

# *Case Studies and practical aspects of MERGERS AND DEMERGERS*

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# Need For Mergers & Demergers

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- # A Panacea for corporate turbulence
- # Opening up of the Indian economy
- # Impetus for foreign investment
- # Interest of foreign companies in exploring business relationships with India
- # Tax planning tool
- # Back door listing
- # Family settlement

# Advantages

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## Strategic Synergies

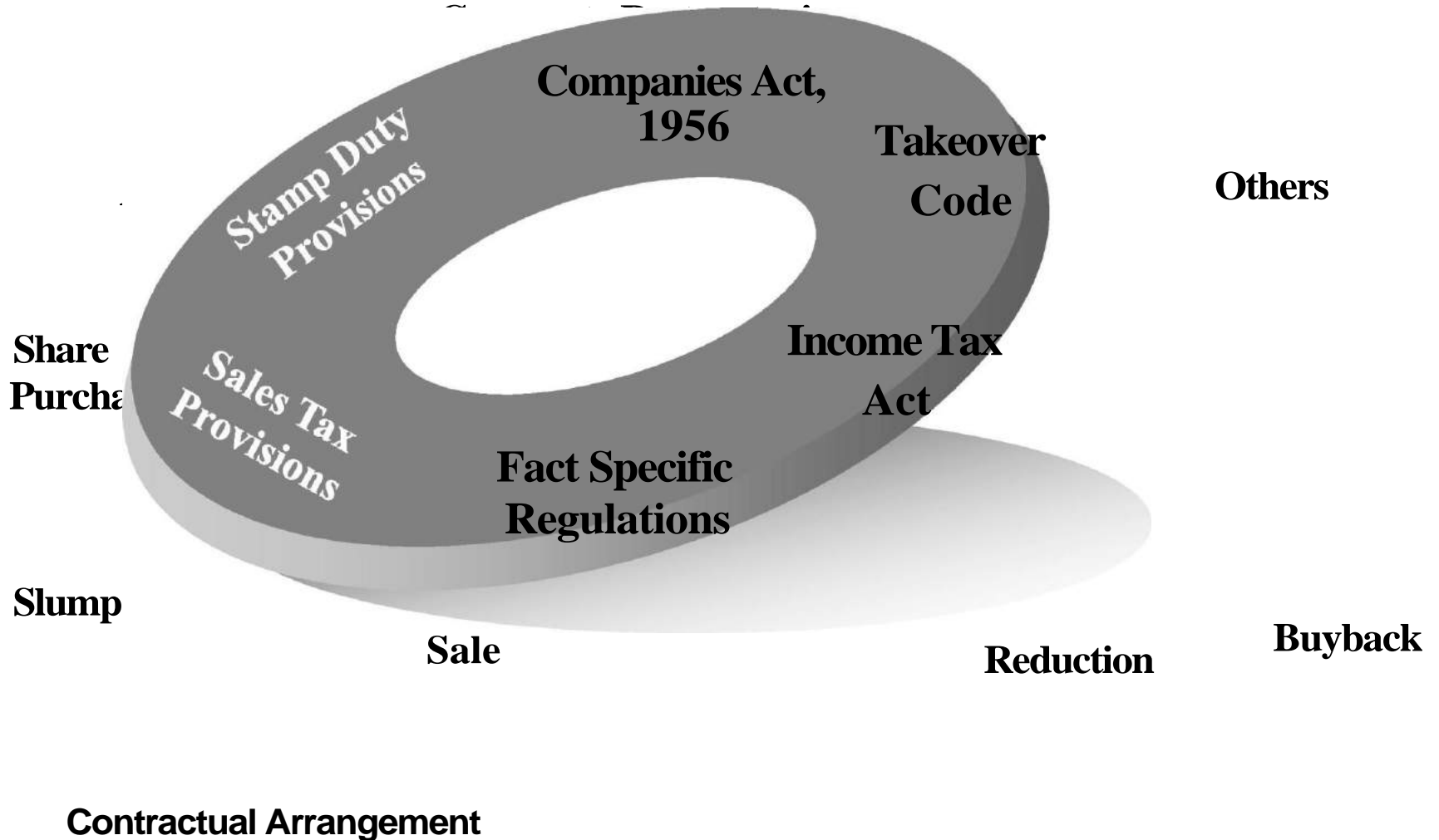
- # Growth in market share.
- # Diversification
- # Product range width
- # Global platform
- # Market penetration
- # Enhancement of technical know how

## Financial Synergies

- # Available liquidity
- # Capital Structure flexibility
- # Tax and cost advantages

# *Regulatory Framework*

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# What is Merger / Amalgamation?

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Mergers ——— M ----- Marriages

De-mergers ----- D ----- Divorces

- ✚ Companies Act, 1956 (CA) facilitates compromise, arrangement or reconstruction of a business (sections 390 to 396A of CA)
- ✚ The terms ‘merger’ and ‘amalgamation’ are synonymous
- ✚ In amalgamation, the undertaking, i.e. property, assets and liability of one or more company (amalgamating company) are absorbed by an existing or a new company (amalgamated company)
- ✚ The amalgamating company integrates with amalgamated company and the former is dissolved without winding up

# **Amalgamation -Definition under the Income-Tax Act, 1961 [section 2(1B)]**

✚ Merger of two or more companies in such a manner that all assets and liabilities of the amalgamating company immediately before the amalgamation, become the assets and liabilities of the amalgamated company

**and**

✚ Shareholders holding not less than 3/4th in value of the shares in the amalgamating company become shareholders of the amalgamated company by virtue of the amalgamation

✚ Sec 47(vii) of Income Tax (IT) Act, 1961 - Exemption from Transfer Any transfer by a shareholder, in a scheme of amalgamation, of shares in the amalgamating company if transfer is made for consideration as shares in the amalgamated company except where the shareholder itself is the amalgamated company. (in a way, earlier CBDT circular of 1967 adopted).

# What is Demerger

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**Section 2(19AA)** of the Income-tax Act defines demerger as under:

*‘demerger’ in relation to companies means the transfer, pursuant to a scheme of arrangement under section 391 to 394 of the Companies Act, 1956 by a demerged company of its one or more undertakings to the resulting company in such a manner that-*

- i. All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of demerger;

*Contd.*

# What is Demerger

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- ii. All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- iii. 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;
- iv. The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis (except where the resulting company itself is a shareholder of the demerged company);



# What is Demerger

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- v. The shareholders holding not less than three-fourth in value of shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger; otherwise than as a result of the acquisition of the property or assets of the demerged or any undertaking thereof by the resulting company;
  
- vi The transfer of the undertaking is on a going concern basis.

## *Procedure for Scheme under section 391-394*

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*Contd.*

- To prepare the draft scheme of amalgamation/arrangement
- To get the valuation report for the purposes of Shares Exchange Ratio
- To obtain fairness opinion from merchant banker on the valuation report (clause 24 of the listing agreement)
- To inform the Stock Exchanges for holding Board Meeting for approving the Scheme of Amalgamation/Arrangement
- To hold Board Meeting for taking note of the valuation report and share exchange ratio, draft scheme of amalgamation and authorizing someone to sign all the application, petition, affidavits etc. on behalf of the company.

## *Procedure*

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*....Contd.*

- To file draft scheme of arrangement/amalgamation with the stock exchanges atleast a month before presenting it to the Court (clause 24 of the listing agreement) along with auditor's certificate confirming the compliance of AS-14 and other related documents
  
- Filing of application before the Hon'ble High Court under section 391 of the Act for convening/dispensing with the meetings of shareholders and creditors of the applicant companies

## *Procedure*

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....Contd.

