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New provisions on compromises and arrangements– shifts the balance from minority interests to corporate convenience

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In an era which beckons increased shareholder activism, the Companies Act, 2013 ("Act, 2013") also has also in its own way ensured the same. By incorporating provisions relating to class action suits, freezing of assets of company on inquiry and investigation, the Act, 2013 seemed to have given more mileage to the cause of minority shareholder activism. However, the Act, 2013 has also taken a step back by deleting the 'headcount test' under section 230(6) and ruling out the opportunity to raise objections by minority shareholders by incorporating proviso to section 230(4). What transpires from these sections is that mileage has clearly been given to corporate convenience. We discuss in detail below about both the provisions in these sub-sections.

The proviso to section 230(4)

The proviso to section 230(4) of Act, 2013 reads as:

> *"Provided that any objection to the compromise or arrangement shall be made only by* ***persons*** *holding not less than ten per cent. of the shareholding or having outstanding debt amounting to not less than five per cent. of the total outstanding debt as per the latest audited financial statement."* [emphasis supplied]

Scenario outside India

Section 411(17)(b) of Corporations Act, 2001 in Australia allows a court to not sanction a scheme of arrangement unless a no objection is received from Australian Securities and Investments Commission ("ASIC"). Any member can undertake to the ASIC that he will object to the scheme.

The Report of the JJ Irani Committee and its effect

The JJ Irani Committee in its report dated May 31, 2005 stated that with a vexatious attitude, shareholders with insignificant stake raise objections to a scheme of arrangement. It suggested that only shareholders with a significant stake should be allowed to raise any objection, so as to streamline the procedure of articulation of the minority interest while restricting the obstructionist attitude on the part of any section of minority.

The Act, 2013 resultantly prescribed a minimum threshold for the same under section 230(4). However, where section 230(4) related to serving of notice for a court convened meeting, the inclusion of this proviso seems to be misplaced. The intention behind the JJ Irani committee prescribing such a minimum threshold was to curtail any vexatious attempt to the scheme. This however, did not mean putting a restriction on voting to the scheme itself. Voting being a fundamental right cannot be taken away by way of any statute. What the proviso actually means is that after the court convened meeting, once the scheme comes to the court for the final hearing, the shareholders fulfilling the minimum threshold may raise objections. Where in a court convened meeting, the minority shareholder can raise objection, the same may not hold any value as the majority shareholders may see the resolution approving the scheme through by the value of their votes.

Such minority shareholders could have objected to the scheme by filing affidavits with the court under the Companies Act, 1956. This right has however been taken away by the proviso to section 230(4) because the minimum criteria prescribed may be difficult to achieve.

Interpretation of the word "persons"

Although, the suggestion of the JJ Irani Committee was noble, yet it has actually turned out to be counterproductive by completely ruling out the chance for minority shareholders say holding less than 10% of the shareholding, to raise an objection. What transpires from a reading of the proviso is that only if such minority shareholders hold 10% of total shareholding or have outstanding debt of Rs. 5.00 lakhs will they be able to object to the scheme. Such a threshold may not be easy to muster. Although, Order I to First Schedule of Civil Procedure Code, 1908 allows two or more persons to raise an objection only if they have a common cause, yet in the judicial process the minority shareholders may not be able to voice their concerns at all.

Section 230(6) of Act, 2013

This section corresponds to section 391(4) of Act, 1956. On a plain reading of the section it is clear that the section requires the approval of the scheme of arrangement by the creditors or members of the company. However, a closer look shows that the line "If a majority in number representing three-fourths in value" etc. can actually have a dual meaning. The use of the words 'number' and 'value' show that under section 391(4) of Act, 1956 approval to a scheme of arrangement requires the majority by way of:

1. Persons in number attending and voting i.e. the 'headcount test'
2. Value of shares held i.e. 'voted-share test'

The difficulty in the 'headcount test'

Since, in a court convened meeting, even proxies can be counted consider the case of an individual attending meeting as a proxy for 50 shareholders. General contention will be to count his vote as only one vote for the purpose of headcount test. However, logic would demand that his votes be counted as 50 since he is acting as proxy for 50 shareholders. Then again, a shareholder may split his shares among various proxies to impede the passing of any resolution by way of headcount test. A similar situation was discussed in the case of *In Re. Little Sheep* by the Grand Court of Cayman Islands. The applicant company had asked the court to count the nominee of the clearing house as one person and to achieve this, the votes cast in favour of the resolution shall be set off by votes cast against the resolution. The Grand Court held that holding such a view would be "highly artificial".

The provision of section 391(2) of Act, 1956 is similar to section 206 of United Kingdom Companies, Act 1948. The same language has been used in several other countries like section 411 of Corporate Act, 2001 of Australia and Section 210 of Companies Act, 2001 (1994 Ed) (Cap 50) in Singapore. Also, section 899 of United Kingdom Act, 1985 reads the same as section 391(2) of Act, 1956.

The headcount test came under serious scrutiny in the Discussion Paper dated June, 2008 titled "Members' scheme of arrangement" by the Corporations and Markets Advisory Committee of the Australian Government[1]. The discussion paper discussed at length that the intent of vexatious shareholders could be achieved if they resorted to splitting their shareholding among various proxies, thereby stopping the resolution from being passed by way of headcount test. In order to combat this, the Law Council Australia in its submission to the Treasury on the Exposure Draft of the Corporations Amendment (Insolvency) Bill, 2007 suggested the following:

1. If in any provision power given to court to dispense with the headcount test is retained, rather than completely letting it go, it should explicitly go beyond share splitting.
2. The headcount test should be amended such that there is a minimum threshold for a valid headcount test and only upon appropriate proof of a trust arrangement for anyone voting on behalf of beneficial owners, would the voting be counted.
3. The headcount test be completely abolished such that only voted-share test and approval of court is retained.
4. The headcount test need not be done away with but a higher threshold is imposed for satisfaction of voted-share test.

In fact, this dichotomy in the headcount test is what led it to its complete deletion in Hong Kong by the Hong Kong Companies Ordinance which was passed in the year 2012.

[1] Read the full text at: http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Members_Schemes_DP_Jun08.pdf

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In India the difficulty in applying the headcount test was discussed in JJ Irani Committee Report dated May 31, 2005. The committee stated that since the voted-value test is also a criterion to determine the intent of the shareholders, the headcount test may be done away with. It was suggested that the requirement may be modified to provide only for approval by 3/4th in value of shareholders and creditors, present and voting. It is in keeping with this that the word 'number' was replaced with the word 'persons' in section 230(6) of Act, 2013. Resultantly, section 230(6) reads as:

> *"Where, at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company."*

Thus, where the Act, 2013 scores by dropping the headcount test and adopting a meaningful approach to the process of seeking members' approval, yet it also takes a step back by prescribing a minimum threshold for raising objections by shareholders/creditors. This has resulted in the balance being tilted towards corporate convenience.

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1. Layers of investment, the new restrictions in Companies Act, 2013 on vertical propagation at: http://india-financing.com/images/Articles/Layers_of_investment_the_new_restrictions_in_Companies_Act_2013_on_vertical_propagation.pdf
2. After SEBI and RBI, does the companies act aids exit options for institutional investors? at: http://india-financing.com/images/Articles/After_SEBI_and_RBI_Does_Company_Act_Aid_Instituitonal_Investors.pdf

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