

**PROFESSIONAL PROGRAMME
STUDY MATERIAL**

**CORPORATE
RESTRUCTURING
AND INSOLVENCY**

MODULE II - PAPER 4



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

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PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING AND INSOLVENCY

Corporate Restructuring may be a one-time exercise for an organisation but it has a lasting impact on the business and other concerned agencies due to its numerous considerations and immense advantages viz., improved corporate performance and better corporate governance. The myriad legal and regulatory provisions and the multitude of judicial and unresolved issues enunciate that the professionals dealing with restructuring should possess unequivocal and explicit knowledge of the objective approach and perspective of the subject.

Due to manifold advantages and the emergence of the concept of restructuring as a necessary concomitant in the present context, corporate restructuring has been incorporated in the curriculum.

Consequently, this study material has been published to aid the students in preparing for the Corporate Restructuring and Insolvency paper of the CS Professional Programme. The purpose of this study material is to provide an in-depth understanding of all aspects and intricacies of law and practical issues affecting and arising out of Corporate Restructuring. The study material also deals with Corporate Insolvency issues. It is a part of the educational kit and takes the students step by step through each phase of preparation, stressing upon and dealing, exhaustively with key concepts, legislative aspects and procedures, duly annotated with judicial references.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read along with the original Bare Acts, Rules, Regulations, Case Law, Student Company Secretary bulletin published and supplied to the students by the Institute every month as well as recommended readings given at the end of each study lesson.

The subject of Corporate Restructuring and Insolvency is inherently complicated and is subjected to constant refinement through new primary legislations, rules and regulations made there under and court decisions on specific legal issues. It, therefore, becomes necessary for every student to constantly update himself with the various legislative changes made as well as judicial pronouncements rendered from time to time by referring to the Institute's journal 'Chartered Secretary' and bulletin 'Student Company Secretary' as well as other law/professional journals like Company Law Journal, Corporate Law Advisor, SEBI and Corporate Laws, Company Cases etc.

The various changes made upto December 31, 2011 have been included in the study material. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students.

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The students are therefore, advised to refer to the Student Company Secretary and other publications for updation of the study material.

In the event of any doubt, students may write to the Directorate of Studies and Publications of the Institute for clarification.

Although care has been taken in publishing this study material, yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the Student Company Secretary.

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PROFESSIONAL PROGRAMME
SYLLABUS
FOR
CORPORATE RESTRUCTURING AND INSOLVENCY
(MODULE II - PAPER 4)

Level of knowledge: Expert knowledge.

Objectives: To provide an in-depth understanding of all aspects of law and practical issues relating to corporate restructuring and insolvency.

Detailed contents:

PART-A : CORPORATE RESTRUCTURING (70 MARKS)

1. Introduction

Meaning of corporate restructuring, need, scope and modes of restructuring, historical background, global scenario, national scenario.

2. Strategies

Planning, formulation and execution of various corporate restructuring strategies - mergers, acquisitions, takeovers, disinvestments and strategic alliances, demergers and hiving off.

3. Mergers and Amalgamations

Meaning and concept; legal, procedural, economic, accounting, taxation and financial aspects of mergers and amalgamations including stamp duty and allied matters; interest of small investors; merger aspects under competition law; jurisdiction of courts; filing of various forms; Amalgamation of banking companies and procedure related to Government companies; Cross border mergers.

4. Takeovers

Meaning and concept; types of takeovers; legal aspects - SEBI takeover regulations; procedural, economic, financial, accounting and taxation aspects; stamp duty and allied matters; payment of consideration; bail out takeovers and takeover of sick units; takeover defences; cross border takeovers.

5. Funding of Mergers and Takeovers

Financial alternatives; merits and demerits; funding through various types of financial instruments including equity and preference shares, options and securities with differential rights, swaps, stock options; ECBs, funding through financial institutions and banks; rehabilitation finance; management buyouts/leveraged buyouts.

6. Valuation of Shares and Business

Introduction; need and purpose; factors influencing valuation; methods of valuation of shares; corporate and business valuation.

7. Corporate Demergers and Reverse Mergers

Concept of demerger; modes of demerger - by agreement, under scheme of arrangement; demerger and voluntary winding up; legal and procedural aspects; tax aspects and reliefs; reverse mergers – procedural aspects and tax implications.

8. Post Merger Re-organisation

Factors in post merger reorganization: integration of businesses and operations, financial accounting, taxation, post merger valuation, human and cultural aspects; assessing accomplishment of post merger objectives; measuring post merger efficiency.

9. Financial Restructuring

Reduction of capital; reorganisation of share capital

Buy-back of shares – concept and necessity; procedure for buy-back of shares by listed and unlisted companies.

10. Legal Documentation.

11. Case Studies.

PART-B : CORPORATE INSOLVENCY (30 MARKS)

12. Revival, Rehabilitation and Restructuring of Sick Companies

Sick companies and their revival with special reference to the law and procedure relating to sick companies.

13. Securitisation and Debt Recovery

Securitisation Act:

Overview of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; process; participants; Special Purpose Vehicle (SPV), Asset Reconstruction Companies (ARCs), Qualified Institutional Buyers (QIB).

Debt Recovery Act:

Overview of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993; Tribunal, Procedure; compromises and arrangements with banks and creditors.

14. Winding up

Concept; modes of winding up; administrative machinery for winding up.

Winding up process and procedure; managing stakeholders and parties in liquidation; conducting meetings of shareholders/creditors etc.; dealing with contracts; managing estate; outsourcing responsibilities to professionals/service providers such as valuers, security agencies, etc; best practices in performing liquidation/administrator functions; accountability and liabilities; Role of liquidators and insolvency practitioners.

Consequences of winding up; winding up of unregistered companies; dissolution.

15. Cross Border Insolvency.

LIST OF RECOMMENDED BOOKS*
CORPORATE RESTRUCTURING AND INSOLVENCY

Readings:

1. Dr. K.R. Chandratre : Corporate Restructuring, 2005 edn.
2. L.M. Sharma : Amalgamation, Mergers, Takeovers, Acquisitions—Principles, Practices & Regulatory Framework; Company Law Journal, New Delhi.
3. J.C. Verma : Corporate Mergers, Amalgamations & Takeovers; Bharat Publishing House, New Delhi.
4. N.L. Bhatia : Takeover Games & SEBI Takeover Regulations; Jagruti Sampat Taxmann Allied Services Pvt. Ltd., New Delhi.
5. Sridharan & Pandian : Guide to Takeovers & Mergers; Wadhwa and Company Law Publisher, Nagpur.
6. S. Shiva Ramu : Corporate Growth through Mergers and Acquisitions; Response Books, New Delhi.
7. A. Ramaiya : Guide to Companies Act; Wadhwa & Co.; Agra and Nagpur.
8. M.C. Bhandari : Guide to Companies Act; Wadhwa & Company; Agra and Nagpur.
9. V.S. Ramaswami & S. Nama Kumari : Strategic Planning formulation of Corporate Strategy, Macmillan India Ltd.

Reference:

1. David M. Schweiger : M & A Integration – A Framework for Executives and Managers; McGraw Hill Book Company
2. AIMA Publication : Corporate Restructuring – Strategies & Implications – Excel Books
3. S. Shiva Ramu : Strategy Formation; Wheeler Publishing, New Delhi
4. V.S. Rameswari & S. Nama Kumari : Strategic Planning
5. Manohar L. Gulati : Strategic Planning & Management

* Latest Editions of all the Books should be referred to.

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6. ICSI Publication : Handbook on Mergers Amalgamations and Takeovers – Law and Practice
7. ICSI Publication : Guidance Note on Buy Back of Securities
8. Ranjan Das/
Uday Kumar : Corporate Restructuring Enhancing the Shareholder Value, McGraw-Hill Education (India) Ltd., B-4, Sector 63, Gautam Budh Nagar, Noida-201301
9. Avtar Singh : Law of Insolvency, Eastern Book Company, 34, Lalbagh, Lucknow-226001
10. J.S. Bhandari,
Lawrence A. Weiss : Corporate Insolvency—Economic and Legal perspectives

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PROFESSIONAL PROGRAMME

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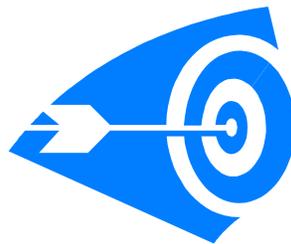
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PROFESSIONAL PROGRAMME
CORPORATE RESTRUCTURING AND INSOLVENCY

STUDY I
INTRODUCTION

LEARNING OBJECTIVES



The objective of this study lesson is to enable the students to understand

- Meaning of Corporate Restructuring
- Historical Background
- Present Scenario – National and Global
- Need & Scope of Corporate restructuring
- Corporate Restructuring tools
- Regulatory Framework for Corporate Restructuring- a Birds eye view
- Important aspects in Corporate Restructuring
- Meaning and reason for Cross Border Mergers

INTRODUCTION

There are primarily two ways of growth of business organization, i.e. organic and inorganic growth. Organic growth is through enhanced customer base, higher sales, increased revenue which is through more deployment of men, money, materials and machine. The inorganic growth provides an organization with an avenue for attaining accelerated growth enabling it to skip few steps on the growth ladder. Restructuring through mergers, amalgamations etc constitute one of the most important methods for securing inorganic growth.

Growth can be organic or inorganic.

- ◆ A company is said to be growing organically when it is increasing the turnover of its existing business.
- ◆ Inorganic growth is the rate of growth of business by increasing output and business reach by acquiring new businesses by way of mergers, acquisitions and take-overs and other restructuring Strategies.

The business environment is rapidly changing with respect to technology,

competition, products, people, geographical area, markets, customers. It is not enough if companies keep pace with these changes but are expected to beat competition and innovate in order to continuously maximize shareholder value. Inorganic growth strategies like mergers, acquisitions, takeovers and spinoffs are regarded as important engines that help companies to enter new markets, expand customer base, cut competition, consolidate and grow in size quickly, employ new technology with respect to products, people and processes. Thus the inorganic growth strategies are regarded as fast track corporate restructuring strategies for growth.

MEANING OF CORPORATE RESTRUCTURING

Restructuring as per Oxford dictionary means, "to give a new structure to, rebuild or rearrange". Corporate restructuring thus implies rearranging the business for increased efficiency and profitability. In other words, it is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving corporate objectives-synergies and continuing as competitive and successful entity.

The meaning of the term 'Corporate Restructuring' is quite wide and varied. Depending upon the requirements of a company, it is possible to restructure its business, financial and organizational transactions in different forms. Restructuring is a method of changing the organizational structure in order to achieve the strategic goals of the organization or to sharpen the focus on achieving them. The essentials of Corporate Restructuring are efficient and competitive business operations by increasing the market share, brand power and synergies.

Simply stated, Corporate Restructuring is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives - synergetic, dynamic and continuing as a competitive and successful entity.

A restructuring wave is sweeping the corporate world. Takeovers, mergers and acquisition activities continue to accelerate. From banking to oil exploration, telecommunication to power generation, petrochemicals to aviation, companies are coming together as never before. Not only this new industries like e-commerce and biotechnology have been exploding and old industries like steel etc are being transformed. Corporate Restructuring through acquisitions, mergers, amalgamations, arrangements and takeovers has become integral to corporate strategy today.

Having understood the meaning of the expression Corporate Restructuring, it is necessary to re-iterate that a restructuring exercise is not undertaken only by business enterprises which are run in the form of a company registered under the Companies Act, 1956. The restructuring could be undertaken by any entity or business unit, whether it is run as a sole proprietorship or partnership or society or in any other form of organization. In this study we are primarily concerned with the scope and objectives of and law and practice relating to Corporate Restructuring.

HISTORICAL BACKGROUND

In earlier years, India was a highly regulated economy. Though Government participation was overwhelming, the economy was controlled in a centralized way by

Government participation and intervention. In other words, economy was closed as economic forces such as demand and supply were not allowed to have a full-fledged liberty to rule the market. There was no scope of realignments and everything was controlled. In such a scenario, the scope and mode of Corporate Restructuring were very limited due to restrictive government policies and rigid regulatory framework.

These restrictions remained in vogue, practically, for over two decades. These, however, proved incompatible with the economic system in keeping pace with the global economic developments if the objective of faster economic growth were to be achieved. The Government had to review its entire policy framework and under the economic liberalization measures removed the above restrictions by omitting the relevant sections and provisions.

The real opening up of the economy started with the Industrial Policy, 1991 whereby 'continuity with change' was emphasized and main thrust was on relaxations in industrial licensing, foreign investments, transfer of foreign technology etc. With the economic liberalization, globalization and opening up of economies, the Indian corporate sector started restructuring to meet the opportunities and challenges of competition.

PRESENT SCENARIO

Today, the economic and liberalization reforms, have transformed the business scenario all over the world. The most significant development has been the integration of national economy with 'market-oriented globalized economy'. The multilateral trade agenda and the World Trade Organization (WTO) have been facilitating easy and free flow of technology, capital and expertise across the globe. A restructuring wave is sweeping the corporate sector the world over, taking within its fold both big and small entities, comprising old economy businesses, conglomerates and new economy companies and even the infrastructure and service sector. From banking to oil exploration and telecommunication to power generation, petrochemicals to aviation, companies are coming together as never before. Not only this new industries like e-commerce and biotechnology have been exploding and old industries are being transformed.

With the increasing competition and the economy, heading towards globalisation, the corporate restructuring activities are expected to occur at a much larger scale than at any time in the past. Corporate Restructuring play a major role in enabling enterprises to achieve economies of scale, global competitiveness, right size, and a host of other benefits including reduction of cost of operations and administration.

GLOBAL SCENARIO

Globalization has given the consumer many choices. Simultaneously, technological advancements have made the rate of obsolescence very fast. Even established brands face challenges from products that offer 'value for money'. In this international scenario, there is a heavy focus on quality, range, cost and reliability of products and services. Companies all over the world have been reshaping and repositioning themselves to meet the challenges and seize the opportunities thrown open by globalization. In turbulent times the strategy of any management would be to look at the strengths within in order to focus on core competencies. Such analysis will

help identify the loss making units so that they can be sold. Managements might also look out for acquiring units, which could contribute to profit and growth of the group. The underlying objective is to achieve and sustain superior performance. In fact, most companies in the world are merging to achieve an economic size as a means of survival and growth in the competitive economy. There has been a substantial increase in quantum of funds flowing across nations in search of potential units for being taken over as part of the restructuring programme. UK has been the most important foreign investor in USA in recent years. There have been huge oil sector mergers, the biggest being Exxon-Mobile, BP-Amoco and Total-Pretrrofina. The major marriages in the financial sector have included Traveller – Citicorp, Nationsbank-Bankamerica and Northwest – Wells Fargo. The Great Western Financial – H.F. Ahmanson merger created the largest thrift and savings institution in the US. A similar trend was witnessed in Europe too. In Europe much of the action – the mergers between Zurich group and BATS insurance interests, and between Sweden’s Nordbanken and Finland’s Merita, and the hostile offer from Italy’s General Finance – AGF was in the financial sector.

In telecommunications, the major deals have included Accr-Gateway, Arrow-Keylink, Cisco – WebEX Dell-SilverBack AT&T – TCI; Bell Atlantic-GTE and SBC-Ameritech. The acquisition of MCI by WorldCom also took place. The healthcare industry has also witnessed significant activity. The major deals have included Misys Healthcare – All scripts, Muskegon Chronicle – Mlive.com Hospital merger, Zeneca-Astra, Hoechst-Rhone Poulenc and Sanofi-Synthelabo. Quite a few deals have even fallen through. This category includes American Home Products—SmithKline Beecham, American Home Products—Monsanto and Glaxo Wellcome-SmithKline Beecham. Health care information technology acquisition activity too picked up in 2006 and has kept pace since. The Eastman Kodak Health Group acquisition by Toronto based Onex Corp has been a case in the point. Not untouched by the mergers and acquisition wave has been the audit business. Price Water House merged with Coopers and Lybrand.

It is estimated that one-in-four US workers have been affected by the wave of mergers and acquisition activity. In the Japanese context, mergers and acquisitions are less relevant as they believe in alliances and joint ventures than mergers and acquisitions. Also, research has shown that Japanese are least preferred ‘merger partners/acquirers’ mainly due to their incompatible language.

Thus the global scenario has been changing very fast. The world is witnessing a make over. Economies are merging. Cross-country investments find interesting acceptance and consumers rule the roost.

NATIONAL SCENARIO

In India, the concept has caught like wild fire with a merger or two being reported every second day and this time Indian Companies are out to make a global presence. The Jamshedpur based steel giant, Tata Steel won the two-month long battle for Corus Group against Anglo-Dutch Steelmaker Cia Sidemrgica National (CSN) by offering \$12.2 billion for the 20 million-tonne high grade steelmaker to become the fifth largest in the world. Close on heels came another giant overseas acquisition with Hindalco, the flagship metal company of Aditya Birla Group buying Atlanta based Novelis Inc. for an enterprise value of \$6 billion. With this transaction, Hindalco has

become world's largest aluminum rolling company and one of biggest producer of primary aluminum in Asia. During the year 2006, India Inc. acquired several other foreign companies, viz., Arcelor (by Mittal Steel) Betapharm (by Dr. Reddy's lab), Terapia (by Ranbaxy), Sabah Forest Industries (by BILT), Eight O'Clock Coffee (by Tata Tea) Hansen (by Suzlan Energy Ltd.), Ritz-Carlton Bostan (by Indian Hotels). The other major takeover making waves has been the acquisition of majority interest of Hutch – Essar by Vodafone.