- Whether joint application/petition (i.e. by all the companies together falling under jurisdiction of one High Court) possible? Yes, there is no restriction
- Order of the High Court for convening of the meetings of the shareholders/creditors under Rule 69 of the Company (Court) Rules, 1959 and appointment of Chairman
- To finalize the draft notice of meetings of the creditors/shareholders in Form 36 and advertisement of the notice of the meeting in Form 38
- To get the notice of the meeting approved from the Chairman appointed by the Court & Registrar of the High Court
- To get the explanatory statement approved from the Chairman & Registrar of the High Court. (In case of listed company, explanatory statement should also comply with the Listing Agreement)

## *Procedure*

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*Contd.*

- To get the notices along with the explanatory statement printed
- To send the notice (Form 36) individually to the shareholders / creditors by the Chairman or under the name of the Chairman by the Company within 21 clear days of the holding of the General Meeting [along with copy of the Scheme, Explanation Statement, Form of Proxy (Form 37) and also by way of advertisement in two newspapers, one in English and other in vernacular language circulating in the area where registered office of the Company is situated]
- To give advertisement in the newspaper at least 21 clear days before the date of the meeting (Advertisement in Form 38)

## *Procedure*

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*Contd.*

- Chairman to file affidavit stating that the directions regarding the issue of notice of advertisement & dispatch of notices have been complied with (at least 7 days before the date of the meeting)
- To convene meetings of the shareholders/creditors - Pass the Resolution with requisite majority and arrange for filing of Chairman's Report as per directions of the Court
- To file petition for obtaining sanction of the Court for the scheme along with all Annexures at the High Court for confirming compromise/arrangement (Form 40) (within 7 days of filing report)

## *Procedure*

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- Publication in the newspapers of the notice of petition
- To follow up with the RD, ROC and OL for submitting their reports that affairs of the Transferor Company and Transferee Company are not prejudicial to the interest of the members or to public interest
- To ensure that RD and OL submit the report with the High Court before the final date of hearing (Guidelines by MCA in next slide)
- To file certified true copy of the order within 30 days with the Registrar of Companies
- To annex copy of the order of every copy of the Memorandum of the company

# *Guidelines to RDs/ROCs for Schemes u/s 391-394*

*Contd.*

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- Ministry of Corporate Affairs, Government of India (“MCA”) has issued General Circular No. 53 of 2011, with guidelines for the Regional Directors **RDs**, and Registrar of Companies (“**ROCs**”), in the matter of scheme of arrangement / amalgamation under section 391- 394
- In order to streamline the procedure, guidelines along with timelines are issued for strict compliance.



## ***Guidelines to RDs/ROCs for Schemes u/s 391-394:***

*Conta.*

Timelines prescribed under the guidelines are as under :

- On receipt of notice from Court, RD should make an entry in register/electronic form. In case the petition is filed with ROC in Form 61 same can be monitored directly from the system.
- RD shall send mail to ROC within 3 days.
- ROC should furnish his report online to RD within 7 days from receipt of Form 61 without waiting for RD's communication
- RD should then send a letter to local branch of Law Ministry / Assistant Solicitor General requesting for nomination of an advocate.
- RD should send a letter to Company within 5 days to provide material of valuation and Chairman's report and the same should be finalized within a week's time thereafter.

- The finalized affidavit be sent to Standing Counsel for signature and it should not take more than 5 days after which should be filed in Court registry.
- ROCs to examine matter and send report to RDs – RD to consider the same before finalizing their comment.

## *Issues to be examined by RDs*

*Contd.*

- 
- Whether companies forming part of scheme are **sensitive sectors** categories companies ?
  - Whether any of the companies are **listed** on any STX ? If so, NOC from STX is submitted ?
  - Whether any **NRI/foreign interest** in the Companies?
  - Whether the companies or its **directors** have contravened any provisions of Act?
  - Whether the companies involved have been inspected u/s **209A** ?
  - Whether **Valuation report** submitted, if so share exchange ratio is as per report and accounting principles ?
  - Whether transfer of **Employees** and their interest is protected ?
  - Whether **Accounting Treatment** clause is as per AS-14 and in tune with provisions of section 211(3A)/ 211(3C) of the Act ?

## *Issues to be examined by RDs*

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- Whether **meeting** of class of shareholders/creditors is conducted ?
- Whether details of **related party transactions** are furnished ?
- Whether **consideration** is made in cash other than of shares ?
- Whether provisions of **buy back** is attracted ?
- Whether any **reduction of share capital** is involved ?
- Whether **authorized share capital** of transferee company is sufficient?
- Whether any foreign entity is involved and **necessary approvals** obtained ?
- Whether compliance of **FEMA/RBI Guidelines** has been done ?
- Whether any qualification has been made by **Statutory Auditor** ?
- Whether a listed company is merging with an **unlisted company** ?
- Whether the **promoters holding** in listed company is increased?

➤ Whether the companies have come up with the schemes under principle of '**Single Window Clearance**', approval from High Court has been obtained ?

## *Issues to be examined by ROCs*

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- Filing Position.
- Investor Grievances.
- Inspection / Investigation / Technical Scrutiny.
- Pending Prosecution.
- Furnishes comments on the scheme.

# *Issues considered by Court in a Scheme of Arrangement*

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- Compliance with the Provisions
- Protection of interest - creditors and shareholders
- Reasonable arrangement
- Scheme in consonance with public interest

## *Issues considered by Court in a Scheme of Arrangement:*

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- In the case of *In Re: Apex Investments Pvt. Ltd.* (1992) CLA 20 (Del), the Hon'ble Delhi High Court held that an arrangement for reconstruction or amalgamation of a company is essentially a contract and therefore parties are free to decide:
  - its terms and conditions
  - consideration to be paid
- According to Section 10 of the Companies Act, 1956, the jurisdiction for petition of amalgamation will lie with the High Court of the State in which the Registered Office of the Company is situated.



## *Appointed Date & Effective Date*

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**Appointed Date:** Date on which assets and liabilities of the transferor company vest in and stand transferred to the transferee company

➤ Accounts on the appointed date form the basis for valuation of shares and determination of share exchange ratio

➤ Appointed date relevant for the *Critical Issues* purpose of assessment of income of the transferor and transferee companies

*[In Re: Marshall Sons (1997) 88 Comp Cases 528 SCJ*

(Can future appointed date be fixed??)

**Effective Date:** Date on which scheme is complete & effective, i.e. certified copy of the High Court order is filed with Registrar of Company or the last of the approvals obtained

➤ From the effective date amalgamation becomes effective and transferor company stands dissolved

(APIIC example)

# Valuation Aspects

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- One of the most important part of the M&A Scheme
- Valuation is an art and not a science
- The Process involves:
  - evaluating the value of the merging company or its business and/or of its shares
  - evaluating the securities of the issuing company on a stand alone basis
  - determining the Exchange Ratio for the securities so as to ensure fair consideration
- The Report is subject to scrutiny by the lending and investment institutions, Regional Director, Official Liquidator

# Valuation Aspects

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- Approval of the Scheme and the Valuation Report by majority of the shareholders and creditors does not mean that the Court is bound to treat the same as fait accompli-Court can view it from the test of fairness
- On some occasion, the Court does appoint independent valuers where dissenting shareholders or creditors make a strong case for such an action
- Valuation not required in case of merger of WOS
- No requirement under the law-only advisory in nature to Board - *Advance Plastics Pvt. Ltd. (2007) 138 Comp Cases 1006 (Bom)*

## Critical Issues

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- **Whether valuation report is mandatory ?**

## Critical Issues



### Companies Act:

- No specific reference for valuation report;
- Though listed companies are required to send “fairness opinion” with notice of the meeting
- Valuation Report is not required in cases of de-merger *Refer: Larsen and Toubro Limited (supra)*
- Valuation report is not mandatory even for mergers/ amalgamations, its only for reference of Board of Directors

## Critical Issues

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### Companies Bill, 2012 (“Companies Bill”):

- Reference is made under clause 230 (2) (v) and 232 (2) (d). The said clauses are reproduced hereunder

230 (2) (v) “A valuation in respect of shares and the property and all assets tangible and intangible, movable and immovable of the company by a registered valuer”

232 (2) (d) “The report of the expert with regard to the valuation if any”



## Critical Issues

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**Whether consent of the shareholder(s)/ creditors(s) can be obtained by way of postal ballot ?**

## Critical Issues



### **Companies Act:**

- Voting is allowed in person or by proxy at meeting.
- Was not permitted in the absence of any specific provision in this regard.

**[In Re: Bharti Airtel]** Hon'ble Delhi High Court specifically permitted to obtain the consent by way of postal ballot instead of the meeting.



