_rule_in_Foss_v_Harbottle_Comparison_of_the_decisions_in_Daniels_v._Daniels_and_Pavildes_v._Jensen))

<sup>10</sup>Baillie v Oriental Telephone Co Ltd, 1915 1 Ch 503 and Cotter v National Union of Seamen, 1929 2 Ch 58

<sup>11</sup>Pender v Lushington, 1877 6 Ch D 70

<sup>12</sup>1956 Ch 565

<sup>13</sup>1978 Ch 406

<sup>14</sup>Small shareholders of an Asset Management Firm, Unifi Capital holds 3% of the shares in the company, Alembic Ltd, and asked Alembic to appoint Murali Rajagopalachari, VC of Unifi Capital, as an independent director. But the proposal was rejected. (P.B. Jayakumar, *A Board Seat*, BUSINESS TODAY, dated 10-09-2017, URL - <https://www.businesstoday.in/magazine/focus/a-board-seat/story/258715.html>)

<sup>15</sup>Rule 7(1) of Companies (Appointment and Qualification of Directors) Rules, 2014

<sup>16</sup>Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014

Tribunal (NCLT) as per the provisions of the Companies' Act, 2013. Sections 241, 242 and 243 deal with the oppression and mismanagement<sup>17</sup>.

### Issues with the provision

The amended Section 236<sup>18</sup> of Companies' Act 2013 lacks the clarity relating to whether the minority shareholders are bound to accept the exit offer or offer to purchase their shares or they have the power to

<sup>17</sup>Mismanagement includes prevention of functioning of directors, violation of statutory provisions and MoA and AoA of the company, misuse of funds of the company, etc.

<sup>18</sup>Purchase of Minority Shareholders-

(1) In the event of an acquirer, or a person acting in concert with such acquirer, becoming registered holder of ninety per cent. or more of the issued equity share capital of a company, or in the event of any person or group of persons becoming ninety per cent. majority or holding ninety per cent. of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, shall notify the company of their intention to buy the remaining equity shares.

(2) The acquirer, person or group of persons under sub-section (1) shall offer to the minority shareholders of the company for buying the equity shares held by such shareholders at a price determined on the basis of valuation by a registered valuer in accordance with such rules as may be prescribed.

(3) Without prejudice to the provisions of sub-sections (1) and (2), the minority shareholders of the company may offer to the majority shareholders to purchase the minority equity shareholding of the company at the price determined in accordance with such rules as may be prescribed under sub-section (2).

(4) The majority shareholders shall deposit an amount equal to the value of shares to be acquired by them under sub-section (2) or sub-section (3), as the case may be, in a separate bank account to be operated by the transferor company for at least one year for payment to the minority shareholders and such amount shall be disbursed to the entitled shareholders within sixty days: Provided that such disbursement shall continue to be made to the entitled shareholders for a period of one year, who for any reason had not been made disbursement within the said period of sixty days or if the disbursement have been made within the aforesaid period of sixty days, fail to receive or claim payment arising out of such disbursement.

(5) In the event of a purchase under this section, the transferor company shall act as a transfer agent for receiving and paying the price to the minority shareholders and for taking delivery of the shares and delivering such shares to the majority, as the case may be.

(6) In the absence of a physical delivery of shares by the shareholders within the time specified by the company, the share certificates shall be deemed to be cancelled, and the transferor company shall be authorised to issue shares in lieu of the cancelled shares and complete the transfer in accordance with law and make payment of the price out of deposit made under sub-section (4) by the majority in advance to the minority by dispatch of such payment.

(7) In the event of a majority shareholder or shareholders requiring a full purchase and making payment of price by deposit with the company for any shareholder or shareholders who have died or ceased to exist, or whose heirs, successors, administrators or assignees have not been brought on record by transmission, the right of such shareholders to make an offer for sale of minority equity shareholding shall continue and be available for a period of three years from the date of majority acquisition or majority shareholding. 149

(8) Where the shares of minority shareholders have been acquired in pursuance of this section and as on or prior to the date of transfer following such acquisition, the shareholders holding seventy-five per cent. or more minority equity shareholding negotiate or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement, the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a pro rata basis. *Explanation*—For the purposes of this section, the expressions —acquirer and —person acting in concert shall have the meanings respectively assigned to them in clause (b) and clause (e) of sub regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(9) When a shareholder or the majority equity shareholder fails to acquire full purchase of the shares of the minority equity shareholders, then, the provisions of this section shall continue to apply to the residual minority equity shareholders, even though,—

(a) the shares of the company of the residual minority equity shareholder had been delisted; and

dissent. For example, in case of merger, it is explicitly mentioned that if the majority of the creditors or shareholders of the company assent to the merger, then Tribunal may sanction the said compromise or arrangement.<sup>19</sup>

Added to that, the Act does not clearly state the time limit within which the minority shareholders are to give away their shares to the majority shareholders.

