SUGGESTED ANSWERS

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING AND INSOLVENCY

(PP-CRI/2010)

THE INSTITUTE OF
Company Secretaries of India
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THE INSTITUTE OF COMPANY SECRETARIES OF INDIA

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PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING AND INSOLVENCY

TEST PAPER 1/2010

(This Test Paper is based on Study Lessons 1 to 8)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Answer ALL Questions*

Question No. 1

(a) Mergers, demergers, takeovers or combinations or acquisitions take place as a vehicle for achieving faster corporate growth. Discuss. (8 marks)

(b) State with reasons whether the following statements are True or False:

1. Court is bound to sanction the scheme of compromise or arrangement.

2. Strategic planning and long range planning are one and the same thing.

3. Where the registered office of the companies fall in the same state separate applications are to be moved to the High court for the purpose of sanction of the scheme of amalgamation.

4. Transfer of any capital asset by demerged company to a resulting Indian company would attract capital gains tax. (2 marks each)

(c) "Core competencies evolve over time". Elucidate (4 marks)

Answer to Question No. 1(a)

Mergers, demergers, takeovers or combinations or acquisitions take place as a vehicle for achieving faster corporate growth. Mergers, amalgamations, acquisitions, consolidation and takeovers are the expressions that have become common to the corporate sector. The wave of economic reforms and liberalization has transformed the business scenario all over the world and integration of national economies and emergence of market oriented globalized economy leads to formations of such combinations.

A merger has been defined as 'the fusion or absorption of one thing or right into another'. A merger has also been defined as an arrangement whereby the assets of two (or more) companies become vested in, or under the control of one company (which may or may not be one of the original two companies). Merger is an external strategy for growth of the organisation. Mergers take place for various reasons and simple cost – benefit analysis would tell whether the merger proposal is beneficial or not. A company does merger or amalgamation to meet certain objectives such as addition of capacity, elimination of competition, acquisition of market share, acquisition of valuable assets, venturing a new activity.

Takeover is a strategy of acquiring control over the management of another company-

either directly by acquiring shares or indirectly by participating in the management. The objective is to consolidate and acquire major portion of the share of market economies of large scale, access to resourceful management, cheaper acquisition business etc. Acquisitions are often made as part of a company's growth strategy whereby it is more beneficial to take over an existing firm's operations and position compared to expanding on its own.

Demerger can be used by companies as a tool to focus on the core competency of the company. In a demerger company sells and transfers one or more of its undertakings to resulting company, for an agreed consideration. Even a revenue generator undertaking can be hived off. One might hive off an undertaking because it is not in line with the main business objectives.

Indian firms have gone for acquisitions as a route for achieving global scale. The unleashing of Indian Economy has opened up lucrative and dependable opportunities to business community as a whole. The absence of strict regulations about the size and volume of business encouraged the enterprises to opt mergers and amalgamations so as to produce on a massive scale, reduce costs of production, makes prices internationally competitive etc.

Synergy, core competencies, consolidation, desired scale of operations and a host of the reasons make a corporate restructuring an important tool. Every kind of restructuring benefits the promoters to enable them to achieve global standards and reach untapped markets swiftly. Restructuring is a path breaking step towards achieving faster corporate growth and attaining various other benefits such as:

(1) Synergistic operations – Coming together to produce a new or enhanced effect compared to separate effects.

(2) Economies of scale – Reduction in the average cost of production and hence in the unit costs when output is increased, to enable to offer products at more competitive prices and thus to capture a larger market share.

(3) Reduction in production, administrative, selling, legal and professional expenses.

(4) Integration – Combining two or more companies under the same control for their mutual benefit by reducing competition, saving costs by reducing overheads, capturing a larger market share, pooling technical or financial resources, cooperating on research and development, etc. Integration may be horizontal (or lateral) or vertical and the latter may be backward integration or forward integration.

(5) Optimum use of capacities and factors of production.

(6) Tax advantages – Carry forward and set off of losses of a loss-making amalgamating company against profits of a profit-making amalgamated company, e.g. Section 72A of the Income-Tax Act, 1961.

(7) Financial constraints for expansion – A company which has the capacity to expand but cannot do so due to financial constraints may opt for merging into another company which can provide funds for expansion.

(8) Strengthening financial strength.

(9) Diversification.

(10) Advantage of brand-equity.

(11) Loss of objectives with which several companies were set up as independent entities.

(12) Survival.

(13) Competitive advantage: The factors that give a company an advantage over its rivals.

(14) Eliminating or weakening competition.

(15) Revival of a weak or sick company.

(16) Sustaining growth.

(17) Accelerating company's market power and reducing the severity of competition.

Answer to Question No. 1(b)

1. *False*. The Court is duty bound to ascertain the bona fides of the scheme and whether the scheme is prima facie feasible. The Court will not act merely as a rubber stamp while sanctioning a scheme. The Court must consider the application on merits. [*N.A.P. Alagiri Raja & Company* v. *N. Guruswamy* (1989) 65 Comp. Cas. 758 (Mad.)].

2. *False*. Long-range planning is generally considered to mean the development of a plan for accomplishing a goal or set of goals over a period of several years, with the assumption that current knowledge about future conditions is sufficiently reliable. Strategic planning assumes that an organisation must be responsive to a dynamic, changing environment.

3. *False*. When the registered offices of both the companies are situated in the same State, a joint application or separate applications should be moved to the High Court having jurisdiction over the State in which registered offices of the companies are situated. They may make joint application or a separate application. If both are under jurisdiction of one High Court, joint application may be made. [*Mohan Exports Ltd.* v. *Tarun Overseas P. Ltd.* (1994).

4. *False*. According to Section 47(vib) of the Income-tax Act, 1961, where there is a transfer of any capital asset in a demerger by the demerged company to the resulting company, such transfer will not be regarded as a transfer for the purpose of capital gains provided the resulting company is an Indian company.

Answer to Question No. 1(c)

The concept about core competencies was developed by C.K. Prahalad and G. Hamel in 1990. 'Core Competency' is central to the resource-based perspective on corporate strategy. The resource-based view of strategy is that sustainable competitive advantage arises out of a company's possessing some special skills, knowledge, resources or competencies that distinguishes it from its competitors. Core competency is a bundle of specific knowledges, skills, technologies, capabilities and organisation which enables it to create value in a market that other competitors cannot achieve in the short term.

The concept is about that the companies, with time develop certain key areas of expertise, which are distinctive to that company and crucial to the company's long-term development. These areas of expertise may be in any area but are most likely to develop in the critical, central areas of the company where most value is added to its products.

Core competencies are not fixed and codified but flexible and evolving over time and changing in response to changes in the company's environment. As the company evolves and adapts to new circumstances and opportunities, so its core competencies will also adapt and change. In this way the company will be able to make the most of its given resources and apply them to new opportunities.

Prahalad and Hamel suggest three factors to help identify core competencies in a company.

(i) core competence provides potential access to a wide variety of markets.

(ii) core competence should make a significant contribution to the perceived customer benefits of the end product.

(iii) core competence should be difficult for competitors to imitate.

Question No. 2

(a) Your company ABC Ltd. is looking for an international venture by acquiring MSD Pharma of South Africa. Your MD wants you to prepare a note on matters to be considered for successful merger and reasons for unsuccessful merger. *(8 marks)*

(b) Give a brief account of funding of a scheme of merger or takeover through employees stock option scheme. *(8 marks)*

Answer to Question No. 2(a)

To,

Managing Director,

ABC Ltd.

Respected Sir,

Sub. : Detailed Note on matters related to successful merger and reasons for failure of a cross border merger.

A variety of strategic imperatives has been driving companies towards mergers and acquisitions. They include globalisation, consolidation, product-differentiation and customer demands, vertical integration, deregulation, technology integration and re-fashioning, market expansion. Considering, the fact that company is willing for a cross border merger with MSD Pharma of South Africa here are major concerns to be kept in mind for a successful merger:

— *Economic Concerns* : Cross-border mergers may not contribute to productive capacity during entry time, but simply transfer assets and ownership from domestic to foreign hands, which are generally accompanied by the reduction in production, R&D activities and employment. Also sometimes it reduces competition in domestic market and lead to monopoly of foreign acquirers.

— *Social, political and cultural concerns* : Since many cross-border mergers are infrastructure- related therefore they are directly linked to social and political opposition. So if the ownership of the national telecommunications or electricity or water provider is to switch to foreigners it may lead to great opposition. Also in the media and entertainment, cross-border mergers may threaten national culture or identity. Also if lots of enterprises are being acquired by foreigners it may be seen as loss of national sovereignty.

Following are the steps involved for Mergers to Succeed:

Partnering Criteria

— Select an Equity partner on strength of character, integrity and philosophy. Understand how will they behave in the long run ?

— People should be able to jointly solve problems instead of finding someone else to blame.

— Put substantial effort during the integration process.

— Plan for integration before doing the deal.

— Work the details.

— Develop a clear communication plan throughout the entire process.

— Ensure human integration by understanding and analyzing difference in cultures.

While cross border mergers have its own benefits of globalization, economies, etc., there are instances of failure too. While it is not possible to pin point any single reason, some of the reasons for unsuccessful mergers could be:

1. Insufficient investigation of the acquired company.
2. Corporation indigestion : To many companies acquired in too short a tie in diverse industries.
3. Too broad a diversification.
4. Overbid to acquire control of a company.
5. Faulty financial evaluation of M&A.

Failure of Integration could result from the following reasons:

— No plan for fit of personnel, plant and facilities	Clash of management styles
— Inadequate diligence by merger partners·	Incompatible marketing systems
— Lack of strategic rationale	Inability to implement change
— Unrealistic expectations of synergies	Inability to manage targets
— Conflicting corporate cultures	Failure to move quickly to merge the two companies

For a successful international merger, the integration of the economies, social political cultural structure is extremely important. Post merger compatibility of the companies should be evaluated on various parameters.

Considering the above, the company needs to first evaluate pros and cons of the prospected merger and the cultural and social environment of both the companies to be brought together. Proper planning for the post merger success requires proper planning and evaluation of all the parameters from the human factor to financial merger.

Thanking You,

Yours sincerely

(Company Secretary)

Answer to Question No. 2(b)

Employees' stock option scheme is a voluntary scheme on the part of a company to encourage its employees to have a higher participation in the company. Stock option is the right (but not an obligation) granted to an employee in pursuance of a scheme, to apply for the shares of the company at a pre-determined price. Suitable percentage of reservation can be made by a company for its employees or for the employees of the promoter company or by the promoter company for employees of its subsidiaries, as the need may arise.

The companies reserve shares under the employees' quota to allot shares to the bona fide employees, subject to the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 and the shares remaining unsubscribed by the employees may be offered to the general public through prospectus in terms of the issue.

As per the guidelines, no employee stock option scheme (ESOS) shall be offered unless the company constitutes a compensation committee for administration and superintendence of the ESOS. The Compensation Committee has to be a committee of the Board of Directors consisting of a majority of independent directors.

As a safeguard, the regulations provide that no ESOS can be offered to the employee of a company unless the shareholders of the company approve ESOS by passing a special resolution in a general meeting.

Funding of entire scheme of merger or amalgamation is not possible with employee stock option scheme, this should be used along with other options of funding. The share capital that may be raised through a Scheme of Employees' Stock Option can only be a fraction of the entire issue. Hence no company can imagine of funding any scheme of merger or takeover entirely through this route.

Question No. 3

(a) Write a brief note on provisions relating to competitive bid under SEBI (Substantial acquisition of shares and takeover),Regulations 1997 ?

(8 marks)

(b) *XYZ Ltd. is intending to acquire ABC Ltd. by merger and the following information is available in respect of both the companies :*

	XYZ Ltd.	*ABC Ltd.*
No. of equity shares	*5,00,000*	*3,00,000*
Profit after tax (Rs.)	*25,00,000*	*9,00,000*
Market price per share (Rs.)	*21*	*14*

(i) *Calculate the present EPS of both companies.* *(1 mark)*

(ii) *If the proposed merger takes place, what would be the new EPS for XYZ Ltd ? Assume that the merger takes place by exchange of equity shares and the exchange ratio is based on the current market price.* *(3 marks)*

(iii) *Will you recommend the merger of both the companies ? Justify your answer.* *(4 marks)*

Answer to Question No. 3(a)

A Competitive bid is a bid by any person, other than the acquirer who has made the first public announcement. In a competitive bid a person, other than the acquirer, shall, within 21 days of the public announcement of the first offer, make a public announcement of his offer for acquisition of the shares of the same target company. Any competitive bid shall be for such number of shares which, when taken together with the shares held by him along with persons acting in concert, shall be at least equal to holding of the first bidder including the number of shares for which the first public announcement has been made.

No public announcement for a competitive bid shall be made after 21 days from the date of public announcement of the first offer.

Upon the public announcement of a competitive bid or bids, the acquirer who had made the public announcement of the earlier offer shall have the option to make an announcement revising the offer. However if no such revision offer announcement is made within fourteen days of the announcement of the competitive bid, the earlier offer(s) on the original terms shall continue to be valid and binding on the acquirer(s), who had made the offer(s) except that the date of closing of the offer shall stand extended to the date of the closure of the public offer under the last subsisting competitive bid.

The acquirers who have made the public announcement of offer including public announcement of competitive bid shall have the option to make upward revision in his offer, in respect of the price and the number of shares to be acquired, at any time, seven working days prior to the date of closure of the offer.

Any such upward revision shall be made only upon the acquirer:

(a) Making a public announcement in respect of such changes or amendments in all the newspapers in which the original public announcement was made;

(b) Simultaneously with the issue of public announcement referred in clause (a)

informing SEBI, all the stock exchanges on which the shares of the company are listed, and the target company at its registered office; and

(c) Increasing the value of the Escrow Account. The date of closure of original bid as also the date of closure of all subsequent competitive bids shall be the date of closure of public offer under the last subsisting competitive bid.

Regulation 27 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, provides that no public offer, once made, shall be withdrawn except when:

(a) the statutory approval(s) required have been refused;

(b) the sole acquirer, being a natural person, has died; and

(c) there are such circumstances which in the opinion of SEBI merits withdrawal.

In the event of withdrawal of the offer under any of the above circumstances the acquirer or the merchant banker shall:

(a) make a public announcement in the same newspapers in which the public announcement of offer was published indicating reasons for withdrawal of the offer; and

(b) simultaneously with the issue of such public announcement, inform (i) the Board, (ii) all the stock exchanges on which the shares of the company are listed; and (iii) the target company at its registered office.

Answer to Question No. 3(b)

(i) Calculation of EPS

Earning Per Share = Profit after tax/No. of Equity shares

XYZ Ltd. — 25,00,000/5,00,000 = Rs. 5

ABC Ltd. — 9,00,000/3,00,000= Rs. 3

(ii) As the exchange ratio is based on the market price hence,

No. shares to be issued to ABC Ltd. will be

(3,00,000x14)/21 = 2,00,000 shares

Total No. of shares of XYZ Ltd. post merger

5,00,000+2,00,000 = 7,00,000

Total Profit after Tax post merger

25,00,000+9,00,000 = 34,00,000

EPS post merger

34,00,000/7,00,000 = Rs. 4.86

(iii) EPS of XYZ Ltd. company falls from Rs.5 to Rs. 4.86.On the other hand ABC Ltd. is benefited by rise in EPS from Rs. 3 to Rs. 4.86. Shareholders value of ABC Ltd. have risen to Rs. 9,72,000 i.e (2,00,000 shares x Rs. 4.86).

Question No. 4

(a) *Discuss the factors involved in post merger reorganization.* *(10 marks)*

(b) *Corporate restructuring is carried out to meet certain predetermined objectives. Discuss.* *(6 marks)*

Answer to Question No. 4(a)

'Post-merger reorganisation' is a wide term which encompasses the reorganisation of each and every aspect of the company's functional areas to achieve the objectives planned and aimed at. The parameters of post merger reorganisation are to be established by the management team only after considering requirements, objectives of merger and management corporate policy. Timely integration of systems evaluation of corporate information is the key to achieve post merger success, considering this here are the factors to be kept in mind by the management team in post merger reorganization.

1. *Gain or loss to stakeholders* : Post merger success depends upon the terms and conditions of the merger and the track record of the transferee or acquirer company. In certain cases, acquisition attempts cause an increase in share price, which benefits the share holders of the target company. Acquisition integration process involves actions suggested by the consultants and merchant bankers and the actions taken by the finance executives, operational heads, HRD head and legal advisors.

2. *Implementation of Objectives* : It is extremely important for the post merger integration that the senior management focuses on developing a 'post-transaction' strategy and integration plan that will generate the revenue enhancements and cost savings that initially prompted the merger or acquisition. After merger or acquisition, the resources of two or more companies should be put together for producing better results through savings in operating costs because of combined management of production, marketing, purchasing, resources etc. To implement the objectives of mergers or acquisitions, there are various factors, which are required to be reorganized in the post merged or acquired company. Such factors can be grouped in the following heads:

   (a) *Legal Requirements* : Fulfilment of legal requirements in post-merger reorganisation of any amalgamating company becomes essential for an effective and successful venture. Adherence of guidelines, regulations and directives of the regulatory bodies should be ensured by the amalgamating companies.

   (b) *Combination of operations* : Consolidation of the operations of transferor company with transferee Company covering production process, technological aspects, manpower requirements, working schedule etc. is important for success of the merger. Integration is carried out in a phased manner after proper planning and extensive preparation .

   (c) *Top Management Changes* : At Senior managerial level, changes for reorganisation involves induction of the directors of the transferor company on the Board of the amalgamating company, or induction of reputed and influential persons from outside who have expertise in directing and policy

planning. Changes at this level are particularly affected to adjust in suitable positions the top executives of the amalgamated company to create a congenial environment and cohesive group leadership within the organization.

(d) *Management of financial resources* : Restructuring of company is a step towards meeting the growth prospects of a company. Considering the growth prospects management plans in advance about the financial resources which would be available to the company to finance its post-merger plans. Such preplanning is based on certain assumptions which might change post-merger depending upon the volatility of a variety of factors involved. Therefore, it is important to revamp the financial resources of the company to ensure optimum utilisation of the financial resources available and the liquidity requirements.

(e) *Financial Restructuring* : Financial restructuring becomes essential in post merger reorganisation. Financial restructuring is characterised by liquidity crisis, 'abnormal' balance sheets and negative equity. Reorganisation of financial structure would be a post-merger event which might compel the company to change its capital base, revalue its assets and reallocate reserves. Replacement of costlier fundings by cheaper borrowings on a long and short term basis as per requirement is one of the several ways and means of financial restructuring for a company.