# Critical Issues



## Companies Bill

- Specific permission in the Companies Bill permitting the voting by postal ballot - Clause 230(4) provides that the consent of shareholders(s)/creditors can be obtained by way of postal ballot. The said clause is reproduced hereunder:

*230(4) A notice under sub-section (3) shall provide that the persons to may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice.*

## Critical Issues

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- **To whom notice of the Scheme is required to be sent??**

## Critical Issues

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### Companies Act:

- Notice of the scheme is to be served to
  - a)Central Government (section 394A);
  - b)Registrar of Companies;
  - c)Official Liquidator, if required;

as per High Court Directions

## Critical Issues

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### • Notice of the Scheme :

Specific timeline of 30 days to respond to the notice for the statutory authorities. The relevant portion of the said clause is reproduced hereunder:

230(5) “ *A notice under sub-section (3) along with all the documents in such form as may be prescribed shall be sent to the Central Government, the Income Tax Authorities, the Reserve Bank of India, The Securities and Exchange Board, the Registrar, the respective stock exchanges, the official liquidator, The Competition Commission of India established under 7(1) of the Competition Act, 2002, **if necessary** and such other sectoral regulators or authorities which are likely to be effected by the compromise or arrangement”*



## Critical Issues

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- **Whether provisions for dispensation of meetings of shareholders/creditors are provided in statute??**

## Critical Issues



### Companies Act:

- No provision in this regard, governed by judicial pronouncements

### Companies Bill:

Specific provisions inserted in this regard. If the consent of 90% of the value of the creditors has been obtained then the High Court may dispense with their meeting else the same has to be convened. (Clause 230(9)). The said clause is reproduced hereunder:

*230 (9): “The Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having atleast ninety percent value agree and confirm by way of affidavit to the scheme of compromise or arrangement”*

## Critical Issues

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- **Whether latest provisional accounts are required to be filed before HC or circulate it to the members ?**

**Critical Issues****Companies Act:**

- Provisional accounts were not mandated; only latest audited accounts (Section 391)

**Companies Bill:**

- Provisional/ supplementary accounts required. Clause 232(2)(e). The said clause is reproduced hereunder:

*“a supplementary accounting statement if the last annual accounts of any of the merging company relate to financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme”*



## Critical Issues

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- **Whether Auditor's Certificate for Compliance of Accounting Standards is also required for unlisted companies??**

## Critical Issues



### Companies Act:

- Earlier there was no requirement for obtaining such compliance certificate in case of unlisted companies. Only required for listed companies. [*Refer: Clause 24(i) of the Listing Agreement*]

## Critical Issues



### Companies Bill:

- Proviso to clause 230(7) provides that auditor's certificate for compliance of Accounting Standards for unlisted companies is also required. The said clause is reproduced hereunder:

*“Provided that no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the **company's auditor** has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards under clause 133”*

## Critical Issues

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- **Time period for filing the order with the ROC**

**Critical Issues****Companies Act:**

- Within 30 days or the time given in Order
- Power of Court to provide a period higher than 30 days also
- In calculating the time period- time taken in drawing up and obtaining a copy of order to be excluded (Sec 640A)
- But e-filing of Form 21 along with order within 30 days from the date of receipt of order only otherwise, an objection can be raised by RoC.

## Critical Issues



### Companies Bill:

- Now, position is clarified order is to filed within 30 days from the **receipt of the order.** (Clause 230(8))

## Single window clearance

- Sanction of a Scheme without power to amalgamate in the memorandum of association

**[Hari Krishna Lohia v. Hoolungoree Tea Co. Ltd. (1996) : 4 Comp LJ 353 (Cal) ]**

- Increase of authorized capital - Post amalgamation events cannot be made subject-matter of objections to scheme of compromise or arrangement

**[Winfield Agro Services (P) Ltd. v. Hindustan Antipest (P) Ltd. (1996) : 3 Comp. LJ 347 (AP)]**

- Change of object clause through the Scheme **[In Re: HCL Infosystems Ltd.]**

*Contd...*

# Single window clearance

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- Change of name of the amalgamated company to the name of amalgamating company [**In Re: Novapan India Ltd., (1997) 88 Com Cases, 596**]
- Change of Registered Office of the transferee company [**In the matter of Indo Rama Synthetics Ltd.**]
- Reduction of Share capital [**In Re: ManekChowk and Ahmedabad Mfg. Co. Ltd**]
- Conversion of status of a company (Private Limited to Public Limited and vice-versa) [**In Re: Maharishi Ayurveda Corporation Pvt. Ltd.**]



## Critical Issues

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- **Can Indian Company be merged with the Foreign Company?**

## Critical Issues



### Companies Act:

- Only Foreign Company can be merged with the Indian Company.
- Sec 394(4)(b) of the Companies Act defines-
  - a. Transferee Company to include any company within the meaning of the Companies Act.
  - b. Transferor Company to include any body corporate, whether a Company under this Companies Act or not.
    - Foreign Co. can be a transferor company but can't be a transferee company [1. *Moschip Semiconductor Technology Ltd.*, (2004) 120 Comp Cas 108 (AP) 2. *Jindal Saw Ltd.* (Allahabad High Court)]

## Critical Issues

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### Companies Bill:

- Specific Insertion - Clause 234 of the Companies Bill provides for merger of the Indian Company with the Foreign Company and *vice-versa* subject to restrictions stipulated in the clause. Relevant part of the clause is reproduced hereunder for ready reference:

*234(1) The provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis to schemes of mergers and amalgamation between companies registered under the Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government.*

*(2) a foreign company, may with the approval of the RBI, merger into a company registered under this Act or **vice-versa and terms and conditions** .....*



## Critical Issues

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- **Can insignificant minority object to the scheme**

## Critical Issues



### Companies Act:

- No provision in the existing Companies Act specifically barring the insignificant minority to object to the scheme

*[Refer: UB Nizam Breweries P. Ltd. In re (2011) 167 Comp Cas 562 (Kar)]*

**Hindalco Industries Ltd., Bombay High Court**

## Critical Issues



### Companies Bill

- Proviso to clause 230(4) provides that a scheme can only be objected by persons holding
  - (a) 10% or more of the shareholding; or
  - (b) 5% or more of the total outstanding debt.

The said proviso is reproduced hereunder:

*Provided that any objection to the compromise and arrangement shall be made only by person holding not less than ten percent of the shareholding or having outstanding debt amounting to not less than five percent of the total outstanding debt as per the latest audited financial statement*

## Critical Issues

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- **Exit to minority??**

## Critical Issues

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➤ Recently, the Division Bench (“DB”) of Delhi High Court, in the matter of **Ram Kohli V. Indrama Investment Pvt. Ltd. and Select Holiday Resorts Ltd.**, has dismissed the appeal rejecting the objections raised by a minority shareholder against a scheme of amalgamation sanctioned by the Company Court/Single Bench **Date of Decision: 16<sup>th</sup> May, 2013 in Company Appeal 70/2012**

➤ “Shareholders holding miniscule percentage of shares in the company would not be permitted to hold the company to ransom when substantial majority has approved the scheme providing for exit to minority”

➤ A scheme of amalgamation was duly passed

LMN, a minority shareholder objected stating that he has been forcibly exited, since he held fractional shares as per the scheme.

He stated that he constituted a separate class.

Delhi High Court while rejecting the objections raised by Objector, held that minority can't suppress the scheme passed by majority



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**EXITING MINORITY SHAREHOLDERS BY DECISION OF MAJORITY:**

ITW Signodge India Limited. In Re (2004) 52 SCL 147 (AP)
Matther and Platt Pumps Limited In re C.P. 69 of 2010
Hoganas India Ltd In Re [2009] 148 Comp Cas Bom
Organon India Limited 2010 (4) Bom CR 268
Sandwik Asia Limited 2009 (3) BOM CR 57
Reckitt Benckister (India) Ltd. 122 (2005) DLT 612

## Critical Issues

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- **Can Treasury Shares be issued in lieu of shareholding of Holding and subsidiary??**

**Critical Issues****Companies Act:**

- No provision restricting/prohibiting the company to hold the treasury stock. However, companies are prohibited from holding own stakes under normal course;
- No specific requirement for cancellation of inter company stakes on merger. Treasury shares can be created instead of cancellation of inter-company shareholdings;
- In different schemes like Reliance, Jaypee, Network 18, treasury shares have been created

## Critical Issues



### Companies Bill:

- Treasury shares cannot be issued under clause 230(3)(b) proviso. The said clause is reproduced hereunder:

*“Provided that a transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the **name of any trust** whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished”*

## ***Can a Partnership Firm be merged with a company?***

Sec 390(a) of Act defines company for Sec 391-393 as a company liable to be wound up under this Act.

