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## ELPRO INTERNATIONAL LTD. IN RE. - AN ANALYSIS

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### I. INTRODUCTION

The ‘*reduction of share capital*’ means ‘*the process of decreasing a company's shareholder equity through share cancellations and share repurchases.*<sup>1</sup> A company limited by shares or by guarantee and having share capital can, if authorised by its articles of association, by special resolution and subject to confirmation by the court on petition reduce its share capital in the manner prescribed under the Companies Act 1956 (hereinafter the Act).

The relevant legal provisions which deal with the reduction of share capital are section 100 to Section 104 of The Companies Act, 1956. These provisions are an exception to the general principle that a company which is limited by shares or guarantee is not allowed to reduce its capital. These sections lay down the ways in which the share capital of a company is allowed to be reduced and the procedure to be followed thereafter.

This case note analyses the recent order passed by the Bombay High Court in the matter of *Elpro International Limited, In re*<sup>2</sup> which deals with the issue that whether selective reduction of share capital is permissible under The Companies Act or not. This case becomes important because it raises the question -is there any legal requirement for the scheme of reduction of capital to be applicable to all shareholders or else can the scheme can be made applicable to a

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<sup>1</sup>Investopedia, *Meaning of Capital Reduction*, <http://www.investopedia.com/terms/c/capitalreduction.asp> (last visited on Mar. 18, 2010).

<sup>2</sup>2009 4 COMP LJ 406 (Bom).

select group of shareholders? This case basically balances the rights of active and minority shareholders. It also gives primacy to shareholder activism in the management of the company.

## II. ELPRO INTERNATIONAL LIMITED, IN RE

### *A. Facts*

1. Elpro International Limited (“**Company**”), a company listed on the Bombay Stock Exchange (“**BSE**”) proposed to extinguish and cancel 8,89,169 shares held by its 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.
2. 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 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.
3. 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 BSE as prescribed under Clause 24(f) of the Listing Agreement.
4. 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.

## ***B. Issue***

Whether a selective reduction of share capital is permissible under the Companies Act, 1956?

## ***C. Law applicable***

Section 100 of the Act provides for “*Special resolution for Reduction of Share Capital.*” It says that -

*(1) Subject to confirmation by the Tribunal<sup>3</sup>, a company limited by shares or a company limited by guarantee and having a share capital, may, if so authorised by its articles, by special resolution, reduce its share capital in any way; and in particular and without prejudice to the generality' of the foregoing power, may--*

*(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid up;*

*(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid- up share capital which is lost, or is unrepresented by available assets; or*

*(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid- up share capital which is in excess of the wants of the company; and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.*

*(2) A special resolution under this section is in this Act referred to as “a resolution for reducing share capital.”*

Section 101 of the Act deals with the *application to be filed with Tribunal for confirming order, objections by creditors, and settlement of list of objecting creditors.* It says that where a company has passed a resolution for reducing share capital, it may apply, by petition, to the Tribunal, for an order confirming the reduction. Sub-section (2) provides that where the proposed reduction of share capital involves either the diminution of liability in respect of unpaid share capital or

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<sup>3</sup>Substituted by Act 11 of 2003, sec 14 for “Court”. But this amendment is yet to be notified.

the payment to any shareholder of any paid-up share capital, and in any other case if the Tribunal so directs, the provisions which have been made there under shall have effect.

***D. Contentions of the parties***

***a) 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 Bombay Stock Exchange); 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.

***b) 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 favour 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.

### ***E. Judgement***

The Court held that a classification of shareholders for the purposes of effecting the reduction of capital is 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*<sup>4</sup> 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;

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<sup>4</sup>2005 S.C.C. OnLine Del 674.

(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 Bombay Stock Exchange'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.

### III. ANALYSIS

The law regards the capital of the company as something sacred<sup>5</sup>. The general principle of law which is founded on the principles of public policy and is rigidly enforced by the Tribunals is that no action resulting in reduction of share capital of a company is permissible except when sanctioned by court. Conservation of capital is one of the main principles of company law.<sup>6</sup> Share capital in effect act as security given by the company to the creditors and the creditors rely on this security for realisation of their interest. So when reduction of share capital takes place, it diminishes the fund out of which the creditors are to be paid. This is the basic reason why a company which is limited by shares or guarantee is not allowed to reduce its share capital except when sanctioned by court and in accordance with the procedure prescribed by the Act. Section 100 to 104 of The Companies Act, 1956 lays down the three different ways by which a company can reduce its share capital and its procedure.

In the present case the basic issue in question was whether selective reduction of share capital is permissible under the Act. The Court answered the question in affirmative relying on law on the point and previous case laws. 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 envisaged under the Act have been procured.

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

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<sup>5</sup>KAPOOR N.D., ELEMENTS OF MERCANTILE LAW (29<sup>th</sup> ed., Sultan Chand & Sons, 2007).

<sup>6</sup>AVATAR SINGH, COMPANY LAW (15<sup>th</sup> ed. Eastern Book Company, Lucknow, 2008).

*shareholders*’ of any paid up share capital and in any other case, if the Court so directs, then the provisions which have been made there under 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 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.

The arguments put forth by the Bombay Stock Exchange that shareholders abstaining from voting on the resolution should not be counted as consenting was negated by the Court. The Court noted 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.

The Court is under an onerous duty to strike a balance between the interest of shareholders and creditors and the company when it is faced up with issues relating to reduction of capital. Although the court must see that the interest of the minority have been protected and there is no unfairness shown to them, but in doing so the court shall keep in view the consideration that the decision has been arrived at by the businessmen who are fully cognizant of their necessities and are the best custodians of their interest and should therefore be slow to interfere<sup>7</sup>.

So according to me the decision arrived at by the High Court was correct having regard to the law on the point and the previous case

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<sup>7</sup>Rourke B.O., *Reduction of Share capital – the reassertion of discretionary power*, 87 SALJ 161 (1970).

laws. This is the second judgment delivered by the Court after the *Sandvik Asia Limited v. Bharat Kumar Padamsi and Ors*<sup>8</sup> 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.

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<sup>8</sup>2009(3)BomCR57(India).