(f) *Rationalisation of Labour Cost* : Post merger reorganisation needs rationalisation of labour cost as it forms the primary factor of prime cost of any product and service. The combined labour force available to the transferee company is to be reviewed in accordance with the requirements of the combined operational functions.

(g) *Production and marketing management* : With regard to the size of the company and its operational scale, its product mix should be adjusted during post-merger period. Management has to choose from various alternatives like adding or dropping out products. Another aspect of production is to improve productivity and cost-reduction without affecting product quality.

(h) *Corporate planning and control* : Corporate planning to a large extent is governed by the corporate policy. Corporate policy prescribes guidelines that govern the decision making process and regulates the implementation of the decisions. The company planning is associated with the management control so that deviations in the planned targets and achievements are recorded and their causes are traced out for remedial measures. Decisions about management structure, key roles, reporting relationships, restructuring, etc. should be made, announced and implemented as soon as possible after the deal is signed.

3. *Integration of businesses and operations* : There are some critical aspects that should be taken into account in the integration stage of a M&A. which are as follows

— *Focus on people and incentive* : changes in the vision, leadership or organization of the newly-formed firm can have important effects on how potential innovators perceive the relevant costs and benefits.

— *Integrate selectively* : The areas where the processes are more standardized and less human capital-intensive are in general more amenable to integration.

— *Prompt decision and communication of the new rules* : Delaying or ineffectively communicating the new rules of the game unnecessarily brings additional uncertainty into the process. Highly mobile human capital may well not be very patient.

4. *Financial Accounting* : Financial aspects of the transaction are of prime importance. It denotes the benefits in terms of financial benefits, i.e., increase in productivity, improved profitability and enhanced dividend paying capacity of the merged or the amalgamated company, which the management of each company involved in this exercise would be able to derive.

5. *Taxation Aspect* : 'Amalgamation' is defined under Section 2(1B) of the Income Tax Act 1961.It provides for three conditions to be satisfied for a merger to qualify as an 'amalgamation'. It covers treatment of various aspects of amalgamation such as Capital Gains Tax, Preliminary Expense, Scientific Research Expenditure, Expenditure on Acquisition of patent and copyright, etc.

Answer to Question No. 4(b)

Corporate Restructuring is concerned with arranging the business activities of the corporate as a whole so as to achieve certain predetermined objectives at corporate level. Such objectives include the following:

— orderly redirection of the firm's activities;

— deploying surplus cash from one business to finance profitable growth in another;

— exploiting inter-dependence among present or prospective businesses within the corporate portfolio;

— risk reduction; and

— development of core competencies.

Corporate Restructuring also aims at improving the competitive position of an individual business and maximizing it's contribution to corporate objectives. It also aims at exploiting the strategic assets accumulated by a business i.e. natural monopolies, goodwill, exclusivity through licensing etc. to enhance the competitive advantages. Thus restructuring would help bringing an edge over competitors. Global Competition drives people to think big and it makes them fit to face global challenges. Global competition drives enterprises and entrepreneurs to become fit globally. The scope of Corporate Restructuring encompasses enhancing economy (cost reduction) and improving efficiency (profitability). When a company wants to grow or survive in a competitive environment, it needs to restructure itself and focus on its competitive advantage. The survival and growth of companies in this environment depends on their ability to pool all their resources and put them to optimum use.

Corporate Restructuring aims at different things at different times for different companies and the single common objective in every restructuring exercise is to eliminate

the disadvantages and combine the advantages. The various needs for undertaking a Corporate Restructuring exercise are as follows:

(i) to focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.

(ii) consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.

(iii) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.

(iv) acquiring constant supply of raw materials and access to scientific research and technological developments.

(v) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.

(vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

Question No. 5

(a) While in a scheme of amalgamation of PQ Ltd. objections were raised by the Regional Director in respect of sanction of scheme of amalgamation stating that (a) there was name change of the transferee company under provisions of section 21 of the Act in respect of filing of necessary forms with Registrar of Companies and (b) upon the sanction of the scheme the authorized capital of the company would automatically increase requiring payment of stamp duty and fees to registrar of companies. The company is directed to comply with sections 94 and 97 of the Act. Are the Regional Director objections correct? Comment citing recent case law. (6 marks)

(b) Prepare a check list of activities and documents involved, for Transferor Company in the case of takeover. (10 marks)

Answer to Question No. 5(a)

Objections raised by Regional Director in the scheme of amalgamation of PQ Ltd., are discussed as under:

(a) in respect of objection concerning the name change, the furnishing of the notice to the Registrar of Companies of the scheme would constitute substantial compliance with the provisions of section 21 of Companies Act.

(b) in respect of objection concerning the authorized capital compliance under section 94 and 97 of the Act, Section 97 of the Companies Act, 1956 (the Act) requires the company increasing its authorized capital to give notice of such increase of capital to the concerned ROC for recording the same and to effectuate the necessary alterations in the Memorandum and Articles of Association of the company. In case of a merger, separate furnishing of notice under section 97 for increase of capital is sufficiently complied with by the furnishing of the notice to the Registrar of Companies of the scheme. Section 391 is a complete code in itself, it is in the nature of 'single window

clearance'. This was also held in the case of PMP Auto Industries Ltd. that there is no need to separately follow the procedure under Section 97 of the Act as the filing of the court's sanction order with ROC takes care of the same.

In *You Telecom India P. Ltd.* v. *You Broadband Networks India (P) Ltd.* (2008) The Bombay High Court overruled the objections raised by Regional Director stating that notice furnished to ROC of sanctioned scheme is sufficient for compliance u/s 21 of the Act, hence no separate notice be sent to Registrar. Secondly, the increase in authorized capital was a amalgam of the authorized share capital of the transferor and transferee companies, Section 391 is intended to ensure that parties are not put to unavoidable, unnecessary, and cumbersome procedure of making repeated notices, hence increase in authorized capital does not require filing of separate fees.

Answer to Question No. 5(b)

The transferor company has to take care of the following points:

1. The offer of a company (Transferee Company) to acquire shares of a Transferor Company should be received from the transferee company.
2. It should have been approved by the Board of Directors at a duly convened and held meeting. If proviso to Sub-section (1) of Section 395 is attracted, the terms of offer should be same for all the holders of that class of shares, whose transfer is involved.
3. Offer received from the transferee company along with other documents, particulars etc. should have been circulated to the members of the company in e-Form No. 35A prescribed in the Companies (Central Government's) General Rules and Forms, 1956. [For e-form 35A]
4. E-form No. 35A must be filed with the Registrar of companies before issuing to the members of the company.
5. The scheme or contract for transfer of shares of the company to the transferee company has been approved by the shareholders of not less than nine-tenths in value of the shares within the stipulated period of four months. If proviso to Sub-section (1) of Section 395 is attracted, the number of such approving shareholders should comprise not less than three-fourths in number of the holders of the shares proposed to be transferred.
6. Comply with any order of the court if any dissenting shareholder had approached the Court against the proposed transfer and if the Court had passed any order contrary to the proposed transfer.
7. If the transferee company wanted to acquire the shares held by dissenting shareholders, the transferor company has received from the transferee company a copy of the notice sent by the transferor company to the dissenting shareholders together with duly filled in and signed transfer instruments along with value of the shares sought to be transferred.
8. The transferee company should have been registered as holder of the transferred shares and the consideration received for the shares has been deposited in a separate bank account to be held in trust for the dissenting shareholders.

Documents etc. involved in this process:

1. Offer of a scheme or contract from the transferee company.
2. Minutes of Board meeting containing consideration of the offer and its acceptance or rejection.
3. Notice calling general meeting.
4. e-form No. 35A circulated to the members.
5. Minutes of general meeting of the company containing approval of the offer by statutory majority in value and in numbers also, if required.
6. Court order if any.
7. Copy of e-form No. 21 which has been filed with the Registrar along with a copy of the Court Order.
8. Register of Members.
9. Notice sent by the transferee company to dissenting shareholders for acquiring their shares.
10. Duly filled in and executed instrument(s) of transfer of shares held by the dissenting shareholders.
11. Bank Pass Book or Statement of Account in respect of the amount deposited in the special bank account to be kept in trust for the dissenting shareholders.
12. Annual Report.

Question No. 6

Write short notes on any four of the following

(a) Conglomerate merger

(b) Creeping acquisition

(c) Leveraged buy out

(d) Continual disclosures

(e) Reverse merger *(4 marks each)*

Answer to Question No. 6(a)

Conglomerate merger : This type of merger involves coming together of two or more companies engaged in different industries and/or services. Their businesses or services, are neither horizontally nor vertically related to each other. They lack any commonality either in their end product, or in the rendering of any specific type of service to the society. The merging companies operate in unrelated markets having no functional economic relationship.

Answer to Question No. 6(b)

Creeping Acquisition : An acquirer who seeks to acquire further shares under Regulation 11(1) of SEBI (Sustantial Acquisition of Shares and Takeovers) Regulations, 1997 shall not acquire such shares during the period of 6 months from the date of closure of public offer at a price higher than offer price. This shall not be applicable

where acquisition is made through stock exchanges. The letter of offer should contain the basis on which the price has been determined. As per Regulation 21A of the Regulations the price at which creeping acquisition is proposed to be made is not less than the offer price. Price related restriction does not apply to acquisition through stock exchanges.

Answer to Question No. 6(c)

Leveraged Buyout : Leveraged Buyout (LBO) is defined as the acquisition by a small group of investors, financed largely by borrowing. This acquisition may be either of all stock or assets, of a hitherto public company. The buying group forms a shell company to act as the legal entity making the acquisition. This buying group may enter into stock purchase deal or asset purchase deal. Under the stock purchase device, the shareholders sell their stock in the target company to the buying group and then the two firms may be merged. Under the asset purchase mode, the target company sells its assets to the buying group. This exercise aims at generating enormous increase in the market value and value gains for shareholders both who own the firm before the restructuring and after the restructuring.

Answer to Question No. 6(d)

Continual Disclosures under SEBI (Sustantial Acquisition of Shares and Takeovers) Regulations, 1997 : Regulation 8 of the said regulations provide for timely disclosures and applies to two categories of persons. A person, who holds more than fifteen per cent shares or voting rights in any company falls under the first category. He is required to make yearly disclosure to the company, within 21 days from the financial year ending 31st March, in respect of his holdings as on 31st March.

The promoter or every person having control over a company falls under the second category. He shall give his disclosure twice i.e. within 21 days from the financial year ending 31st March as well as within 21 days from the record date of the company for the purposes of declaration of dividend. He shall disclose the number and percentage of shares or voting rights held by him and by persons acting in concert with him in that company, to the company.

Every company, whose shares are listed on a stock exchange, shall likewise give its disclosure twice i.e. within 30 days from the financial year ending 31st March, as well as within 30 days from the record date of the company for the purposes of declaration of dividend. It shall make yearly disclosures to all the stock exchanges on which the shares of the company are listed. The disclosures shall be made, of the changes, if any, in respect of the holdings of the persons and also holdings of promoters or person(s) having control over the company.

As per Regulation 8(4) every company, whose shares are listed on a stock exchange, is required to maintain a register in the specified format to record the specified information received by it from specified persons and promoters.

Answer to Question No. 6(e)

Reverse Merger : Reverse merger takes place when a healthy company amalgamates with a financially weak company. In the context of the provisions of the Companies Act, 1956, there is no difference between regular merger and reverse merger.

It is like any other amalgamation. Reverse merger automatically makes the transferor-company entitled for the benefit of carry forward and set-off of loss and unabsorbed depreciation of the transferee-company. Section 72A ensures the tax relief, which becomes attractive for such reverse mergers, since the healthy and profitable company can take advantage of the carry forward losses/of the other company. The healthy units loses its name and surviving sick company retains its name. A reverse merger is carried out through the High Court route. However, where one of the merging companies is a sick industrial company in terms of the Sick Industrial Companies (Special Provisions) Act, 1985, such merger has necessarily to be through the Board for Industrial and Financial Reconstruction (BIFR). On the reverse merger becoming effective, the name and objects of the sick company (merged company) may be changed to that of the healthy company.

TEST PAPER 2/2010

(This Test Paper is based on Study Lessons 9 to 15)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Answer ALL Questions*

Question No. 1

(a) *Briefly discuss the role of Lok Adalats in disposing of cases relating to debt recovery ?* *(6 marks)*

(b) *Discuss the grounds on which a company may be wound up by the court.* *(10 marks)*

Answer to Question No. 1(a)

The concept of Lok Adalat is of recent origin and is set up under the Legal Service Authorities Act, 1987 (39 of 1987). Where the borrower and the banker are not able to arrive at a compromise, Lok Adalat can prove to be successful in bringing the borrower to terms by using some kind of social pressure.

Lok Adalats are being organized at different places under the auspices of local judiciary and voluntary organizations with the object of speedy disposal of disputes of different kinds. Bank's claims against its borrowers are also being taken-up by such Lok Adalats. The Indian Banks Association (IBA) has considered the matter relating to participation by banks before Lok Adalats by which cases of banks are settled speedily and also saving legal charges.

If either of the parties does not give consent for settlement of dispute through Lok Adalat, the Lok Adalat cannot settle the matter. The procedure followed by lok adalats is not like civil suits, which are tried by the ordinary civil court. Neither the Lok Adalat records any evidence, nor are any arguments heard for deciding intricate legal question. The presiding members of Lok Adalat, are usually social workers. The members discuss the matter with both the parties without the help of their advocates and make efforts to bring the parties to an amicable settlement in the spirit of give and take. The members persuade the parties to settle the matter on the basis of a reasonable agreement. If a settlement is arrived at, terms thereof are recorded by the Presiding Officer of the Lok Adalat and signed by the parties. If there is no settlement, the matter is left unresolved.

Settlements arrived at Lok Adalats are not legally enforceable, as Lok Adalats do not have statutory status. where settlement has been arrived at, in a matter regarding which no civil suit is pending, the settlement has to be filed before a competent court of civil jurisdiction in the form of a plaint for obtaining a decree in terms of the settlement. On the other hand, where settlement has been arrived at in respect of a matter for which a civil suit is already pending, the settlement has to be filed in the form of a compromise and the court passes necessary decree in the civil suit itself. Thus, settlements arrived at before Lok Adalats can be made legally enforceable only by obtaining appropriate court decree.Several State governments have announced remissions in court fees where matters are settled through Lok Adalats.

In settling claims of Banks before Lok Adalats following precautions should be taken:

(a) Where there is a guarantor to the loan the liability of the guarantor should also be settled before the Lok Adalat and incorporated in the settlement and decree, co-extensive with the borrower.

(b) Where there are securities in the nature of hypothecation/pledge/mortgage, recourse to the Bank, for selling such securities should also be incorporated in the settlement, and also in the consequential decrees to be obtained.

(c) Decree in appropriate forms should be obtained immediately from civil court upon settlement of a claim from Lok Adalat.

(d) Where the settlement/decree provides for payment of settled amount in instalments, a suitable default clause should also be incorporated in the settlement/ decree to the effect that in default of payment of any two instalments, the entire liability will become due and payable forthwith in lump-sum.

(e) In case of mortgage claims, the settlements should provide for passing of an outright final mortgage decree by the court surpassing the stage of preliminary decree.

(f) Where the borrowers/guarantors commit default in making payment in accordance with the terms of the settlement/decree, immediate steps for execution of decree and realization of securities should be taken.

(g) When settlements are arrived at in respect of cases pending before civil courts, refund of court fees paid on the plaint should be applied for, with the court in which the suit was filed.

Answer to Question No. 1(b)

Winding up by the Court or compulsory winding up is initiated by an application by way of petition to the appropriate Court for a winding up order. A winding up petition has to be resorted to only when other means of healing an ailing company are of absolutely no avail. Remedies are provided by the statute on matters concerning the management and running of company. There must be strong reasons to order winding up as it is a last resort to be adopted. Temporary difficulty cannot be ground for liquidating company when company is on path of revival. *D. Ashokan* v. *S.T. Reddiar & Sons (2002)*. Section 433 of Companies Act '1956, a company may be wound up by the Court if:

(a) The company has passed special resolution: A company may be wound up for any cause whatever if it passes a special resolution to that effect. The Court is, however, not bound to order winding up simply because the company has so resolved. The power may not be exercised if the winding up is opposed to the public or company's interest. The power of the Court in such a case is discretionary and should be exercised only where a bona fide case is made out.

(b) Default in filing statutory report or holding statutory meeting(sub section (3)): Petition for winding up of a company on this ground can only be made by either of the following:

  (i) Registrar with the previous sanction of the Central Government

(ii) A contributory on or after the expiration of 14 days after the last day on which the statutory meeting ought to have been held.

The power of the Court is discretionary. Instead of making an order for winding up, the Court may direct that the statutory report shall be filed or a meeting should be held, as the nature of the default may be. The Court may order the costs to be paid by any persons who, in its opinion, are responsible for the default.

(c) Non-Commencement or Suspension of Business: If a company does not commence its business within a year from its incorporation or has suspended business for a whole year, it may be ordered to be wound up. The power of the Court is discretionary and will be exercised only when there is a fair indication that there is no intention to carry on business or where the delay has been sufficiently accounted for and there is no evidence or any probability of its commencing its business within a reasonable time. Where a company having many businesses discontinues one of them, it cannot be said to have suspended its business [*Paramjit Lal Badhwar* v. *Prem Spg. and Weaving Mills Ltd. (1983)*. The decisive question is whether there is reasonable hope of the company commencing or resuming business and doing it at profit and whether substratum of the company has disappeared. Another consideration is taking into account the wishes of majority of shareholders about continuing the business.

(d) Reduction of members below minimum: If the number of members is reduced, in the case of a public company, below seven, and in case of a private company, below two, the company may be ordered to be wound up. The word "member" in clause (d) of Section 433 means actual members and does not include past members or representatives of the deceased members, or trustees or assignees of bankrupt members. The Court usually in such a case does not order winding up, but leaves it to the company to go into voluntary liquidation. This ground for winding up is meant to enable a member to escape personal liability for the company's debts which he will incur under Section 45 of the Act.