Tata's pioneering acquisition of Corus coupled with Hindalco's acquisition of Novelis and other acquisitions, exemplify the arrival of India Inc in the global arena. The event is path breaking and displays a level of confidence and values, which places Indian industry at an altogether new level.

Recently, Bharti Airtel announced that it has entered into a legally binding definitive agreement with South Africa based 'Zain' group to acquire them on enterprise valuation of USD 10.7 billion with this Bharti is set to become world's fifth largest wireless company with operations across several countries.

NEED AND SCOPE OF CORPORATE RESTRUCTURING

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.

When we say corporate level it may mean a single company engaged in single activity or an enterprise engaged in multi activities. It could also mean a group having many companies engaged in related or unrelated activities. When such enterprises consider an exercise for restructuring their activities they have to take a wholesome view of the entire activities so as to introduce a scheme of restructuring at all levels. However such a scheme could be introduced and implemented in a phased manner. Corporate Restructuring also aims at improving the competitive position of an individual business and maximizing its 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.

Competition drives technological development. Competition from within a country is different from cross-country competition. Innovations and inventions do not take place merely because human beings would like to be creative or simply because human beings tend to get bored with existing facilities. Innovations and inventions do happen out of necessity to meet the challenges of competition. Cost cutting and value addition are two mantras that get highlighted in a highly competitive world. Monies flow into the

stream of production in order to be able to face competition and deliver the best possible goods at the convenience and affordability of the consumers. Global Competition drives people to think big and it makes them fit to face global challenges. In other words, global competition drives enterprises and entrepreneurs to become fit globally. Thus, competitive forces play an important role. In order to become a competitive force, Corporate Restructuring exercise could be taken up. Also, in order to drive competitive forces, Corporate Restructuring exercise could be taken up.

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. A larger company, resulting from merger of smaller ones, can achieve economies of scale. If the size is bigger, it enjoys a higher corporate status. The status allows it to leverage the same to its own advantage by being able to raise larger funds at lower costs. Reducing the cost of capital translates into profits. Availability of funds allows the enterprise to grow in all levels and thereby become more and more competitive.

Before going into the need for corporate restructuring, you can take a look at the following simple illustrations:

- Assume ABC Limited has surplus funds but it is not able to consider any viable project. Whereas XYZ Limited has identified viable projects but has no money to fund the cost of the project. Assume the merger of both the said companies. A viable solution emerges resulting in mutual help and benefit and in a competitive environment, it offers more benefits than what meets your eyes.
- Assume ABC Ltd is engaged in manufacture of injection moulding machines. Naturally it will serve the needs of consumers of such machines. It means the company is engaged in a capital goods activity and demand for its goods will vary from time to time and therefore it might not see a regular cash flow arising from its operations. Assume, there is another company in the same group engaged in manufacture of plastic moulded goods. It deploys the injection moulding machines for manufacturing the moulded goods. Its supplies are to the consumers and therefore it has a regular cash flow. If both of them merge, the resultant company could utilize the benefit of regular cash flow in its one unit and overcome the cash flow problem in the other. If the merger does not take place, one company would see its cash bells ringing on a daily basis while in other there will be defaults in servicing the banks and financial institutions, payment of wages, settlement of dues to creditors, defaults in meeting delivery schedule and in addition the human beings of such a company will undergo a lot of stress and strain affecting their health.

Thus going by the above simple illustrations, one should be able to understand that 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.

Regulatory Framework of Corporate Restructuring – A Birds' Eye view

The Regulatory Framework of Mergers and Amalgamations covers

1. The Companies Act, 1956
2. Companies (Court) Rules, 1959
3. Income Tax Act, 1961
4. Listing Agreement
5. The Indian Stamp Act 1899
6. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011

1. Companies Act, 1956

Chapter V of Companies Act, 1956 comprising Section 390 to 396A contains provisions on 'Arbitration, Compromises, Arrangements and Reconstructions'. There are however, no provision on Arbitration Since Section 389 which dealt with Arbitration was deleted. The scheme of Chapter V goes as follows.

1. Section 390 contains interpretation of certain expressions used in Section 391 and 393
2. Section 391 is relating to the power of the company to compromise or to make arrangement with its creditors and members.
3. Section 393 deals with regard to information as to compromises and arrangements with creditors and members.
4. Section 394 deals with facilitation of reconstruction and amalgamation of companies.
5. Section 394A deals with a notice to be given to the Central Government in respect of applications under Section 391 and 394.
6. Section 395 deals with provisions regarding the power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority shareholders.
7. Section 396 contains provisions as to the power of the central government to provide for amalgamation of companies in national

interest.

8. Section 396 A deals with preservation of books and papers of amalgamated companies.

2. Companies Court Rules 1959

Rules 67-87 contains provisions dealing with the procedure for carrying out a scheme of compromise or arrangement including amalgamation or reconstruction.

3. Under the Income Tax Act, 1961

A scheme of amalgamation is not a transfer at all for the purpose of the Income Tax Act, 1961. However, when a scheme of merger or demerger involves the merger of a loss making company or a hiving off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, inter alia, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferor Company. Important aspects of Income Tax Act have already been dealt with in Study 3 and Study 7. Students are instructed to refer them.

4. Under the Listing Agreement

Under Clause 24(f) of the Listing Agreement, where the scheme of merger or demerger involves a listed company, it is necessary to send a copy of the scheme to the stock exchanges where the shares of the said company are listed to obtain their No Objection Certificate (NOC). Generally stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the takeover code or the Disclosure and Investor Protection Guidelines, Stock Exchanges accord their approval. Where the shares are listed on BSE or NSE, other Stock Exchanges wait for the approval by BSE or NSE before granting their approval.

5. Under the Indian Stamp Act

It is necessary to refer to the Indian Stamp Act 1899 to check the stamp duty payable on transfer of undertaking through a merger or demerger.

6. SEBI (Substantial Acquisition of shares and Takeovers) Regulations 2011 deals with provisions on creeping acquisition limits, open offer etc.

Important aspects of Corporate Restructuring

The restructuring process requires various aspects to be considered before, during and after the restructuring. They are

- Legal and procedural aspects
- Taxation Aspects
- Stamp duty aspects
- Economic aspects

- Valuation aspects
- Accounting aspects
- Due diligence aspects
- Competition aspects etc.
- Human and Cultural aspects

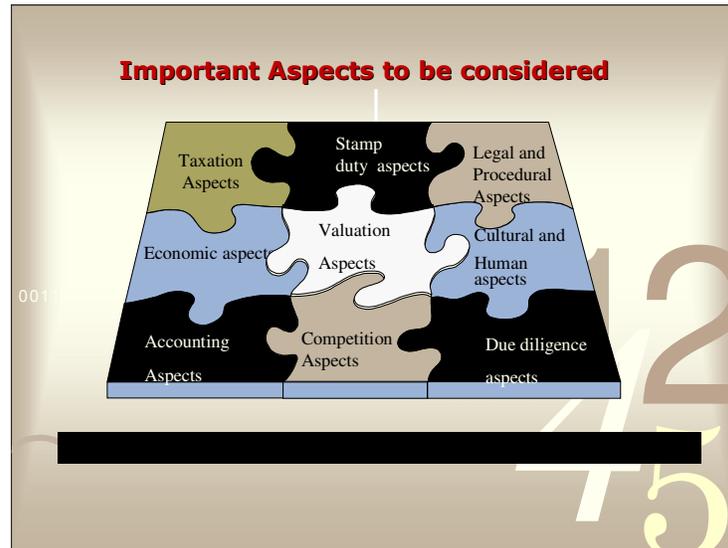
In any merger or amalgamation, financial aspects of the transaction are of prime importance. It denotes the benefits in terms of financial benefits, i.e., increase in productivity, improved profitability and enhanced dividend paying capacity of the merged or the amalgamated company, which the management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

The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.

Accounting Standard-14 'Accounting for Amalgamations' lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves.

The merger is a period of great uncertainty for the employees of the merging organisations. The uncertainty relates to job security and status within the company leading to fear and hence low morale among the employees. It is natural for employees to fear the loss of their revenue or change in their status within the company after a merger since many of these employees literally invest their whole lives in their jobs. Hence the possibility of a change in their position is likely to be viewed with fear and resentment. The possibility of a change in compensation and benefits also creates a feeling of insecurity and unease. The influx of new employees into the organisation can create a sense of invasion at times and ultimately leads to resentment. Further, the general chaos which follows any merger results in disorientation amongst employees due to ill defined role and responsibilities. This further leads to frustrations resulting into poor performance and low productivity since strategic and financial advantage is generally a motive for any merger. Top executives very often fail to give attention to the human aspects of mergers by neglecting to manage the partnership in human terms. By failing to give attention to the problems faced by their employees, they fail to fully develop their companies' collaborative advantage.

The exercise of due diligence starts much before the process of restructuring and helps in better negotiation of deals, to handle taxation and stamp duty aspects in better manner, to minimize and resolve the human and cultural issues that may arise out of mergers/amalgamation etc.



Due Diligence is the process by which confidential legal, financial and other material information is exchanged, reviewed and appraised by the parties to a business transaction, which is done prior to the transaction.

“Due diligence” is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may affect the outcome of the transaction.

It is basically a “background check” to make sure that the parties to the transaction have the required information they need, to proceed with the transaction.

Due diligence is used to investigate and evaluate a business opportunity. The term due diligence describes a general duty to exercise care in any transaction. As such, it spans investigation into all relevant aspects of the past, present, and predictable future of the business of a target company.

Due diligence report should provide information and insight on aspects such as the risks of a transaction, the value at which a transaction should be undertaken, the warranties and indemnities that needs be obtained from the vendor etc.

KINDS OF RESTRUCTURING

Restructuring may be of the following kinds:

- *Financial restructuring* which deals with the restructuring of capital base and raising finance for new projects. This involves decisions relating to acquisitions, mergers, joint ventures and strategic alliances.
- *Technological restructuring* which involves, inter alia, alliances with other companies to exploit technological expertise.

- *Market restructuring* which involves decisions with respect to the product market segments, where the company plans to operate based on its core competencies.
- *Organizational restructuring* which involves establishing internal structures and procedures for improving the capability of the personnel in the organization to respond to changes. This kind of restructuring is required in order to facilitate and implement the above three kinds of restructuring. These changes need to have the cooperation of all levels of employees to ensure that the restructuring is successful.

The most commonly applied tools of corporate restructuring are amalgamation, merger, demerger, slump sale, acquisition, joint venture, disinvestment, strategic alliances and franchises.

Cross Border Mergers and Acquisitions

There has been a substantial increase in the quantum of funds flowing across nations in search of takeover candidates. The UK has been the most important foreign investor in the USA in recent years, with British companies making large acquisitions. With the advent of the Single Market, the European Union now represents the largest single market in the world. European as well as Japanese and American companies have sought to increase their market presence by acquisitions.

Many cross-border deals have been in the limelight. The biggest were those of Daimler Benz-Chrysler, BP-Amoco, Texas Utilities-Energy Group, Universal Studios-Polygram, Northern Telecom-Bay Networks and Deutsche Bank-Bankers Trust. Nearly 80 per cent of the transactions were settled in stock rather than through cash. The markets even witnessed merger between publishing groups Reed Elsevier and Wolters Kluwer and a hostile bid for U.K. building materials company Red Line from the French Cement group Lafarge.

In telecommunications, the major deals include Accr-Gateway, Arrow-Keylink, Cisco – WebEX Dell-SilverBack AT&T - TCI; Bell Atlantic-GTE and SBC-Ameritech. The acquisition of MCI by WorldCom also took place. Low international oil prices promoted huge oil sector mergers like Exxon-Mobil, BP-Amoco and Total-Petrofina. The healthcare industry has also witnessed significant activity. The major deals include Misys Healthcare – All scripts, Muskegon Chronicle – Mlive.com Hospital merger, Zeneca-Astra, Hoechst-Rhone Poulenc and Sanofi-Synthelabo. Quite a few deals have even fallen through. This category includes American Home Products-SmithKline Beecham, American Home Products-Monsanto and Glaxo Wellcome-SmithKline Beecham. Health care information technology acquisition activity too picked up in 2006 and has kept pace since. The Eastman Kodak Health Group acquisition by Toronto based Onex Corporation has been a case in the point. Not untouched by the Mergers and Acquisition wave has been the audit business. Price Water House merged with Coopers and Lybrand.

Euroland has also seen hectic merger and acquisition activity in the last couple of years, more for strategic reasons than operational due to the inherent strength of the eleven European Union (EU) countries, the Euro.

The new currency is likely to lead to a wave of consolidation in the Eurozone as

seen from the merger of Bankers Trust with Deutsche Bank and the consolidation attempts involving Society Generale, Paribas and Banque Nationale de Paris.

The going global is rapidly becoming Indian Company's mantra of choice. Indian companies are now looking forward to drive costs lower, innovate speedily, and increase their International presence. Companies are discovering that a global presence can help insulate them from the vagaries of domestic market and is one of the best ways to spread the risks. As mentioned earlier, Indian Corporate sector has witnessed several strategical acquisitions. Tata Steel's acquisition of Corus Group, Mittal Steel's acquisition of Arcelor, Tata Motors acquisition of Daewoo Commercial Vehicle Company, Tata Steel acquisition of Singapore's NatSteel, Reliance's acquisition of Flag is the culmination of Indian Companies' efforts to establish a presence outside India. Not only this, to expand their operations overseas the Indian companies are acquiring their counterparts or are making efforts towards the end viz. the merger of Air India and Indian Airlines.

Why Companies Merge ?

What are the key drivers of this unprecedented merger and amalgamation activity globally? There is no doubt about the extent of excess capacity in almost all industrial segments, across all regions. The excess capacity increases competition, erodes profits and reduces growth. Instinctively, companies adopt the easiest way to insulate themselves from competition induced pressures. As neither governments nor consumers allow companies to insulate themselves through cartels, they have been taking the M&A route to achieve earnings growth and competitiveness. M&A, which earlier used to be about conglomerates, is now about concentration.

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.

Motivations behind Cross-border Acquisitions

Briefly stating, companies go in for international acquisitions for a number of strategic or tactical reasons such as the following:

- *Growth orientation*: To escape small home market, to extend markets served, to achieve economy of scale.
- *Access to inputs*: To access raw materials to ensure consistent supply, to access technology, to access latest innovations, to access cheap and productive labour.
- *Exploit unique advantages*: To exploit the company's brands, reputation, design, production and management capabilities.
- *Defensive*: To diversify across products and markets to reduce earnings volatility, to reduce dependence on exports, to avoid home country political and economic instability, to compete with foreign competitors in their own territory, to circumvent protective trade barriers in the host country.
- *Response to client needs*: To provide home country clients with service for their overseas subsidiaries, e.g. banks and accountancy firms.

- *Opportunism*: To exploit temporary advantages, e.g. a favourable exchange rate making foreign acquisitions cheap.

MERGER AND ACQUISITION TRENDS

Identification of economic or financial motives is not very difficult. When they exist they are usually stated in the annual reports and merger schemes/documents of the companies during the period of merger. They are widely quoted in newspapers. However, there is no objective guideline to measure psychological or motivational factors of the mergers.

The past couple of years have seen a spate of mergers and acquisitions by Indian Companies. Following are the few companies which have undertaken mergers and acquisitions to grow in size by adding manpower and to facilitate expansion and to gain new customers.

The Polaris-OrbiTech merger saw a spurt in the merged entity's revenues from \$60 million to \$125 million. The merger also added 1,400 employees to Polaris, taking the total employee strength to 4,000. The Polaris-OrbiTech merger helped in combining skill sets of both companies, which in turn led to growth and expansion of the merged entity. While Polaris Software was looking for a specialized product suite, OrbiTech was looking forward to efficient marketing and service support for its products. Post-merger, Polaris got the Orbi suite framework and combined it with its service expertise to win more customers. After the merger, Polaris has become a large, specialized company in the banking, financial services and insurance (BFSI) space, offering solutions, products and transactions services. Polaris has had some recent post-merger wins, including ABN-AMRO Bank, Kuwait Commercial Bank and Deutsche Leasing.

Wipro acquired GE Medical Systems Information Technology (India) to leverage its specialization in the health science domain. The intellectual property that Wipro acquired from the medical systems software company provided it with a platform to expand its offerings in the Indian and the Asia-Pacific healthcare IT market. Similarly, when Wipro acquired the global energy practice of American Management System and the R&D divisions of Ericsson, it acquired skilled professionals and a strong customer base in the areas of energy consultancy and telecom R&D.

Bangalore-based Mascot Systems' acquisition of US-based eJiva and Hyderabad-based Aqua Regia enhanced the company's value proposition and made it globally competitive. With the acquisition of eJiva and Aqua Regia, the total employee strength of Mascot Systems increased from 1,700 to 2,000. Likewise Bangalore-based Mascot Systems was benefited by the technical expertise of eJiva and Aqua Regia, the two companies it recently acquired. The acquisition also helped Mascot to extend its offerings through a portfolio of complementary services, technologies and skills.

Polaris Software had six major customer wins after it acquired the Intellectual Property Rights (IPR) of OrbiTech's Orbi suite framework of banking solutions. vMoksha also saw a rise in the number of its customers due to acquisitions as it expanded considerably in the US market and leveraged on the existing customer base. Mphasis also added new customers in the Japanese and Chinese markets after the acquisition of Navion.