**‘Company liable to be wound up’ –**

all co.’s to which provisions of winding up applies & Part X of the Act deals with winding up of an unregistered company.

Unregistered Co. as per Sec 582(b) includes any partnership firm, association or co. consisting of more than 7 members at the time of presenting the petition. (minimum 8)

**CLC Corporation and Spentex Industries Ltd.** (Co. App. (Main)15/2005)

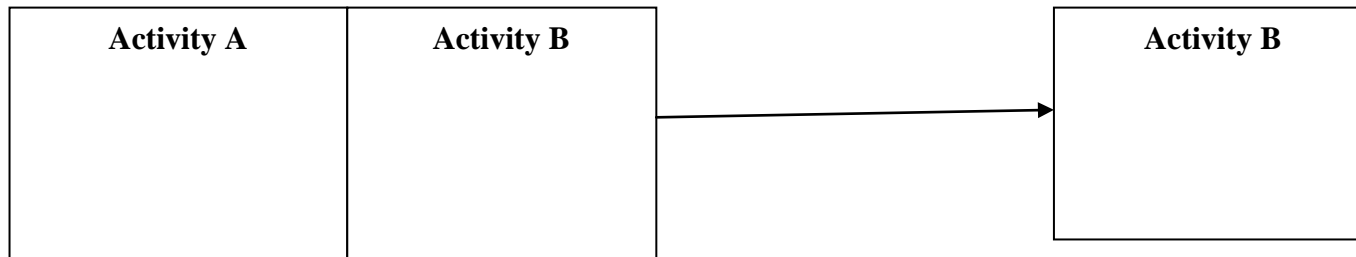
# ***Back Door Listing through Scheme:***

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- **Listing of a company without IPO**

**A Ltd.** (Listed Company)

**B Ltd.** (Listing through Scheme)



**Compliance of Circular of SEBI (CFD/SCRR/01/2009/03/09) dated September 3, 2009**

## Critical Issues

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➤ **Merger of listed company with unlisted company:**

## Critical Issues

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### Companies Act:

- No specific provision for such reverse mergers, involving a listed and an unlisted company. SEBI vide its circular dated September 3, 2009 provides for terms for such mergers.

### Companies Bill:

Specific provisions included for such mergers [**Section 232(3)(h)**]

Exit opportunity being provided for shareholder(s) of listed transferor company [**Clause 232 (3) (h)**]





## Critical Issues

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However, SEBI, vide its circular dated February 04, 2012 (by superseding the earlier circular) has significantly revised the requirements in respect of listed companies and desirous of undertaking a scheme of arrangement (including without limitation, an amalgamation, a merger, a reconstruction or a reduction of capital) under Chapter-V (covering section 390-396A) of the Companies Act, 1956.

New Circular is not clear for the following:

- a) Whether it is applicable to all the schemes proposed by listed company or only the schemes for seeking exemption u/r 19(2)(b)?
- b) Whether it is applicable to reduction of capital simplicitor u/s 100 ??
- c) Method of obtaining shareholders approval ??

## Critical Issues

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### **Procedure under the new Circular issued by SEBI:**

- a) Valuation Report to be placed before Audit Committee.
- b) STX to SEBI in 3 days (scheme and other docs)
- c) Independent CA Clarification
- d) Objection or No objection letter by STX to SEBI within thirty (30) days from the date of application, or within seven (7) days from the receipt of the last clarification sought from the company or CA
- e) SEBI, after its evaluation, shall submit a report to STX within thirty (30) days from the later of: (a) Date of receipt of clarification from company, if any, sought by SEBI; or (b) Date of receipt of opinion of CA, if sought by SEBI; or, (c) Date of receipt of the no-objection (or objection, as the case may be) from the Stock Exchange(s).

## Critical Issues

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f) STX within 7 days from SEBI's comments shall issue an Observation letter to the Company, which shall produced before the Court and also sent to the members.

g) Obtaining the shareholders approval through a special resolution passed by postal ballot and e-voting.

h) The Scheme must also provide that the special resolution shall be acted upon only if the votes cast by the public shareholders in favour of the proposal, amount to at least two (2) times the number of the votes cast by public shareholders against it.

## Critical Issues



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Subsequent to the Circular No. CIR/CFD/DIL/5/2013 issued by Securities and Exchange Board of India (“SEBI”) on February 4, 2013 - SEBI has issued Circular No. CIR/CFD/DIL/8/2013 dated May 21, 2013 (“Circular”). The said Circular addresses the concerns of the market participants that were facing operational difficulties in implementing certain provisions. This Circular aims at providing clarification and modifying certain provisions of the earlier circular.

## Critical Issues

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### **Applicability:**

The aforesaid circular is applicable to all the Schemes of Arrangement, including amalgamation, merger, reconstruction and reduction of capital. Further the Circular clarifies that it is even applicable to cases where no exemption from Rule 19 (2) (b) of Securities Contracts (Regulations) Rules, 1957 (“SCRR”) is sought from SEBI

## Critical Issues

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### **Valuation Report from independent Chattered Accountant (“CA”) not required in some cases:**

It has been clarified that a Valuation Report from an independent CA is not required in cases where there is no change in the shareholding pattern of the listed company/ resulting company.



**Critical Issues****Modifications to the erstwhile circular:**

- A listed company can choose the stock exchange having nation-wide trading terminals as the designated stock exchange for the purpose of coordinating with SEBI.
- Companies listed solely on regional stock exchange wherein exemption from SCRR is sought, the company is required to "obtain in-principle approval for listing of equity shares on any stock exchange having nationwide trading terminals.
- Those companies which have not sought the required exemption from SCRR, one of the stock exchanges having nationwide trading terminal shall provide a platform for dissemination of information of such Schemes, by charging reasonable fees from such companies



**Critical Issues****Voting by public shareholders through postal ballot and e-voting:**

The Circular provides that in the following cases, Listed Companies are to ensure that the Scheme submitted with the Hon'ble High Court for sanction, provides for voting by public shareholders through postal ballot and e-voting. Such Schemes shall also provide that the Scheme shall be acted upon only if the votes cast by the public shareholders in favor of the proposal are more than the number of votes cast by the public shareholders against it.

- a) Where additional shares have been allotted to Promoter/ Promoter Group, Related Parties of Promoter/ Promoter Group, Associates of Promoter/ Promoter group, Subsidiary/ (s) of Promoter Groups ( “Promoters”) of the listed company or;
- b) Where the Scheme of Arrangement involves the listed company and any other entity involving Promoters;



**Critical Issues**

**Voting by public shareholders through postal ballot and e - voting:**

c) Where the parent listed company, has acquired the equity shares of the subsidiary, by paying consideration in cash or kind in the past to any of the shareholders of the subsidiary who may be Promoters of the parent listed company, and is the subsidiary is being merged with the parent listed company under the Scheme.

## Critical Issues

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- **Whether the liability in respect of any offence committed before merger gets absolved after merger ?**

## Additions:

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- [Section 232(7)] Every Company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as ,may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or **a company secretary in practice** indicating whether the scheme is being complied with in accordance with the orders the Tribunal or not.

# Stamp Duty Aspects

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*Contd.*

- Every instrument for transfer of property, whether movable or immovable, attracts stamp duty prescribed in Schedule-I of the Indian Stamp Act, 1899 (“Stamp Act”)
- Instrument attracts duty not the transfer/conveyance
- In order to create a valid charge for levy of stamp duty on conveyance, the following ingredients must exist; (i) there should be an instrument of transfer, and (ii) the property, whether movable or immovable, should be transferred inter-vivos between the parties
- It is also pertinent to note that stamp duty is a State subject. The applicability is determined on two grounds: the State/states(s) in which the registered office of the Companies is situated and the situs of the properties being transferred under the Scheme.