(e) Inability to pay debts: Section 434 of the Companies Act lays down the specific circumstances when the company shall be deemed to be unable to pay its debts. These are:

(i) If a creditor to whom the company owes more than Rs. 500/- then due, has served on the company a demand in writing for payment of the debt and the company has within three weeks thereafter, neglected to pay or secure or compound for it to the reasonable satisfaction of the Court. The debt must be really due and not under dispute.

(ii) If an execution or other process has not been satisfied by the company. The decree or order contemplated by this clause is confined not to money decree only but is of a general nature.

(iii) If it is proved to the satisfaction of the Court that the company cannot pay its debts including the contingent and prospective liabilities, it may be ordered to be wound up. The company is liable to be wound up if it is unable to pay its current demands even though the assets, when realised, would exceed

its liabilities or where its assets are locked up and it is running at a loss. A debt must be a definite sum of money payable immediately or at a future date. A contingent or conditional liability is not a debt unless the contingency or condition has already happened [*Registrar of Companies* v. *Kavita Benefit Pvt. Ltd.*]

(f) *Just and Equitable* : If the Court is of opinion that it is just and equitable that the company should be wound up, it may be ordered to be wound up. In this case, the Court has wide powers and has a complete discretion to decide when it is just and equitable that the company should be wound up. Some of the cases by way of illustration are given here in which, the Court ordered winding up of the company under 'just and equitable' clause to indicate the general categories:

(i) Where the whole object of the company was fraudulent

(ii) Where the substratum of the company is gone. The substratum of a company is deemed to have gone where (a) the subject matter of the company is gone, or (b) the object for which it was formed has substantially failed, or (c) it is impossible to carry on the business of the company except at a loss, or (d) the existing and possible assets are insufficient to meet the existing liabilities of the company.

(iii) Where the main object of the company for which it was incorporated has been completely achieved.

(iv) Where there is a complete deadlock in the management of the company e.g., where two shareholders, who were also directors of private company, were not on speaking term [In Re. *Yenidjye Tobacco (1916)*].

(v) Where the main business of the company has been taken over by the Government and there is no prospect of the company doing any other business mentioned in the objects clause of the Memorandum of Association.

(vi) Where the company is insolvent and its business is being carried on for the benefit of the debenture holders.

(vii) Where there has been mismanagement and misapplication of funds by the directors of private company.

(viii) Where the petitioner was excluded from all participation in the business of a private company.

Question No. 2

(a) State with reasons whether the following statements are True or False:

1. "Net Worth means the total paid up capital of the company" under SICA Act 1985.

2. Any borrower or any aggrieved person can file an appeal to Debt Recovery Tribunal under Securitisation Act 2002.

3. Committee of Inspection appointed by creditors shall not have more than 5 persons as members of the committee.

4. The Board of Directors can authorize the buy back of securities not exceeding 25% of free reserves of the company.

5. Reducton in minimum number of members of a company may call for its winding up. (2 marks each)

(b) Describe 'financial restructuring'. Give an account of the steps that are taken in case of under-capitalisation and over-capitalisation ? (6 marks)

Answer to Question No. 2(a)

(1) *False* : Under SICA Act 1985 "Net worth" means the sum total of the paid-up capital and free reserves. For this purpose, "free reserves' means all reserves credited out of the profits and share premium account but does not include reserves credited out of re-valuation of assets, write back of depreciation provisions and amalgamation.

(2) *True* : Section 17 of the Securitisation Act provides that any borrower or any other person aggrieved by the action of the secured creditors can file an appeal to the concerned Debt Recovery Tribunal.

(3) *False* : The creditors may appoint a Committee of Inspection consisting of not more than 5 persons; and in that event, the company may also appoint not more than 5 persons to be members of the committee, subject to the power of the creditors to disapprove any nominee of the company.

(4) *False* : The Board of directors of a company are authorized to pass resolution for buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company. [Proviso to Section 77A(2) of Companies Act 1956].

(5) *True* : Under Section 433(d), If the number of members is reduced, in the case of a public company, below seven, and in case of a private company, below two, the company may be ordered to be wound up. The word "member" in the aforesaid clause means actual members and does not include past members or representatives of the deceased members, or trustees or assignees of bankrupt members.

Answer to Question No. 2(b)

Financial restructuring of a company involves a rearrangement of its financial structure so as to make the company's finances more balanced. A company is required to balance between its debt and equity in its capital structure and the funding of the resulting deficit. When, during the life time of a company, any of the following situations arise, the Board of Directors of a company is compelled to think and decide on the company's restructuring:

(i) necessity for injecting more working capital to meet the market demand for the company's products or services;

(ii) when the company is unable to meet its current commitments;

(iii) when the company is unable to obtain further credit from suppliers of raw materials, consumable stores, bought-out components etc. and from other parties like those doing job work for the company.

(iv) when the company is unable to utilise its full production capacity for lack of liquid funds.

An under-capitalized company may restructure its capital by taking one or more of the following corrective steps:

(i) injecting more capital whenever required either by resorting to rights issue/ preferential issue or additional public issue.

(ii) resorting to additional borrowings from financial institutions, banks, other companies etc.

(iii) issuing debentures, bonds, etc. or

(iv) inviting and accepting fixed deposits from directors, their relatives, business associates and public.

If a company is over-capitalized, its capital also requires restructuring by taking following corrective measures:

(i) Buy-back of own shares.

(ii) Paying back surplus share capital to shareholders.

(iii) Repaying loans to financial institutions, banks, etc.

(iv) Repaying fixed deposits to public, etc.

(v) Redeeming its debentures, bonds, etc.

Both, an under-capitalized and an over-capitalised company may restructure their capital by taking certain corrective steps.

Question No. 3

(a) What are the modes of reduction of share capital without the sanction of the court ? (6 marks)

(b) ABC ltd. is looking forward to restructure its capital by buying back its capital. Give a detailed note on conditions and obligations to be fulfilled by the company for this purpose. (10 marks)

Answer to Question No. 3(a)

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company. Section 100 of Companies Act 1956, requires court sanction for the reduction of share capital, if the articles of the company so authorise. The following are cases which amount to reduction of share capital but where no confirmation by the Court is necessary:

(a) *Surrender of shares* – "Surrender of shares" means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. The Companies Act contains no

provision for surrender of shares. Thus surrender of shares is valid only when Articles of Association provide for the same and:

(i) where forfeiture of such shares is justified; or

(ii) when shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. However, in the case of forfeiture, it is at the initiative of company and in the case of surrender it is at the initiative of member or shareholder.

(b) *Forfeiture of shares* – A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Court.

Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised bona fide and in the interest of the company.

(c) Diminution of capital – Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 94(1)(3)].

(d) Redemption of redeemable preference shares.

(e) Purchase of shares of a member by the company under Section 402.

(f) Buy-back of its own shares under Section 77A.

Answer to Question No. 3(b)

Buy-back of shares means the purchase by the company of its own shares. Under Section 77A of the Companies Act, 1956 any company limited by shares or a company limited by guarantee and having a share capital can buy-back its own securities, whether it is a private, public, listed or unlisted company.

The buy-back in respect of shares or other specified securities which are not listed on any recognised stock exchange must be in accordance with the guidelines as may be prescribed [Section 77A(2)(g)]. The guidelines prescribed in this behalf are Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

Buy-back of securities should be authorised by the Articles of Association of the company. [Section 77A(2)(a)]. The Board of directors of a company are authorized to pass resolution for buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company. [Proviso to Section 77A(2) of Companies Act 1956]. the shareholders can authorize the buy-back of securities not exceeding 25% of the total paid-up capital and free reserves of the company in that financial year. [Section 77A(2)(b) and (c)].

According to Section 77A(1) of the Companies Act, 1956 a company may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Following are the conditions and obligations to be followed by ABC Ltd. for the buy Back of securities:

I. Under Section 77A (2)(e) Only fully paid-up securities qualify for buy-back. If some securityholders have not made the payment of calls or any sums due on the securities, it would not disentitle the company from buy-back. However, the securities on which the call money remains in arrears cannot be bought back.

II. After buy-back, the company should have a debt-equity ratio not exceeding 2:1. All secured and unsecured debts of the company should not be more than twice the aggregate of its capital and free reserves.

III. Section 77AA provides that where buy-back of shares is made out of free reserves, the company should transfer to the capital redemption reserve account referred to in clause (d) of the proviso to Sub-section (1) of Section 80, a sum equal to the nominal value of the shares so bought back and the details of such transfer should be disclosed in the balance sheet.

IV. Section 77A(8) state that no further issue of the same kind of securities should be made within a period of 6 months from the date of completion of buy-back of securities. However, further issue of the same kind of securities is allowed by way of bonus issue or in discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

V. No issue of any security including bonus shares should be made till the closure of offer of buy-back.

VI. A company should not make any announcement in respect of buy-back of securities from the date of approval by the Board of any scheme of compromise or arrangement pursuant to the provisions of the Act, upto the date of filing of the court order with the Registrar.

VII. No offer of buy-back of securities should be made if such offer would result in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (Disclosure and Investor Protection) Guidelines, 2000 as applicable at the time of initial listing.

VIII. Convertible debentures can be bought back before the date of their conversion but such a purchase would amount to the company purchasing its own shares and all the provisions relating to buy-back shall become applicable.

IX. Promoters or persons acting in concert should not deal in the securities of the company while the buy-back offer is open.

Question No. 4

(a) *What is the procedural requirement for recognition of a foreign proceedings under UNCITRAL model laws ?* *(8 marks)*

(b) *Describe winding up of unregistered companies.* *(8 marks)*

Answer to Question No. 4(a)

Article 15 of UNCITRAL Model law defines the core procedural requirements for an application by a foreign representative for recognition. In incorporating the provision into national law, it is desirable not to encumber the process with additional requirements beyond these requirements. A foreign representative may apply to the court for recognition of the foreign proceeding in which the foreign representative has been appointed. An application for recognition shall be accompanied by:

(a) A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; or

(b) A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or

(c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.

An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative. The court may require a translation of documents supplied in support of the application for recognition into an official language of State.

According to Article 16, the court is entitled to presume that those documents are authentic whether or not they have been legalized. In respect of the provision relaxing any requirement of legalization, the question may arise whether that is in conflict with the international obligations of the enacting State. Several States are parties to bilateral or multilateral treaties on mutual recognition and legalization of documents. According to Article 3 of the Model Law, if there is still a conflict between the Model Law and a treaty, the treaty will prevail.

It further requires that an application for recognition must be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.

A foreign proceeding shall be recognized if:

(a) The foreign proceeding is a proceeding within the meaning as defined under Article 2;

(b) The foreign representative applying for recognition is a person or body within the meaning as defined under Article 2;

(c) The application meets the requirements of Article 15; and

(d) The application has been submitted to the court referred to in Article 4.

The purpose of Article 17 is to indicate that, if recognition is not contrary to the public policy of the enacting State and if the application meets all the requirements, recognition will be granted as a matter of course. A decision to recognize a foreign proceeding would normally be subject to review or rescission, as any other court decision.

Answer to Question No. 4(b)

Section 582 of the Act specifies "unregistered companies", which may be wound up by the order of the Court under the provisions of Part X of the Act. By virtue of that section, an "unregistered company" does not include the following:

(a) a railway company incorporated by any Act of Parliament or other Indian Law or any Act of Parliament of the United Kingdom;

(b) a company registered under the Companies Act, 1956; or

(c) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India.

Except as aforesaid, any partnership, association or company consisting of more than seven members at the time when the petition for winding up the partnership, association or company, as the case may be, is presented before the Court, will be deemed to be an unregistered company and may be wound up by the order of the Court. It should be noted that if the number of members is not more than seven, the Court has no jurisdiction to wind up such a company. It was held In *Polaroid Industries* v. *Nav Nirman Co. (2001)* that an unregistered partnership is an unregistered company and winding up of such partnership is permissible under Section 583, if number of partners are more than seven.

The Court cannot entertain a petition for winding up of a company formed in contravention of the provisions of Section 11 of Companies Act 1956. An illegal association "formed in contravention of Section 11 of the Companies Act, 1956, is not an unregistered company as defined by Section 582 above, and cannot be wound up under Section 583" as was held in *Raghubar Dayal* v. *The Sarafa Chamber,* AIR 1954.

The circumstances in which an unregistered company may be wound up by the Court are following:

(a) if the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs;

(b) if the company is unable to pay its debts;

(c) if the Court is of the opinion that it is just and equitable that the company should be wound up.

Question No. 5

(a) Draft a specimen agreement between the acquirer and the management of the target company. (8 marks)

(b) Draft notice of Extra Ordinary General Meeting to seek approval of shareholders to acquire shares of another company. (8 marks)

Answer to Question No. 5(a)

This Agreement entered at ……………. on this …………….. day of ……….., ………… between …………….(hereinafter referred to as the acquirer) and …………… (hereinafter referred to as the sellers' i.e. the holders of controlling interest in the offeree Company).

WHEREAS the acquirer is desirous of acquiring the substantial shares and taking over the management of…………………(the offeree Company);

AND WHEREAS the sellers holding ………. Equity shares aggregating to …………..% of the total paid up equity share capital of the offeree Company are desirous of selling their total paid up equity capital in the offeree company.

Now, therefore, for and in consideration of the mutual covenants and agreements herein contained, it is hereby agreed by and between the parties hereto as follows:

1. The sellers agree to sell to the acquirer …………. Equity Shares of the Offeree Company namely ……………. having its Registered Office at ……….. at a price of Rs. …………. per equity share aggregating to Rs. ……..
2. On execution of transfer deeds for the transfer of …….. equity shares of the offeree Company, the acquirer shall pay to the sellers the said consideration by cheque/demand draft.
3. The sellers agree to abide by their obligations as contained in SEBI (SAST) Regulations, 1997, as amended from time-to-time.
4. At the Board Meeting of the offeree Company at which the representatives of the acquirer will be co-opted, the following Directors of the sellers will vacate their positions as Directors by way of resignation:
   1. Mr. / Ms. ....
   2. Mr. / Ms. ....
   3. Mr. / Ms. ....
5. The acquirer has represented and the sellers believe that the acquirer has adequate financial resources to acquire shares from the remaining shareholders as per the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
6. It is clearly understood by and between the parties that it will be the sole responsibility of the acquirer to comply with the provisions of the applicable laws and obtain necessary approvals wherever required.
7. It is also understood by and between parties that the sellers will co-operate with the acquirer in furnishing any information required for the purpose of takeover.
8. It is agreed by and between the parties that in case the desired level of acceptance is not received, the acquirer shall not acquire any shares under the agreement and shall rescind the offer.

IN WITNESS WHEREOF the parties hereto have executed this agreement on the date and year first hereinabove written.

For Acquirer

IN THE PRESENCE OF

……………………

……………………

……………………

For Sellers

IN THE PRESENCE OF

……………………

……………………

……………………

Answer to Question No. 5(b)

Notice for extraordinary general meeting to seek approval of shareholders to acquire shares of another company

ABC Limited

Registered Office : ___________________________

NOTICE is hereby given that an Extraordinary General Meeting of the members of ABC Limited will be held at………………….. on Thursday, ………….., 2010, at 10.00 A.M. to transact the following business.

1. To consider and, if thought fit, to pass, with or without modification/s, the following resolution as a ORDINARY RESOLUTION:

   "RESOLVED THAT subject to the provisions of Section 372A and other applicable provisions, if any, of the Companies Act, 1956 and subject to the approval of Central Government, Securities and Exchange Board of India, Stock Exchange(s) and such other approvals as may be necessary, consent of the shareholders be and is hereby accorded to the Board of Directors for acquiring upto 29,00,000 fully paid-up equity shares of Rs. 10 each of………………….., from Promoters of the company, at a price not exceeding Rs.……….... per share and upto additional 9,40,000 equity shares of Rs. 10 each from other shareholders, whose names appear in the Register of Members of……………….. on the record date, at a price to be determined as per statutory rules and regulations for the time being in force through a Letter of Offer."

   "RESOLVED FURTHER THAT the Board of Directors of the Company be and is hereby authorised to make investment of such lesser amount as may be sanctioned/ approved by the Central Government."

   "RESOLVED FURTHER THAT the Board of Directors be and is hereby authorised

to do all such acts, deeds and things as may be deemed expedient and necessary to give effect to this resolution."

By Order of the Board

Registered Office — For ABC Ltd.

……………………

……………………

…………………… — Company Secretary

New Delhi, ………….., 2010

Notes :

1. The relative explanatory statement pursuant to Section 173(2) of the Companies Act, 1956, in respect of the business to be transacted at the Extraordinary General meeting is annexed hereto.
2. A member entitled to attend and vote at the above meeting is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member of the company.

Explanatory Statement

As required by section 173(2) of Companies Act, 1956, the following explanatory statement sets all material fact relating to the business mentioned under Items No. 1 of the Notice dated:_____________.

Item No.1

The Company is proposing to acquire upto 38,40,000 fully paid-up equity shares of Rs. 10 each of………………… by following the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1977. However, as the proposed acquisition of shares will exceed………….. of the subscribed capital of……………. it is necessary to obtain approval of the shareholders and Central Government as per the provisions of Section 372A of the Companies Act, 1956. Further, pursuant to the above acquisition of shares, ……………………, will become a subsidiary.

As…………………….., is in the business of manufacturing and marketing of…………………… the Board of Directors of your Company are of the opinion that by acquiring the control over management and operations of…………………. the Company can further strengthen its presence in the………………… market. Your Directors therefore recommend the said resolution for your approval.

None of the Directors of the Company is concerned or interested in the Resolutions.

By Order of the Board

For ABC Ltd.

Registered Office

……………………

……………………

……………………

New Delhi, ……….., 2010

Question No. 6

Write short notes on any four of the following:

(a) Committee of Inspection.

(b) "Foreign proceeding" under UNCITRAL Model Laws.

(c) Rehabilitation and revival fund.

(d) Insolvency laws in United States of America.

(e) Debt Recovery Tribunals and its composition. *(4 marks each)*

Answer to Question No. 6(a)

Committee of Inspection : Under Creditors Voluntary winding up proceedings, under section 503 of Companies Act 1956, the creditors may appoint a Committee of Inspection consisting of not more than 5 persons; and in that event, the company may also appoint not more than 5 persons to be members of the committee, subject to the power of the creditors to disapprove any nominee of the company. On such disapproval, the nominees of the company shall not, unless otherwise directed by the Court, act as members of the committee. The Court may, however, give any directions to appoint other persons to act as members of the committee of inspection in place of the persons mentioned in the creditor's resolution.