An Array of Acquisitions

In the year of 2006, Indian companies announced 125 foreign acquisitions with a value nearly 10 billion. That is roughly eight times that it did in year 2000. However, in year 2007 first 5 months itself has crossed \$ 15 billion (Thanks to a \$12 billion Tata-Corus deal) and there are big acquisitions in pipeline. The sign of things to come! In 2006, largest proportion of outbound deals (Indian companies acquiring international companies) occurred in Europe (50% of deal value), followed by North America (24% of deal value). The IT sector saw the lion's share of outbound M&A deals, with 23% of the total number of international acquisitions, followed by pharmaceuticals/healthcare/biotech (14%). As for deal value, telecommunications led the way with a 33.6% share of deal value, followed by energy (14%), IT (8%) and steel (6.5%).

One of the major U.S. acquisition took place last year, when GHCL, based in the state of Gujarat, India, acquired Dan River, a Danville, Va.-based maker of home textiles for \$93 million (\$17 million in cash and the assumption of \$76 million in debt). Also making major moves in 2006 were members of the Tata Group, a major Mumbai-based conglomerate with interests in, among other things, manufacturing, transportation, software and hotels. In June, Tata Coffee paid \$220 million to buy Eight O'Clock Coffee, a venerable U.S. brand. In August, Tata Tea paid \$677 million for a 30% stake in Glaceau, a maker of vitamin water. It is now safe to say that Indian companies are now firmly setting up themselves in global marketplace.

Mergers & Acquisitions (Global) by Indian Companies

<i>Company</i>	<i>Merged with/Acquired</i>	<i>Reason/Benefits</i>
Polaris	Merged with OrbiTech	Acquired IPR of OrbiTech's range of Orbi Banking product suite. Helped in combining skill sets of both companies which in term led to growth and expansion of the merged entity.
Wipro	Acquired Spectramind	Aimed at expanding in the BPO space, the acquisition gave Wipro an opportunity to run a profitable BPO business.
Wipro	Acquired global energy practice of American Management Systems	It acquired skilled professionals and a strong customer base in the area of energy consultancy.
Wipro	Acquired the R&D divisions of Ericsson	It acquired specialised expertise and people in telecom R&D.
Wipro	GE Medical Systems (India)	It acquired IP from the medical systems company, which in turn gave it a platform to expand its offerings in the Indian and Asia Pacific healthcare IT market.
vMoksha	Challenger Systems & X media	Primarily aimed at expanding its customer base. The company also leveraged on the expertise of the companies in the BFSI space.

Mphasis	Acquired China-based Navion software	Expanded its presence in the Japanese and the Chinese markets. It also plans to use it as a redundancy centre for its Indian operations.
Mascot Systems	Acquired US-based eJiva and Hyderabad-based Aqua Regia	Expanded in size and leveraged on technical expertise of the acquired companies. Acquisitions have helped the company in offering multiple services and expanding its customer base considerably.
Tata Steel	Acquired Corus	In a giant leap, Tata Steel's acquisition of the Anglo-Dutch steel major Corus has vaulted the former to the fifth position from 56th in global steel production capacity.
GHCL	Acquired Dan River	The acquisition of Dan River enables GHCL to enter into existing marketing arrangements to the tune of \$250 million and the US-based company will be used primarily as a marketing arm.
Tata Coffee	Acquired Eight O'Clock Coffee (EOC)	EOC provides a sizable entry platform and an established brand to Tata Coffee in the US\$ 21 billion (Rs 97,000 crore) US coffee market.

In India, what motivates the interested parties to consummate merger between two or more companies has been stated in annual reports, merger schemes and/or media. Motives of some companies as stated in the merger documents or the media are stated hereunder for specific reference.

1. The move of J.K. Industries Ltd. (JK Tyre) for merging its subsidiary Vikrant Tyres Ltd. with itself seems to be a fall out of Apollo Tyres Ltd. (ATL) decision to acquire the tyre making facilities of Modi Rubber Ltd. (MRL) which would add around ₹ 600-800 crores to the top line of ATL from ₹ 1700 crore making it country's target tyre company ahead of MRF Ltd. Simultaneously, the JK Tyre also hived off its Sugar and Pharmaceuticals divisions to concentrate better on its core business of manufacturing and marketing tyres.
2. After the failure in taking over of Indian Aluminium Ltd. in 1998 Sterlite group has acquired Bharat Aluminium Company Ltd. (Balco), the Chhattisgarh based aluminium Company from the Government over howls of protests and today, it seems as if it has managed to turn an explosive situation into a win-win thing for the MP State government, shareholders and perhaps, employees, as well. The group has also acquired Hindustan Zinc Ltd. and its ownership has been privatised smoothly.

3. For the last over five decades Hindustan Lever Ltd. (HLL) operating in India has become a role model not just for FMCG companies but the entire Indian Corporate Sector. Through disinvestment it has acquired Modern Food Industries (India) Ltd. for ₹ 149.4 crores. In mid 80's, Lipton and Brooke Bond were merged with HLL. TOMCO and Lakme were acquired from Tata group. The merger of International Best Food Ltd. and Aviance Ltd. in 2001 with HLL was with the object of achieving greater synergy, elimination inter se business overlapping, preventing industrial sickness, and economies in costs—benefits of combined financial, managerial, technical, distribution and marketing expertise. However, it is unfortunate to note from the point of view of the minority shareholders, that the share prices of Brooke Bond, Lipton, Ponds, Tomco and HLL valued separately as five different companies would probably be higher than the current share price of HLL.
4. Having identified the pharmaceutical sector Mr. Ajay G. Piramal had dispensed with the textile business and acquired Nicholas Laboratories Ltd. in 1988. Consequently, Nicholas Piramal India Ltd. (NPIL) was incorporated on 30th November, 1988. In 1995 it acquired Bulk Drug division of Sumitra Pharmaceuticals & Chemicals Ltd. The objective was optimum utilisation of the manufacturing facilities, enhancing profitability and becoming a leading health care company in India. In 1997, Boehringer Mannheim India Ltd. and Piramal Healthcare Ltd. were merged with it for achieving synergistic linkage, profitability and growth in business. In 2001, Rhone-Poulenc (India) Ltd., NPIL Fininvest Ltd., Super Pharma Ltd. were merged with it with the same objective of optimum utilisation of the manufacturing, technological and marketing expertise, distribution networks, manpower and other resources.

In 1988, NPIL was then ranked 48 in the industry. Within 14 years it has been ranked as 4th in the Industry. The acquisition led strategy coupled with joint ventures and alliances has registered manifold growth of the company. Its share price has also improved from around ₹ 100/- in 1995 to ₹ 250/- in 2002 inspite of the fact that the year was passing through a bearish phase.
5. In 1989, Usha Alloys & Steels Ltd. (UASL) was merged with Usha Martin Industries Ltd. (UMIL) with the objective of stable profitability, preventing sickness, achieving economies of scale, reduction of overhead reforms and efficient utilisation of the resources etc. Post merger results were however, not encouraging.
6. In 1989, Tata Fertilisers Ltd. (TFL) was merged with Tata Chemicals Ltd. (TCL) with the objective of unhindered flow of financial, technological and managerial resources for completion of the TFL's project utilisation, of the proven expertise and greatly enhanced financial, technical and managerial potential of TCL. Post merger results proved satisfactory. In 1990-91 and 1995-96 bonus issues were made in the ratio of 1 for 2 and 3 for 5 respectively. The company has been paying dividend continuously on the increased capital at higher rate.
7. Many companies were merged with J.K. Corp Limited (formerly Straw Products Ltd.) such as M.P. Industries Ltd. (Drycell Battery Project), Dena Bank Ltd. (excluding banking business), Orissa Synthetics Ltd. and it has

now hived off its principal Paper undertaking to Central Pulp Mills Ltd. a group company for restructuring of its debts due to Institutions and banks. Its Drycell Plant was closed and Synthetics plant was disposed off to Reliance Industries Ltd. Post merger results however have not been encouraging.

8. In mid 70's Ankur Chemicals Ltd. was merged with J.K. Business Machines Ltd. (now Hifazat Chemicals Ltd.). The merged company has been notified as a sick undertaking and its plant was taken over by Gujarat Industrial Investment Corporation which has also been appointed as the Operating Agency (OA) by the Board for Industrial and Financial Reconstruction (BIFR). Post merger results are unfavourable to the merged company and its stake holders.
9. In 2001, Ciba CKD Biochem Ltd. (CCBL) merged with its promoter company Novartis India Ltd. (NIL) with the objective of business broad base, economies of scale, strategic importance of anti-TB business and preventing sickness.
10. In June 2002, the Benares State Bank was integrated with Bank of Baroda and in March 2003, Punjab National Bank took over Nedungadi Bank. These too, like the recent GTB-OBC amalgamation were driven by crises.
11. In 2004, the Global Trust Bank (GTB) was merged with the Oriental Bank of Commerce (OBC) with the vision of instant geographical advantage with the takeover.

With the amalgamation, OBC, a north India-based bank, gains not just in terms of geographical network of 103 branches, 265 ATMs and 8.3 lakhs customer base in southern and western India. It also gains GTB's technological infrastructure and focus area. Clearly, it was a sinking GTB that strengthened OBC. While OBC has been a public sector bank, GTB a technology - savvy private bank.

For OBC, visibly, the positive was an effortless network in the south. It also gained approximately ₹ 300 crore worth of fixed assets of GTB. Its deposit base of ₹ 35,673.5 crore increased by ₹ 6,920.9 crore. On the flip side, GTB's non-performing assets of ₹ 9,000 crore were adjusted against OBC's assets.

However, the GTB shareholders had to face loss with not even an assurance for any compensation from the amalgamation of GTB with the OBC.

12. In 2005, IDBI Ltd. was merged with Industrial Development Bank of India (IDBI). The IDBI bank-IDBI merger though not driven by a crisis, is technically a bailout for IDBI – with the ₹ 9,000 crore-government assistance to facilitate a clean up of its balance sheet.
13. On January 31, 2007, India based Tata Steel Limited (Tata Steel) acquired the Anglo Dutch steel company, Corus Group Plc (Corus) for US\$ 13.70 billion. The merged entity, Tata-Corus, employed 84,000 people across 45

countries in the world. It had the capacity to produce 27 million tons of steel per annum, making it the fifth largest steel producer in the world as of early 2007.

Many analysts and industry experts felt that the acquisition deal was rather expensive for Tata Steel and this move would overvalue the steel industry world over.

There were many likely synergies between Tata Steel, the lowest-cost producer of steel in the world, and Corus, a large player with a significant presence in value-added steel segment and a strong distribution network in Europe. Among the benefits to Tata Steel was the fact that it would be able to supply semi-finished steel to Corus for finishing at its plants, which were located closer to the high-value markets.

Though the potential benefits of the Corus deal were widely appreciated, some analysts had doubts about the outcome and effects on Tata Steel's performance. They pointed out that Corus' EBITDA (earnings before interest, tax, depreciation and amortization) at 8 percent was much lower than that of Tata Steel which was at 30 percent in the financial year 2006-07.

Before the acquisition, the major market for Tata Steel was India. The Indian market accounted for sixty nine percent of the company's total sales. Almost half of Corus' production of steel was sold in Europe (excluding UK). The UK consumed twenty nine percent of its production. After the acquisition, the European market (including UK) would consume 59 percent of the merged entity's total production.

14. British telecom giant Vodafone has bagged the 67% Hutch Telecom International (HTIL) stake in Hutch-Essar at an enterprise value of \$19.3 billion (approx Rs 86,000 crore) which comes to \$794 per share.

Hutch's migration to the Vodafone brand marks the completion of UK-based Vodafone's acquisition of Hong Kong-based Hutchison Telecommunication Ltd's Indian assets in May 2007. The company was in July 2007 renamed Vodafone Essar.

India is the world's fastest-growing major mobile phone market, and the acquisition is expected to help offset slowing growth in Vodafone's core European operations. The acquisition is expected to give a tough competition to other leading brands in India as well.

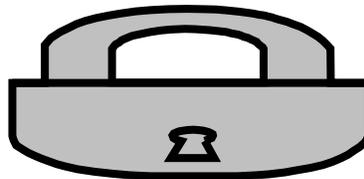
Thus, core competence seems to be the operative word. At times, players who have undertaken M&A do face serious liquidity and resource crunch, and all grand plans shelved in the desperate struggle for survival. Corporate mergers are like bush fires. Therefore, post merger integration becomes very important.

LESSON ROUND UP



- Growth of organization may be organic/inorganic growth. Growth in the factors of production is organic growth, whereas corporate restructuring initiatives leads to inorganic growth which is relatively faster.
- Restructuring may be financial restructuring, technological, market and organizational restructuring.
- The most commonly applied tools of corporate restructuring are amalgamation, merger, demerger, acquisition, joint venture, disinvestments etc.
- The important aspects to be considered during Corporate Restructuring process are financial, valuation, stamp duty, taxation and accounting aspects.
- Due diligence is an important tool in the process of mergers, acquisition or any other restructuring process.
- The regulatory framework for corporate restructuring includes, The Companies Act, 1956, SEBI(SAST) Regulations 2011, Listing agreement, Indian Stamp Act, 1899, Companies(Court) Rules etc.

SELF TEST QUESTIONS

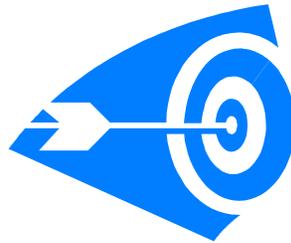


(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What do you mean by Corporate Restructuring?
2. Briefly discuss the scope and mode of Corporate Restructuring.
3. Illustrate the emergence of Corporate Restructuring in the national perspective.
4. Explain with the help of case law, the synergies on corporate restructuring.
5. “On-going corporate restructuring is a must for survival due to globalisation, liberalization and economic reforms.” Discuss.
6. Briefly explain the importance of due diligence in restructuring process.

STUDY II STRATEGIES

LEARNING OBJECTIVES



The objective of this study lesson is to enable the students to understand

- Strategies, strategic planning, implementation
- Strategies for Corporate Restructuring
- Various tools of Corporate Restructuring
 - Merger/Amalgamation
 - Takeover
 - Demerger- Case Studies on Reliance and L&T
 - Slump sale etc

Introduction

Basically, strategy provides broad contours of business. It usually refers to set forth guidelines by which the enterprise moves ahead. The importance of strategy is well evidenced in business history of India and other countries. The growth and diversification which have taken place in the corporate India is the result of business strategies in the form of merger, amalgamation, takeovers etc.

Generally, strategic decisions are related with several areas of operations of the organization. Thus it is necessary that these decisions must be with a perspective of understanding and anticipation of internal and external environment and its impact on the business. Formulation of strategy must be with the involvement of functional heads, strategic business units, divisions etc to have a right correlation of different levels of strategy with the overall strategic objective of the business.

Why Corporate Strategies?

1. *Better Decisions* – Information communicated through vision and strategy allows people to make better decisions (hiring and rewarding the right people, adopting and developing the right systems, making the right investments, etc.).
2. *Increased Energy* – Elimination of conflict leads to increased energy.
3. *Increased Capacity* – Enables people to focus on what is important and be less concerned about what isn't, that leads to increased capacity.

4. *Improved Customer Satisfaction* – Better performance and better strategy leads to increased customer satisfaction.
5. *Competitive Advantage* – Enables to 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 selective few.
7. *Market Recognition* – Over a period of time the organisation “owns” a position and space in the marketplace.
8. *Greatly enhances the chance of success!*
 - Strategic planning encourages managers to take a holistic view of both the business and its environment.
 - 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 including decisions on business, products and markets, manufacturing facilities, investments and organisational structure.
 - It works as the path finder to various business opportunities.
 - It also serves as a corporate defence mechanism helping the firm avoid costly mistakes in product market choices or investments.
 - Strategic planning has the ultimate burden of providing an organisation with certain core competencies and competitive advantages in its fight for survival and growth.
 - It seeks to prepare the organisation to face the future.
 - Its ultimate success lies in shaping the organisation to withstand turbulences or uncertainties.
 - Thus the success of the efforts and activities of the enterprise depends heavily on the quality of strategic planning i.e. the vision, insight, experience, quality of judgement and the perfection of methods and measures.

LEVELS OF STRATEGIES

Strategies exist at several levels in any organisation – ranging from the over all business (or group of business) to individuals working in it.

Strategies can be visualised to operate at three different levels viz. Corporate level, divisional or business level and operational or functional level.

(i) Corporate Level Strategy

Corporate strategy is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily

influenced by investors in the business and acts to guide strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a “mission statement”.

Such strategies are known as grand, overall or root strategies. If these are to succeed, they have to take into account political, economical, technological environments and in accordance with the societal and national priorities without ignoring the organisational paradigm and stakeholders' expectations. The strategy is usually planned for a period of five years or more.

(ii) Divisional/Business Level Strategy

Strategies at divisional or business level are directly concerned with the future plans of the profit centres. Business unit strategy is concerned more with how a business competes successfully in a particular market. It concerns strategic decisions about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities etc.

In an enterprise, the functions are divisionalised. Strategies at divisional levels are sub-strategies. They emanate from grand strategies and they have to necessarily devolve from the grand strategies. They have to operate within the framework of the grand strategy. They have market orientation because sub-strategies deal with the current and future product lines and current and future markets including overseas businesses.