## ***Stamp Duty Aspects***

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- Whether order of the Court for amalgamation is an instrument of conveyance under the Stamp Act or not?
- Maharashtra, Gujrat, Karnataka, Rajasthan, Chattisgarh, Madhya Pradesh, Andhra Pradesh, West Bengal and Uttar Pradesh –have included the orders passed u/s 394 of the Companies Act in the definition of ‘Conveyance’.

***Hindustan Lever Vs. State of Maharashtra (2004) 1 CLJ 148 (SC)*** - held that order of the Court is an instrument constituting a transfer inter-vivos and therefore, falls within the ambit of the definition of conveyance

The ***Hon’ble High Court of Calcutta*** vide its order dated 8th February, 2012, in the matter of Emami Biotech Limited (CP. No. 627 of 2011) and ITP Limited (CP No. 398 of 2011) and Brijbhumi Agents Private Limited (CP No. 474 of 2011) held that an order sanctioning a scheme of amalgamation or demerger under Section 394 of the Companies Act answers to the description of the words "instrument" and "conveyance" within the meaning of the Indian Stamp Act, 1899 as applicable in the State of West Bengal and is, accordingly, exigible to stamp duty.

## *Stamp Duty Aspects*

*Contd.*

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Further, it states that the judgment as given in *Madhu Intra Limited V. Registrar of Co.* [2005] 58 SCL 160 (CAL) does not hold good in light of the *Hindustan Lever* case.

- ***Delhi Towers Limited vs. G.N.C.T. of Delhi [(2010) 159 Comp Cas 129 (Del)]*** it was held that the order of the High Court under section 394 of the Companies Act constitutes an instrument by virtue of which the assets and liabilities of the transferor/demerged company are transferred and vested in the transferee/resulting company disregarding the fact that there is no specific entry in the schedule-I of the Delhi Stamp Act and hence, made such order eligible to stamp duty.
- Stamp duty in Delhi on instrument of conveyance for transfer of property is 3% on the consideration set forth in the instrument and in case of transfer of immovable property, and additional transfer duty of 3% of the consideration amount shall be applicable
- The Allahabad High Court in the case of [***Hero Motors Limited vs. State of Uttar Pradesh (2009) 2 AWC 1336***] vide order dated 23.01.2009, held as under:

## *Stamp Duty Aspects*

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*...Contd.*

“..... *the scheme of arrangement sanctioned by the Court is a conveyance and an instrument within the meaning of Sections 2 (10) and 2 (14) of the Indian Stamp Act as applicable in Uttar Pradesh.*

*a scheme of arrangement involves transfer of business of a going concern. The consideration of transfer under a scheme of arrangement would be the shares allotted by the transferee company to the shareholders of the transferor company. The valuation of the shares would therefore be the consideration upon which stamp duty would be payable at the rate provided for conveyance of movable property. A going concern or an undertaking transferred under a scheme of arrangement would therefore be ‘movable property’. In view of the aforesaid discussion, I am of the opinion that the scheme of arrangement is covered by Article 23 (b) of Schedule 1-B of the Indian Stamp Act as applicable in U.P.”*

## *Stamp Duty Aspects*

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- **Notification No. 1 dated January 16, 1937**, issued by the Finance Department, Central Board of Revenue, provided for remission of stamp duty chargeable on instruments evidencing transfer of property in cases, where the transfer of properties is between a parent company and its subsidiary company, where the transferor is the beneficial owner of not less than 90% of the issued share capital of the transferee or vice-versa.
- The said notification was superseded by **Notification No. 13 dated 25th December, 1937**
- **Notification No. 1 dated January 16, 1937** is withdrawn in Delhi vide notification number No. F.I( 423 )/Regn.Br./HQ/[Div.Com./IO/266](#) dated 1st June, 2011.
- What about **Notification No. 13 dated 25th December, 1937?**



## **Fast Track Scheme (under Companies Bill, 2012)**

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The Companies Bill, 2012 (Bill) has introduced a (fast track) concept whereby they have simplified the procedures in respect of merger and amalgamation of:

Holding company and its wholly owned subsidiary or such other class of companies, as may be prescribed; OR

Two or more small companies subject to the process given under clause 233 of the Companies Bill

## **Fast Track Scheme (under Companies Bill, 2012)**

**Clause 2(85):** Small Company means a company other than a public company

whose:

(a) paid up share capital does not exceed Rs. 50 Lac or such higher amount as may be prescribed which shall not be more than Rs. 5 crore; OR

(b) turnover of which as per its last profit and loss account does not exceed Rs. 2 crore or such other amount as may be prescribed which shall not be Rs.20 crore.

Further the definition of small company excludes a holding company and its subsidiary, Section 8 (presently section 25 company), a company or body corporate governed by any special act.

# **Fast Track Scheme** (under Companies Bill, 2012)

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## **Fast Track Process Steps:**

- 1) Notice of the proposed scheme is to be sent to the ROC and OL or **any persons affected by the scheme** and they are to provide their objections or suggestions within 30 days of this notice at the registered office of the Transferor and Transferee Company(s).
- 2) These objections and suggestions have to be considered at a general meeting of the respective companies and the scheme has to be duly approved by **at least 90% of the total number of shares**. *(There is no clarification on present and voting)*

## Fast Track Scheme

- 3) 

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 Each of the companies involved is required to file a declaration of solvency with the concerned ROC
- 4) Scheme is to be approved by 9/10<sup>th</sup> in value of the creditors or class of creditors either by way of written consents or by a meeting wherein notice is to be sent to these creditors at least 21 days in advance
- 5) Transferee Company shall file a copy of the approved scheme with the Central Government, ROC and OL

## Fast Track Scheme

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- 6) In case the ROC and the OL have no objection, the Central Government shall approve and register the scheme and also issue a confirmation in this regard to the companies.
- 7) In case the ROC or OL have objections they are to communicate the same to the Central Government within 30 days, otherwise it shall be presumed that they have no objections.
- 8) In case the Central Government, after receiving the objections from ROC and OL, is of the opinion that the scheme is not in public interest or the interest of the creditors, the same shall be referred to the Tribunal within 60 days of receipt of scheme stating its objections and requesting the court to invoke clause 232

## Fast Track Scheme

- 9) 

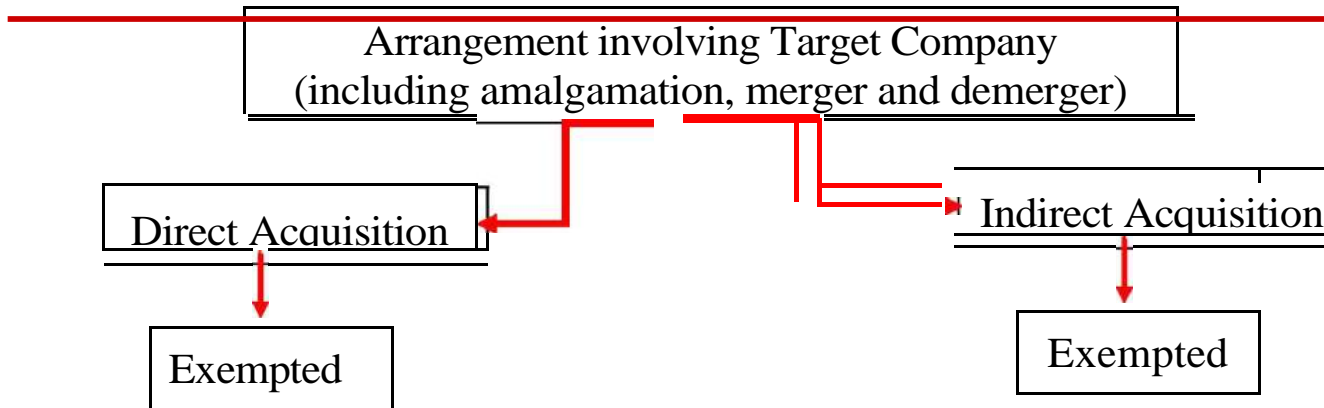
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On receipt of an application from Central Government **or from any person, if the Tribunal**, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down u/s 232, the Tribunal may direct accordingly or confirm the scheme by passing such order as it deems fit;
- 10) 

If CG does not have any objection or has not filed any application with Tribunal, it shall be deemed that it has no objection to the scheme.
- 11) 

Once the scheme is approved by the Tribunal a copy of the order shall be filed with the ROC having jurisdiction over the transferee company. ROC shall register the same and issue a confirmation to the companies and ROC of the transferor company.