The Committee of Inspection may fix the liquidator's remuneration, or the Court may fix it, if no remuneration, is so fixed.

Answer to Question No. 6(b)

"Foreign proceeding" means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

Foreign insolvency proceedings, to be covered within the scope of the Model Law, needs to possess certain attributes. These include the basis in insolvency-related law of the originating State; involvement of creditors collectively; control or supervision of the assets and affairs of the debtor by a court or another official body; and reorganization or liquidation of the debtor as the purpose of the proceeding. Within those parameters, a variety of collective proceedings would be eligible for recognition, be they compulsory or voluntary, corporate or individual, winding-up or reorganization. It also includes those in which the debtor retains some measure of control over its assets, i.e. under court supervision (e.g. suspension of payments, "debtor in possession"). An inclusive approach is used also as regards the possible types of debtors covered by the Model Law.

Answer to Question No. 6(c)

The 2002 Companies Amendment Act introduced a scheme for rehabilitation through a fiscal measure by levy of cess on all companies. Sections 441A to 441G of the Act deal with matters connected with the levy of the said cess and constitution of a Fund called the Rehabilitation and Revival Fund. The scheme involves levy and collection of a cess. The cess shall be payable by all companies. The proceeds of the cess levied and collected under section 442A shall first be credited to the Consolidated Fund of India.Central

Government shall transfer funds to the aforesaid fund For the purposes of rehabilitation or revival or protection of assets of sick industrial companies.

Sources [Section 441C]

— All amounts paid by companies as the cess.

— Any amount given as grants by the Central Government for the purposes of this Fund;

— Any amount given to the Fund from any other source;

— Any income from investment of the amount in the Fund;

— Amount refunded by the company under Section 441G, after the sick company is revived.

Application (Section 441D)

— making interim payment of workmen's dues pending the revival or rehabilitation of the sick industrial company; or

— payment of workmen's dues to the workmen, referred to in Sub-section (3) of Section 529, of sick industrial company; or

— protection of assets of sick industrial company; or

— revival or rehabilitation of sick industrial company.

Answer to Question No. 6(d)

US has a parallel system of insolvency or bankruptcy laws at Federal as well as States Level. Each state has laws governing the insolvency of a corporation or other legal persons, while the federal government has enacted the US Bankruptcy Code (the Bankruptcy Code), which is applicable to all states. The Bankruptcy Code prohibits the following persons from filing a petition for relief under the Bankruptcy Code: domestic or foreign insurance companies, banks, savings and loan associations, small business investment companies and similar federally insured institutions providing that these types of persons only may seek relief from their creditors using the laws of the State in which they are registered or incorporated.

The Bankruptcy Code establishes mainly two types of bankruptcy cases – liquidations or 'straight bankruptcy' and reorganisations or 'rehabilitative cases'. Under liquidation, a trustee is automatically appointed by the Office of the US Trustee and, subsequently, is either confirmed or replaced by vote of the creditors of the debtor. Under reorganisations the trustee has the duty of collecting and reducing to money property of the debtor's estate, may be authorised to operate the debtor's business, and is required to make a distribution to creditors, if sufficient funds exist. In case of liquidation, the debtor generally, will be discharged from all of its pre-bankruptcy filing debts and obligations.

In reorganisation case, a trustee is not automatically appointed and the debtor remains 'in possession', operating its business and managing its affairs as it did prior to the bankruptcy filing. If a sufficient number of creditors or shareholders express an interest,

statutory committees of unsecured creditors and/or shareholders may be appointed by the US Trustee. With respect to the formation of a plan of reorganisation, the debtor possesses during the first 120 days of the bankruptcy case (and through any subsequent court ordered extension of this period), the exclusive right to file and confirm a numerous other significant events may take place in reorganisation case, including the acceptance or rejection of executory contracts, motions for relief from the automatic stay, post-petition financing orders and orders seeking the use of cash collateral, actions seeking the recovery of preferential transfers and fraudulent conveyances, and motions to sell assets. A plan of reorganisation may be confirmed by the bankruptcy court, subject to certain exceptions, when:

— creditors or equity holders of each particular class of claims or equity interests owning at least two-thirds in amount and one-half in number of the claims or interests in that class vote to accept the plan or

— when at least one impaired class votes in favour of the plan and the plan is 'fair and equitable' with respect to the remaining classes.

Answer to Question No. 6(e)

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 provides for the setting up of a separate set of tribunals to hear such matters and these tribunals are termed as Debt Recovery Tribunals (DRTs). the Debts Recovery Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act. The Central Government shall also specify in the notification the areas within which the Tribunal may exercise jurisdiction for entertaining and deciding the applications filed before it.

The Act provides that a Tribunal shall consist of one person only, to be called the Presiding Officer, to be appointed, by notification, by the Central Government. The Central Government may also authorise the Presiding Officer of one Tribunal to discharge also the functions of the Presiding Officer of another Tribunal. Any person who has been, or is qualified to be, a District Judge may be appointed as the Presiding Officer, who shall, hold office for a term of five years from the date on which he enters his office or until he attains the age of sixty-two years, whichever is earlier. The Central Government shall also appoint one or more Recovery Officers and such other officers and employees as the Government may think fit. The Recovery Officers and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer.

TEST PAPER 3/2010

(This Test Paper is based on ALL Study Lessons)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Answer ALL Questions*

Question No. 1

(a) *During the process of winding up of a company what preferential payments are to be kept in mind ?* *(8 marks)*

(b) *What are the measures for the purpose of asset reconstruction by Assets Reconstruction Companies ?* *(4 marks)*

(c) *What is the role of Operating Agency in revival of sick industrial concern ?* *(4 marks)*

(d) *Briefly describe buy back of securities through the stock exchange.* *(4 marks)*

Answer to Question No. 1(a)

Preferential Payments

Section 529A, provides notwithstanding anything contained in any other provision of this Act or any other law for the time being in force in the winding up of the company– (a) workmen's dues; and (b) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to Sub-section (1) of the section 529 *pari passu* with such dues shall be paid in priority to all other debts. The provisions of this section override the provisions of section 530 of the Act relating to preferential payments.

Section 530 provides that in winding up, subject to the provisions of Section 529A, the following debts shall be paid in priority to all other debts:

(a) all revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority. The amount should have become due and payable within twelve months before the date of commencement of winding up. The amount imposed and demanded as advance-tax under Section 207 of the Income-tax Act, 1961, is a tax within the meaning of this clause but any amount due to the Government in relation to commercial transactions does not enjoy preferential right, as it is not tax or cess.

(b) all wages or salary of any employee in respect of services rendered to the company and due for a period not exceeding four months within twelve months before the relevant date. The amount to be paid as preferential payment must not exceed Rs. 20,000 in the case of each employee or workmen.

(c) all accrued holiday remuneration becoming payable to any employee or in the case of his death to any other person in his right on termination of his employment before or by the effect of the winding up order or resolution.

(d) unless the company is being wound up voluntarily only for the purpose of

reconstruction or of amalgamation with another company in respect of all contributions payable during 12 months next before the relevant date, by the company as the employer of any persons, under the Employees State Insurance Act, 1948, or any other law for the time being in force.

(e) unless as in (d) above or unless workmen's compensation insurance policy is taken, all sums due as compensation under the Workmen's Compensation Act, 1923.

(f) all sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.

(g) the expenses of any investigation held under Section 235 or Section 237 in so far as they are payable by the company.

Where any payment has been made to an employee of a company (i) on account of wages and salary, or (ii) to him or in case of his death, to any other person in his right, on account of accrued holiday remuneration, out of money advanced by some person for that purpose, the person by whom the money was advanced, shall in a winding up, have a right of priority in respect of the money so advanced and paid-up to the amount by which the employee would have been entitled to priority.

All the preferential debts rank equally among themselves and are to be paid in full unless the assets are insufficient, in which case they will abate in equal proportion. After retaining sufficient sum for costs charges and expenses of winding up, preferential debts must be paid forthwith so far as assets are sufficient to meet them.

Answer to Question No. 1(b)

Measures of ARC for Asset Reconstruction

"Asset reconstruction" under Section 2(1)(b) means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance.

"Reconstruction company" under Section 2(1)(v) means a company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction.

Measures to assist the banking systems to realise its Non Performing Assets has resulted into creation of specialised bodies called Asset management companies which in India have been named asset reconstruction companies ('ARCs'). The buying of impaired assets from banks or financial institutions by ARCs will make balance sheets of banks and financial institutions cleaner and they will be able to use their time, energy and funds for development of their business. ARCs may be able to mix up their assets, both good and bad, in such a manner to make them saleable. The main objective of asset reconstruction company ('ARC') is to act as agent for any bank or financial institution for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers' asset taken over by banks, or financial institution, to act as the receiver of properties of any bank or financial institution and to carry on such ancillary or incidental business with the prior approval of Reserve Bank wherever necessary.

ARC can take the following measures for the purposes of asset reconstruction:

— Proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower.

— The sale or lease of a part or whole of the business of the borrower.

— Rescheduling of payment of debts payable by the borrower.

— Enforcement of security interest in accordance with the provisions of the Ordinance.

— Settlement of dues payable by the borrower.

— Taking possession of secured assets in accordance with the provisions of the Ordinance.

Answer to Question No. 1(c)

Operating Agency

Under Section 2(31A) Companies (Second Amendment) Act, 2002 'Operating Agency' means any group of experts consisting of persons having special knowledge of business or industry in which the sick industrial company is engaged and includes public financial institution, state level institution, scheduled bank or any other person as may be specified as the Operating Agency by the Tribunal [Section 2(31A)].

Role of Operating Agency includes the following:

(a) Conduct of inquiry on reference received, as per Section 424 B(2);

(b) Preparation of a scheme of rehabilitation as per Section 424C(3) and 424D(1);

(c) Apply to Tribunal for review of its order under Section 424C(4)(b);

(d) Recommend to the Tribunal, on the various steps to be taken to implement the scheme and remove the difficulties therein under Section 424D(14);

(e) Implementation of rehabilitation scheme, ordered by Tribunal [Section 424D(15)];

(f) Appointment as liquidator in case of winding up of industrial company [Section 424G(2)];

(g) Preparation of detailed inventory and lists of any industrial company ordered by Tribunal [Section 424H].

Answer to Question No. 1(d)

Buy-back through the stock exchange

Regulation 15 of Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998 provides that a company can buy-back its specified securities through the stock exchange as provided hereunder:

(a) the special resolution as under Regulation 5 and 5A should specify the maximum price at which the buy-back will be made;

(b) the buy-back of securities should not be from the promoters or persons in control of the company;

(c) the company should appoint a merchant banker and make a public announcement as referred to in Regulation 8 at least seven days prior to the commencement of buy back;

(d) a copy of the public announcement which should contain disclosures regarding details of the brokers and stock exchanges through which the buy-back would be made must be filed with SEBI within two days of the announcement along with the fees as specified in Schedule IV to the Regulations;

(e) the buy-back should be made only on stock exchanges having Nationwide Trading Terminal facility and only through the order matching mechanism except 'all or none' order matching system;

(f) the company and the merchant banker should give information to the stock exchange on a daily basis regarding the securities bought-back and the same should be published in a national daily;

(g) the identity of the company as a purchaser would appear on the electronic screen when the order is placed.

Question No. 2

(a) What do you understand by enforcement of security interest by the creditors under Securitisation Act ? (8 marks)

(b) What do you mean by strategic planning? Strategic Planning is the foundation on which business activities are connected; in this context discuss its features and benefits. (8 marks)

Answer to Question No. 2(a)

Enforcement of Security interest by a Creditors

Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 provides for the enforcement of security interest by a secured creditor straight away without intervention of the court, on default in repayment of instalments, and non compliance with the notice of 60 days after the declaration of the loan as a non-performing asset. The Reserve Bank of India has a detailed policy providing guidelines or prudential norms for the classification of assets as non performing which is to be followed by the financial institutions.

The Secured Creditor has been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustee appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance.

The secured creditor has two options. It can either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act. Section 13(4) of the Act empowers the recourse to one more of the following measures, after giving proper notice, for the recovery of the secured debts, namely:

— Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;

— Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset;

— Appoint any person (hereafter referred to as the manager), to manage the secured assets, the possession of which has been taken over by the secured creditor;

— Require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

In cases of joint financing under consortium or multiple lending arrangements if 75% of the secured creditors in the value agree to initiate recovery action the same is binding on all secured creditors.

If the company is being wound up after the commencement of this Act, the secured creditor of such company, who opts to realize its security, instead of relinquishing its security and proving its debts under proviso to Sub-section (1) of Section 529 of the Companies Act, may retain the sale proceeds of its secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of Section 529A of that Act.

Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

Secured creditor is entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified above in relation to the secured assets under this Act.

Answer to Question No. 2(b)

A strategy is a plan or course of action which is of vital, pervasive or continuing importance to the organization as a whole. Strategy is essential for every organisation – clear & effective strategies are necessary for success and the manager is responsible for determining and implementing strategies.

Strategic planning is a management tool, used to help an organisation do a better job to assess and adjust the organisation's direction in response to a changing environment. Strategic planning is a disciplined effort to produce fundamental decisions and actions that shape and guide as to what an organisation is, what it does, and why it does, with a focus on the future at the same time. Strategic planning enables management to improve the chances of making decisions which will stand the test of time, and revising the strategy on the basis of monitoring the progress of R&D and the changes in product-market conditions.

Regardless of the size of a company, a strategic plan is the foundation on which all business activities can be connected and "aligned". For a successful planning and its implementation following are some key points:

1. *Creating Vision and Direction that is simple and clear* – a strategy may be fairly

complicated at the highest level but the closer it gets to the front line and the marketplace, the simpler it has to be.

2. *A Good Plan* - That is well thought out, challenges assumptions, and is created with input from sources inside and outside the organisation.

3. *Great Execution* – This requires commitment from the very top. This commitment must be demonstrated through behaviour, investment, communication and accountability.

4. *Communicate* – continuously using different medium and in terms that connect individuals and their roles to the vision and success.

Strategic planning is not a substitute for the exercise of judgement by leadership. So the data analysis and decision-making tools of strategic planning are there to support the intuition, reasoning skills, and judgement that the personnel contribute to their organisation. The salient features of Strategic planning are as follows:

1. It involves participation of responsible persons at different levels, either directly or indirectly (shared ownership).
2. It is a key ingredient of effective management.
3. It prepares the firm not only to face the future but also to shape the future in its favour.
4. It is based on quality data.
5. It draws from both intuition and logic.
6. It accepts accountability to the community.
8. It helps to avoid hap hazardous response to environment.
9. It ensures optimum leveraging of firm's resources at every opportunity.

Strategic planning has many benefits to the organization which include:

1. *Better Decisions* – Information communicated through vision and strategy allows people to make the best decisions (hiring and rewarding the right people, adopting and developing the right systems, making the right investments, etc.).
2. *Increased Energy* – Resulting from rallying behind a cause, and elimination of conflict and confusion of priorities.
3. *Increased Capacity* – Enables people to be focused on what is important and less concerned about what isn't.
4. *Improved Customer Satisfaction* – A true test of value and leads to higher retention and growth.
5. *Competitive Advantage* – Doing what you do better than others.
6. *Better Solutions* – Uncovering the enormous intellectual and creative capacity of an organization that collectively works towards solutions rather than relying on select few.

7. *Market Recognition* – Over time one can "own" a position and space in the marketplace.
8. *Enhances the chance of success* - The strength of strategic planning is its ability to harness a series of objectives, strategies, policies and actions that can work together. Managing a company strategically means thinking and accordingly taking suitable action on multiple fronts. Strategic planning provides the framework for all the major business decisions of an enterprise. It also serves as a corporate defence mechanism helping the firm avoid costly mistakes in product market choices or investments. Strategic planning provides an organisation with certain core competencies and competitive advantages. Thus Strategic planning is the key to withstand turbulences and uncertainties on the way of success of the enterprise.

Question No. 3

(a) State with reasons whether the following statements are True or False:

(i) Transferee company can commence with the business of the transferor company without approval of members, as scheme have been approved under "single window clearance" system

(ii) In the process of winding up, payment of workmen's dues is prior most.

(iii) Leveraged buyout and management buy out mean the same.

(iv) Reverse merger means foreign company is merged with Indian company for want of funds.

(v) National company law tribunal is responsible for the implementation of debt recovery provisions. *(2 marks each)*

(b) What do you understand by Fraudulent Preference ? *(6 marks)*

Answer to Question No. 3(a)(i)

False

Approval of shareholders should be obtained for the commencement of business of transferor company in Extra ordinary General Meeting to be held either before or after or the same day the meeting convened by the High Court for the purpose of approving the amalgamation.

Answer to Question No. 3(a)(ii)

False

Section 529A of Companies Act, 1956 provides that workmen's dues rank *pari passu* with the debts due to secured creditors to the extent they have been appropriated towards workmen's dues and are to be paid in preference to all other debts. The provisions of this section even override the provisions of Section 530 of the Act relating to preferential payments.

Answer to Question No. 3(a)(iii)

False

Leveraged Buyout (LBO) is defined as the acquisition by a small group of investors, financed largely by borrowing. This acquisition may be either of all stock or assets of a

company. The buying group forms a shell company to act as the legal entity making the acquisition.

A Management Buyout (MBO) is simply a transaction through which the incumbent management buys out all or most of the other shareholders. The management may take on partners, it may borrow funds or it can organize the entire restructuring on its own. A MBO begins with arrangement/raising of finance.

Answer to Question No. 3(a)(iv)

False

Reverse merger is nowhere defined under Companies Act 1956, it takes place when a healthy company amalgamates with a financially weak company. Reverse merger makes the transferor-company entitled for the benefit of carry forward and set-off of loss and unabsorbed depreciation of the transferee-company.

Answer to Question No. 3(a)(v)

False

Debt Recovery Tribunals are responsible for the implementation of debt recovery provisions.

Answer to Question No. 3(b)

Fraudulent Preference

Section 531 of Companies Act 1956 provides that every transfer of property, movable or immovable, delivery of goods, payment, execution or other act relating to property made, taken or done by or against the company within six months before the commencement of its winding up shall be deemed, in the event of its being wound up, a fraudulent preference of its creditors and, therefore, invalid. It will amount to a fraudulent preference if it is shown that-

(i) the company was at the date of transfer unable to pay its debts as they became due;

(ii) the transaction took place within six months of the presentation of the petition to the Court and in case of voluntary winding up, within six months from the date of the resolution for winding up;

(iii) the dominant motive of the company, acting through its directors was to prefer one creditor to another;

(iv) the transaction was made in favour of a creditor.