(iii) Operational Strategy

Sub-strategies that are undertaken at the operational or functional level target the departmental or functional aspects of the operations. Operational strategy is concerned with how each part of the business is organized to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people etc. Success of grand strategies is largely dependent upon the successful implementation of strategic decisions regarding activities at the operational level.

Strategies and business environment:

A good strategy results in effective aligning of the organisation with its environment. A company needs to tune its vision continually to the requirements of a constantly changing business environment. Every company, influenced by the cause and effect of its environment, draws resources from the environment and provides value-added resources back to the environment. The effectiveness of the manner in which a company draws resources and delivers back to the environment depends on its strengths and weaknesses. Strategy is a major focus in the quest for higher revenues and profits, with companies pursuing novel ways to 'hatch' new products, expand existing businesses and create the markets of tomorrow.

The global economic environment has been posing both threats and opportunities to companies. If a company's response were to be weak to the environment in which it is operating, the environment could pose a threat to the company. Therefore an enterprise should plan a strategy that affords protection to it from the environment in which it is operating. It is similar to an individual or an animal that plans to protect himself or itself from the environment in which it is living. This could be described as the basic self-defence mechanism that an organization ought

to develop. When the going is steady, the organization cannot afford to adopt a laid-back approach. It is necessary for every enterprise to plan its strategies in order to make use of the numerous opportunities that the environment around it offers. As such, strategic management is a continuous process of effectively synchronising the goals of an organization with the economic environment at a macro level, to understand its strengths and weaknesses and to be prepared to face the threats and equip itself to take advantage of the opportunities.

Strategic planning in line with vision, mission etc.

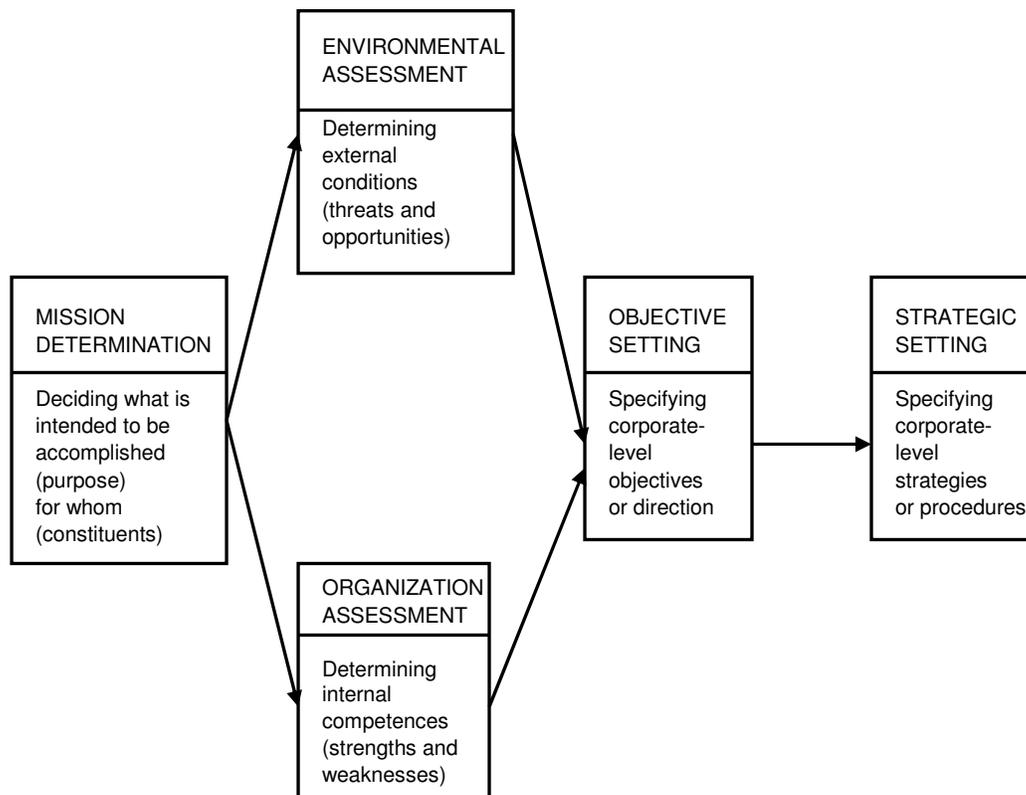
Strategic planning is a management tool, used to help an organisation do a better job to assess and adjust the organisation's direction in response to a changing environment. Strategic planning is likely to be beneficial particularly in organizations when there is a long time lag between managerial decisions and results thereof.

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.

It involves the following

1. Vision and mission of the company and its revision at regular intervals.
2. Assessment of internal and external environment
3. Objective and strategy setting.

Strategic planning can be represented as shown in following figure.



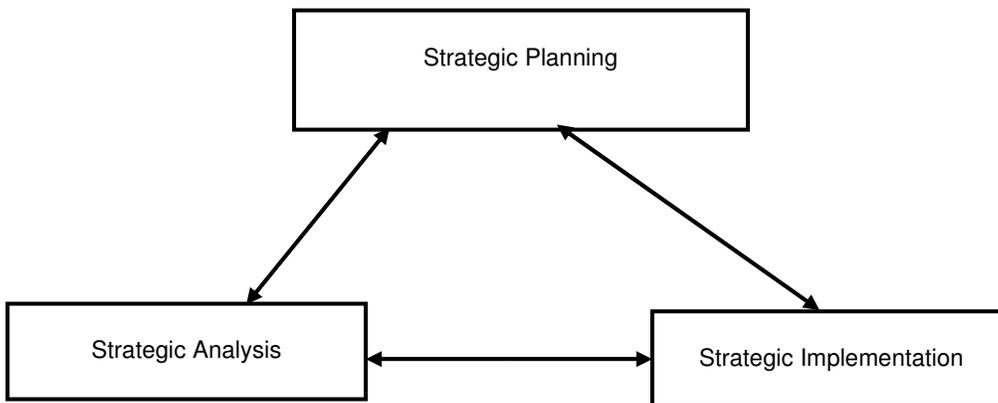
Strategic Management

Strategic Management involves, Strategy planning, Strategy analysis and strategy implementation.

Strategic Planning and Implementation

Strategic planning is a process where the organization through its Board and the core management team formulates, reviews the values and vision of the organization and designs a strategic path in order to achieve the desired objectives.

Strategic implementation is a process where the management of an organization implements the designed strategic plan through various mechanism. Strategy analysis involves regular analysis of impact of internal and external factors on the business of the corporate.



FORMULATION AND EXECUTION OF CORPORATE RESTRUCTURING STRATEGIES

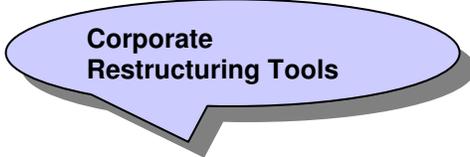
One of the purpose of corporate restructuring is to have an optimum business portfolio, by deciding whether to retain, divest or diversify the business. Business portfolio restructuring can be done in a variety of ways like amalgamation, merger, demerger, slump sale, takeover, disinvestment, joint venture, foreign franchises, strategic alliances, etc.

The ultimate choice of strategy by the organization would depend upon its growth objectives, attitude towards risk, the present nature of business and technology in use, resources at its command, its own internal strengths and weaknesses, Government policy, etc.

METHODS FOR IMPLEMENTATION OF STRATEGIES

Amalgamation, mergers, demergers, takeovers, acquisitions, disinvestment, joint ventures, franchising and alliances are some of the methods through which Corporate restructuring strategies are implemented. Strategies that are planned for being enforced within an enterprise do not fall under the above methods. For

example, mergers and acquisitions are external growth strategy which have been a regular feature of corporate enterprises in all developed countries. In amalgamation or merger, the strategy could be either equipping the company with additional revenue streams or improving size or market or segment or many more such things. Through demergers a strategist could achieve hiving off of potential business units for substantial cash or unviable units could be sold to concentrate on core competence. In technologically advanced product, there would be fast rate of obsolescence. In other words products would become outdated very soon. In such cases a strategist would like to acquire facilities on lease basis rather than spending more for owning the same. A good illustration would be the airline companies who lease aircraft so that advancements in technology do not affect them substantially. These strategies are also called inorganic growth strategies.



Corporate Restructuring Tools

- Amalgamation.
- Merger.
- Demerger.
- Slump Sale.
- Takeover.
- Joint Venture.
- Franchises.
- Strategic Alliance etc.

Merger

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), which has as its shareholders, all or substantially all, the shareholders of the two companies.

In merger, one of the two existing companies merges its identity into another existing company or one of more existing companies may form a new company and merge their identities into the new company by transferring their business and undertakings including all other assets and liabilities to the new company (hereinafter referred to as the merged company). The shareholders of the company whose identity has been merged (i.e. merging company) get substantial shareholding in the merged company. They are allotted shares in the merged company in exchange for the shares held by them in the merging company according to the shares exchange ratio incorporated in the scheme of merger as approved by all or prescribed majority of the shareholders of the merging companies and the merged companies in their

separate general meetings and sanctioned by the Court as per the agreed exchange ratio.

Merger is an external strategy for growth (i.e. inorganic growth strategy) of the organisation. Merger as a growth strategy is pretty old all over the world including India. Many business firms go in for merger instead of internal source of growth because of certain reasons. The benefits that occur to merging units include easy and quick entry, reduced competition and dependence, faster rate of growth, merits of diversification, availing tax concessions, benefits of synergy etc.

Acquisition

A corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. 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.

Amalgamation

In amalgamation, two or more existing companies merge together or form a new company keeping in view their long term business interest. The transferor companies lose their existence and their shareholders become the shareholders of the new company. Thus, 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 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 the new or amalgamated company.

Both the existing companies may form a new company and amalgamate themselves with the new company. The shareholders of each amalgamating company become the shareholders in the amalgamated company.

To give a simple example of amalgamation, We may say A Ltd. and B Ltd. merges their entities to form C Ltd. It may be said in another way that A Ltd. + B Ltd. = C. Ltd.

Therefore, the essence of amalgamation is to make an arrangement thereby uniting the undertakings of two or more companies so that they become vested in, or under the control of one company which may or may not be the original of the two or more of such uniting companies.

For purposes of Companies Act, 1956, the terms 'merger' and 'amalgamation' are synonymous.

Take Over

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 regulatory framework of take over listed companies is governed by the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. Take over may be friendly or hostile.

Disinvestment

Disinvestment is another strategic initiative from the point of view of public sector enterprises. The Disinvestment Policy of the Government of India in the area of privatizing the public sector undertakings refers to transfer of assets or service delivery from the government to the private sector. The concept of disinvestment takes different forms - from minimum government involvement to partnership with private sector where the government is the majority shareholder.

The salient features of the procedure evolved by the Department of Disinvestment include (i) proposals in accordance with the prescribed policy to be placed before the Cabinet Committee on Disinvestment (CCD); (ii) selection of adviser after clearance of proposal; (iii) issue of advertisement in leading newspapers inviting Expression of Interest (EOI); (iv) short-listing of bidders on the basis of laid down criteria; (v) drafting of Share Purchase Agreement and Shareholders' Agreement; (vi) finalization of Share Purchase Agreement and Shareholders' Agreement after negotiations; (vii) Inter-Ministerial Group (IMG) meeting to approve the proposal and agreements, and (viii) evaluation by the Comptroller and Auditor General (CAG) of India after the transaction is completed.

Unlike private enterprises where disinvestment or hiving off could take place quickly, any decision to disinvest would have its own political repercussions and therefore it has to be carefully planned keeping in mind a host of important factors including safety, security and integrity of the country.

Strategic Alliances

Any arrangement or agreement under which two or more parties co-operate in order to achieve certain commercial objectives while remaining independent organisations is called a strategic alliance. Thus, a strategic alliance is a partnership between firms whereby resources, capabilities and core competencies are combined to pursue mutual interests. The following are the features of strategic alliances:

- Strategic alliances are often motivated by considerations such as reduction in cost, technology sharing, product development, market access to capital.
- Strategic alliances facilitate a market entry strategy, which maximises the potential for high return while mitigating economic risks and other exposures.
- Strategic alliance is gaining importance in infrastructure sectors, more particularly in areas of power, oil and gas.
- The basic idea is to pool resources and facilitate innovative ideas and techniques while implementing large projects, with the common objective of reduction of cost and time, and sharing the resultant benefits, in proportion to the contribution made by each party in achieving the targets.
- Strategy formulation is thus a sequential process which consists of strategic situation analysis and strategic choice analyses.

- Strategic situation analysis is self examination of the corporation's existing strategic posture, whereas strategic choice analysis is forward looking scenario building approach to the firm's future strategic posture.
- The strategic choice to be made by a firm will depend on its assessment of its competitive strengths and weaknesses and to match these against the opportunities and threats posed by the market forces.

Demerger

In demerger, the demerged company sells and transfers one or more of its undertakings to the resulting company for an agreed consideration. The resulting company issues its shares at the agreed exchange ratio to the shareholders of the demerged company. Demerger might take place for various reasons viz. a conglomerate company carrying out various activities might transfer one or more of its existing activities to a new company to give effect to rationalization or specialization in the manufacturing process; or such transfer might be of a less successful part of the undertaking to the newly formed company, or demerger may be result of the family owned properties of the company transferring to the new companies formed by the different family members to carry on different activities etc.

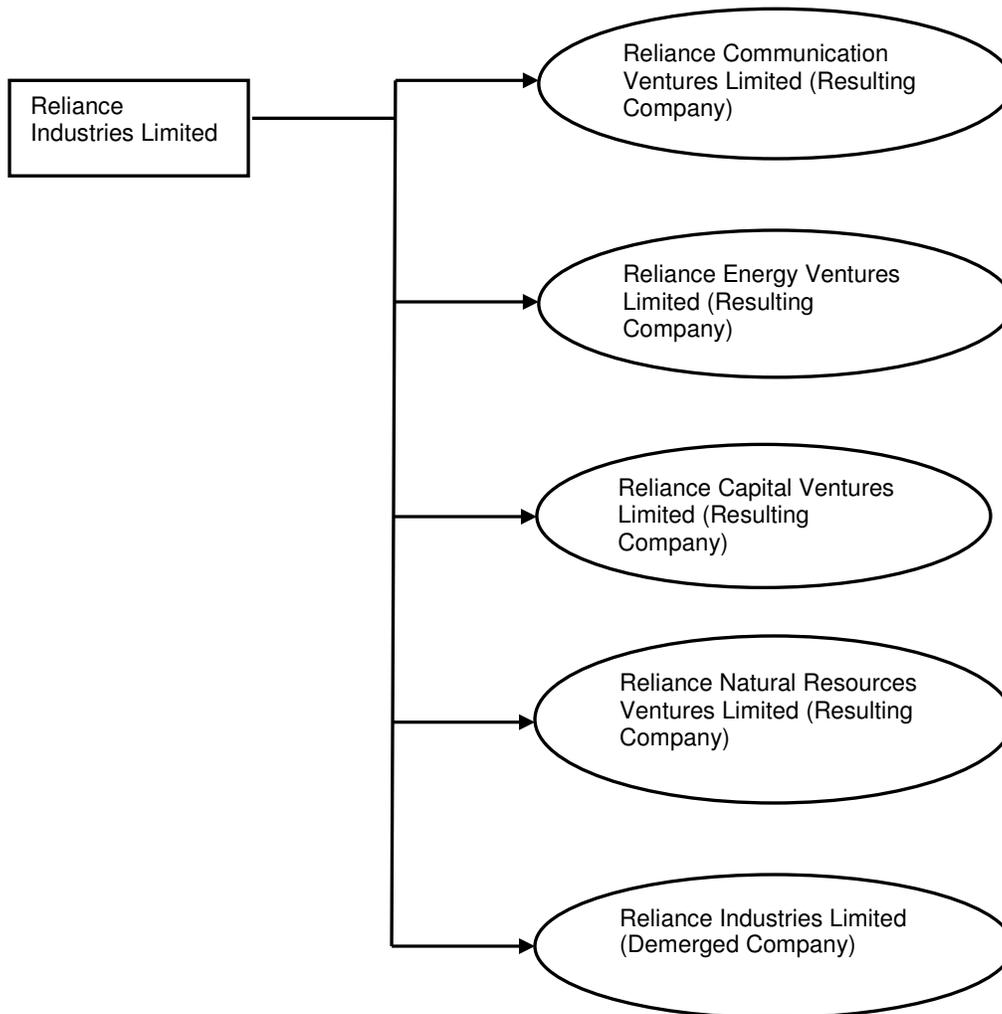
Section 2(19AA) of Income Tax Act, 1961 defines Demerger as follows:

“Demerger”, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 39479 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any 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 the demerger;
- (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;
- (v) the shareholders holding not less than three-fourths in value of the 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 share-holders 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 company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Some Examples –Demerger

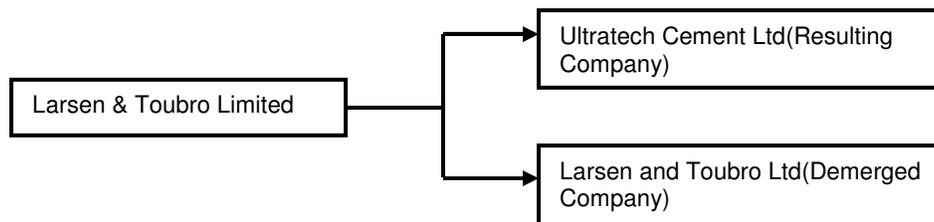
Reliance Industries Limited – Demerger of Four Units



The demerger of four entities like Reliance Communication Ventures Ltd., Reliance Energy Ventures Ltd., Reliance Natural Resources Ventures Ltd., and Reliance Capital Ventures Ltd. which spun off from Reliance Industries Ltd. (RIL), were perhaps the most prominent restructurings in recent times.

