NCLT Kolkata's Rejection of Philips India's Capital Reduction Proposal: A Legal and Analytical Perspective

The Kolkata Bench of the National Company Law Tribunal (NCLT)[1] recently dismissed the application filed by Philips India Limited (Philips) for capital reduction under Section 66 of the Companies Act, 2013 (CA 2013). The case has sparked widespread debate on the scope of capital reduction, minority shareholder rights, and valuation methodologies in corporate restructuring.

Philips, a privately held entity, is majorly owned by Koninklijke Philips N.V. and Philips Radio B.V., which collectively hold 96.13% of its share capital, while the remaining 3.87% is held by public shareholders, including 0.71% by the Investor Education Protection Fund (IEPF). The company was delisted from the Bombay Stock Exchange in 2004, after which it offered an exit option to its shareholders at INR 105 per share. However, some minority shareholders chose to retain their holdings, leading to continued public shareholding.

Philips' capital reduction plan sought to cancel and extinguish the 3.87% minority-held share capital, offering shareholders INR 915 per share—24% higher than the independently determined fair value of INR 740 per share. The valuation was based on the Discounted Cash Flow (DCF) method, approved by the Board, and was overwhelmingly approved by 99.58% of shareholders. Despite this, a group of minority shareholders objected, prompting NCLT scrutiny, which eventually resulted in the tribunal rejecting the proposal.

Philips justified the capital reduction on two primary grounds: providing liquidity to minority shareholders who had been unable to exit due to the illiquid nature of the shares, and reducing administrative and compliance costs incurred in managing a large base of minority shareholders. The company argued that minority shareholders had approached them multiple times seeking an exit mechanism. The scheme, therefore, was structured to provide a fair and beneficial outcome for all stakeholders.

However, the minority shareholders challenged the proposal on multiple fronts, primarily contesting the valuation methodology and questioning whether the proposed transaction was a veiled buyback, which is prohibited under Section 66(6) of CA 2013. They contended that the Comparable Companies methodology would have yielded a higher valuation and criticized the lack of external benchmarks in the DCF approach. The minority shareholders also claimed that the capital reduction was coercive, as they were not being given a voluntary choice to participate.

[1] CP/312(KB)2023

In its ruling, the NCLT rejected the proposal, holding that capital reduction under Section 66 can only be invoked in limited circumstances: to extinguish unpaid share capital liabilities, to cancel lost capital, or to reduce excess capital. The tribunal found that Philips' reasons for capital reduction—liquidity and cost savings—did not align with any of these categories and, therefore, could not be permitted under the law. It further held that the transaction resembled a buyback, which is expressly prohibited under Section 66(6). On the valuation issue, while the NCLT did acknowledge discrepancies in valuation reports, it refrained from adjudicating on the fairness of the valuation since it had already determined that the proposal was not legally sustainable.

The judgement raises important questions regarding the scope of capital reduction under Indian company law. Traditionally, courts have allowed companies to utilize capital reduction for reasons beyond the three situations prescribed under Section 66, particularly where it serves as a means for minority shareholder exits. Several precedents have supported such an approach, provided the valuation is fair and the transaction is not discriminatory. The Bombay High Court in *Elpro International Limited,* upheld the permissibility of selective capital reduction, ruling that classifying shareholders for capital reduction does not violate Section 101 of CA 2013. Similarly, in *Sandvik Asia Limited v. Bharat Kumar Padamsi,* the Bombay High Court affirmed that capital reduction schemes involving the acquisition of minority holdings by the promoter group are valid if procedural requirements are met. However, the NCLT's narrow interpretation effectively restricts the flexibility of companies to restructure their shareholding through this route.

The ruling also highlights the significance of valuation methodology in corporate transactions. The DCF method, as used by Philips, is often preferred for companies with steady revenue models, while the Comparable Companies approach is typically used when there are similar publicly traded companies for benchmarking. The NCLT acknowledged that Philips' business model was unique, making DCF a more appropriate method. However, the sharp variance in valuations between Philips' report and that of the minority shareholders raises concerns over the subjectivity of valuation models and the potential for disputes in corporate restructuring.

One of the broader implications of this ruling is the impact on minority shareholder protection. While the judgement prevents involuntary exclusion of minority shareholders through capital reduction, it also complicates corporate restructuring efforts by limiting the avenues available for companies to consolidate ownership. With reverse flipping—where Indian companies reincorporate within India after previously being structured offshore—gaining momentum, this ruling could create hurdles for companies seeking to streamline ownership structures.

Given the challenges posed by the NCLT's restrictive interpretation of Section 66, Section 236 of CA 2013 could serve as an alternative route for majority shareholders to acquire minority stakes. However, Section 236 grants minority shareholders the option to reject the offer, making it a less effective tool for forced exits. This creates a dilemma where majority shareholders seeking to consolidate control may have limited legally viable options.

The judgement also draws a critical distinction between capital reduction and buyback. While Section 66 allows for selective reduction, buybacks under Section 68 must be conducted proportionately among all shareholders. The tribunal's reasoning that Philips' capital reduction resembled a buyback raises questions about the legal interpretation of these provisions and the extent to which capital reduction can be used as a tool for restructuring.

In conclusion, the NCLT's ruling in Philips India's case underscores the complexities and evolving legal landscape of capital reduction, minority shareholder rights, and valuation disputes in India. While the decision protects minority shareholders from forced exits, it may inadvertently discourage companies from using capital reduction as a legitimate restructuring tool. The legal community and businesses will be watching closely to see if higher courts provide further clarity on the scope of Section 66 and whether alternative mechanisms such as Section 236 or structured buybacks emerge as more viable options for corporate restructuring.

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