# Whether Takeover Code is applicable on a Scheme u/s 391-394?



*Reporting is mandatory under Reg.10(7) in respect of acquisitions arising out of inter-se transfers of shares, arrangement or reconstruction not directly involving the target company including amalgamation, merger or demerger.*

## **Proviso 1 :-**

The component of cash and cash equivalents in the consideration paid being less than 25 % of the consideration paid under the scheme.

## **Proviso 2 :-**

Where after implementation of the scheme of arrangement, persons directly or indirectly holding atleast 33% of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.

# Competition Act, 2002



# REGULATIONS OF COMBINATIONS

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- **Applicable Provisions** – Sections 5 - 6; Sections 29 - 30 of the Competition Act; Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (“**Combination Regulations**”)
- **Combination** is an acquisition of one or more enterprises by one or more persons or a merger or amalgamation of enterprises, where such acquisition, merger or amalgamation meets the thresholds specified in Section 5 of the Competition Act and involves:

# REGULATIONS OF COMBINATIONS

- any acquisition of control or shares or voting rights or assets of enterprises ;
- acquiring of control by person over an enterprises, where such person already has direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service ;
- any merger or amalgamation between enterprises

## REGULATIONS OF COMBINATIONS APPLICABLE THRESHOLD

Threshold for proposed (acquirer)	combination + target)	Threshold for	group post acquisition
in india	in or outside india	in india	in or outside india
assets	assets	assets	assets
Jointly worth more than Rs 1500 crores (INR 15 billion)  Click to edit	Jointly worth more than US \$750 million ( <b>including</b> assets worth at least Rs 750 crores (Rupees 7.5 Billion) in India)	Jointly worth more than Rs 6000 Crores (INR 60 billion)	Jointly worth more than US \$3 billion ( <b>including</b> assets worth at least Rs 750 crores (INR 7.5 billion) in India)
turnover	turnover	turnover	turnover
Jointly worth more than Rs 4500 Crores (INR 45 billion)	Jointly worth more than US \$2.25 billion ( <b>including</b> at least Rs 2250 Crores (INR 22.50 billion) in India)	Jointly worth more than Rs 18000 Crores (INR 180 billion)	Jointly worth more than US \$9 billion ( <b>including</b> at least Rs 2250 Crores (INR 22.50 billion) in India)

# REGULATIONS OF COMBINATIONS - EXEMPTIONS

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Acquisitions, share subscriptions or financing facilities entered into by public financial institutions, FIIs, banks or VCF, pursuant to a covenant of a loan agreement or investment agreement **Exemption under Section 6(5) of the Competition Act**

Acquisitions made solely as an investment or in ordinary course of business provided the shares or voting rights held by the acquirer does not exceed 25% of the total shares or voting rights;

Acquisitions where the acquirer already has 50% or more shares or voting rights in the target enterprise;

- Acquisitions not directly related to the business of acquirer and such acquisition does not lead to control over the target enterprise except where the assets being acquired represent substantial business operations in a particular location or for a particular product or service of the target enterprise;

# REGULATIONS OF COMBINATIONS - EXEMPTIONS

Acquisitions of share or voting rights pursuant to a bonus issue or stock splits or consolidation of face value of shares or subscription to rights issue, not leading to acquisition of control;

Acquisitions made by one person or enterprise of another person or enterprise within the same group; amended or renewed tender offer where a Notice to CCI has been filed prior to such amendment or renewal of the offer, subject to intimation of any change being duly made to CCI.

Overseas combinations with *insignificant local nexus* and *effect* on markets in India

## REGULATIONS OF COMBINATIONS . CCI NOTIFICATIONS

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- Combinations that meet the applicable thresholds must be notified to the CCI through a **Notice** in the **Form** and with the **fee**.
- A Notice to CCI needs to be given within **30 days** of:  
Approval of the proposal relating to merger or amalgamation, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;
- The execution of any agreement or other document for acquisition or acquiring of control referred under the relevant provisions.

## REGULATIONS OF COMBINATIONS - CCI NOTIFICATIONS

- An acquisition, share subscription or financing facility entered into by a public financial institution, FII, bank or VCF pursuant to any covenant of a loan agreement or investment agreement - Details of the acquisition must be filed within 7 days of the date of acquisition
- A notifiable combination cannot be brought into effect until the expiry of 210 days or till the approval thereof by CCI under the Competition Act.
- The Combination Regulations have, however, kept a target for CCI of issuing an order within 180 calendar days of filing the Notice by the parties - However statutory limit for the issuance of a final order i.e. 210 days under the Competition Act has remained unchanged

## RECENT AMENDMENTS :

The Competition Commission of India ('CCI') vide Gazette Notification No. F.No.3-1/Amend/Comb. Regl./2013/ CD/CCI - dated April 04, 2013 has published the "The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2013 (No. 1 of 2013)", under section 64 of the Competition Act,2002 further amending the existing Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011. ("Combination Regulations").

**The changes are all in Schedule I of Regulation No. 4 of the Combination Regulations.**



## RECENT AMENDMENTS :

Category 9 has been substituted by inserting that there is no requirement to file the notice if a merger or amalgamation of two enterprises where one of the enterprise has more than 50% shares or voting rights of the other enterprise, and/or merger or amalgamation of enterprises in which more than 50% shares or voting rights in each of such enterprises are held by enterprise(s) within the same group: provided that the transaction does not result in transfer from joint to sole control. This means that the exemption granted to the intra-group mergers and amalgamations between holding companies and its subsidiaries and between subsidiaries owned by enterprises belonging to the same group, by the 1<sup>st</sup> Amendment has now been modified to the above extent