Demerger of the cement division of Larsen and Toubro Ltd

The demerger of the cement division of Larsen and Toubro Ltd. (L&T), named Ultratech Cement Ltd., seems to be one of the L&T's grand strategies to concentrate more on infrastructure, engineering, energy and turnkey businesses.



Slump Sale

In a slump sale, a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration. In a slump sale, an acquiring company may not be interested in buying the whole company, but only one of its divisions or a running undertaking which may be on a going concern basis. The sale is made for a lump sum price, without values being assigned to the individual assets and liabilities transferred. The business to be hived-off is transferred from the transferor company to an existing or a new company. A "Business Transfer Agreement" (Agreement) is drafted containing the terms and conditions of transfer. The agreement provides for transfer by the seller company to the buyer company, its business as a going concern with all immovable and movable properties, at the agreed consideration.

Section 2(42C) of Income tax Act, 1961 defines Slump Sale as Follows

"*Slump sale*" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

Explanation 1.—For the purposes of this clause, "undertaking" shall have the meaning assigned to it in Explanation 1 to clause (19AA).

Explanation 2.—For the removal of doubts, it is hereby declared that the determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities

Demerger Vs Slump Sale

Both Demerger/slump sale result in hiving off a division or undertaking. Then what is the difference between Demerger and Slump Sale?

1. In slump sale values are not assigned to individual assets and liabilities and the sale of undertaking is for a lump sum consideration. In demerger, valuation of individual assets and liabilities are mandatory.
2. In case of demerger, the shareholders of demerged company has to be issued the shares of resulting company and in case of slump sale the issue of shares does not take place.
3. Demerger results in reorganization of capital where as slump sale does not result in reorganization of capital.
4. In case of demerger, the resulting company has to continue the business of transferred undertaking of demerged company, where as in slump sale it is not so.
5. Demerger is more tax efficient than slump sale.

Joint Venture

Joint venture means an enterprise formed with participation in the ownership, control and management of a minimum of two parties. Mostly the parties hailing from different countries join in a venture to form a joint venture. Parties from abroad may join in India with Indian parties providing equity, technology and other resources to an enterprise created by them for their joint venture. Indian parties may go over to other countries as part of their strategy for setting up in a foreign country an enterprise by contributing equity, technology or other valuable resources for forming a company abroad. In joint ventures the parties have to keep in mind the country's specific laws and regulations.

Joint ventures imply the existence of a strategic business policy whereby a business enterprise is formed for profit in which two or more parties share responsibilities in an agreed manner, by providing risk capital, technology, patent/trade mark/brand names and access to market. Joint ventures with multinational companies contribute to the expansion of production capacity, transfer of technology and penetration into the global market and obtain new technological knowledge. In joint ventures, assets are managed jointly. Skills and knowledge flow both ways. In a joint venture between foreign and domestic firm, the domestic firm provides labour and foreign firm provides technology. Joint venture has a relatively short life span (5-7 years) and therefore do not represent a long term commitment.

As a strategy joint ventures may offer several advantages. A number of studies have shown that the main purposes of joint ventures within the country were controlling, influencing or reducing competition and/or influencing suppliers. Generally, joint ventures between companies within a country may take place for one or more of the following reasons:

- It may enable new technology to be introduced more conveniently;
- High risks involved in new ventures may be reduced through joint ventures;
- Smaller firms joining hands may be able to compete with larger organizations.

Firms in different countries may also find it beneficial to jointly establish a new enterprise.

Franchising

Franchising aims primarily at distributing goods and services that have a high reputation in the market and involves servicing the customers and end users. Franchisers support, train and to an extent control franchisees in selling goods and rendering services. The most popular form of franchising is the product distribution franchise.

Franchising may be defined as a contract, either expressed or implied, written or oral, between two persons or parties by which franchisee is granted the right to engage in the business of offering, selling, distributing goods and services prescribed in substantial part by franchisor. In other words franchising is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to independent people (the franchisees) the right to market and distribute the

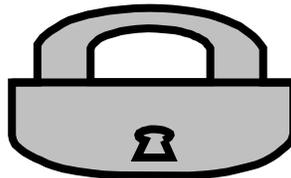
franchisor's goods or service, and to use the business name for a fixed period of time. Operation of franchisee's business is substantially associated with franchisor's trademark, service mark or logo or advertisement or commercial symbol. Franchisee pays directly or indirectly the fees to the franchiser. The franchising may cover the entire system or a specified territory or a specified retail outlet. Usually franchisers have standard agreements for all their franchisees because uniformity and conformity is considered very important.

LESSON ROUND UP



- Strategy provides broad contours of business
- Strategies may be at different levels viz Corporate Level strategy, business unit level strategy, operational strategy.
- Strategic planning is a process where the organization through its Board and the core management team formulates, reviews the values and vision of the organization and designs a strategic path in order to achieve the desired objectives.
- Strategic implementation is a process where the management of an organization implements the designed strategic plan through various mechanism. Strategy analysis involves regular analysis of impact of internal and external factors on the business of the corporate.
- The current day business looks forward to inorganic growth in the business through restructuring tools like, mergers amalgamation, takeover etc.

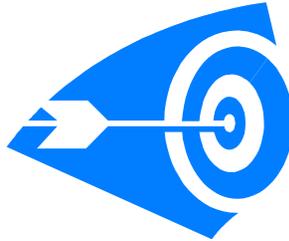
SELF TEST QUESTIONS



1. Describe the strategy and its importance for business success?
2. What is demerger? How does it impact the business decisions?
3. What are the various tools for corporate restructuring?
4. What is slump sale? Briefly discuss the process of slump sale.

STUDY III
MERGERS AND AMALGAMATIONS

LEARNING OBJECTIVES



This lesson explains the concept of mergers and amalgamations and the respective provisions under the Companies Act, 1956 which govern mergers or amalgamations of two companies. The lesson also discusses the various important aspects of mergers and amalgamations.

At the end of the lesson, you should be able to understand:

- Concept of mergers and amalgamations.
- Reasons for mergers and amalgamations and their objectives.
- Legal aspects of mergers and amalgamations.
- Procedural aspects of mergers and amalgamations.
- Latest judicial pronouncements including some conflicting pronouncements.
- Accounting aspects of mergers and amalgamations.
- Financial aspects of mergers and amalgamations.
- Human aspects of mergers and amalgamations.
- Taxation aspects of mergers and amalgamations.
- Stamp duty aspects of mergers and amalgamations.
- Filing of various forms in the process of merger/amalgamations.
- Amalgamations of banking companies.
- Cross border mergers.
- Merger aspects under competition law.
- Procedure relating to Government Companies.

INTRODUCTION

A company may decide to accelerate its growth by developing into new business areas, which may or may not be connected with its traditional business areas, or by exploiting some competitive advantage that it may have. Once a company has decided to enter into a new business area, it has to explore various alternatives to achieve its aims.

Basically, there can be three alternatives available to it:

- (i) the formation of a new company;

- (ii) the acquisition of an existing company;
- (iii) merger with an existing company.

The decision as to which of these three options are to be accepted, will depend on the company's assessment of various factors including in particular:

- (i) the cost that it is prepared to incur;
- (ii) the likelihood of success that is expected;
- (iii) the degree of managerial control that it requires to retain.

For a firm desiring immediate growth and quick returns, mergers can offer an attractive opportunity as they obviate the need to start from 'scratch' and reduce the cost of entry into an existing business. However, this will need to be weighed against the fact that unless the shareholders of the transferor company (merging company) are paid the consideration in cash, part of the ownership of the existing business remains with the former owners.

Merger with an existing company will, generally, have the same features as an acquisition of an existing company. However, identifying the right candidate for a merger or acquisition is an art, which requires sufficient care and calibre.

Once an organization has identified the various strategic possibilities, it has to make a selection amongst them. There are several managerial factors which moderate the ultimate choice of strategy. This would depend upon its growth objectives, attitude towards risk, the present nature of business and technology in use, resources at its command, its own internal strengths and weaknesses, Government policy, etc. The changing economic environment is creating its own compulsions for consolidation of capacities. With growing competition and economic liberalization, the last two decades have witnessed a large number of corporate mergers.

CONCEPT OF 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).

In a merger one of the two existing companies merges its identity into another existing company or one or more existing companies may form a new company and merge their identities into a new company by transferring their businesses and undertakings including all assets and liabilities to the new company (hereinafter referred to as the merged company). The shareholders of the company or companies, whose identity/ies has/have been merged (hereinafter referred to as the merging company or companies, as the case may be) are then issued shares in the capital of the merged company. For the purpose of issue of shares in exchange for the shares held by the shareholders of the merging companies, the value of shares of merging companies, and the merged company is computed and thereafter the share exchange ratio is fixed as part and parcel of the scheme of merger. The scheme requires approval of the Board of Directors of the respective companies, approval of the shareholders of both the company exercised by means of a resolution with the prescribed majority and in addition the sanction of the respective high courts.

Therefore, a merger may mean absorption of one company by another company, wherein one of the two existing companies loses its legal identity after transferring all its assets, liabilities and other properties to the other company as per a scheme of arrangement approved by all or the statutory majority of the shareholders of both the companies in their separate general meetings and sanctioned by the Court.

Amalgamation is an 'arrangement' or 'reconstruction'. 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. Similar to merger the shareholders of amalgamating companies get shares of amalgamated company. All the approvals explained in the case of merger are required to be obtained in the case of amalgamations also.

The shareholders of each amalgamating company become the shareholders in the amalgamated company. To give a simple example of amalgamation, we may say A Ltd. and B Ltd. form C Ltd. and merge their legal identities into C Ltd. It may be said in another way that A Ltd. + B Ltd. = C. Ltd.

The word 'amalgamation' or 'merger' is not defined anywhere in the Companies Act, 1956. However Section 2(1B) of the Income Tax Act, 1961 defines 'amalgamation' as follows:

"Amalgamation in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as amalgamating company or companies and the company with which they merge or which is formed as result of the merger, as the amalgamated company), in such a manner that—

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company."

Thus, for a merger to qualify as an 'amalgamation' for the purpose of the Income Tax Act, the above three conditions have to be satisfied. This definition is relevant inter alia for Sections 35(5), 35A(6), 35E(7), 41(4) Explanation 2, 43(1) Explanation 7, 43(6) Explanation 2, 43C, 47 (vi) & (vii), 49(1)(iii)(e), 49(2), 72A of Income Tax Act.

Transfer of assets to the transferee company pursuant to a scheme of amalgamation is not a 'transfer' and does not attract capital gains tax under Section 47(vi). Likewise, shares allotted to shareholders of the transferor company is not a transfer attracting capital gains tax under Section 47(vii).

Difference between Merger and Amalgamation

The terms merger, amalgamation and consolidation are sometimes used interchangeably and denote the situation where two or more companies, keeping in view their long term business interests, combine into one economic entity to share risks and financial rewards. However, in strict sense, merger is commonly used for the fusion of two companies. 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.

In an amalgamation by purchase, one company's assets and liabilities are taken over by another and a lump sum is paid by the latter to the former as consideration, which is within the purview of Sections 391 and 394 of the Act – Re. SPS Pharma Ltd. (1997) 25 CLA 110 (AP).

Thus, an amalgamation is an organic unification or amalgam of two or more legal entities or undertakings or a fusion of one with the other. There is no bar to more than two companies being amalgamated under one scheme – Re. Patrakar Prakashan Pvt. Ltd. (1997) 33 (MP) 13 SCL.

In simple terms:

- Companies Act, 1956 is the legislation that facilitates amalgamation of two or more companies.
- For the purpose of Companies Act, 1956 the terms 'Merger' and 'Amalgamation' are synonymous.
- Amalgamation is not defined in the Companies Act, 1956.
- Sections 390-396A of the Companies Act contain provisions on 'compromise, arrangements and reconstructions'. Amalgamation is an 'arrangement' or 'reconstruction'.
- Companies (Court) Rules, 1959 lay down procedure for carrying out amalgamation.
- The word 'amalgamation' has no definite legal meaning. It contemplates a state of things under which two companies are so joined as to form a third entity, or one company is absorbed into and blended with another company.

Right to amalgamate

No company involved in amalgamation need be financially unsound or under winding-up though as per Section 390(a), for purposes of Section 391 'company' means "any company liable to be wound up". But it does not debar amalgamation of financially sound companies. [Bank of India Ltd. v. Ahmedabad Manufacturing & Calico Printing Co. Ltd. (1972) 42 Comp Cas 211 (Bom); Re. Rossell Inds. Ltd. (1995) 5 SCL 79 (Cal)].

Section 390(a) is applicable to a company incorporated outside India. If court has jurisdiction to wind up such a company on any of the grounds specified in the Act, court has jurisdiction to sanction scheme of amalgamation if a company incorporated outside India is a transferor-company. [Bombay Gas Co. Pvt. Ltd. v. Regional Director (1996) 21 CLA 269 (Bom.)]. There is no bar to a company amalgamating with a fifteen-day old company having no assets and business. [Re. Apco Industries Ltd. (1996) 86 Comp Cas 457 (Guj.)].

Amalgamation calls for compliance with both Sections 391 and 394. While Section 391 requires sanction of court for 'compromise or arrangement', Section 394 empowers the court to provide for the matters stated in that section to facilitate amalgamation.

Amalgamation involving a 'sick industrial company' as transferor or transferee-company is outside the purview of Companies Act, 1956. It is governed by the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).

Amalgamation of a company licensed under Section 25 of the Companies Act, 1956 with a commercial, trading or manufacturing company could be sanctioned under Section 391/394. [Re. Sir Mathurdas Vissanji Foundation (1992) 8 CLA (Bom); Re. Walvis Flour Mills Company P. Ltd. (1996) 23 CLA 104]. There is nothing in law to prevent a company carrying on business in shares from amalgamating with one engaged in transport. [Re EITA India Ltd. (1997) 24 CLA 37 (Cal)].

REASONS FOR MERGER AND AMALGAMATION

Mergers must form part of the business and corporate strategies aimed at creating sustainable competitive advantage for the firm. Mergers and amalgamations are strategic decisions leading to the maximisation of a company's growth.

Mergers and amalgamations are usually intended to achieve any or some or all of the following purposes:

- (1) Synergistic operational advantages – Coming together to produce a new or enhanced effect compared to separate effects.
- (2) Economies of scale (scale effect) – 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) Benefits of 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.

UNDERLYING OBJECTIVES IN MERGERS

Major objectives and their benefits are given below:

Market Leadership

The amalgamation can enhance value for shareholders of both companies through the amalgamated entity's access to greater number of market resources. With the addition to market share, a company can afford to control the price in a better manner with a consequent increase in profitability. The bargaining power of the firm vis-a-vis labour, suppliers and buyers is also enhanced. In the case of the amalgamation of Reliance Petroleum Limited with Reliance Industries Limited, the main consideration had been that the amalgamation will contribute towards strengthening Reliance's existing market leadership in all its major products. It was foreseen that the amalgamated entity will be a major player in the energy and

petrochemical sector, bringing together Reliance's leading positions in different product categories.

Improving Economies of Scale

One of the most frequent reason given for mergers is to improve the economies of scale. Economies of scale arise when increase in volume of production leads to a reduction in cost of production per unit. They are generally associated with the manufacturing operations, so that the ratio of output to input improves with the volume of operations. Mergers and amalgamations help to expand the volume of production without a corresponding increase in fixed costs. Thus, the fixed costs are distributed over a large volume causing the unit cost of production to decline. Economies of scale may also be obtained from the optimum utilisation of management resources and systems of planning, budgeting, reporting and control. A combined firm with a large size can make the optimum use of the management resources and systems resulting in economies of scale. This gives the company a competitive advantage by gaining an ability to reduce the prices to increase market share, or earn higher profits while maintaining a price.

Operating Economics

Apart from economies of scale, a combination of two or more firms may result in reduction of costs due to operating economies. A combined firm may avoid overlapping of function and facilities. Various functions may be consolidated and duplicate channels may be eliminated by implementing an integrated planning and control system. The merger of Sundaram Clayton Ltd. (SCL) with TVS Suzuki Ltd. (TSL) was motivated by operating economies and by virtue of this, TSL became the second largest producer of two wheelers. TSL needed to increase its volume of production but also needed a large manufacturing base to reduce its production costs. Large amount of funds would have been required for creating additional production capacity. SCL was also required to upgrade its technology and increase its production. Both the firms' plants were closely located offering various advantages, the most versatile being the capability to share common research and development facilities.

Financial Benefits

A merger or amalgamation is capable of offering various financial synergies and benefits such as eliminating financial constraints, deployment of surplus cash, enhancing debt capacity and lowering the costs of financing. Mergers and amalgamations enable external growth by exchange of shares releasing thereby, the financial constraint. Also, sometimes cash rich companies may not have enough internal opportunities to invest surplus cash. Their wealth may increase through an increase in the market value of their shares if surplus cash is used to acquire another company. A merger can bring stability of cash flows of the combined company, enhance the capacity of the new entity to service a larger amount of debt, allowing a higher interest tax shield thereby adding to the shareholders wealth. Also, in a merger since the probability of insolvency is reduced due to financial stability, the merged firm should be able to borrow at a lower rate of interest. Apart from this, a merged firm is able to realize economies of scale in floatation and transaction costs related to an issue of capital i.e. issue costs are saved when the merged firm makes a larger security issue.