There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. The essence of fraudulent preference is the giving of an improper benefit to a few creditors leading to inequality between them and the generality of the creditors.

Question No. 4

(a) What is the mode of recovery of debts determined by the Debt recovery tribunal?
(10 marks)

(b) *Discuss the power of court to sanction modification of scheme of restructuring. Citing the case laws.* *(6 marks)*

Answer to Question No. 4(a)

Section 19 of the Recovery of Debts Due to Banks and Financial Institutions Act,1993 provides that where a Bank or a Financial Institution has to recover any debt from any person, it may make an application to the Tribunal within the local limits of whose jurisdiction the defendant, or each of the defendants where there are more than one, at the time of making the application, actually and voluntarily resides, or carries on business or personally works for gain; or any of the defendants, where there are more than one, at the time of making the application, actually and voluntarily resides, or carries on business, or personally works for gain; or the cause of action, wholly or in part, arises.

After considering all the facts, claims, counter claims, the Tribunal may order the attachment or conditional attachment of the property. Where it appears to the Tribunal to be just and convenient, it may, by order any of the following:

(a) appoint a receiver of any property, whether before or after the grant of certificate for recovery of debt;

(b) remove any person from the possession or custody of the property;

(c) commit the same property to the possession, custody or management of the receiver;

(d) confer upon the receiver all such powers, as to bringing and defending suits in the courts, or filing and defending applications before the Tribunal and for the realization, management, protection, preservation and improvement of the property, the collection of rents and profits thereof, the application and disposal of such rents and profits, and the execution of documents as the owner himself has, or such of those powers as the Tribunal thinks fit; and

(e) appoint a Commissioner for preparation of an inventory of the properties of the defendant or for the sale thereof.

Where under section 25 of the said Act, certificate of recovery is received by the Recovery officer; he shall proceed to recover the amount due by following any of the following modes:

(a) attachment and sale of the movable or immovable property of the defendant;

(b) arrest of the defendant and his detention in prison;

(c) appointing a receiver for the management of the movable or immovable properties of the defendant.

Besides these modes Section 25 of the Act provides for other modes of recovery of amount which are hereunder discussed:

1. If any amount is due from any person to the defendant, the Recovery Officer may require such person to deduct from the said amount, the amount of debt due from the defendant under this Act and such person shall comply with any such requisition and shall pay the sum so deducted to the credit of the Recovery Officer.

2. The Recovery Officer may, at any time or from time to time, by notice in writing, require

   — any person from whom money is due or may become due to the defendant;or;

   — to any person who holds or may subsequently hold money for or on account of the defendant,

   to pay to the Recovery Officer either forthwith upon the money becoming due or being held or within the time specified in the notice, so much of the money as is sufficient to pay the amount of debt due from the defendant or the whole of the money when it is equal to or less than that amount.

   A notice under this sub-section may be issued to any person who holds or may subsequently hold any money for or on account of the defendant jointly with any other person and for the purposes of this sub-section, the shares of the joint holders in such amount shall be presumed, until the contrary is proved, to be equal.

   Every person to whom a notice is issued under this sub-section shall be bound to comply with such notice, and, in particular, where any such notice is issued to a post office, bank, financial institution, or an insurer, it shall not be necessary for any pass book, deposit receipt, policy or any other document to be produced for the purpose of any entry, endorsement or the like to be made before the payment is made notwithstanding any rule, practice or requirement to the contrary.

   The Recovery Officer may, at any time or from time to time, amend or revoke any notice under this sub-section or extend the time for making any payment in pursuance of such notice.

   Any person discharging any liability to the defendant after the receipt of a notice under this sub-section shall be personally liable to the Recovery Officer to the extent of his own liability to the defendant so discharged or to the extent of the defendants liability for any debt due under this Act, whichever is less.

   If the person to whom a notice has been sent under this sub-section, fails to make payment in pursuance thereof to the Recovery Officer, he shall be deemed to be a defendant in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realization of the amount as if it were a debt due from him, in the manner provided in Section 25, 26 and 27 and the notice shall have the same effect as an attachment of debt by the Recovery Officer in exercise of his powers under Section 25.

3. The Recovery Officer may, by order, at any stage of the execution of the certificate of recovery, require any person, and in case of a company, any of its officers against whom or which the certificate or recovery is issued, to declare on affidavit the particulars of his or its assets. The Recovery officer may recover any amount of debt due from the defendant by the seizure of property and sale of his movable property in the manner laid down in the Third Schedule to the Income-Tax Act, 1961.

Answer to Question No. 4(b)

As regards the modification of a scheme, application thereof can be made by any person interested. 'Any person interested' should not be confined to creditor or liquidator

of the company whereby any person who has obtained a transfer of shares in the company but has not yet been registered as a member is also to be included therein. In *Saroj G. Poddar (Smt.), in Re., (1996); T. Mathew v. Saroj Poddar* (1996) the following main points emerged:

(a) The scheme can be modified by the Court either at the time of or after its sanction.

(b) Such modification can include the substitution of sponsorer of the scheme.

(c) Modification of scheme or substitution of sponsor should be necessary for proper, efficient and smooth working of the scheme.

(d) Modification can be made at the instance of any person who is interested in the affairs of the company and the court can also introduce modification suo motu.

(e) The Court should examine the bona fides of the person applying to be substituted as a sponsor, his capability and his interest in the company.

Question No. 5

(a) When can liquidator disclaim onerous property belonging to the company being wound up ? (6 marks)

(b) Discuss the provisions relating to Escrow account under SEBI (Substantial acquisition of shares and takeover), Regulations 1997. (6 marks)

(c) Income Tax Act,1961 provides reliefs to the resulting company, in this context discuss the provisions relating to expenditure on acquisition of patent rights and copyrights. (4 marks)

Answer to Question No. 5(a)

Section 535 of Companies Act 1956, states that the liquidator may disclaim onerous properties belonging to the company. Following types of properties are regarded as onerous for purposes of this section:

(a) land of any tenure, burdened with onerous covenants; or

(b) shares or stock in companies; or

(c) any other property which is unsaleable or is not readily saleable by reason of the fact that it requires the possessor to perform certain acts or pay a sum of money.

(d) unprofitable contracts; or

The liquidator may, with the leave of the Court, disclaim any such property. The Court will assist the liquidator to get rid of "onerous and burdensome contracts" whenever it is necessary to safeguard in full the interests of the body of creditors and the shareholders of the company. The right of disclaimer can be exercised in relation only to property which in effect has ceased to be an asset and has become a liability. The disclaimer should be made in writing signed by the liquidator within 12 months after the commencement of the winding up or such extended period as the Court may allow. If the liquidator does not come to know of the existence of an onerous property within one

month of the commencement of the winding up, the period of 12 months begins from the date of his knowledge.

The disclaimer shall operate to determine, as from the date of disclaimer, the rights, interests and liabilities of the company. It release the company and the property from liability. However, it does not affect the rights and liabilities of any other person in respect of the property. Any person injured by the operation of a disclaimer is deemed to be a creditor of the company to the amount of the compensation or damages payable in respect of the injury.

Where a person interested in the property has required the liquidator to decide whether he will or will not disclaim the property, the liquidator should, within 28 days, give notice to the applicant that he intends to apply to the Court for leave to disclaim. If he fails to do so, he shall not be entitled to disclaim the property and where the property is a contract which he has not disclaimed within the aforesaid time, he shall be deemed to have adopted it.

Answer to Question No. 5(b)

Regulation 28 of SEBI (Substantial Acqusition of shares and Takeovers) Regulations 1997,requires the acquirer to open an escrow account as a security for performance of his obligations in terms of the public offer. The amount will be refunded or used for timely fulfilment of the obligations and forfeited if offer is not completed. This is a strong deterrent against frivolous takeover offers and secures interest of the public shareholders.

The value of escrow amount shall be 25% upto Rs.100 crores and 10% above Rs.100 crores, of the consideration payable under the public offer. In case the acquirer has made the offer subject to a minimum level of acceptance and he does not want to acquire minimum of 20% then he has to provide 50% of the consideration payable under the offer in cash in escrow account. The acquirer has the option of keeping differential pricing and if he so opts, he shall deposit in the escrow account, amount calculated with reference to highest price offered. In the event of upward revision of the offer, the acquirer is supposed to enhance the escrow value upto 10% of consideration payable upon such revision.

The acquirer can exercise the option of tendering bank guarantee or approved securities in escrow account instead of cash. Bank guarantee has to be executed by acquirer in favour of merchant banker and has to be valid atleast for a period commencing from the date of public announcement until 20 days after closure of the offer.

Approved securities with appropriate margins are to be deposited with the merchant banker with the authority to realize the value of such escrow account, by sale or otherwise and if any deficit occurs, the merchant banker shall be liable to make good such deficit.

If the acquirer deposits cash with a scheduled bank, acquirer has to authorize the bank to act on any instructions given by merchant banker in respect of said account. Merchant Banker is also prohibited from returning the bank guarantee or securities until all the obligations under the offer have been completed by the acquirer.

In case, the acquirer offers bank guarantee or approved securities in the escrow account, he shall deposit with a bank atleast 1% of total consideration payable. SEBI has been empowered to forfeit the escrow account, either in full or in part in the event of non-fulfilment of obligations by the acquirer.

Answer to Question No. 5(c)

According to Sub-section (7) of Section 35A of the Income-tax Act, 1961, where in a scheme of demerger, the demerged company sells or otherwise transfers the rights to the resulting company, being an Indian company:

(i) the provisions of Sub-sections (3) and (4) of Section 35A shall not apply in the case of the demerged company; and

(ii) the provisions of this section shall, as far as may be apply to the resulting company as they would have applied to the demerged company, if the latter had not sold or otherwise transferred the rights.

Sub-section (3) lays down that where the rights either come to an end without being subsequently revived or are sold in their entirety and the proceeds of the sale, so far as they consist of capital sums, are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed, or, as the case may be, such cost remaining unallowed as reduced by the proceeds of the sale, shall be allowed in respect of the previous year in which the rights come to an end, or, as the case may be, are sold.

Sub-section (4) lays down that where the whole or any part of the rights is sold and the proceeds of the sale, (so far as they consist of capital sums), exceed the amount of the cost of acquisition thereof remaining unallowed, so much of the excess as does not exceed the difference between the cost of acquisition of the rights and the amount of such cost remaining unallowed shall be chargeable to income-tax as income of the business of the previous year in which the whole or any part of the rights is sold. Explanation to this sub-section provides that where the whole or any part of the rights is sold in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in the previous year.

However, if such expenditure is incurred by the demerged company after 31.03.98, deduction under Section 35A is not allowed, as such expenditure will be eligible for depreciation.

Question No. 6

Write short notes on any four of the following:

(a) Non- Performing Assets

(b) National Company Law Appellate Tribunal

(c) Mandatory Bid

(d) Status of a liquidator in the process of winding up

(e) Strategic management *(4 marks each)*

Answer to Question No. 6(a)

Non Performing Assets

When a borrower, who is under a liability to pay to secured creditor, makes any default in repayment of secured debt or any installment thereof, the account of borrower

is classified as non-performing asset (NPA). NPAs constitute a real economic cost to the nation because they reflect the application of scarce capital and credit funds to unproductive uses. The money locked up in NPAs are not available for productive use and to the extent that banks seek to make provisions for NPAs or write them off, it is a charge on their profits.

"Non-performing asset" under Section 2(1)(o) of Securitisation Act, 2002 means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset—

(a) in case such bank or financial institution is administered or regulated by an authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;

(b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank

Answer to Question No. 6(b)

National Company Law AppellateTribunal

According to Section 2(1B) of the Companies Act, 1956, Appellate Tribunal means the National Company Law Appellate Tribunal constituted under Sub-section (1) of Section 10FR.

Section 10FR of the Act lays down that the Central Government shall, by notification in the Official Gazette, constitute with effect from such date as may be specified therein, an Appellate Tribunal to be called the "National Company Law Appellate Tribunal" consisting of a Chairperson and not more than two members, to be appointed by the Government, for hearing appeals against the orders of the Tribunal under this Act.

The Chairperson of the Appellate Tribunal shall be a person who has been, a Judge of the Supreme Court or the Chief Justice of a High Court.

A Member of the Appellate Tribunal shall be a person of ability, integrity and standing having special knowledge of, and professional experience of not less than twenty-five years in, science, technology, economics, banking, industry, law, matters relating to labour, industrial finance, industrial management, industrial reconstruction, administration, investment, accountancy, marketing or any other matter, the special knowledge of, or professional experience in which, would be in the opinion of the Central Government be useful to the Appellate Tribunal.

Answer to Question No. 6(c)

Mandatory Bid

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, require acquirers to make bids for acquisition of certain level of holdings subject to certain conditions. Regulations 10, 11 and 12 of the said Regulations contain necessary provisions. A takeover bid is required to be introduced through a public announcement through newspapers. This type of regulatory bid is called the Mandatory Bid. The need for mandatory bid arises in the following cases:

(a) for acquisition of 15% or more of the shares or voting rights;

(b) for acquiring additional shares or voting rights to the extent of 5% of the voting rights in any financial year ending on 31st March if such person already holds not less than 15% but not more than 55% of the shares or voting rights in a company;

(c) for acquiring shares or voting rights, along with persons acting in concert to exercise more than 55% but less than 75% of voting rights in a company.

(d) for acquiring control over a company.

Answer to Question No.6(d)

Status of liquidator in the process of winding up

Under Member's Voluntary Winding up

— Under Section 490(1) of the Companies Act 1956, the Company shall appoint one or more liquidators, in a general meeting, who shall look after the affair of winding up procedure, and distribution of assets.

— Sub section (2) of section 490 of the aforesaid section, provides that the liquidator so appointed, shall be paid remuneration for his services, which shall also be fixed in general meeting.

— According to section 493 of the said section, the Company shall also give notice of appointment of liquidator to the registrar within ten days of appointment.

— Section 491 of the said section, provides that once the company has appointed liquidator, the powers of Board of Directors, Managing Director, and Manager, shall cease to exist.

— The liquidator is generally given a free hand, to carry out the winding up procedure, in such manner as he thinks best in the interest of creditors and company.

— In case, under section 496 the winding up procedure, takes more than one year, then liquidator will have to call a general meeting, at the end of each year, and he shall present, a complete account of the procedure, and position of liquidator.

Under Creditor's Winding Up

— Section 502 of the Act provides that company in the general meeting [in which resolution for winding up is passed], and the creditors in their meeting, appoint liquidator. They may either agree on one liquidator, or if two names are suggested, then liquidator appointed by creditor shall act.

— Sub section (2) of section 502 any director, member or creditor may approach the court, for direction that: Liquidator appointed in general meeting shall act, or he shall act jointly with liquidator appointed by creditor, or appointing official liquidator, or some other person to be appointed as liquidator.

— In the terms of Section 504, the remuneration of liquidator shall be fixed by the creditors, or by the court.

— Section 505 of the Act provides that on appointment of liquidator, all the power of Board of Directors shall cease.

Answer to Question No. 6(e)

Strategic Management

Strategy is a plan or course of action which is of vital, pervasive or continuing importance to the organisation as a whole. Whereas management is defined as the conducting or supervising of something (as a business) especially the executive function of planning, organising, directing, controlling and supervising any industrial or business project or activity with, responsibility for results. Strategic management can be defined as the formulation and implementation of plans and the carrying out of activities relating to matters which are of vital, pervasive or continuing importance to the total organisation. In other words, strategic management is the application of strategic thinking to the job of leading an organisation. Strategic management is a multi dimensional function. Planning or doing (formulation or implementation) relating to such matters is strategic management.

Strategic Management has four basic doctrines:

(i) matching business requirements with internal capabilities,

(ii) having strategically balanced portfolio,

(iii) achieving and sustaining competitiveness, and

(iv) developing long-term internal and core competencies.

Strategic planning is useful only if it supports strategic thinking and leads to strategic management.

TEST PAPER 4/2010

(This Test Paper is based on ALL Study Lessons)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Answer ALL Questions*

Question No. 1

(a) *Discuss the role of court in approving a scheme of restructuring under sections 391-394 of Companies Act 1956.* *(8 marks)*

(b) *What all can a company do to protect its value of brand ?* *(5 marks)*

(c) *List the various forms to be filed in the process of amalgamation/merger.* *(3 marks)*

(d) *When can Special Directors be appointed under the Companies Act, 1956 ?* *(4 marks)*

Answer to Question No. 1(a)

Court for the purposes of Sections 391 to 394 of the Act would mean the High Court having jurisdiction over the registered office of the company. In every High Court, a judge will be designated as company judge who will hear, inter alia, petitions under these sections.

Court has been given wide powers under this section, to frame a scheme for the revival of a company. Being a complete code, the Court can, under this 'section', sanction a scheme containing all the alterations required in the structure of the company for the purpose of carrying out of the scheme. Court only after considering all the merits and demerits of the scheme shall pass orders accordingly. The Court will also see whether all interested parties or whether all parties whose rights are likely to be affected have been put on notice about the scheme. The Court may order a meeting of the creditors and or the members. While ordering the convening of a meeting, the Court has the power to direct the manner in which the meeting should be conducted and how the proceedings and the result of the meeting should be reported. Under Section 391, Court has the discretion to sanction the scheme of restructuring the company.

The Court may also refuse a meeting to be called where the proposals contained therein are illegal, or in violation of provisions of the Act or incapable of modification. The Court is duty bound to ascertain the bona fides of the scheme and whether the scheme is prima facie feasible. The Court will not act merely as a rubber stamp while sanctioning a scheme. The Court must consider the application on merits. If a compromise or arrangement is not bona fide but intended to cover misdeeds of delinquent directors, the Court shall not sanction the scheme.

The following emerges as the role of Court prior to sanctioning the scheme of compromise or arrangement:

— The scheme of compromise or arrangement should be prepared as a written document. It should be presented to the Court.

— Court will direct the convening of meetings of creditors/members or any class of them. Giving opportunity to all.

— Under Section 391(1) of the Act, the Court gives directions with regard to conducting of meetings.

— The Court also fixes the time and place of such meeting, and appoint a chairman of the meeting.

— The Court fixes the quorum and lays down the procedure to be followed at the meeting, including voting by proxy; determines the value of creditors or members and the persons to whom notice is to be given.

