

PROPOSED TAKEOVER NORMS FOR UNLISTED COMPANIES

Majority vs minority shareholders: Need for a high-wire balancing act

SUDIPTO DEY

The ministry of corporate affairs (MCA) is in the process of coming out with takeover norms for unlisted companies. Legal experts explain how the new rules may change the playing field between majority and minority shareholders.

Why is there a need for takeover norms for unlisted companies?

These provisions existed in Section 395 of the Companies Act, 1956, and also under Section 236 of the Companies Act, 2013. However, these were never notified in the absence of rules or guidelines.

These norms were for the benefit of minority shareholders (less than 10 per cent) in cases where an acquirer gets 90 per cent shareholding in a company. In such cases, minority shareholders were given an option to exit the company according to a prescribed valuation.

The provision should benefit minority shareholders as long as there is no compulsory acquisition of shares of the minority, and the minority is given an option whether to tender the shares or not, notes



Lalit Kumar, partner in law firm J Sagar Associates.

According to Sandeep Parekh, managing partner, Finsec Law Advisors, the takeover framework envisaged for unlisted companies would be different from the framework under the Sebi takeover regulations for listed companies. "While the Sebi takeover regulations seek to protect minority shareholder

rights by providing exit rights if controlling stakes are changed, the unlisted proposal will be a means for 'squeezing' the minority shareholders out of an unlisted company," he says. Parekh is of the view that the norms would have to carefully balance the rights of the majority with that of the minority.

Experts say the recent corporate governance lapses in unlisted

companies seem to be a trigger for bringing in the norms. "The government would be curious to know more about the changes in the ownership or management of unlisted companies. The objective would be to bring in transparency and accountability," says company secretary Gaurav Pingle.

How will the norm change the playing field between majority and minority shareholders?

Experts say the takeover norms would be with respect to the threshold, pricing, compliances, disclosures, manner of making an offer, etc. The government has recently introduced several compliance measures for unlisted companies, including compulsory dematerialisation of shares. There is also a proposal to introduce a quarterly reporting mechanism for unlisted public companies.

According to Parekh, the proposal for takeover norms for unlisted companies will need to be done delicately and with a lot of expertise. Shriram Subramaniam, managing director, InGovern Research Services, agrees. "There

needs to be a smooth mechanism for the exit of minority shareholders, including the right to first refusal, wherein if minority shareholders want to sell to any other third-party, the first right is to the majority shareholder to buy the shares at a valuation that the third party is offering," he says.

Experts are also wary of information asymmetry between majority and minority shareholders in unlisted companies. Subramaniam points out the majority shareholder may have access to insider information and use it to buy the shares of the minority.

What could complicate the matter further is that the Companies Act and various Sebi regulations, do not define unlisted companies.

How do other jurisdictions handle these issues?

In most jurisdictions, transactions involving mergers and acquisitions of unlisted companies are largely governed by the respective company law statutes and other ancillary laws, such as laws governing contracts, competition, tax, labour, environment, and foreign exchange. "There are no specific takeover codes/regulations governing M&A transactions where unlisted entities are concerned," says Astha Pandey, senior research fellow, Vidhi Center for Research Policy. These jurisdictions include the US, the UK, Australia, Denmark, Finland, the Netherlands, Sweden, and Japan.