Acquiring a New Product or Brand Name

Acquiring a new product is different from acquiring a brand name. A company may be able to build a brand name for a particular line of business. In a related field, the company might think of introducing another product so that reputation and goodwill associated with a brand name of the company could be advantageously exploited. In this situation, the company would be either installing a manufacturing facility for the new product or looking for a good party in the market with a reasonable market share. If the company acquires its manufacturing facility, the company can save a lot of time and energy in creating a new industry. The combination of the ability of the company to takeover the manufacturing facility and build the said product with the company's brand name develops a great market for the company. On the one hand the company has bought a competitor because the party from whom the company had bought the unit would have given up the said line of business. Another advantage is that the company with its definite name and reputation and with plenty of money would be able to establish a strong presence for its new product and create a higher market share. At the same time there could be a case, where the company has a production facility but its market share for the said product is abysmally low. In spite of its best efforts the product may not steal the hearts of customers or consumers. The company, for strategic reasons, may wish to acquire a brand name by buying out the entire market share of another party who may be having strong presence for the said product. This acquisition can happen in certain circumstances only. An aggressive player in the market will be always on the look out for such possibilities and cash in when opportunity strikes. Thus through amalgamation, it is possible to acquire either the entire production facility including human resources or a new brand for an existing product or range of products. In an acquisition of a facility the difficulties of getting the required know-how from reliable sources, installing and commissioning a plant and then launching the new product which may take a lot of time and result in heavy cost could be avoided. Amalgamation in such cases would make available ready-made facilities, which would provide a quicker entry for encashing the comparative advantage of the new product before new entrants make the market much more competitive and much less profitable. On the other hand, acquiring a leading brand positions the products of one company in a new level in the market. Amalgamation enables all these activities in a simpler and cost effective manner, though there are other methods too.

Diversifying the Portfolio

Another reason for merger is to diversify the company's dependence on a number of segments of the economy. Diversification implies growth through the combination of firms in unrelated businesses. All businesses go through cycles and if the fortunes of a company were linked to only one or a few products then in the decline stage of their product life cycles, the company would find it difficult to sustain itself. The company therefore looks for either related or unrelated diversifications, and may decide to do so not internally by setting up new projects, but externally by merging with companies of the desired product profile. Such diversification helps to widen the growth opportunities for the company and smoothen the ups and downs of their life cycles.

Strategic integration

Considering the complementary nature of the businesses of the concerned companies, in terms of their commercial strengths, geographic profiles and site integration, the amalgamated entity may be able to conduct operations in the most cost effective and efficient manner. The amalgamation can also enable optimal utilization of various infrastructural and manufacturing assets, including utilities and other site facilities.

Synergies

Synergy refers to a situation where the combined firm is more valuable than the sum of individual combining firms ($2+2=5$). The combination of operations can create a unique level of integration for the amalgamated entity spanning the entire value chain in the line of business. This will enable the amalgamated entity to achieve substantial savings in costs, significantly enhancing its earnings potential. Synergies can be expected to flow from more focused operational efforts, rationalization, standardization and simplification of business processes, productivity improvements, improved procurement, and the elimination of duplication. The main criteria for synergy lies in the ability of an organization to leverage in resources to deliver more than its optimum levels. By combining the strengths of two complementary organizations, not only one could achieve synergy but also eliminate the disadvantages each had. Consider the garment manufacturer acquiring a spinning mill. The garment manufacturer can assure himself of quality of cotton and the yarn that goes into the production of garments and expand your imagination by enabling him acquire processing facilities. Imagination, competitor watch, constant vigil, conservation of resources are the key drivers and amalgamations happen in this process only. One of the most important reason for mergers and amalgamations is to realize synergies; either through cheaper production bases as in case of Jindal Strips purchase of two units from Bethlehem in US, or by cost savings and pooling of resources in R&D marketing and distribution as in case of Astra's \$36 billion merger with Zeneca, Hoechst merger with Rhone Poulenc or other pharma mergers.

Taxation or Investment Incentives

A company, which has incurred losses in the past, can carry forward such losses and offset them against future taxable profits and reduce tax liabilities. Such a company when merged with a company with large taxable profits would help to absorb the tax liability of the latter.

A similar advantage exists when a company is modernizing or investing heavily in plant and machinery, which entitles it to substantial investment incentives, but has not much taxable profits to offset them with. Acquiring or merging such a company with a highly profitable company would help make full use of the investment incentives for the latter.

Survey findings

In the early seventies, the Organization for Economic Cooperation and Development (OECD) published a Report of their Committee of Experts on Restrictive Business Practices, on 'Mergers and Competition Policy'. The report listed twelve motives most often cited for mergers, which may be grouped together under

the following categories:

<i>Category</i>	<i>Motives</i>
A. Economies of Scale	1 Obtain Real Economies of Scale
	2 Acquire Capacity at Reduced Prices
B. Market share	3 Increase market power
	4 Expand production without price reduction
	5 Build an empire
	6 Rationalize production
C. Financial Synergy	7 Obtain Tax advantages
	8 Obtain monetary economies of scale
	9 Use complementary resources
	10 Gain promotional profits
D. Diversification of Risk	11 Spread risks by diversification
	12 Avoid firm's failure

Limiting Competition

It would be wrong to conclude that mergers limit or restrict competition from the consumers' point of view. Competition is always enabled to do its part and competition is protected by well defined and administered law and administration of the same. In mergers business enterprises achieve what could be termed as a buy out of the competition's market shares or stake. The purpose of such acquisition could be to consolidate or to eliminate the competition posed by the acquired enterprise. It does not mean new competitive forces cannot emerge or survive. It is only natural for business enterprises and the people who drive such enterprises to look at opportunities for acquiring more and more market stake. Mergers therefore are tools in the hands of the entrepreneurial community to keep a watch on the competition and take appropriate action.

CATEGORIES OF MERGERS

Mergers may be broadly classified as follows:

- (i) Cogeneric – within same industries and taking place at the same level of economic activity – exploration, production or manufacturing wholesale distribution or retail distribution to the ultimate consumer.
- (ii) Conglomerate – between unrelated businesses.

Cogeneric Mergers

Cogeneric mergers are of two types:

(a) 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. It is a combination of two or more firms in similar type of production/distribution line of business. 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. However, their main drawback, is that they promote monopolistic trend in the industrial sector as the number of firms in an industry is decreased and this may make it easier for the industry members to collude for monopoly profits.

(b) 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. When a company combines with the supplier of material, it is called a backward merger and where it combines with the customer, it is known as forward 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. It may also pose a risk of monopolistic trend in the industry.

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. This is the type of merger of companies which are neither competitors, nor complimentaries nor suppliers of a particular raw material nor consumers of a particular product or consumable. A conglomerate merger is one which is neither horizontal nor vertical. In this, the merging companies operate in unrelated markets having no functional economic relationship.

Mergers may further be categorised as:

Cash Merger

A merger in which certain shareholders are required to accept cash for their shares while other shareholders receive shares in the continuing enterprise.

Defacto Merger

Defacto merger has been defined as a transaction that has the economic effect of a statutory merger but is cast in the form of an acquisition of assets.

Down Stream Merger

The merger of parent company into its subsidiary is called down stream merger.

Up stream Merger

The merger of subsidiary company into its parent company is called an up stream merger.

Short-form Merger

A number of statutes provide special company rules for the merger of a subsidiary into its parent where the parent owns substantially all of the shares of the

subsidiary. This is known as a short form merger. Short form mergers generally may be effected by adoption of a resolution of merger by the parent company, and mailing a copy of plan of merger to all shareholders of subsidiary and filing the executed documents with the prescribed authority under the statute. This type of merger is less expensive and time consuming than the normal type of merger.

Triangular Merger

Triangular merger means the amalgamation of two companies by which the disappearing company is merged into subsidiary of surviving company and shareholders of the disappearing company receive shares of the surviving company.

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. [For a detailed analysis of the concept of reverse merger, refer to Gujarat High Court judgement in Bihari Mills Ltd. case (1985) 58 Comp Cas 61].

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. There is no need to comply with Section 72A of Income Tax Act, 1961.

PRELIMINARY STEPS IN MERGERS

The process of screening and selecting the right companies for mergers and amalgamations should proceed in a systematic manner i.e. from general to the more specific. The process starts by identifying the general domains of potential industries to the specific selection of companies to be evaluated and approached for merger or acquisition. The process of screening is generally as follows:

Identifying Industries

First a set of industries is selected which meet the strategic conditions outlined by the company for the merger. This may be in terms of size. For instance, a company wanting to acquire a medium scale investment will leave out the large investment industries such as petrochemicals, shipbuilding, etc.

Selecting Sectors

A broad group of acceptable sectors are then identified. For each of these sectors, data with respect to the sales turnover and growth, return on investment (or sales), market shares, competition and asset turnover etc. is collected for the various companies. On the basis of this comparison, the more desirable sectors are chosen.

Choosing Companies

Potential companies are carefully looked at with respect to the competitive environment in which they operate. Specific attention is paid to the competitive strengths of these companies in their sectoral environment. Comparable sizes are favourable to the chances of success of the merger.

Generally sales turnover and the asset level, which in turn determines the cost level of acquisition, characterize the size of companies. A common rule of thumb

followed is to consider companies, which are 5 to 10 per cent in size of the bidding companies. However, it is not a hard and fast rule in the present global scenario as is evident from the recent acquisition of Corus Steel by Tata Steel. Corus was almost thrice the size of Tata Steel.

Comparative Cost and Returns

The next step is to consider the financial obligations associated with merger and amalgamation on the basis of which the potential companies are reduced further on the basis of their likely return. The companies are listed and compared with respect to their return on investments and the future expected returns are also developed on the basis of different market scenarios. The risks and uncertainties are incorporated to determine the possible variations in returns. Finally, the various companies are ranked on the basis of their position against each of the identified objectives.

Short-listing Good Companies

Generally a merger with another company is considered, if it will increase the overall economic value of the company. To achieve this, it is necessary to identify the companies, which have:

- High Market share
- Large Sales Volume
- Good Management Systems
- Diversified portfolio or its potential
- A return on Investment above a benchmark specified for acquisition.

Assessing the Suitability

The suitability is to be judged against three strategic criteria i.e. business fit, management and financial strength. Once the proposal fits into the strategic motive, then all relevant information will be collected relating to the other company like share price movements, earnings, dividend track record, market share, management, shareholding pattern, financial position, etc. A SWOT analysis of both the companies is carried out. It is necessary to consider not only the benefits that can be obtained but also the attendant risks. If the proposal is suitable from all angles, then the matter will be carried further.

Appropriateness of Timing

The amalgamating companies must carefully review if they can afford to spare their time for integrating the companies and whether in terms of business cycles etc., it is the right time to merge.

Negotiation Stage

This is where the importance of proper valuation is essential. After the consideration is decided, the payment terms and exchange ratio of shares between the companies will be decided. The exchange ratio is an important factor in the process of amalgamation. This has to be worked out by valuing the shares of both, transferor and transferee company as per norms and methods of valuation of shares. Valuation is usually carried out by commissioning a firm of experts. Company secretaries, chartered accountants, chartered engineers, chartered financial analysts,

cost accountants, management consultants carry on practice as valuers of shares, business, goodwill and properties which include intellectual properties also.

Approval of Proposal by Board of Directors

Once the consideration of the deal and terms of payment are worked out, the proposal will then be put up for the Board of Director's approval.

Approval of Shareholders

As per the provisions of the Companies Act, 1956, the shareholders of both the companies hold meeting under the directions of the respective high court(s) and consider the scheme of amalgamation. A separate meeting for both preference and equity shareholders is convened for this purpose.

Approval of Creditors/Financial Institutions/Banks

Approvals from the constituents for the scheme of merger are required to be sought for, as per the respective agreement/arrangement with each of them and their interest is considered in drawing up the scheme of merger.

The regulator examines the request keeping in view the statutory, regulatory and other prudential requirements and the need for compliance with the various provisions of the statute and approves the same with or without conditions.

For example, in the case of the application for merger of ICICI Ltd. with ICICI Bank Ltd. submitted to the Reserve Bank of India (RBI) for regulatory approvals, the Reserve Bank approved the merger subject to certain conditions.

Approvals of Respective High Court(s)

Approval of the respective high court(s) of both the companies confirming the scheme of amalgamation are required. The court issues orders for winding up of the amalgamating companies without dissolution on receipt of the reports from the official liquidator and the Regional Director that the affairs of the amalgamating companies have not been conducted in a manner prejudicial to the interests of its members or to public interest.

Integration Stage

The structural and cultural aspects of the two organizations, if carefully integrated in the new organization will lead to the successful merger and ensure that expected benefits of the merger are realized.

REGULATORY FRAMEWORK FOR MERGER/AMALGAMATION

The Regulatory Framework of Mergers and Amalgamations covers

1. The Companies Act, 1956
2. Companies (Court) Rules, 1959
3. Income Tax Act, 1961
4. Listing Agreement
5. The Indian Stamp Act, 1899
6. Competition Act, 2002

1. Companies Act, 1956

Chapter V of Companies Act, 1956 comprising Section 390 to 396A contains provisions on 'Arbitration, Compromises, Arrangements and Reconstructions'. There are however, no provision on Arbitration Since Section 389 which dealt with Arbitration was deleted. The scheme of Chapter V goes as follows.

1. Section 390 contains interpretation of certain expressions used in Section 391 and 393
2. Section 391 is relating to the power of the company to compromise or to make arrangement with its creditors and members.
3. Section 393 deals with regard to information as to compromises and arrangements with creditors and members.
4. Section 394 deals with facilitation of reconstruction and amalgamation of companies.
5. Section 394A deals with a notice to be given to the Central Government in respect of applications under Section 391 and 394.
6. Section 395 deals with provisions regarding the power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority shareholders.
7. Section 396 contains provisions as to the power of the central government to provide for amalgamation of companies in national interest.
8. Section 396 A deals with preservation of books and papers of amalgamated companies.

2. Companies Court Rules 1959

Rules 67-87 contains provisions dealing with the procedure for carrying out a scheme of compromise or arrangement including amalgamation or reconstruction.

3. Under the Income Tax Act, 1961

A scheme of amalgamation is not a transfer at all for the purpose of the Income Tax Act, 1961. However, when a scheme of merger or demerger involves the merger of a loss making company or a hiving off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, inter alia, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferor Company. Important aspects of Income Tax Act have already been dealt with in Study 3 and Study 7. Students are instructed to refer them.

4. Under the Listing Agreement

Under Clause 24(f) of the Listing Agreement, where the scheme of merger or demerger involves a listed company, it is necessary to send a copy of the scheme to the stock exchanges where the shares of the said company are listed to obtain their No Objection Certificate (NOC). Generally stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the takeover code or the Disclosure and Investor Protection Guidelines, Stock Exchanges

accord their approval. Where the shares are listed on BSE or NSE, other Stock Exchanges wait for the approval by BSE or NSE before granting their approval.

5. Under the Indian Stamp Act

It is necessary to refer to the Stamp Act to check the stamp duty payable on transfer of undertaking through a merger or demerger.

6. Competition Act, 2002

The provisions of Competition Act and the Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 are to be complied with.

PROVISIONS OF THE COMPANIES ACT 1956

Section 391 – Power to compromise or make arrangements with creditors and members.

Section 391 lays down in detail the power to make compromise or arrangements with its creditors and members. Under this Section, a company can enter into a compromise or arrangement with its creditors or its members, or any class thereof without going into liquidation.

Scope of Section 391

Section 391 deals with the rights of a company to enter into a compromise or arrangement (i) between itself and its creditors or any class of them; and (ii) between itself and its members or any class of them. The arrangement contemplated by the section includes a reorganisation of the share capital of a company by consolidation of its shares of different classes or by sub-division of its shares into shares of different classes or by both these methods.

Once a compromise or arrangement comes within the ambit of the section, it may be sanctioned by the court, even if it involves certain acts for which a particular procedure is specified in other sections of the Act e.g., reduction of share capital of a company may form part of a compromise or arrangement and when the court sanctions the compromise or arrangement as a whole, reduction of share capital is also sanctioned and the company is not required to follow the procedure laid down in Section 100 of the Act. The court can refuse to sanction a scheme of merger or amalgamation or reconstruction if it is satisfied that the scheme involves any fraud or illegality. Once the reduction of share capital of a company is a part of a compromise or arrangement, the requirements of the Companies Act as regards reduction of share capital are not applicable because the court is empowered to sanction reduction of share capital as a part of the compromise or arrangement.

The section also applies to compromise or a management entered into by companies under winding up. Therefore, an arrangement under this section can take a company out of winding up.

Once a compromise or arrangement under this section is approved by statutory majority, it binds the dissenting minority, the company and also the liquidator, if the company is in the process of winding up.

Reduction of capital forming part of compromise/arrangement sanctioned by the court does not require the procedure to be followed under Section 100.

Sub-section (1) – Application to the court for convening meetings of members/creditors.

Where a company proposes a compromise or arrangement between it and its creditors or between it and its members or with any class of the creditors or any class of members, the company or the creditor or member may make an application to the court. On such application the court may order a meeting of the creditors or members or any class of them as the case may be and such meeting shall be called, held and conducted in such manner as the court may direct. In the case of a company which is being wound up, any such application should be made by the liquidator.