Lastly, there is no provision in the Act which talks about conducting a separate meeting for the minority shareholders to enable them to bring forward their concerns relating to buying of their shares by the majority shareholders.

### Legislation across countries relating to Purchase of Minority Shareholding<sup>20</sup>

#### **United Kingdom<sup>21</sup>**

The concept of "Squeezing Out" is prevalent in United Kingdom. As per the Companies' Act 2006 of UK, squeezing out of the minority shareholders can be done by two ways:

1. By takeovers, and
2. By the scheme of arrangement

The majority shareholder can acquire the shares of the minority shareholders *only if* they are able to acquire or unconditionally contracted to acquire 90% of shares carrying voting rights, then they have to send a notice to the minority shareholders regarding *compulsory acquisition* of their share. If notice containing all the terms of acquisition is not sent, then it shall be considered to be a criminal offence.

#### **United States of America<sup>22</sup>**

In USA, the shareholders, if they acquire 90% or even 85% of shares can offer the minority shareholders to acquire their shares at a price without taking approval from other shareholders. The minority shareholders have the right or power to challenge the price paid against such shares by the majority shareholders. But the shareholders who accept tender offers are not eligible to challenge or question the price paid.

#### **Norway<sup>23</sup>**

Like UK, USA and India, Norway too has a provision according to which the majority shareholders i.e. the shareholders holding 90% of shares having voting rights can compulsorily acquire the shares of minority shareholders. The minority shareholders can only demur about the price paid for the shares.

#### **Australia<sup>24</sup>**

There are two methods of squeeze out:

1. Compulsory acquisition following takeover, and
2. Compulsory acquisition in other conditions

Here also, the threshold for compulsory acquisition is 90%. The minority shareholders can dissent to the acquisition by signing an objection form and the company needs to submit the same to the Australian Securities and Investment Commission (ASIC). The ASIC has to decide and resolve the said proceeding and accordingly the acquisition shall take place.

### Conclusion

Squeezing Out is a situation where minority shareholders are given the opportunity to give up their shares to the majority shareholders and exit. Section 236 elucidates the purchase of minority shareholdings by the majority shareholders in exchange of considerations.

(b) the period of one year or the period specified in the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992 (15 of 1992), had elapsed.

<sup>19</sup>Section 230(6) of Companies' Act 2013

<sup>20</sup>PammyJaiswal and Rahul Maharshi, Vinod Kothari & Co, Company Secretaries, Corporate Law Services Division, 31st January 2017, Minority Squeeze Out: A strong provision under Section 236 of the Companies Act 2013 (URL-[http://vinodkothari.com/wp-content/uploads/2017/02/Squeezing\\_out\\_of\\_minority\\_section\\_236\\_of\\_the\\_Companies\\_Act\\_2013.pdf](http://vinodkothari.com/wp-content/uploads/2017/02/Squeezing_out_of_minority_section_236_of_the_Companies_Act_2013.pdf))

<sup>21</sup>[http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga\\_20060046\\_en.pdf](http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf)

<sup>22</sup>United States of America, Squeeze-Out Guide, IBA Corporate and M&A Law Committee, 2014

<sup>23</sup>[https://www.oslobors.no/ob\\_eng/obnewsletter/download/20fd77664bccdf3f6b8cb0dc95eeb7bb/file/fil\\_e/Norwegian%20Public%20Limited%20Liability%20Companies%20Act.pdf](https://www.oslobors.no/ob_eng/obnewsletter/download/20fd77664bccdf3f6b8cb0dc95eeb7bb/file/fil_e/Norwegian%20Public%20Limited%20Liability%20Companies%20Act.pdf)

<sup>24</sup>Australia Squeeze out Guide- IBA Corporate and M&A Law Committee 2010

Though inclusion of the concept of squeezing out<sup>25</sup> is no-doubt a progressive move for India, yet the drawback lies to the fact that there is no clarity to the provision. Like in case of UK, USA and Norway as elucidated above, the term “compulsory acquisition” has been mentioned, which indicates that the minority shareholders do not have much option but to give their shares away for acquisition. They have the right to dissent to the price paid to them. Whereas in case of Australia the minority shareholders can submit objection which are required to be considered. So, if Section 236 is amended to an extent that it shall clear out the ambiguity, then it can be treated as a fulcrum for deciding the boon and controversies in future.

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