The Court also gives directions to the chairman to report to the Court the result of the meeting within a given period.

The Chairman appointed by Court who presides over the meeting has to file his report within 7 days of the conclusion of the meeting with the Court. The Court, while sanctioning the scheme, must be satisfied that there is full and fair disclosure of information by the petitioner about the state of affairs of the company and its latest financial position. Section 392 of the Companies Act, 1956 confers the powers on the High Court sanctioning a compromise or arrangement in respect of a company, to supervise the carrying out of a compromise or arrangement and give any directions or making modifications in the scheme, as it considers necessary, either at the time of sanctioning it or any time thereafter.

If the Court is satisfied that a compromise or arrangement sanctioned under Section 391 cannot be carried out satisfactorily with or without modifications, it may vide Section 392(2) of the Act, either on its own motion or on the application of any person interested in the affairs of the company, make an order for winding up which shall be deemed to be the same as under Section 433 of the Act.

Where an application is made to the Court under Section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as mentioned therein, and the Court is satisfied that the scheme relates to the reconstruction or amalgamation of any two or more companies, it will make consequential orders as provided in Section 394 of the Act.

The order of the Court should be filed within 30 days of the date of the order with the Registrar of Companies having jurisdiction over the registered office of the company. The Registrar has to register the order and issue a certificate of registration of the same.

Sub-Section (4) of Section 391 provides that a copy of every such order of the Court has to be attached to every copy of the Memorandum of Association of the Company.

Answer to Question No. 1(b)

Black's Dictionary defines "Brand" as a word, mark, symbol, design, term, or a combination of these, both visual and oral, used for the purpose of identification of some product or service.

Brands indicate the origin of goods. They connect the consumer's mind to the manufacturer or service provider. They create a value premium for the goods and services. Brands do not command any value unless they are able bring cash flows to the Company.

Brands have to be constantly associated with good quality goods and services; they require proper show casing and servicing and they should remain active in appropriate markets.

In order to sustain the valuation of the brand, there must a constant attempt from the Company on the following aspects:

— To secure registration of the Brand in all relevant classes and countries where there are opportunities to sell Branded Products of the Company.

— To set up a "surveillance team" within the Marketing Department of the Company so as to ensure that there is no dilution to the value of the Brand.

— To ensure that attempts to use fake brands that are similar or deceptively similar are challenged with full force so as to spread the message that the Company is conscious of the value of its brand and it will be aggressive in taking steps not only to put an end to such illegal, dishonest and unauthorized use but also to punish such users and claim exemplary damages from those who had passed off their goods to people and those who are found to be guilty of infringement.

— To ensure that there is always a budget allocation for promoting the brand. The Company should devise a continuous process for being present in the existing markets and prospective markets.

— To ensure that there is a conspicuous distinction in the description of the brand when it is used to sell premium products as opposed to use of the same brand for selling goods to the masses.

— To ensure that the extent of growth in the value of the brand very year is always higher than the depreciation or dent that existing or new competition may cause.

— To adopt a proper policy with regard to slogans and catchy phrases so that the Company does not knowingly cause any infringement of the industrial and intellectual property rights of any other person in any country or territory.

— To adopt a proper policy with regard to statements made in advertisements carrying the brand in order to ensure that those statements are not mere attractive words and they would stand the test of the market.

— To adopt a proper policy to augment IP profile of the Company and constantly update and upgrade the same.

For the purpose of valuation of brands, it may be necessary to make a through enquiry into the policies and business of the company to the extent they relate to brands.

Answer to Question No. 1(c)

Various forms in the process of merger/amalgamation:

— For filing, resolution passed under any of these sections 17,31,81(1A),149(2A)— E-form No. 23.

— For filing, resolution passed Under section 149(2A)— E- form 20A.

— To file with the Registrar of Companies, e-Form No. 21 along with a certified

copy of the High Court's order on summons directing the convening and holding of meetings.

— To file with the Registrar of Companies within thirty days of allotment of shares to the shareholders of the transferor company e-Form No. 2.

Answer to Question No. 1(d)

Under Section 424B(5), when the National Company Law Tribunal deems it fit to make an inquiry or to cause an inquiry to be made into any industrial company by an operating agency, it may appoint one or more persons who possess knowledge, experience and expertise in management and control of the affairs of any other company to be a special director (or special directors) on the board of such industrial company on such terms and conditions as may be prescribed for safeguarding its financial and other interests, or in the public interest. The special director(s) appointed under the aforesaid section shall submit a report to the Tribunal within sixty days from the date of his/their appointment about the state of affairs of the company in respect of which reference has been made. Such special director or directors shall have all the powers of a director of a company under this Act, necessary for discharge of his or their duties.

Any special director appointed, shall —

(a) hold office during the pleasure of the Tribunal and may be removed or substituted by any person by order of the Tribunal;

(b) not incur any obligation or liability by reason only of his being a director or for anything done or omitted to be done in good faith in the discharge of his duties as a director or anything in relation thereto;

(c) not be liable to retirement by rotation and shall not be taken into account for computing the number of directors liable to such retirement;

(d) not be liable to be prosecuted under any law for anything done or omitted to be done in good faith in the discharge of his duties in relation to the sick industrial company.

Question No. 2

(a) Give a detailed account of bail out takeover under SEBI (Substantial acquisition of shares and takeover), Regulations 1997. *(10 marks)*

(b) What are the obligations of the company to be fulfilled for buying back of securities under SEBI (Buy-back of securities), Regulations 1998. *(6 marks)*

Answer to Question No. 2(a)

Regulation 30 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 states that the provisions of Chapter IV of the Regulations is applicable to a substantial acquisition of shares in a financially weak company not being a sick industrial company, in pursuance to a scheme of rehabilitation approved by a public financial institution or a scheduled bank (or the lead institution).

In the above context "Financially weak company" in this context means a company which has at the end of the previous financial year accumulated losses resulting in

erosion of over 50% but below 100% of its net worth (total of the paid-up capital and free reserves) as at the beginning of the previous financial year.

In a bail out takeover, the lead institution, which is a public financial institution or a bank, appraises the financially weak company, which is not a sick industrial company, taking into account its financial viability, its requirement of funds for revival and draws up a rehabilitation package on the principle of protection of interests of minority shareholders, good management, effective revival and transparency. For the purpose of takeover the lead institution is required to invite offers for acquisition of the shares of the said company from at least three parties. The lead institution evaluates the bids received with respect to the purchase price or exchange of shares, track record, financial resources and reputation of the management of the person acquiring shares. The offers are listed in the order of preference and after consultation with existing management.

The scheme may provide for acquisition of shares in the financially weak company as:

(a) an outright purchase of shares, or

(b) exchange of shares, or

(c) a combination of both.

Lead institutions/ banks shall provide in the rehabilitation scheme the details of changes it seeks to make in the management and the payment of consideration whether outright purchase or shares or exchange of shares or a combination of both.

The lead institution shall provide necessary information to any person, intending to make an offer to acquire shares, about the financially weak company, particularly regarding its present management, technology, range of products manufactured, shareholding pattern, financial holding and performance and assets and liabilities of the company for five years from the date of offer and also the minimum financial and other commitments expected of the person acquiring shares. (Regulation 31)

The lead institution shall evaluate the bids received in terms of purchase price or exchange of shares, track record, financial resources, reputation of the management of the person acquiring shares and ensure fairness and transparency in the process. After evaluating the offers, the lead institution has to list them in order of preference, and in consultation with the persons concerned with the affairs of the management of the company, accept one of the bids.

The person identified by the lead institution shall, on receipt of a communication in this behalf from the lead institution, make a formal offer to acquire shares from promoters etc. of the company, financial institutions and also other shareholders of a company, financial institutions and also other shareholders of a mutually determined price.

The person acquiring shares is required to make a public announcement of his intention to acquire shares from the other shareholders of the company. The public announcement shall contain relevant details about the offer including the information about the identity and background of the person acquiring shares, number and percentage of shares proposed to be acquired, offer price, the specified date, the date of opening of the offer and the period for which the offer shall be kept open and such other particulars as may be required by SEBI.

No person shall make a competitive bid for acquisition of shares of the financially weak company once the lead institution has evaluated the bids and accepted the bid of the acquirer who has made the public announcement of offer for acquisition of shares of the company.

Answer to Question No. 2(b)

Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998, Regulation 19 provides for the obligations which are required to be fulfilled by the company looking for the buy back of securities. The regulation provides that the company shall ensure the following obligations:

1. The company shall ensure that:

   (a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material contains true, factual and material information and does not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

   (b) the company shall not issue any specified securities including by way of bonus till the date of closure of the offer is made under these Regulations;

   (c) the company shall pay consideration only by cash;

   (d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;

   (e) the promoter or the person shall not deal in the specified securities of the company in the stock exchange during the period the buy-back offer is open.

2. No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act, 1956.

Compliance officer and investors service centres

The company should nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

Particulars of extinguished and destroyed certificates

The particulars of the said security certificates extinguished and destroyed should be furnished by the company to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates.

Locked-in securities not to be bought-back

Under Sub-regulation 5 the company should not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable [(5)].

Publication of post-buy-back advertisement

According to Sub-regulation (7), the company should issue, within two days of the

completion of buy-back, a public advertisement in a national daily, inter alia, disclosing the following:

(i) number of securities bought;

(ii) price at which the securities were bought;

(iii) total amount invested in the buy-back;

(iv) details of the security-holders from whom securities exceeding one per cent of the total securities were bought-back; and

(v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Question No. 3(a)

(a) State with reasons whether the following statements are True or False:

1. A special resolution is not necessary where buy back is less than ten per cent of total paid up equity capital and free reserves of the company.

2. A company can be declared as insolvent under the provisions of Companies Act 1956.

3. When the holding company sells off the shares acquired by virtue of acquisition of majority stake, it is covered for payment of tax under Income tax Act 1961.

4. Walter valuation model assumes that all earnings are distributed as dividends.

5. Section 4A of the Companies Act 1956, do not cover Asset Reconstruction Companies under any circumstance. (2 marks each)

(b) What do you mean by "demerged Company" and "Resulting Company" ? (6 marks)

Answer to Question No. 3(a)(1)

True.

By passing a resolution, the Board can authorize the buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company.

Answer to Question No. 3(a)(2)

False.

Under companies Act 1956, a Company cannot be declared as Insolvent. A company can be wound up and later be dissolved but it cannot be declared as insolvent.

Answer to Question No. 3(a)(3)

True.

When the holding company sells the shares, the sale would involve the payment of

Capital Gains Tax (short-term or long-term) under the Income-tax Act, 1961 depending on the period for which the shares are held by the holding company.

Answer to Question No. 3(a)(4)

True.

Walter Valuation Model assumes that all earnings are either distributed as dividends or invested internally immediately.

Answer to Question No. 3(a)(5)

False.

All the Asset Reconstruction Company's who have obtained certificate of registration from Reserve Bank to carry on the business of asset reconstruction, are public financial institution as defined under Section 4A of the Companies Act, 1956. This is a special status conferred by the Act on Asset Reconstruction Companies.

Answer to Question No.3(b)

Demerged Company

According to Sub-section (19AAA) of Section 2 of the Income-tax Act, 1961, "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

Resulting Company

According to Sub-section (41A) of Section 2 of the Income-tax Act, 1961 "resulting company" means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

Demerger involves 'transfer' of one or more 'undertakings'. The transfer of 'undertakings' is by the demerged company, which is otherwise known as Transferor Company. The company to which the undertaking is transferred is known as resulting company which is otherwise known as 'Transferee Company'.

Question No. 4

(a) Discuss the procedure followed by Debt Recovery Tribunal for recovery of any debt. *(10 marks)*

(b) When can the court intervene in voluntary winding up of a company ? *(6 marks)*

Answer to Question No. 4(a)

Section 19 of the Act provides that where a Bank or a Financial Institution has to recover any debt from any person, it may make an application to the Tribunal within the local limits of whose jurisdiction the defendant, or each of the defendants where there

are more than one, at the time of making the application, actually and voluntarily resides, or carries on business or personally works for gain; or any of the defendants, where there are more than one, at the time of making the application, actually and voluntarily resides, or carries on business, or personally works for gain; or the cause of action, wholly or in part, arises.

Any other bank or financial institution may join the applicant bank or financial institution at any stage of the proceedings, before the final order is passed by making an application to that Tribunal. Every application has to be made in such form and be accompanied by such documents or other evidence and by such fee as may be prescribed.

On receipt of application, the Tribunal shall issue summons requiring the defendant to show cause within thirty days of the service of summons as to why the relief prayed for should not be granted. The defendants shall, at or before the first hearing or within such time as the Tribunal may permit, present a written statement of his defence. The written statement shall have the same effect as a plaint in a cross suit so as to enable the Tribunal to pass a final order in respect of both the original claim and of the set off.

Tribunal may, after giving the applicant and the defendant an opportunity of being heard, pass such orders on the application as it deems fit. The applicant shall be at liberty to file a written statement in answer to the counterclaim of the defendant within such period as may be fixed by the Tribunal.

Where a defendant sets up a counterclaim and the applicant contends that the claim thereby raised ought not be disposed of by way of a counter-claim but in an independent action, the applicant may, at any time before issues are settled in relation to the counter-claim, apply to the Tribunal for an order that such counterclaim may be excluded, and the Tribunal may, on hearing of such application, make such order as it thinks fit.

The Tribunal may make an interim order (whether by way of injunction or stay or attachment) against the defendant to debar him from transferring, alienating or otherwise dealing with, or disposing of, any property and assets belonging to him without the prior permission of the Tribunal.

Where at any stage of the proceedings, the Tribunal is satisfied by affidavit or otherwise, that the defendant, with intent to obstruct or delay or frustrate the execution of any order for recovery of the debt that may be passed against him,

(i) is about to dispose of the whole or any part of his property; or

(ii) is about to remove the whole or any part of his property from the local limits of the jurisdiction of the Tribunal; or

(iii) is likely to cause any damage or mischief to the property or effect its value by misuse or creating third party interest,

the Tribunal may direct the defendant, within a time fixed by the Tribunal, either to furnish security, in such sum as may be specified in the order, or to appear and show cause why he should not furnish security.

Where the defendant fails to show cause why he should not furnish security, or fails to furnish the security required, within the time fixed by the Tribunal, the Tribunal may order the attachment of the whole or such portion of the properties claimed by the

applicant as the properties secured is his favour or otherwise owned by the defendant as appears sufficient to satisfy any certificate for the recovery of debt.

The Tribunal may also in the order direct the conditional attachment of the whole or any portion of the property. In case of disobedience of an order made by the Tribunal or breach of any of the terms on which the order was made, the Tribunal may order the properties of the person to be attached and may also order such person guilty of such disobedience or breach be detained in the civil prison for a term not exceeding three months, unless in the meantime the Tribunal directs his release.

Where it appears to the Tribunal to be just and convenient, it may, by order—

(a) appoint a receiver of any property, whether before or after the grant of certificate for recovery of debt;

(b) remove any person from the possession or custody of the property;

(c) commit the same property to the possession, custody or management of the receiver;

(d) confer upon the receiver all such powers, as to bringing and defending suits in the courts, or filing and defending applications before the Tribunal and for the realization, management, protection, preservation and improvement of the property, the collection of rents and profits thereof, the application and disposal of such rents and profits, and the execution of documents as the owner himself has, or such of those powers as the Tribunal thinks fit; and

(e) appoint a Commissioner for preparation of an inventory of the properties of the defendant or for the sale thereof.

Where the certificate of recovery is issued against a company registered under the Companies Act, 1956, the Tribunal may order the sale proceeds of the company to be distributed among its secured creditors in accordance with the provisions of Section 529A of the Companies Act, 1956 and to pay the surplus, if any, to the company.

The Tribunal may, after giving the applicant and the defendant an opportunity of being heard, pass such interim or final order. The Tribunal shall send a copy of every order passed by it to the applicant and the defendant. The Presiding Officer shall issue a certificate under his signature on the basis of the order of the Tribunal, to the Recovery Officer for recovery of the amount of debt specified in the certificate. Where the Tribunal, which has issued a certificate of recovery, is satisfied that the property is situated within the local limits of the jurisdiction of two or more Tribunals, it may send the copies of the certificate of recovery for execution to such other Tribunals where the property is situated. The application made to the Tribunal shall be dealt with by it as expeditiously as possible.

Answer to Question No. 4(b)

The Companies Act, 1956, contains certain provisions which provide a means of access to the Court with a view to speed up the liquidation proceedings and to overcome the difficulties that may arise in the course of liquidation. The Court will intervene in the voluntary winding up whenever it is satisfied that such an intervention will be just and beneficial.

The Court can be approached for compulsory winding up (Section 440) or winding up being conducted under the supervision of the Court (Section 522).

The Court is vested with the following powers in voluntary winding up:

(i) Section 515(1), to appoint the Official Liquidator or any other person as liquidator where no liquidator is acting.

(ii) Subsection 2 of the said section provides to remove the liquidator and appoint the Official Liquidator or any other person as liquidator on justifiable cause being shown.

(iii) According to Sub section (3) of section 515 the court shall determine the remunerations of liquidator when the Official Liquidator is appointed as a liquidator.

(iv) Section 517 provides that court can amend, vary, confirm or set aside the arrangement entered into between a company and its creditors on an appeal being made by any creditor or contributory within 3 weeks of the completion of the arrangement.

(v) On an application of the Liquidator or contributory or creditor the Court under section 518 shall intervene:

  (a) Subsection (1) clause(a) of the aforesaid section provides to determine any question arising in the winding up of a company.

  (b) Subsection (1) clause(b)to exercise, as respects the enforcing of calls, the staying of suits or other legal proceedings or any other matter, all or any of the powers which the Court might exercise if the company were being wound up by the Court.

(vi) Sub section (3) and (4) of section 518 provides to set aside any attachment, distress or execution started against the estate or effects of the company after the commencement of the winding up on such terms as it thinks fit on an application made by the liquidator, creditor or contributory if the Court is satisfied that it is just and beneficial to do the same.

(vi) Section 519, provides to order public examination of any person connected with promotion or formation of a company or any officer connected with the affairs of the company in regard to matters of promotion or formation or conduct of the business of the company or as to his conduct or dealing as officer thereof. Such an examination can be ordered on a report of the liquidator where he is of the opinion that a fraud has been committed by the persons aforesaid in the formation or promotion of the company or in the conduct of its affairs.