The key words and expressions under sub-section are 'creditors', 'court', 'class of creditors or members', 'a company which is being wound up', 'liquidator'. When a company is ordered to be wound up, the liquidator is appointed and once winding up commences liquidator takes charge of the company in all respects and therefore it is he who could file any application of any compromise or arrangement in the case of a company which is being wound up. A company which is being wound up would mean a company in respect of which the court has passed the winding up order.

Who can make application under Section 391 to the court for the purpose of calling meeting of creditors/members as the case may be?

1. The Company
2. Creditor/Member
3. Liquidator in case of the company being wound up.

Sub-section (2) – Approval of the Scheme and order of the court sanctioning the scheme of amalgamation.

Sub-section (2) provides that when the court directs the convening, holding and conducting of a meeting of creditors or members or a class of them, a particular majority of the creditors or members or a class of them should agree to the scheme of compromise or arrangement. As per the sub-section, the majority required is the majority in number representing three-fourths in value of the creditors or members or a class of them, as the case may be, present and voting in the meeting so convened either in person, or by proxy. After the said meeting agrees with such majority, if the scheme is sanctioned, by the court, it shall be binding upon the creditors or members or a class of them, as the case may be.

As per the proviso under Sub-section (2), no order sanctioning any compromise or arrangement shall be made by the court unless it is satisfied that the applicant has made sufficient disclosure about the following particulars:

- All material facts relating to the company;
- Latest financial position of the company;
- Latest auditors report on the accounts of the company;
- Information about pendency of any investigation proceeding in relation to the company under Sections 235 to 251 and the like.

What is the majority required for compromise under Section 391?

Majority in number representing three fourths in value.

Sub-section (3) – Filing of court order with ROC.

The order made by the court under Sub-section (2) should be filed with the Registrar of Companies. If the order is not filed with the Registrar, it will not have any effect. The requirement under this section is limited to filing of the order of the court and it does not specify the need for the Registrar to register it.

The order of the court under Section 391 sanctioning compromise or arrangement will not have effect unless filed with Registrar of Companies.

Sub-section (4) – Memorandum to be annexed to the copy of court order while filing.

It is necessary to annex a copy of every such order to every copy of the Memorandum of company issued after the filing of the certified copy of the order. In the case of a company not having a memorandum the order aforesaid shall be annexed to every copy of the instrument constituting or defining the constitution of the company.

Sub-section (5) – Penalty.

Any default in complying with Sub-section (4) invites the penalty prescribed in this sub-section. As per the penal clause contained in this sub-section, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹100/- for each copy in respect of which the default is made.

Sub-section (6)

The court has powers to stay the commencement of or continuation of any suit or proceeding against the company on such terms as it thinks fit until the application is finally disposed of.

Section 392 – Power to enforce compromise and arrangement.

Sub-section (1)

The court has the power to supervise the carrying out of the scheme. The court may give such directions or make such modifications to the scheme for the purpose of proper working of the scheme.

Sub-section (2)

The court has the power to order winding up of the company if it thinks that the scheme sanctioned cannot work satisfactorily.

Section 393 – Information as to compromise or arrangements with creditors and members.

Sub-section (1)

Every notice of any meeting called as per orders of court under Section 391, should include an explanatory statement. The statement should set out the terms of compromise or arrangement and all material interests of the directors, managing director or manager of the company and effect of such interest on the scheme. It can also be given by way of an advertisement containing the above mentioned particulars.

Sub-section (2)

Such disclosure shall also be made, in the case of a scheme affecting debenture holders, about the interest of the debenture trustees.

Sub-section (3)

If the notice states that creditors or members can have copies of the scheme from the company, the company shall provide copies of the scheme of compromise or arrangement, to the creditor or member who applies for the same.

Sub-section (4)

This sub-section is a penal clause. In case of default in complying with the requirements of Section 393, the default is a punishable offence.

Sub-section (5)

Every director, managing director, manager or as the case may be, the debenture trustees, shall give all necessary information to the company failing which they shall be liable for the penal consequences stipulated in this sub-section.

Section 394 – Provisions for facilitating reconstruction and amalgamation of companies.

It is only in Section 394 of the Act there is reference to reconstruction of any company or companies or amalgamation of any two or more companies.

Sub-section (1)

Where the scheme involves reconstruction of any company or companies or amalgamation of any two or more companies and vesting of the whole or substantially the whole of the properties or liabilities of any company concerned in the scheme (Transferor Company) to another company (Transferee company), the court may make provision for the following matters also:

- Transfer to the Transferee Company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- The allotment or appropriation by the Transferee company of any shares, debentures to any person under the scheme.
- Continuation of proceedings by or against the Transferee Company of any legal matters pending by or against any Transferor Company.
- The dissolution, without winding up, of any Transferor Company.
- Provision to be made for any person who does not agree to the scheme.
- Such incidental, consequential and supplemental orders passed by the court as it may think fit so that the reconstruction or amalgamation could be fully and effectively carried out.

As per the proviso under this sub-section, it is necessary to have the report from the Registrar of companies in case the scheme involves a company that is being wound up and the report of the liquidator, in case the scheme involves the dissolution of a company. These reports are mandatory in order to ensure that the affairs of the company in question have not been conducted in a manner prejudicial to the interests of its members or to public interest.

Sub-section (2)

The sub-section provides for the order of the Court and the vesting of the properties and liabilities of the transferor company to the transferee company.

Sub-section (3)

Under this sub-section, the time limit for filing the order of the Court for registration by the Registrar is 30 days after the making of the order.

Sub-section (4)

As per clause (a), the expression 'property' has been defined to include property, rights and powers of every description and the expression 'liabilities' includes duties of every description. As per clause (b), 'Transferee Company' does not include any company other than a company within the meaning of this Act but 'Transferor company' includes any body corporate, whether a company within the meaning of this Act or not. Thus, the transferee company in a scheme of merger or amalgamation has to be necessarily a company within the meaning of the Act.

Section 394A

The court is supposed to give notice of every scheme under Section 391 or 394 to the Central Government and consider representation, if any by the said Government.

Therefore, merger or amalgamation under a scheme of arrangement as provided under Sections 391-394 of the Act is the most convenient and most common method of a complete merger or amalgamation between the companies. There is active involvement of the Court and an amalgamation is complete only after the Court sanctions it under Section 394(2) and takes effect when such order of court is filed with the Registrar of Companies. In fact, Sections 391 to 394 of the Act read with Companies (Court) Rules, 1959 serve as a complete code in themselves in respect of provisions and procedures relating to sponsoring of the scheme, the approval thereof by the creditors and members, and the sanction thereof by the Court.

Accordingly, amalgamation can be effected in any one of the following ways:

- (i) *Transfer of undertaking by order of the High Court (Section 394 of the Companies Act, 1956)*

Under Section 394 of the Companies Act, the High Court may sanction a scheme of amalgamation proposed by two or more companies after it has been approved by a meeting of the members of the company convened under the orders of the court with majority in number of shareholders holding more than 75 percent of the shares who vote at the meeting, approve the scheme of amalgamation, and the companies make a petition to the High Court for approving the Scheme. The High Court serves a copy of petition on the Regional Director, Company Law Board and if they do not object to the amalgamation, the Court sanctions it. Once the Court sanctions the scheme, it is binding on all the members of the respective companies.

- (ii) *Purchase of shares of one company by another company (Section 395 of the Companies Act, 1956)*

Under Section 395 of the Companies Act, 1956, the undertaking of one company can be taken over by another company by the purchase of shares. This section obviates the need to obtain the High Court's sanction. While purchasing shares, the company which acquires shares should comply with the requirements of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and Section 372A of the Companies Act, 1956. This Section also provides the procedure for acquiring the shares of dissenting members.

(iii) Amalgamation of Companies in National Interest (Section 396)

Where the Central Government is satisfied that an amalgamation of two or more companies is essential in the public interest, then the Government may, by an order notified in the Official Gazette, provide for the amalgamation of those companies into a single company. The amalgamated company shall have such constitution, property, powers, rights, interest and privileges as well as such liabilities, duties and obligations as may be specified in the Government's order.

(iv) Amalgamation of Companies under Section 494

Amalgamation of two companies is also possible under Section 494 of the Companies Act, where the liquidator of a company transfers its assets and liabilities to another company.

(v) Amalgamation for Revival and Rehabilitation

The Board for Financial and Industrial Reconstruction (BIFR) can in exceptional cases order amalgamation for the revival and rehabilitation of a sick industrial company under the provisions of Sick Industrial Companies (Special Provisions) Act, 1985.

APPROVALS IN SCHEME OF AMALGAMATION

The companies are required to obtain following approvals in respect of the scheme of amalgamation:

(i) Approval of Board of Directors

- The first step in carrying out amalgamation is approval of scheme of amalgamation by the Board of both the companies.
- Board resolution should, besides approving the scheme, authorise a Director/Company Secretary/other officer to make application to court, to sign the application and other documents and to do everything necessary or expedient in connection therewith, including changes in the scheme.

(ii) Approval of Shareholders/Creditors

Members' and creditors' approval to the scheme of amalgamation is sine qua non for Court's sanction. Without that the Court cannot proceed. This approval is to be obtained at specially convened meetings held as per court's directions [Section 391(1)]. However, the court may dispense with meetings of members/creditors. Normally, creditors' meetings are dispensed with subject to certain conditions. For instance, members' meeting may be dispensed with if all the members' individual consent is obtained.

However, it is a discretionary power of the court for which a separate application must be made for court's order.

The scheme of compromise or arrangement has to be approved as directed by the High Court, by—

- the members of the company; or
- the members of each class, if the company has different classes of shares; and
- the creditors; or
- each class of creditors, if the company has different classes of creditors.

The approval of the members and creditors (or each class of them) has to be obtained at specially convened meetings as per High Court directions. [Section 391(1)]. An application seeking directions to call, hold and conduct meetings is made to the High Court, which has jurisdiction having regard to the location of the registered office of the company.

A learned Judge of Bombay High Court in *Kaveri Entertainment Ltd. in re.*, (2003) 117 Comp Cas 245 (Bom) expounded the procedure required to be followed by a company which seeks the court's sanction to a scheme of compromise or arrangement as:

“A company which desires to enter into any arrangement with its members and/or creditors first makes an application to the court under Sub-section (1) of Section 391 of the Act for directions for convening of the meeting or meetings of the members and/or creditors, as the case may be, for considering the proposed scheme of arrangement.

The court, on receiving such an application, issues directions for convening of separate meetings of the members and/or creditors or different classes of members and/or creditors, as the case may be. In those meetings, the scheme of arrangement is required to be approved by majority in number representing 3/4th in value of the creditors or class of creditors or members or class of members as the case may be. After the scheme is approved by all concerned, a petition is presented to the court for sanctioning of the scheme of arrangement.

If the court is satisfied that the scheme is just and fair and not prejudicial to the interest of the members/class of members or creditors/class of creditors, as the case may be, then the court may sanction it.”

A subsidiary company being a creditor cannot be included along with other unsecured creditors; their interest in supporting a scheme proposed by the holding company would not be the same as the interest of the other unsecured creditors [*Hindustan Development Corporation Ltd. v. Shaw Wallace & Co. Ltd.* (supra)]. Secured creditors should not be clubbed together with the unsecured creditors. Their interest would not be the same.

Scheme to be approved by special majority

The Scheme must be approved by a resolution passed with the special majority stipulated in Section 391(2), namely a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or, by proxy.

Thus, 51% majority in number, and 75% in value present and voting at the meeting must approve the scheme. [Section 391(2)]. For example, if at the meeting 100 persons (members in person and proxies) are present, at least 51 of them must vote in favour the resolution and they must be holding at least 75% of the paid-up share capital carrying voting rights. In the case of creditors, those voting in favour must have the claim not less than 75% of the total amount of claim of all the creditors present and voting.

The majority is dual, in number and in value. A simple majority of those voting is sufficient, whereas the 'three - fourths' requirement relates to value. The three-fourths value is to be computed with reference to paid-up capital held by members (or to total amount owed by company to creditors) present and voting at the meeting. [Re Maknam Investments Ltd. (1995) 6 SCL 93 Cal; Re Mafatlal Industries Ltd. (1995) 84 Comp Cas 230 (Guj)].

A full bench of the Punjab and Haryana High Court in Hind Lever Chemicals Limited and Another [2005] 58S CL 211(Punj. & Har.) held that In our view, the language of Section 391(2) of the Act is totally unambiguous and a plain reading of this provision clearly shows that the majority in number by which a compromise or arrangement is approved should represent three-fourth in value of the creditors/ shareholders who are 'present and voting' and not of the total value of the shareholders or creditors of the company.

This is neither an ordinary resolution nor a special resolution within the purview of Section 189 of the Act. This is an extraordinary resolution. A copy of this resolution need not be filed with the Registrar of Companies under Section 192.

Where a Scheme is not approved at a meeting, by the requisite majority, but is subsequently approved by individual affidavits, the court may sanction the Scheme as Section 391(2) is not mandatory but is merely directory and there should be substantial compliance thereof. [SM Holdings Finance Pvt Ltd. v. Mysore Machinery Mfrs Ltd. (1993) 78 Comp Cas 432 (Kar)].

In Kaveri Entertainment Ltd., in re. (2003) 17 Comp Cas 245 (Bom.): (2003) 45 SCL 294 (Bom): (2003) 57 CLA 127 (Bom), a learned Judge of the Bombay High Court expounded the requirement of Sub-section (2) as:

"Sub-section (2) of Section 391 of the Act requires that the resolution approving the scheme of arrangement should be passed by majority in number representing 3/4th in value of the creditors or class of creditors and/or members or class of members as the case may be. If the resolution granting approval to the scheme of arrangement is passed by more than 3/4th in value of the creditors but, is not carried by the majority in number of the creditors, the scheme would not be approved by the court. The majority in number of the creditors is provided in the section for safeguarding the interests of the large number of small creditors whose voice is often lost amongst small number of big creditors. The conditions of approval by majority in number and 3/4th in value of credit are cumulative."

In determining whether a resolution has been passed by the requisite majority or not, the members remaining neutral or not participating in voting are to be ignored. This is because the section clearly provides that the votes of only the members present and voting either in person or, by proxy, are to be taken into account. Where in a meeting for the sanction of a scheme, holders of shares of the value of

₹ 6,42,700 were present but holders of shares of the value of ₹ 4,42,700 alone voted in favour of the resolution and the others remained neutral, voting neither in favour of, nor against, the resolution, it was held that there was a unanimous passing of the resolution and the requisite majority contemplated by Section 391(2) agreed to the scheme. [Hindustan General Electric Corporation Ltd., in re. (1959) 29 Comp Cas 46 (Cal)].

In Re: Kirloskar Electric Company Ltd., [2003] 116 Com Cas 413 (Kar): The Karnataka High Court held that the three-fourth majority required under Sub-section (2) of Section 391 of the Act was of the value represented by the members who were not only present but who had also voted. In fact, it went a step further to hold that the creditors who were present and had even voted but whose votes had been found to be invalid, could not be said to have voted because casting an invalid vote is no voting in the eyes of law. Thus, it was held that "the proper construction to be placed in calculating whether any resolution is approved or passed by a three-fourth majority present and voting necessarily mean the value of the valid votes and out of the same whether the resolution has been passed with three-fourth the majority"

(iii) Approval of the Stock Exchanges

As per Clause 24(f) of the Listing Agreement all the listed companies are required to file the scheme of merger or amalgamation with all the stock exchanges where it is listed at least one month prior to filing it with High Court and obtain its No Objection to scheme.

(iv) Approval of Financial Institutions

The approval of the Financial Institutions, trustees to the debenture holders and banks, investment corporations would be required if the Company has borrowed funds either as term loans, working capital requirements and/or have issued debentures to the public and have appointed any one of them as trustees to the debenture holders.

(v) Approval from the Land Holders

If the land on which the factory is situated is the lease-hold land and the terms of the lease deed so specifies, the approval from the lessor will be needed.

(vi) Approval of the High Court

- Both companies (amalgamating as well as amalgamated) involved in a scheme of compromise or arrangement or reconstruction or amalgamation are required to seek approval of the respective High Courts for sanctioning the scheme.
- Every amalgamation, except those, which involve sick industrial companies, requires sanction of High Court which has jurisdiction over the State/area where the registered office of a company is situated.
- If transferor and transferee companies are under the jurisdiction of different High Courts, separate approvals are necessary.
- If both are under jurisdiction of one High Court, joint application may be made. [Mohan Exports Ltd. v. Tarun Overseas P. Ltd. (1994) 14 CLA 279 (Del) dissenting from Re Electro Carbonium P. Ltd. (1979) 49 Comp Cas 825 (Kar) wherein it was held that a joint application cannot be made].

Alternatively, where both the companies are situated in the same State and only one company moves the court under Section 391, the other company may be made a party to the petition (DCA Circular No.14 of 1973 dated 5th June, 1973).

- The notice of every application filed with the Court has to be given to the Central Government (Regional Director, having jurisdiction of the State concerned).
- After the hearing is over, the Court will pass an order sanctioning the Scheme of amalgamation, with such directions in regard to any matter and with such modifications in the Scheme as the Judge may think fit to make for the proper working of the Scheme. [Section 391(2); Rule 81, Companies (Court) Rules].

The court under Section 391-394 of the Act is also empowered to order the transfer of undertaking, property or liabilities either wholly or in part, allotment of shares or debentures and on other supplemental and incidental matters.