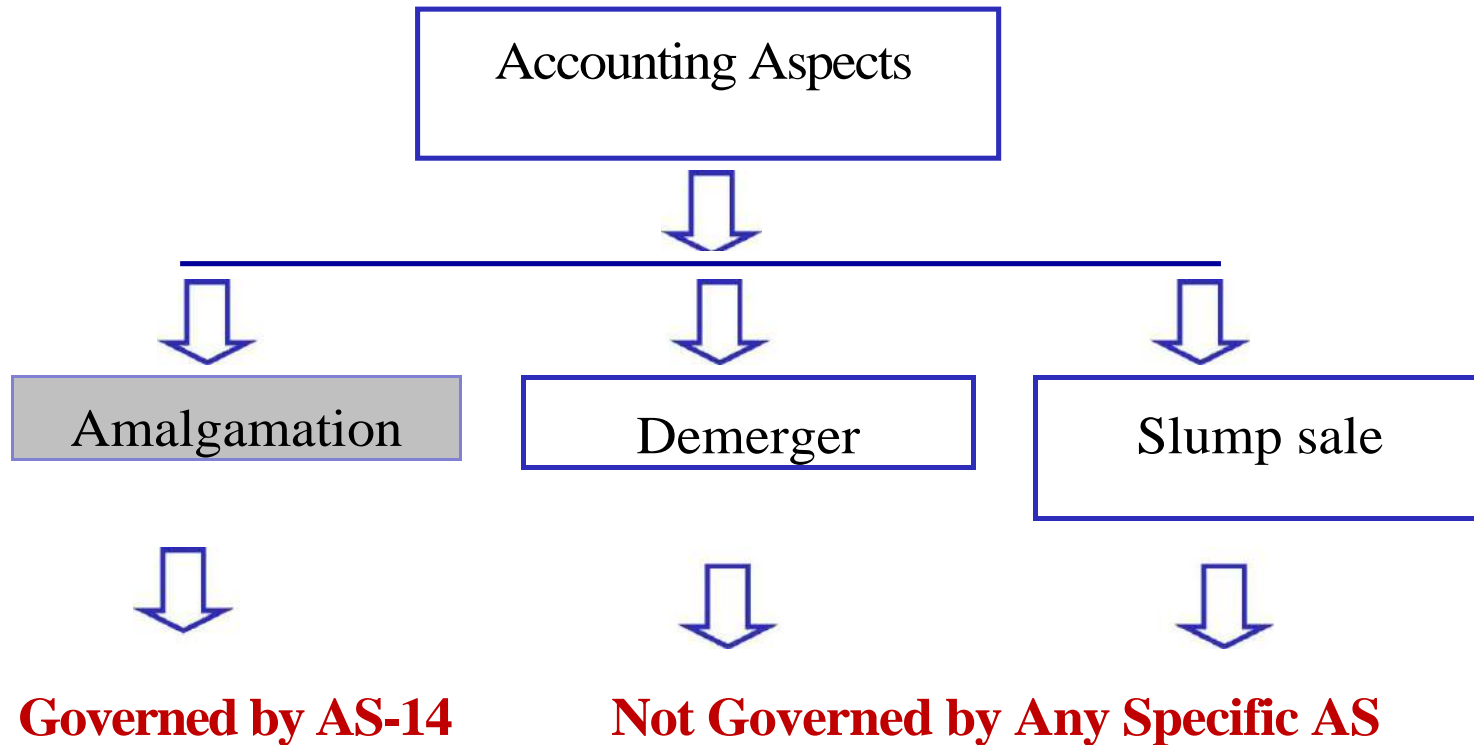
## *Other Important Aspects*

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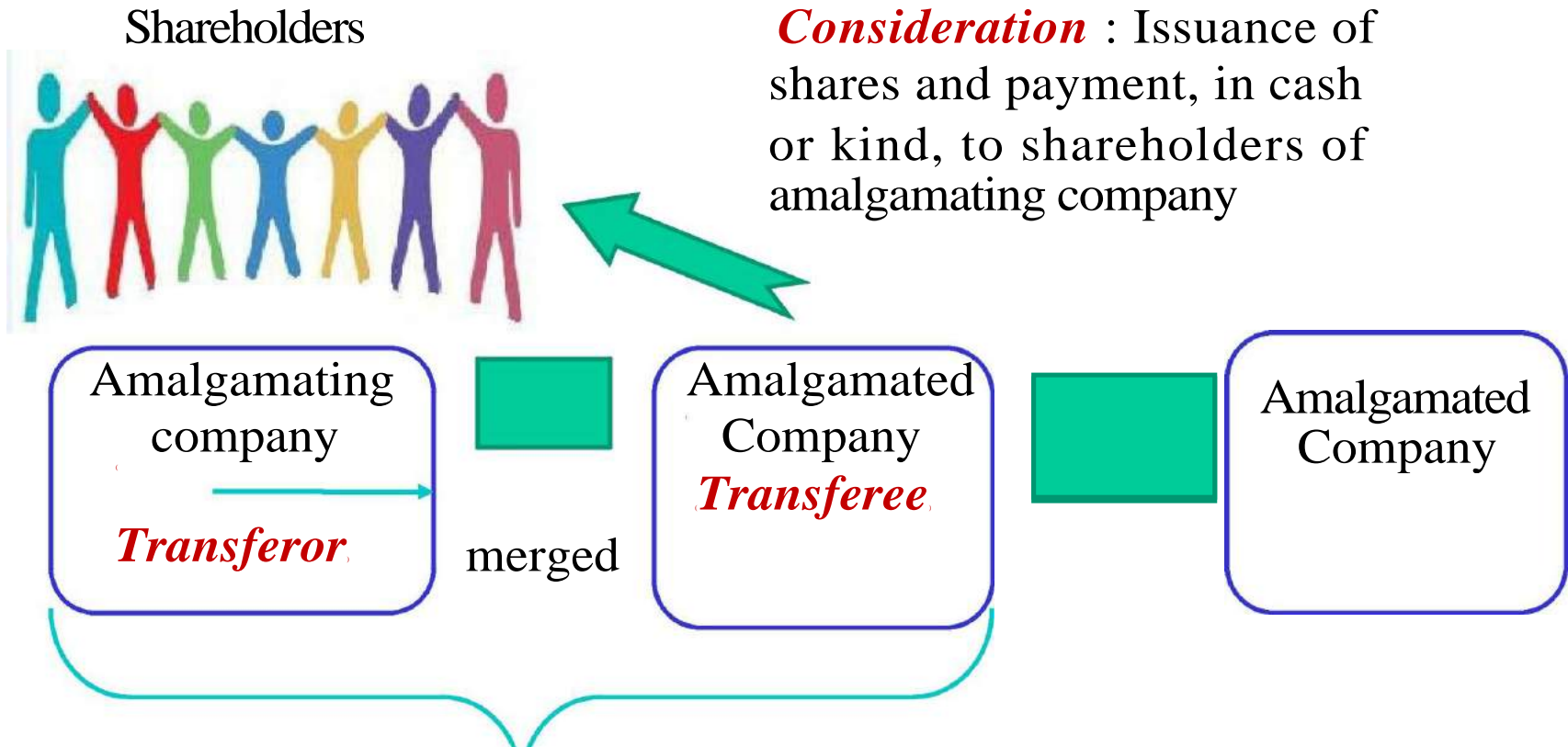
- **FIPB/RBI Issues**
- **Labour Issues**
- **Excise Issues**
- **NBFC Issues**

# *Accounting Aspects*

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# Terms Used in AS-14



**Amalgamation** As per Companies Act, 1956 or any other statute applicable to companies

# *Terms Used in AS-14*

## *Reserve :*

- portion of earning or receipt,
- surplus of an enterprise (whether capital or revenue)
- appropriated by the management for general or specific purpose

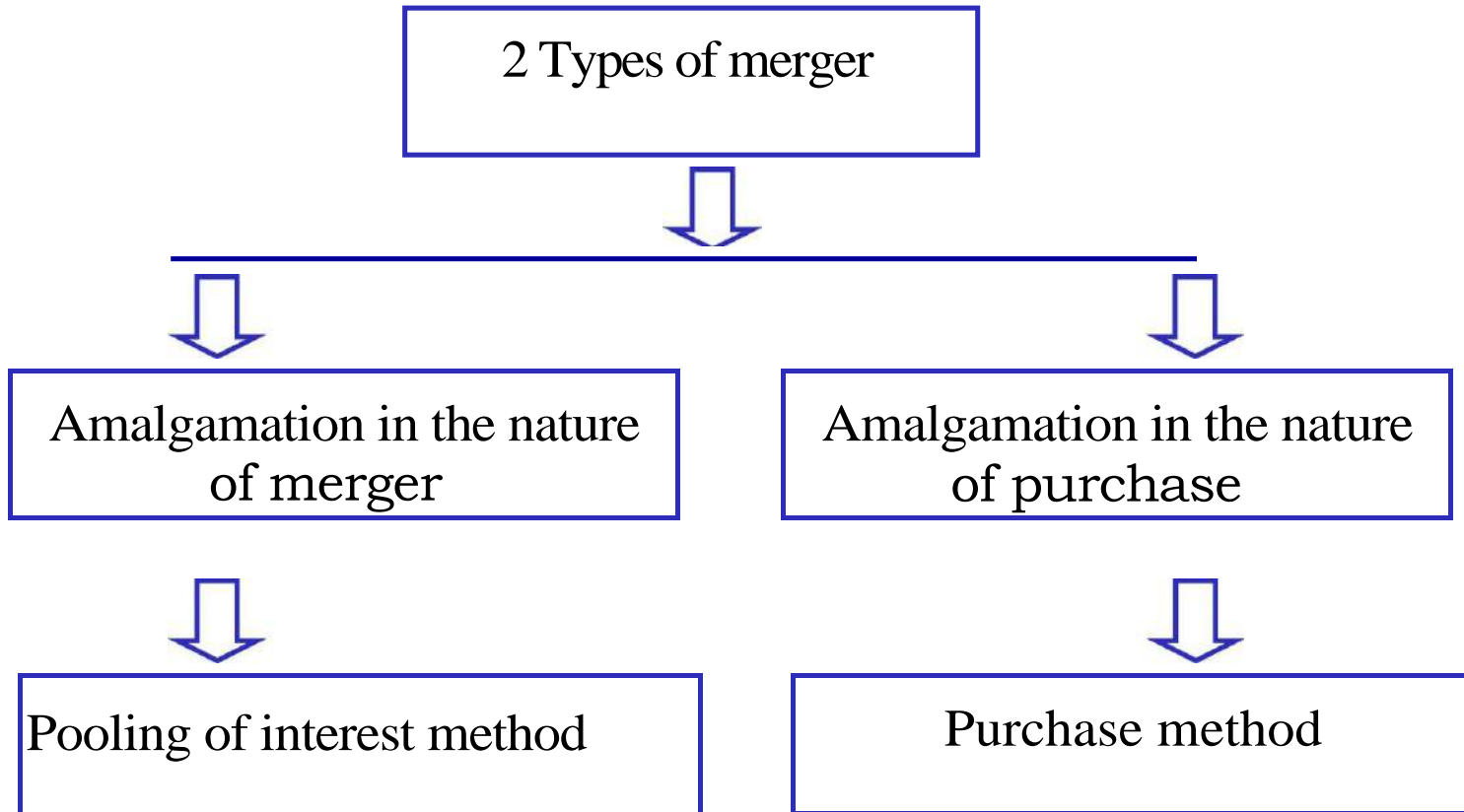
## *Excluding -*

- other than provision for
  - (a) depreciation;
  - (b) diminution in the value of asset;
  - (c) for a known liability