Question No. 5

(a) Draft a specimen of Declaration of insolvency covered under section 488 of Companies Act, 1956. (4 marks)

(b) Discuss Discounted cash flow valuation method of Shares. (7 marks)

(c) Give a brief account of External Commercial Borrowing as the mode of funding the scheme of restructuring the companies. (5 marks)

Answer to Question No. 5(a)

Specimen of Declaration of Solvency (under Section 488)

We .... of .... of .... being all the/majority of Directors of.................. Company Limited declare that we have made a full enquiry into the affairs of this company; and that having so done, we have formed the opinion that this company has no debt or will be able to pay its debts in full within a period, not exceeding three years from the commencement of the winding up.

Signature of Directors

1……………………….

2……………………….

3……………………….

Sworn/solemnly affirmed by the above named directors at………this……….day of……..20……..before me.

.......Commissioner of Oaths.

Answer to Question No. 5(b)

Discounted cash flow analysis consists of projecting future cash flows, deriving a discount rate and applying this discount rate to the future cash flows and terminal value.

The first step in conducting a discounted cash flow analysis is to project future operating cash flows over projected holding periods. These projections are generally done before debt (but after taxes) to obtain an accurate indication of future free cash flow, without making any assumptions about the company's leverage. The future free cash flow is the cash left over after operating the business and investing in necessary property, plant and equipment, but before servicing debt or paying out any cash to owners.

The second step in the discounted cash flow analysis is to develop a discount rate. The discount rate is also referred to as the Weighted Average Cost of Capital (WACC). Discount rates are generally calculated by deriving the company's cost of equity capital and the company's after-tax cost of debt. These financing costs are weighted and result in a WACC percentage, or discount rate.

The cost of equity capital is generally determined using the capital asset pricing model (CAPM), which is based on three inputs:

1. the risk free rate (the expected return on long term government bonds).
2. the beta, which is a measure of the relative riskiness of the company and
3. the equity risk premium (the expected rate of return on common stocks in the long run)

The derived discount rate is applied to the projected future cash flows to determine the present value of the future cash flows. The next step involves calculating a terminal, or residual value. A terminal value calculation combines assumptions used to derive

future projections and the discount rate to obtain a current value for a company's long-term future cash flows. The next step involves calculating a terminal, or residual value. A terminal value calculation combines assumptions used to derive future projections and the discount rate to obtain a current value for a company's long-term future cash flows. The assumption underlying this step is that a company is a going concern and that its value is embedded in its ability to generate value in the long term as well.

A terminal value is calculated by determining the cash flow in the period beyond the last projected period. This predicted future cash flow is then capitalized by a percentage (represented by the company's discount rate less the predicted long term growth rate) and this capitalized figure is then discounted back to the present using the discount rate.

The step wise discounted cash flow (DCF) model is as under:

1. Estimate the future cash flows of the target based on the assumption for its post-acquisition management by the bidder over the forecast horizon.
2. Estimate the terminal value of the target at forecast horizon.
3. Estimate the cost of capital appropriate for the target.
4. Discount the estimated cash flows to give a value of the target.
5. Add other cash inflows from sources such as asset disposals or business divestments.
6. Subtract debt and other expenses, such as tax on gains from disposals and divestments, and acquisition costs, to give a value for the equity of the target.
7. Compare the estimated equity value for the target with its pre-acquisition stand-alone value to determine the added value from the acquisition.
8. Decide how much of this added value should be given away to target shareholders as control premium.

Answer to Question No. 5(c)

Funding Through External Commercial Borrowing

External Commercial Borrowings (ECB) are regulated by the ECB Guidelines issued by the External Commercial Borrowing Division, Department of Economic Affairs, Ministry of Finance, Government of India. Being a Capital Account transaction it is covered under Section 6 of Foreign Exchange Management Act, 1999. ECB refers to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds, etc., availed from non resident lenders with minimum average maturity of 3 years. ECB can be accessed under two routes, viz., (i) automatic route; and (ii) approval route.

ECB under the automatic route is permitted for investment in the real sector, industrial sector including small and medium enterprises and especially infrastructure sector. The infrastructure includes (i)power; (ii)telecommunication,railways;(iii)road including bridges;(iv)ports, seaport & airport;(v)industrial parks;(vi)urban infrastructure (water supply, sanitation and sewerage projects).

Corporates (Companies registered under the Companies Act) except financial intermediaries (such as banks, financial institutions (FIs), housing finance companies and NBFCs) are eligible for accessing ECB under the automatic route. Individuals, trusts, and non-profit organizations are not eligible to raise ECB. ECB can be accessed only for investment in real sector – industrial sector including small and medium enterprises (SME) and infrastructure sector in India.

Limitations of ECB Route

(a) Accessing ECB is not permitted under both the automatic route and the approval route for on-lending or investment in capital market or acquiring company (or a part thereof) in India by a corporate.

(b) Utilisation of ECB proceeds is also not permitted in real estate. The term 'real estate' excludes development of integrated township.

(c) End uses of ECBs for working capital, general corporate purpose and repayment of existing rupee loans are also not permitted.

ECBs are permitted by the Government as a source of finance for Indian corporates for expansion of existing capacity as well as for fresh investment.

Utilisation of ECB proceeds is permitted in the first stage; acquisition of shares in the disinvestments process and also in the mandatory second stage; offer to the public under the Government's disinvestments programme of PSU shares.

Question No. 6

Write a short note on any four of the following:

(a) Partial Bid

(b) Jurisdiction of High Court for considering amalgamation and merger.

(c) Difference between merger and amalgamation.

(d) The "Crown Jewel" Strategy.

(e) Persons Acting in concert (PACs) under SEBI (Substantial acquisition of shares and takeover) , Regulations 1997 *(4 marks each)*

Answer to Question No. 6(a)

Partial Bid

Partial bid covers a bid made for acquiring part of the shares of a class of capital where the offeror intends to obtain effective control of the offeree through voting power. Such a bid is made for equity shares carrying voting rights. Regulation 12 of SEBI (Substantial Acquisition of Shares) Regulations, 1997 qualifies partial bid in the form of acquiring control over the target company irrespective of whether or not there has been any acquisition of shares or voting rights in a company. For such acquisitions, it is necessary to make public announcement in accordance with the Regulations.

Answer to Question No. 6(b)

Jurisdiction of High Court

If the registered offices of both the companies are situated in the same State, a joint application or separate applications should be moved to the High Court having jurisdiction

over the State in which registered offices of the companies are situated and if the registered offices of the companies involved are situated in different States, they should make separate applications to their respective High Courts.

In case of a foreign company, the Madras High Court in Travancore National & Quilon Bank [(1939) 9 Comp. Cases 14] has held that the court which would have jurisdiction for purpose of above provisions would be the court which has jurisdiction to wind up such a company.

Answer to Question No. 6(c)

Difference between merger and amalgamation

A merger can be defined as the fusion or absorption of one company by another. It may also be understood as an arrangement, whereby the assets of two (or more) companies get transferred to, or come under the control of one company (which may or may not be one of the original two companies).

Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or the amalgamated company.

Merger is normally a strategic vehicle to achieve expansion, diversification, entry into new markets, acquisition of desired resources, patents and technology. It also helps companies in choosing business partners with a view to advance long term corporate strategic plans. Mergers are also considered as a revival measure for industrial sickness.

Amalgamation is an arrangement for bringing the assets of two companies under the control of one company, which may or may not be one of the original two companies. Amalgamation signifies the transfer of all or some part of the assets and liabilities of one or more existing business entities to another existing or new company.

Answer to Question No. 6(d)

The Crown Jewel Strategy

The Jewel is a defense strategy to a takeover bid. The central theme in such a strategy is the divestiture of major operating unit most coveted by the bidder. Consequently, the hostile bidder is deprived of the primary intention behind the takeover bid. The target sells off not only the crown jewel but also properties to diminish its worth. However, the practice in India is not so flexible. The Companies Act, 1956 has laid down certain restrictions on the power of the Board. Vide Section 293(1), the Board cannot sell the whole or substantially the whole of its undertakings without obtaining the permission of the company in a general meeting.

SEBI (Substantial Acquisitions and Takeover) Regulations, 1997 vide Regulation 23 prescribes general obligations for the Board of Directors of the target company in this context.

Answer to Question No. 6(e)

Person Acting in Concert (PAC)

PACs are individual(s)/company(ies)/any other legal entity(ies) who are acting together

for a common objective or for a purpose of substantial acquisition of shares or voting rights or gaining control over the target company pursuant to an agreement or understanding whether formal or informal. Acting in concert would imply co-operation, co-ordination for acquisition of voting rights or control. This co-operation/ co-ordinated approach may either be direct or indirect.

The concept of PAC assumes significance in the context of substantial acquisition of shares since it is possible for an acquirer to acquire shares or voting rights in a company “in concert” with any other person in such a manner that the acquisition made by them may remain individually below the threshold limit but may collectively exceed the threshold limit.

Unless the contrary is established certain entities are deemed to be persons acting in concert like companies with its holding company or subsidiary company, mutual funds with its sponsor/trustee/Asset management company, etc.

TEST PAPER 5/2010

(This Test Paper is based on ALL Study Lessons)

Time allowed : 3 hours *Max. marks : 100*

NOTE : *Answer ALL Questions*

Question No. 1

(a) Fill in the Blanks

a. The proceeds of cess levied and collected under Section 442A shall first be credited to_____________________.

b. The order made by the court under Section 391(2) should be filed with the Registrar of Companies within __________________.

c. The liquidator within ____ days after his appointment delivers a notice of his appointment to the Registrar in e-form ___.

d. In case of buy back the shares bought back have to be statutorily extinguished within ______ from the last date of completion of buy back.

e. The __________________ has been empowered under the Act to strike off the name of a company from its register on the ground of non working.

(1 mark each)

(b) State with reasons whether the following statements are True or False:

a. A body corporate is qualified for appointment as a liquidator of a company.

b. 'Winding up' and 'dissolution' mean the same thing under Companies Act, 1956.

c. The offer of takeover once made cannot be withdrawn.

d. Shark Repellant is a anti takeover defense tool.

e. Securitisation and reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is constitutionally valid. (2 mark each)

(c) What are the disclosure requirements to be followed by the amalgamating companies as per AS-14 ? (5 marks)

Answer to Question No. 1(a)

a. The proceeds of cess levied and collected under Section 442A shall first be credited to **Consolidated Fund of India** .

b. The order made by the court under Section 391(2) should be filed with the Registrar of Companies within **30 day** .

c. The liquidator within **30** days after his appointment delivers a notice of his appointment to the Registrar in e-form **62** .

d. In case of buy back the shares bought back have to be statutorily extinguished within **seven days** from the last date of completion of buy back.

e. The **Registrar of Companies** has been empowered under the Act to strike off the name of a company from its register on the ground of non working.

Answer to Question No. 1(b)

a. *False.*

A body corporate doesnot qualify for appointment as a liquidator of a company.

b. *False.*

Winding up is the first stage in the process whereby assets are realised, liabilities are paid off and the surplus, if any, distributed among its members. Dissolution is the final stage whereby the existence of the company is withdrawn by the law.

c. *False.*

The offer once made can be withdrawn only in the following circumstances:

— Statutory approval(s) required have been refused;

— he sole acquirer being a natural person has died;

— Such circumstances as in the opinion of the Board merits withdrawal.

d. *True.*

An increasingly used defense mechanism is anti-takeover amendments to the company's constitution or articles of association, popularly called "shark repellants". The mechanism consists of the companies amending its articles, regulations, bye-laws etc. to make the company less attractive to the corporate bidder. Such proposed amendment are to be voted and approved by the shareholders.

e. *True.*

The Hon'able Supreme Court in *Mardia Chemicals Ltd.* v. *UOI* [2004] held that though some of the provisions of Securitisation Act, 2002 are be a bit harsh for some of the borrowers but on those grounds the impugned provisions of the Act cannot be said to unconstitutional in the view of the fact that the objective of the Act is to achieve speedier recovery of the dues declared as Non Performing Assets and better availability of capital liquidity and resources to help in growth of economy of the country and welfare of the people in general which would sub-serve the public interest.

Answer to Question No. 1(c)

The Institute of Chartered Accountants of India has formulated Accounting Standard (AS) 14 for accounting and disclosure requirements of mergers and amalgamation. This said Accounting Standard became effective from April 1, 1995.

Accounting Standard 14 is based on the International Accounting Standard 22, captioned "Accounting for Business Combinations". The Accounting Standard 14 deals with the accounting requirements of amalgamations and mergers and treatment of all

aspects of the amalgamation, e.g., valuation of goodwill, assets revaluation reserves etc.

Disclosure Requirements

(a) For amalgamations of every type, the following disclosures should be made in the first financial statements following the amalgamations:

(i) names and general nature of business of the amalgamating companies;

(ii) effective date of amalgamation for accounting purposes;

(iii) the method of accounting used to reflect the amalgamation; and

(iv) particulars of the scheme sanctioned under a statute.

(b) In case of amalgamations accounted for under the pooling of interests method, the following additional disclosures are required to be made in the first financial statements following the amalgamation:

(i) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

(ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

(c) In case of amalgamations accounted for under the purchase method the following additional disclosures are required to be made in the first financial statements following the amalgamations:

(i) consideration for the amalgamation and a description of the consideration paid or contingently payable, and

(ii) the amount of any difference between the consideration and the value of net identifiable assets required, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Question No. 2

(a) The provisions of Companies Act are not applicable to the amalgamation of banking company. Give a detailed account of the related provisions and procedure ? (10 marks)

(b) When can Central Government exercise its powers to amalgamate two or more companies ? (6 marks)

Answer to Question No. 2(a)

Amalgamation of one banking company with another banking company is governed by the provisions of Banking Regulation Act, 1949. The provisions of the Companies Act, 1956 are not applicable in this case. Section 5(1)(c) of the Banking Regulation Act, 1949 defines a "banking company" as any company which transacts the business of banking in India.

Section 44A of the Banking Regulation Act, 1949 provides for the procedure for amalgamation of banking companies.

The procedure for the amalgamation of banking companies is as follows:

I. The scheme shall be placed before the Board of Directors of each of the concerned companies and after considering all the aspects the Board will pass resolutions to –

   (a) approve the scheme of amalgamation;

   (b) fix the time, date and place of the extraordinary general meeting;

   (c) authorise the Managing Director/Company Secretary/any director or officer of the company to issue notice of the meeting;

   (d) do such other acts, things and deeds as may be necessary or expedient to do for the purpose of securing approval of the shareholders or others to the scheme

II. On the date fixed by the Board a Extra-ordinary General Meeting shall be specially convened meeting. According to section 44A(1) to amalgamate one banking company with another banking company, a scheme of amalgamation must be placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy. For convening the shareholders meeting following shall be taken care of:

   (a) Notice of every extraordinary general meeting as is referred to above must be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association. The notice of the meeting must indicate the time, place and object of the meeting.

   (b) The notice of the meeting must also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities.

   (c) It is advisable to explain in a note the salient features of the scheme and also to enclose to the notice full scheme of amalgamation.

III. Dissenting Shareholders and their right to claim return of capital are to be dealt in the following manner:

   (a) Any shareholder, who has voted against the scheme of a amalgamation at the meeting or has given notice in writing at or prior to the meeting to the company concerned or to the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled in the event of the scheme being sanctioned by the RBI, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the RBI when sanctioning the scheme .

   (b) The determination by the RBI regarding the value of the shares to be paid to the dissenting shareholders shall be final for all purposes.

IV. Approval by Reserve Bank of India:

(a) If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the RBI (Reserve Bank of India) for its sanction. The RBI may sanction a scheme by an order in writing.

(b) A scheme sanctioned by the RBI shall be binding on the banking companies concerned and also on all the shareholders thereof.

(c) An order sanctioning a Scheme of Amalgamation, passed by the RBI under Section 44A(4) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied with.

(d) A copy of the said order certified in writing by an officer of the RBI to be a true copy of such order and a copy of the scheme certified in the like manner to be a true copy thereof shall, in all legal proceedings (whether in appeal or otherwise) be admitted as evidence to the same extent as the original order and the original scheme.

V. Transfer of Property

(a) On the sanctioning of a scheme of amalgamation by the RBI, the property of the amalgamated banking company, i.e. the transferor company, shall, by virtue of the order of sanction, be transferred to and vest in the transferee company. No other or further document will be necessary for effecting the transfer and vesting of the property from the transferor company to the transferee company.

(b) The liabilities of the transferor company shall, by virtue of the said order, be transferred to, and become the liabilities of the transferee company.

VI. Dissolution of Transferor Company

(a) According to Section 44A(6A), Where a scheme of amalgamation is sanctioned by the RBI, the RBI may, by a further order in writing, direct that on the date specified in the order, the amalgamated banking company i.e., the transferor company, shall stand dissolved.

(b) Sub-clause (6B) of the said section lays that a copy of the order directing dissolution of the amalgamated banking company shall be forwarded by the RBI to the office of the Registrar of companies at which it has been registered. On receipt of such order, the Registrar shall strike off the name of the company.

Answer to Question No. 2(b)

Section 396 of Companies Act, 1956 gives for the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate. If the Government is so satisfied, it may pass an order providing for the amalgamation of those companies into a single company.

Notwithstanding anything contained in any other section Central government shall amalgamate two or more companies where it is essential in the public interest.

According to section 44A(7) of the Banking Regulation Act, 1949, in the case of amalgamation of two or more banking companies, the Central Government must consult the RBI before passing any order under Section 396.

The Central Government may exercise the power under Section 396 of its own motion without any application being received from the companies intending to amalgamate. The order of the Central Government under this section may provide for such constitution: such property, powers, rights, interests, authorities and privileges; and such liabilities, duties, and obligations as may be specified in the order.

The order passed by the Government must be published in the Official Gazette. The order aforesaid may also provide for the continuation by or against the transferee company or legal proceedings pending by or against any transferor company and may also contain such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

If the Government decides to order amalgamation of companies under this section, it must ensure that the following requirements are complied with in regard to the proposed order:

(a) a copy of the proposed order has been sent in draft to each of the companies concerned;

(b) the time for preferring an appeal under Sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and

(c) under Sub section 4 of the said section, the Central Government has considered, and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

Copies of every order made under this section shall, as soon as may be after it has been made, be laid before both Houses of Parliament.