# *Key Provisions of AS-14*

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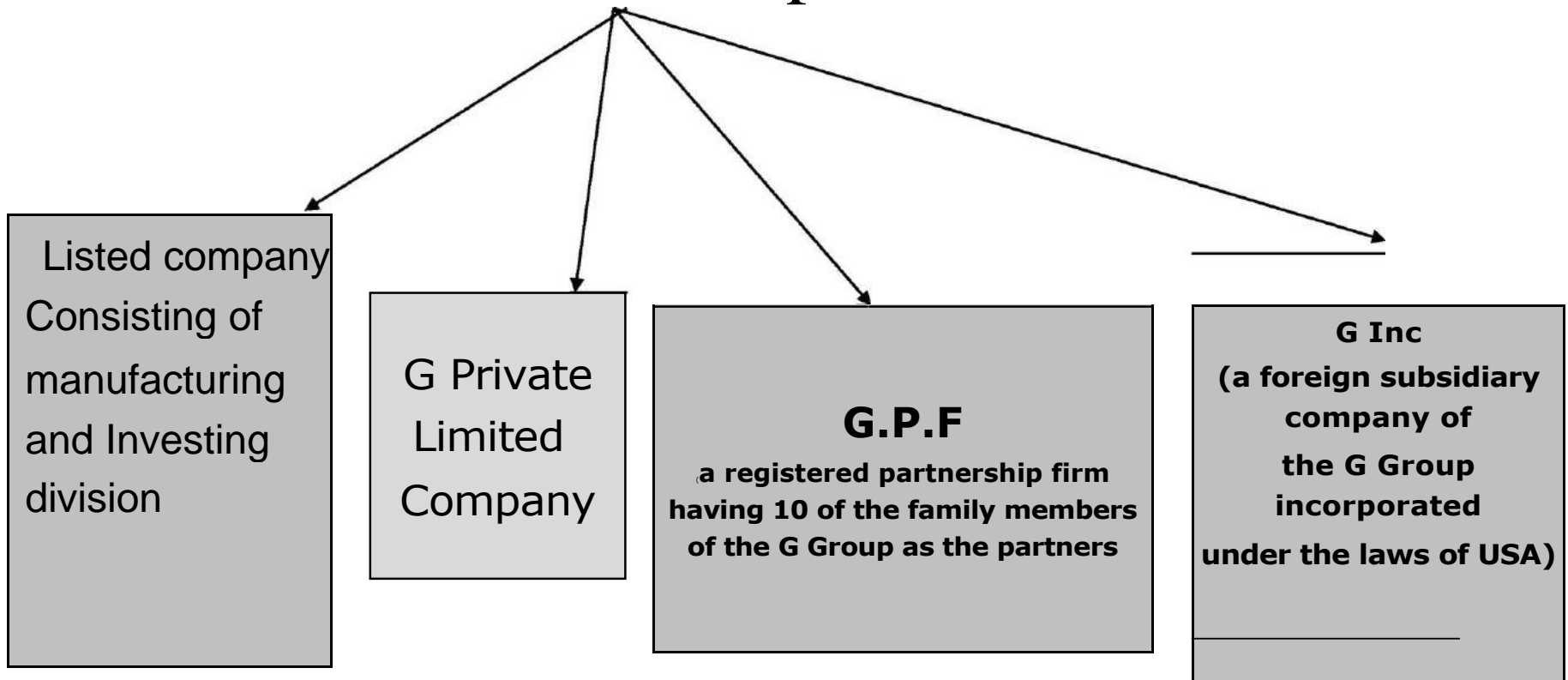


# *Case Study*

# *Facts of the Case before Restructuring*

Mr. B.G. and Mr. C.G.

G Group





## Facts Cont

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- Requirement -1 Both brothers wants to restructure the entities under the G Group in order to attain controlling interest in the individual capacity with no interference from the other brother
- Requirement -2 Both the brothers want the listed company after the restructuring
- Requirement 3 None of the brothers want the Foreign Company in their kitty

## **Objectives of the Case Study**

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*Resolving the stumbling issues.*

*Explain the routes available for getting a company listed*

*How the family settlement can be made through Corporate Restructuring*

*Section 391-394 of the Companies Act as the single window clearance.*

# *Resolving the 1<sup>st</sup> problem: i.e. both brothers wants listed entities:*

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- **Demerger of the Investment division into the private company of the Group under Section 391-394 of the Companies Act, 1956,**
- **Applying to SEBI and STX for Back Door Listing in compliance of Circulars issued by SEBI**

# *Resolving the 2<sup>nd</sup> problem:*

*i.e. no brother wants the partnership firm*

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- **Merger of the G.P.F. with listed company (remaining company having M division)**
- **All companies liable to be wound up under the Act [Sec 390(a)]**
- **Not only company but also any member or any creditor or by the liquidator in case company is in winding up [Sec 391]**
- **Courts interpretation of the term ‘Liable to be wound up’**
- **[Sec 582]**
- **Transferee Company must be a company incorporated under the Companies Act [Sec 394(4)(b)]**

## ***Resolving the 2<sup>nd</sup> issue contd***

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**Sec 390(a) of Act defines company for Sec 391-393 as a company liable to be wound up under this Act**

**‘Company liable to be wound up’**

**All co.’s to which provisions of winding up applies & Part X of the Act deals with winding up of an unregistered company**

**G.PF. Partnership Firm to be treated as an Unregistered Company.**

**Unregistered Co. as per Sec 582(b) includes any P.F., association or co. consisting of more than 7 members at the time of presenting the petition. (minimum 8)**

***Rugs India & others with Riveria Home Furnishings Ltd***

# *Resolving the 3<sup>rd</sup> Issue*

*(i.e. no brother wants the foreign entity):*

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- **Merger of Foreign Company with Private company to be listed after the restructuring under the Companies Act, 1956**
  
- **Sec 394(4)(b) of CA, 1956 defines-**
  - i. **Transferee Company to include any co. within the meaning of this Act.**
  
  - ii. **Transferor Company to include any body corporate, whether a co. under this Act or not.**

## *Resolving the 3<sup>rd</sup> issue contd.....*

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Foreign Co. Transferor Co. due to Sec 2(7) + Sec 394(4) of CA after complying law of both the Countries but cant be Transferee

### ***Moschip Semiconductor Technology Ltd.- In Re***

*California based company was merged into an Indian Company.*

*No separate dissolution of Foreign Co. is required only laws of California to be complied with.*

# Role of Company Secretaries in Restructuring

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- Conceptualization of structures; analysing the implications under Companies Act, 1956, Stamp duty provisions, competition act provisions, SEBI provisions with tax advisors
- Ground work for the restructuring
- Obtaining and follow up for the report of Regulatory Authorities
- Replies to queries of Regulatory Authorities
- Post Scheme Compliances
- Level playing field with other professionals in the era of NCLT
- Certificate under clause 232(7) [*Companies Bill, 2012*]
- Fast Track Merger (*under Companies Bill, 2012*)



# THANK YOU

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