Question No. 3

(a) ABC ltd. obtained a loan of Rs. 85 lacs from XYZ Bank against the mortgage of its land and building. The company failed to pay installments, to which bank issued show cause notice to the company. The bank denied of having received any representation from company and attached the property of the director who stood guarantee. The company created third party interest in the property mortgaged and also shifted machinery and material without informing the bank. Whether the attachment by the bank is valid under Securitisation and reconstruction of Financial Assets and enforcement of security interest Act, 2002, cite recent cases. *(6 marks)*

(b) ABC ltd. became sick and made reference to BIFR, during the pendency of the reference it prepared a scheme of compromise which was approved by the

majority creditors. The petition under section 391(2) was made for sanction of the scheme. The petition was opposed by many banks claiming towards principal and interest and claiming the scheme involved sacrifice and oppressive to minority secured creditors. Whether the court should allow the petition? Decide citing recent cases. *(6 marks)*

(c) *ABC ltd. has no secured creditors and all its unsecured creditors had accorded consent to proposed scheme of compromise along with shareholders of both the companies. The company wants to know whether it is necessary to move to the court for sanction of the scheme under these circumstances also. Decide citing recent cases.* *(4 marks)*

Answer to Question No. 3(a)

In the given case ABC Ltd. has made default in repayment of loan of Rs. 85 lacs.In addition to this the company has created third party interest in the property mortgaged and also shifted the property mortgaged i.e. machinery and material without informing the lending bank. The company claims that as it has made a representation to the bank for repayment the bank cannot takeover the property mortgaged under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act,2002.

The Bank on the other hand claims to have not received any representation from the company. On the basis of non receipt of any representation has issued notice to take over the property.

As the company has hidden the facts relating to creation of third party interest and shifting of property it comes with no clean hands, hence the claim of the company cannot be accepted and Bank's action to attach the property of the company is valid enough.

In a similar decided case of Prestige light Ltd. v. State bank of India (2007), the Supreme court found that the appellant was not entitled to ask for extraordinary remedy under article 226 of the Constitution from the High Court, and also under Article 136 from the Supreme Court, as the party whose hands are soiled cannot hold writ of the court.

Answer to Question No. 3(b)

In the present case, ABC Ltd. became sick and made reference to BIFR and during the pendency of the reference majority creditors approved made a scheme of compromise so, prepared. They made a petition under section 391(2) for sanction of the scheme.

Banks opposed the scheme saying the scheme to be oppressive to minority shareholders and required heavy sacrifices on there behalf.

BIFR is a complete code in itself and being later enactment it shall prevail over Companies Act,1956, in case of any inconsistency in view of section 32 of the Act. The High shall not interfere where the matter of rehabilitation of sick company is pending before the BIFR under the 1985 Act, as decided in *NGEF Ltd.* v. *Chandra Developers (2005).*

In a similar case of Modern Syntex (India) Ltd. (2006) the Court upheld the aforesaid decision and refused to sanction the scheme if it involved excessive sacrifice from the secured creditors and oppressive to minority shareholders.

Considering the above, BIFR proceedings cannot be interfered by High Court and if the scheme involes excessive sacrifice and oppression the court cannot act as a mere rubber stamp, the petition shall be refused.

Answer to Question No. 3(c)

According to the relevant provisions of compromise and arrangements under sections 391-394 of companies Act 1956,Court's sanction is a must for all kinds of schemes of compromise and arrangements.

In the present case, the company had no secured creditors and all unsecured creditors had approved the scheme. The company claims that sanction of the court is not required under these circumstances.

In a decided case of *Milind Holdings (P) Ltd. and Darshan Holdings (P) Ltd.* v. *Mihir Engineers Ltd. (1996)*, it was held that even if the scheme is approved by the unsecured creditors and the company has no secured creditors the sanction of the court is necessary.

Question No. 4

(a) Distinguish between:

(i) Demerger and Reconstruction

(ii) Split-off and split-up

(iii) Friendly take over and hostile take over

(iv) Horizontal merger and vertical merger. *(2 marks each)*

(b) Whether court orders, sanctioning the scheme of amalgamation, instrument liable to stamp duty ? *(8 marks)*

Answer to Question No. 4(a)(i)

Demerger and Reconstruction

"Demerger" has been defined in Sub-section (19AA) of Section 2 of the Income-tax Act, 1961, which provides that "demerger" in relation to companies, means transfer, pursuant to a scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company, in such a manner that all the property of the undertaking, being transferred by the demerged company becomes the property of the resulting company; all the liabilities relatable to the undertaking, being transferred by the demerged company become the liabilities of the resulting company; the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger.

The expression *"reconstruction"* has been used in Section 394 of the Companies Act, 1956. The term "reconstruction" usually mean the transfer of an undertaking or business of a company to one or more other companies, specially formed for the purpose. The old company goes into liquidation and its shareholders, instead of being repaid their capital are issued and allotted equivalent shares in the new company. "Reconstruction" involves the winding up of an existing company and the transfer of its assets and liabilities to a new company formed for the purpose of taking over the business and undertaking of

the existing company. Shareholders in the existing company become shareholders in the new company. The business, undertaking and shareholders of the new company are substantially the same as those of the old company.

In the case of reconstruction, a new company (hereinafter referred to as 'transferee company') is formed, the existing company (hereinafter referred to as 'transferor company') is dissolved by passing a special resolution for members' voluntary winding up and authorising the liquidator to transfer the undertaking, business, assets and liabilities of the transferor company to the transferee company. The transferee company pays the consideration by issue and allotment of its shares to the shareholders of the transferor company in accordance with the pre-determined share exchange ratio.

Answer to Question No. 4(a)(ii)

Split-off and Split –up

"Split-off" is a process of reorganizing a corporate structure whereby the capital stock of a division or subsidiary of a corporation or of a newly affiliated company is transferred to the stakeholders of the parent corporation in exchange for part of the stock of the latter, or

'Split-up' is a process of re-organizing a corporate structure where by all the capital stock and assets are exchanged for those of two or more newly established companies, resulting in the liquidation of the parent corporation.

Answer to Question No. 4(a)(iii)

Friendly Takeover and Hostile Takeover

Friendly Takeover : Friendly takeover is with the consent of taken over company. In friendly takeover, there is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company. This kind of takeover is done through negotiations between two groups. Therefore, it is also called negotiated takeover.

Hostile Takeover : When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management, such acts of acquirer are known as 'hostile takeover'. Such takeovers are hostile on the management and are thus called hostile takeover.

Answer to Question No. 4(a)(iv)

Horizontal Merger and Vertical Merger

Horizontal merger : This class of merger is a merger between business competitors who are manufacturers or distributors of the same type of products or who render similar or same type of services for profit. It involves joining together of two or more companies which are producing essentially the same products or rendering same or similar services or their products and services directly competing in the market with each other. Horizontal mergers result in a reduction in the number of competing companies in an industry; increase the scope for economies of scale and elimination of duplicate facilities.

Vertical merger : Vertical mergers occur between firms which are complementary to each other, e.g. one of the companies is engaged in the manufacture of a particular product and the other is established and expert in the marketing of that product. In this merger the two companies merge and control the production and marketing of the same product. Vertical merger may take the form of forward or backward merger. A vertical merger may result into a smooth and efficient flow of production and distribution of a particular product and reduction in handling and inventory costs.

Answer to Question No. 4(b)

Section 2(g) of Indian Stamp Act 1899, defines Conveyance

2(g) "Conveyance" includes,—

(i) a conveyance on sale,

(ii) every instrument,

(iii) every decree or final order of any Civil Court,

(iv) every order made by the High Court under Section 394 of the Companies Act, 1956 (I of 1956) in respect of amalgamation of companies;

by which property, whether moveable or immovable, or any estate or interest in any property is transferred to, or vested in, any other person, inter vivos, and which is not otherwise specifically provided for by Schedule I;…"

The order of the Court ordering the transfer of assets and liabilities of the transferor Company to the transferee Company is deemed to be a conveyance under the aforesaid section.

The amended definition of term 'conveyance' under Section 2(g) of the Bombay Stamp Act, 1958 (amended in 1985) *inter alia* includes every order made by the High Court under Section 394 of the Companies Act,1956 in respect of amalgamation of Companies by which property, whether moveable or immovable, or any estate or interest in any property of transferor is transferred to, or vested in the transferee company.

The landmark decision of *Bombay High Court in Li Taka Pharmaceuticals* v. *State of Maharashtra* (1996) 8 SC 102 (Bom.) has serious implications for mergers covered not just by the Bombay Stamp Act, 1958 but also mergers covered by Acts of other States. The following are the major conclusions of the Honourable Court:

(1) An amalgamation under an order of Court under Section 394 of the Companies Act, 1956 is an instrument under the Bombay Stamp Act.

(2) States are well within their jurisdiction when they levy stamp duty on instrument of amalgamation.

(3) Stamp duty would be levied not on the gross assets transferred but on the "undertaking", when the transfer is on a going concern basis, i.e. on the assets less liabilities. The value for this purpose would thus be the value of shares allotted. This decision has been accepted in the Act and now stamp duty is leviable on the value of shares allotted plus other consideration paid.

The Supreme Court in *Hindustan Lever* v. *State of Maharashtra* (2004) has held that the amalgamation scheme sanctioned by the court would be an "Instrument", within the meaning of Section 2(i) of the Bombay Stamp Act, 1958, which transfers the properties from the transferor company to the transferee company and the State Legislature has the legislative competence to impose stamp duty on the order of amalgamation passed by a court.

In *Gemini Silk Ltd.* v. *Gemini Overseas Ltd.* (2003) the High Court has held that a court order sanctioning a scheme of reconstruction or amalgamation under Section 391/ 394 is covered by the definition of the words 'conveyance' and 'instrument' under the Stamp Act and was, therefore liable to stamp duty.

Where the State Legislature, in relation to a matter within its jurisdiction, prescribes the payment of stamp duty in respect of certain instruments, all such instruments, on execution, will have to suffer stamp duty.

Considering the above jugdements it is clear that Court order is an instrument under the Stamp Act and hence liable to stamp duty.

Question No. 5

(a) As a company secretary of a company your management wants you to suggest different parameters to assess the success of mergers. Prepare a note in this context. (8 marks)

(b) Under SEBI (Buy-back of Securities) Regulations, 1998 what are the obligations which a company needs to abide by ? (8 marks)

Answer to Question No. 5(a)

The fundamental economic rationale for a merger is that the value of the merged entity is expected to be greater than the sum of the independent values of the merging entities. A merger can join two cultures, two sets of procedures and protocols, two sets of policies and change the employment environment and prospects of several hundreds of employees, who have been the bed rock of past successes and the key to future value. Timely integration of systems, applications and data provide the corporate information needed to achieve the post-merger objectives and success.

Every merger is not successful. The factors which are required to measure the success of any merger are briefly discussed below.

1. The earning performance of the merged company can be measured by return on total assets and return on net worth.
2. Whether the merged company yields larger net profit than before, or a higher return on total funds employed or the merged company is able to sustain the increase in earnings.
3. The capitalisation of the merged company, the dividend rate and payouts determines its success or failure.
4. Whether merged company is creating a larger business organisation which survives and provides a basis for growth.

5. Comparison of the performance of the merged company with the performance of similar sized company in the same business in respect of (I) Sales, (ii) assets, (iii) net profit, (iv) earning per share and (v) market price of share.

6. Fair market value is one of the valuation criteria for measuring the success of post merger company. Fair market value is understood as the value in the hands between a willing buyer and willing seller, each having reasonable knowledge of all pertinent facts and neither being under pressure or compulsion to buy or sell.

7. In valuing the whole enterprise, one must seek financial data of comparable companies in order to determine ratios that can be used to give an indication of the company position. The following information must be made available and analyzed for post-merger valuation:

   I. All year-end balance sheets and income statements, preferably audited, for a period of five years and the remaining period upto the valuation date.

   II. All accounting control information relating to the inventory, sales, cost, and profit contribution by product line or other segment; property cost and depreciation records; executives and managerial compensation; and corporate structure.

   III. All records of patents, trademarks, contracts, or other agreements.

   IV. History of the company, including all subsidiaries

   Analysis of these items provides data upon which forecasts of earnings, cash flow, etc. can be made.

8. Gains to shareholders have so far been measured in terms of increase or decrease in share prices of the merged company.

9. In some mergers there is not only increase in the size of the merged or amalgamated company in regard to capital base and market segments but also in its sources and resources which enable it to optimize its end earnings.

10. Other than above factors, improved debtors realisation, reduction in non-performing assets, improvement due to economies of large scale production and application of superior management in sources and resources available relating to finance, labour and materials also count for success of mergers.

Answer to Question No. 5(b)

Section 77A of Companies Act 1956, provides for the provisions of Buy back of securities of a company. The section provides that only fully paid up securities qualify for buy back, however the securities on which the call money remains in arrears cannot be bought back. Sub section (2) of the section provides that the company should have a debt-equity ratio not exceeding 2:1, i.e. all secured and unsecured debts of the company should not be more than twice the aggregate of its capital and free reserves.

It is required under sub section (8) of section 77A that the company shall make no further issue of the same kind of securities should be made within a period of 6 months

from the date of completion of buy-back of securities. Section 77AA provides that where buy-back of shares is made out of free reserves company should transfer to the capital redemption reserve account referred to in clause (d) of the proviso to Sub-section (1) of Section 80, a sum equal to the nominal value of the shares so bought back and the details of such transfer should be disclosed in the balance sheet.

Regulation 19 of SEBI (Buy-back of Securities) Regulations, 1998

1. The company shall ensure that:

   (a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material contains true, factual and material information and does not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

   (b) the company shall not issue any specified securities including by way of bonus till the date of closure of the offer is made under these Regulations;

   (c) the company shall pay consideration only by cash;

   (d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;

   (e) the promoter or the person shall not deal in the specified securities of the company in the stock exchange during the period the buy-back offer is open.

2. No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act, 1956.

Compliance officer and investors service centres

The company should nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors [Sub-regulation (3)].

Particulars of extinguished and destroyed certificates

The particulars of the said security certificates extinguished and destroyed should be furnished by the company to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates [Sub-regulation (4)].

Locked-in securities not to be bought-back

The company should not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable [Sub-regulation (5)].

Publication of post-buy-back advertisement

According to Sub-regulation (7), the company should issue, within two days of the

completion of buy-back, a public advertisement in a national daily, inter alia, disclosing the following:

(i) number of securities bought;

(ii) price at which the securities were bought;

(iii) total amount invested in the buy-back;

(iv) details of the security-holders from whom securities exceeding one per cent of the total securities were bought-back; and

(v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Question No. 6

Write short note on any four of the following:

(a) Extinguishing of bought back securities

(b) Poison Pill devices

(c) American Depository Receipts

(d) Contributories in winding up of an unregistered company. *(4 mark each)*

Answer to Question No. 6(a)

Extinguishing of Bought Back Securities

Sub-section (7) of Section 77A of the Companies Act lays down that where a company buys back its own securities, it should, within seven days of the last date of completion of the buy-back, extinguish and physically destroy the securities so bought back. Regulation 12 of the SEBI (Buy Back of Securities)Regulations, 1998 provides that—

1. The company should extinguish and physically destroy the security certificates so bought back, in the presence of a Registrar or the Merchant Banker, and the Statutory Auditor within seven days from the date of acceptance of the securities.

2. If the securities offered for buy-back are already dematerialized, then they should be extinguished and destroyed in the manner specified under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and the bye-laws made thereunder.

3. The company is required to furnish a certificate to SEBI fully verified by:

   (a) the registrar and whenever there is no registrar through the merchant banker;

   (b) two whole-time directors including the managing director;

   (c) the statutory auditor of the company; and

   (d) certifying compliance as specified in Sub-regulation (I), within seven days of the extinguishment and destruction of the certificates.

4. The particulars of the security certificates extinguished and destroyed under

Sub-regulation (1) should be furnished to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates.

Answer to Question No. 6(b)

Poison Pill Devices

A popular defense mechanism against hostile takeover bids is the creation of securities called "poison pills". These pills provide their holders with special rights exercisable only after a period of time following the occurrence of a triggering event such as a tender offer for the control or the accumulation of a specified percentage of target shares. These rights take several forms but all are difficult and costly to acquire control of the issuer, or the target firm. Poison pills are generally adopted by the Board of Directors without shareholder approval. These provisions force the acquirer to negotiate directly with the target company's board and allow some takeover bids to go through. Poison pills enhance the ability of the Board of Directors to bargain for a "fair price".

Answer to Question No. 6(c)

American Depository Receipts

An ADR is a certificate that represents a non-US company's publicly traded shares or debt. ADR's trade freely like any other US security as they are priced and quoted in US dollars. They can be traded on either an exchange or over the counter market and settle according to US standards. ADR's can also trade in markets outside US and can be used to raise capital in US or in markets outside US.

ADR is a tradeable instrument, equivalent to a fixed number of shares, which is floated on overseas markets. ADR issues can be made at four levels depending on the preference of the company. The norms for each level differ and is based on the specific criteria to be satisfied by the issuer. The features of ADRs are as follows:

1. This instrument permits the foreign investor to access non-US market for investment thereby insulating him from exchange risk, as an ADR is denominated in dollars and dividends are also paid in dollars.

2. ADRs are listed on the New York Stock Exchange or Over the Counter Exchange in the USA. ADR's attract a much wider investor base than the GDRs, since pensions funds and individual investors are permitted to invest in them.

3. The size of the ADR issue can be expanded or contracted according to demand as depository banks can issue or withdraw corresponding shares in the local market. GDR is a one time issue and can be contracted in size only if investors decide to redeem.

4. ADR issue is more expensive than a GDR issue.

5. ADR issue requires drawing up the accounting statements in accordance with the stringent requirements of the Securities and Exchange Commission and US GAAP.

Answer to Question No. 6(d)

Contributories in winding up of an unregistered company

Section 585 of Companies Act 1956, Where an unregistered company is being wound up, every person shall be deemed to be a contributory, who is liable to pay, or contribute to the payment of:

(a) any debt or liability of the company; or

(b) any sum for the adjustment of the rights of the members among themselves; or

(c) the cost, charges and expenses of the winding up of the company.

Every contributory shall be liable to contribute to the assets of the company, all sums due from him in respect of any liability to pay or contribute as aforesaid, and in the event of death or insolvency of any contributory the provisions of the Act with respect to legal representatives of deceased contributories or with respect to assignees of insolvent contributories shall apply.