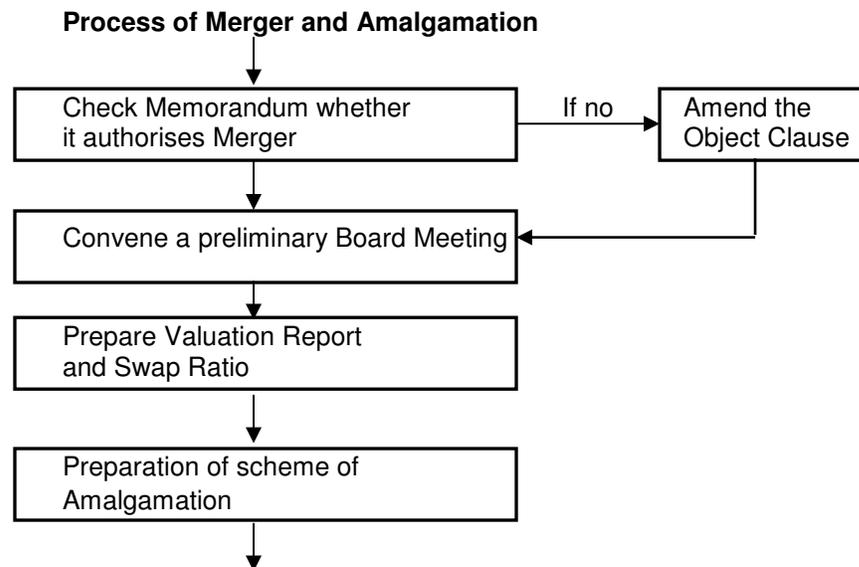
(vii) Approval of Reserve Bank of India

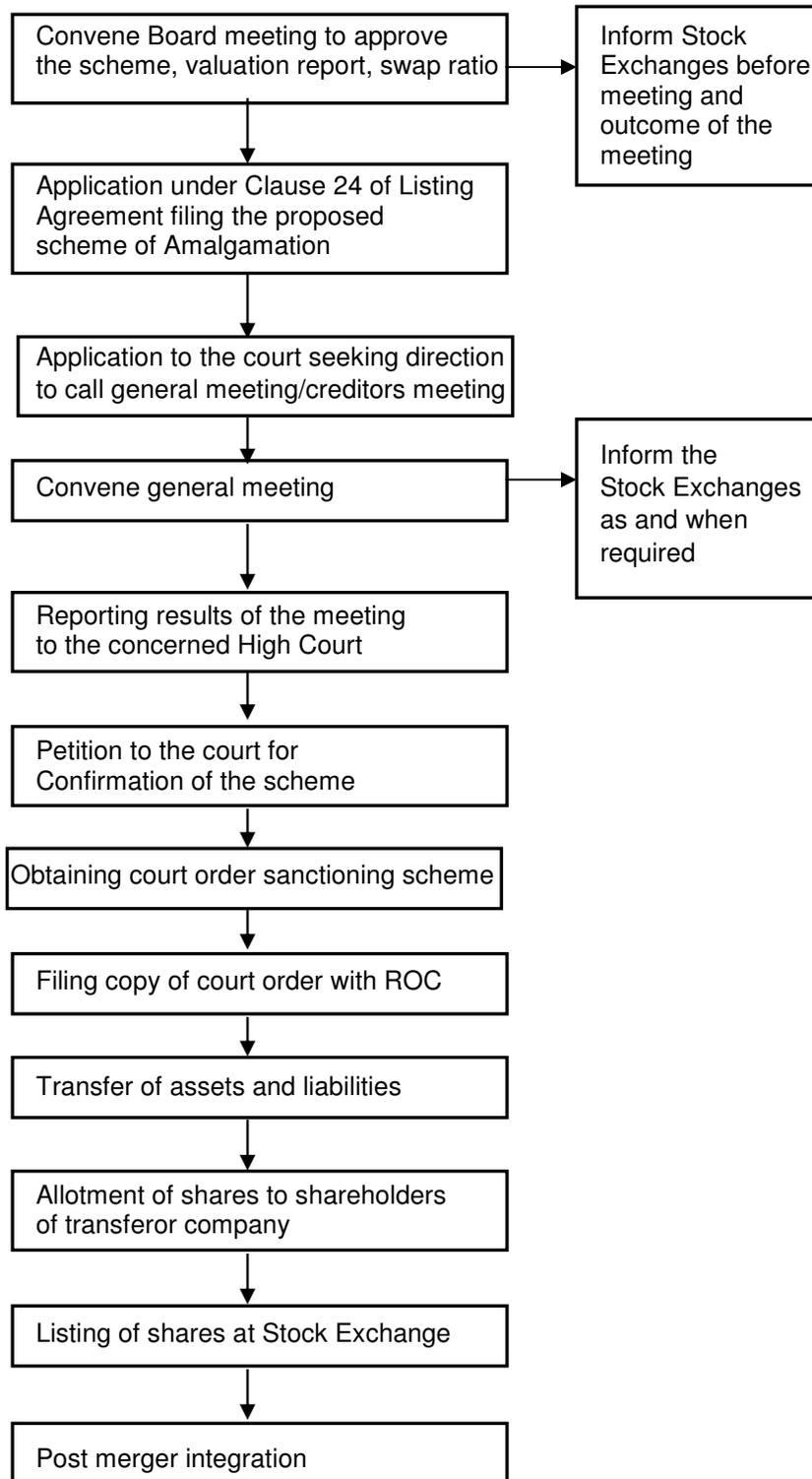
Where the scheme of amalgamation envisages issue of shares/cash option to Non-Resident Indians, the amalgamated company is required to obtain the permission of Reserve Bank of India subject to conditions prescribed under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

(viii) Approvals from CCI

The provisions relating to regulation of combination as provided under Sections 5 and 6 of the Competition Act, 2002 would also be required to be complied with by companies, if applicable. These provisions would be effective from June 01, 2011.

STEPS INVOLVED IN MERGER PROCESS - A FLOW CHART





The procedure commencing with an application for seeking directions of the Court for convening, holding and conducting meetings of creditors or class of creditors, members or class of members, as the case may be, to the stage of the court's order sanctioning the scheme of compromise or arrangement is contained in Sections 391 to 395 of the Companies Act, 1956 and rules 67 to 87 of the Companies (Court) Rules, 1959. The Rules also prescribe Forms for various purposes relating to compromise or arrangement:

The following are the process involved:

(i) Memorandum to authorise amalgamation

The memorandum of association of most of the companies contain provisions in their objects clause, authorising amalgamation, merger, absorption, take-over and other similar strategies of corporate restructuring. If the memorandum of a company does not have such a provision in its objects clause, the company should alter the objects clause, for which the company is required to hold a general meeting of its shareholders, pass a special resolution under Section 17 of the Companies Act, 1956 and file e-Form No. 23 along with a certified copy of the special resolution along with copy of explanatory statement under Section 173 and Memorandum of Association & Articles of Association and a copy of agreement with the concerned Registrar of Companies and the prescribed filing fee. The e-form should be digitally signed by Managing Director or Director or Manager or Secretary of the company duly authorized by the Board of Directors. The e-form should also be certified by chartered accountant or cost accountant or company secretary (in whole time practice) by digitally signing the e-form.

Alteration should be registered by the Registrar of companies and only on such registration the alteration will become effective.

No confirmation by the Company Law Board or by any outside agency is now required. The compromise or arrangement should be within the powers of the company and not ultra vires. If it is beyond the company's objects or power, the court will have no jurisdiction to sanction it. [Oceanic Steam Navigation Co., Re, (1939) Com Cases 229: (1938) 3 All ER 740 (Ch.D)]

There are two different opinions expressed by various courts on a simple query that whether the court can sanction an amalgamation when the Memorandum of Association of the company does not contain powers to amalgamate. It has been held by certain courts that there is no necessity to have special power in the objects clause of the memorandum of association of a company for its amalgamation with another company as to amalgamate with another company, is a power of the company and not an object of the company. The Karnataka High Court in Hindhivac (P) Ltd. In re (CP No.15 and 16 of 2005), (206) 62 CC 58, the High Court had sanctioned the scheme of amalgamation taking note of the fact that the shareholders of both the companies had unanimously approved the scheme. The Court held that Section 17 is an aid to company seeking amalgamation, reconstruction etc. Therefore, there would be no impediment on the scheme of amalgamation even if there is no provision in the objects clause of Memorandum of Association as to amalgamate with another company. In Marybong & Kyel Tea Estates Ltd., Re (1977) 47 Com Cases 802, a previous decision in Hari Krishan Lohia v. Hoolungoree Tea

Company, (1970) 40 Com Cases 458: AIR 1969 Cal 312 (DB) was followed and it was asserted that where there is a statutory provision dealing with the amalgamation of companies, no special power in the objects clause of memorandum of association of a company is necessary for its amalgamating with another company. It is submitted that to amalgamate with another company is a power of the company and not an object of the company. Amalgamation may be effected by order of the court under Sections 391 and 394.

Observing Memorandum of Association of Transferee Company

It has to be ensured that the objects of the Memorandum of Association of the transferee company cover the objects of the transferor company or companies. If not then it will be necessary to follow the procedure for amendment of objects by passing a special resolution at an Extraordinary General Meeting convened for this purpose. It has been held by various decisions of the courts that there is no necessity to have special power in the object clause of the Memorandum of Association of a company for its amalgamation with another company. It has been laid down that to amalgamate with another company is power of the company and not an object of the company.

Since the amalgamation will involve issue of shares by the transferee company to the shareholders of the transferor companies, a general meeting convened for the purpose of the amendment of the Object Clause of Memorandum of Association of the transferee company to incorporate the object of the transferor company, should also cover resolutions relating to the increase of authorised capital, consequential changes in the Articles of Association and resolution under Section 81(1-A) of the Companies Act, 1956 authorising the Directors to issue shares of the shareholders of the transferor companies without offering them to the existing shareholders of the company. It is also a normal practice that alongwith the special resolution for amendment of the Object Clause, special resolution is also passed under Section 149(2-A) of the Companies Act, 1956 authorising the transferee company to commence the business of the transferor company or companies as soon as the amalgamation becomes effective.

Convening a Board Meeting

A Board Meeting is to be convened and held to consider and approve in principle, amalgamation and appoint an expert for valuation of shares to determine the share exchange ratio.

Consequent upon finalisation of scheme of amalgamation, another Board Meeting is to be held to approve the scheme.

Preparation of Valuation Report

Simultaneously, Chartered Accountants are requested to prepare a Valuation Report and the swap ratio for consideration by the Boards of both the transferor and transferee companies and if necessary it may be prudent to obtain confirmation from merchant bankers on the valuation to be made by the Chartered Accountants.

Preparation of scheme of amalgamation or merger

All the companies, which are desirous of effecting amalgamation of or merger

must interact through their companies auditors, legal advisors and practicing company secretary who should report the result of their interaction to their respective Board of directors. The Boards of the involved companies should discuss and determine details of the proposed scheme of amalgamation or merger and prepare a draft of the scheme of amalgamation or merger. If need be, they can obtain opinion of experts in the matter. The drafts of the scheme finally prepared by the Boards of both the companies should be exchanged and discussed in their respective Board meetings. After such meetings a final draft scheme will emerge. The scheme must define the “effective date” from which it shall take effect subject to the approval of the High Courts.

Contents of Amalgamation Scheme

Any model scheme of amalgamation should include the following:

Transfer Date: This is usually the first day of the financial year preceding the financial year for which audited accounts are available with the companies. In other words, this is a cut-off date from which all the movable and immovable properties including all rights, powers, privileges of every kind, nature and description of the transferor-company shall be transferred or deemed to be transferred without any further act, deed or thing to the transferee company.

Effective Date: This is the date on which the transfer and vesting of the undertaking of the transferor-company shall take effect i.e., all the requisite approvals would have been obtained.

Arrangement with secured and unsecured creditors including debenture-holders.

Arrangement with shareholders (equity and preference): This refers to the exchange ratio, which will have to be worked out based on the valuation of shares of the respective companies as per the audited accounts and accepted methods and valuation guidelines.

Cancellation of share capital/reduction of share capital: This will be necessitated when the shares of the transferor-company(ies) are held by the transferee-company and/or its subsidiary(ies) or vice versa.

Pending receipt of the requisite approvals to the amalgamation, the transferor-company(ies) possesses the property to be transferred and to carry on the business for and on behalf and in trust for the transferee-company.

The Scheme should suitably provide for:

1. Brief details of transferor and transferee companies.
2. Appointed date.
3. Main terms of transfer of assets and liabilities from transferor to transferee, with power to execute on behalf or for transferee, the deed/documents being given to transferee.
4. Effective date of the scheme.
5. Details of happenings and consequences of the scheme coming into effect on effective date.

6. The terms of carrying on the business activities by transferor between 'appointed date' and 'effective date'.
7. Details of share capital of transferor and transferee company.
8. Proposed share exchange ratio, conditions attached thereto, fractional certificates to be issued to transferee company, approvals and consent required etc.
9. Conditions about payment of dividend, ranking of equity shares, prorata dividend declaration and distribution.
10. Status of employees of transferor companies and various schemes or funds created for their benefit, from the effective date.
11. Agreement between transferor and transferee companies towards making applications/petitions under Sections 391 and 394 and other provisions to the respective High Courts.
12. Impact of various provisions covering income tax dues, contingencies and other accounting entries deserving attention.
13. Statement to bear costs, expenses etc. in connection with the scheme by transferee company.
14. Qualifications attached to the Scheme, requiring various approvals and sanctions etc.
15. Enhancement of borrowing limits of the transferee company upon the scheme coming into effect.
16. Surrender of shares by shareholder of transferor company for exchange into new share certificates.

Approval of Scheme

- It would be necessary to convene a Board Meeting of both the transferor and transferee companies for approving the Scheme of Amalgamation, Explanatory Statement under Section 393 and the Valuation Report including the swap ratio.
- Notice has to be given to the regional Stock Exchanges and other Stock Exchanges where shares of the Company are listed under the listing requirements at least two days before the Board Meeting is proposed to be held for purpose of approving the Amalgamation.
- Within 15 minutes after the Board Meeting, the Regional Stock Exchange and all other Stock Exchanges are required to be given intimation of the decision of the Board as well the swap ratio before such information is given to the shareholders and the media.
- Pursuant to clause 24 of the listing agreement, all listed companies shall have to file scheme/petition proposed to be filed before any Court/Tribunal under Sections 391, 394 and 101 of Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal.

Application to High Court seeking direction to hold meetings

Rule 67 of the Companies (Court) Rules, 1959 lays down that an application

under Section 391(1) of the Companies Act, 1956 for an order seeking direction for convening meeting(s) of creditors and/or members or any class of them shall be by way of Judge's summons supported by an affidavit. A copy of the proposed scheme should be annexed to the affidavit as an exhibit thereto. The summons should be moved ex parte in Form No. 33 of the Companies (Court) Rules, 1959. The affidavit in support of the application should be in Form No. 34.

Jurisdiction of High Court

As explained earlier 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. However, if the registered offices of the companies involved are situated in different States, they should make separate applications to their respective High Courts.

Accordingly, an application should be made to the concerned High Court under Section 391(1) of the Companies Act, 1956 in accordance with the provisions of rule 67 of the Companies (Court) Rules, 1959, for an order directing convening of meeting(s) of creditors and/or members or any class of them, by a Judge's summons supported by an affidavit.

Normally, an application under Section 391 of the Act is made by the company, but a creditor or a member may also make the application. Although a creditor or a member or a class of creditors or a class of members may move an application under Section 391(1) of the Act, yet, such an application may not be accepted by the court because the scheme of compromise or arrangement submitted to the court along with the application will not have the approval of the Board of directors of the company or of the company in general meeting. However, the court has the discretion to give such directions as it may deem proper.

Where the company is not the applicant

Rule 68 lays down that where the company is not the applicant, a copy of the summons and of the affidavit shall be served on the company, or, where the company is being wound up on the liquidator not less than 14 days before the date fixed for the hearing of the summons.

Where an arrangement is proposed for the merger or for the amalgamation of two or more companies, the petition must pray for appropriate orders and directions under Section 394 of the Act for facilitating the reconstruction or amalgamation of the company or companies.

Obtaining order of the court for holding class meeting(s)

On receiving a petition, the court may order meeting(s) of the members/creditors to be called, held and conducted in such manner as the court directs. Once the ordered meetings are duly convened, held and conducted and the scheme is approved by the prescribed majority in value of the members/creditors, the court is bound to sanction the scheme.

The court looks into the fairness of the scheme before ordering a meeting because it would be no use putting before the meeting, a scheme containing illegal

proposals which are not capable of being implemented. At that stage, the court may refuse to pass order for the convening of the meeting.

According to Rule 69 of the said Rules, upon hearing of the summons, or any adjourned hearing thereof, the judge shall, unless he thinks fit for any reasons to dismiss the summons, give directions as he may think necessary in respect of the following matters:

- (i) determining the members/creditors whose meeting or meetings have to be held for considering the proposed scheme of merger or amalgamation;
- (ii) fixing time and place for such meetings;
- (iii) appointing a chairman or chairmen for the meetings;
- (iv) fixing quorum and procedure to be followed at the meetings including voting by proxy;
- (v) determining the values of the members/creditors, whose meetings have to be held;
- (vi) notice to be given of the meetings and the advertisement of such notice; and
- (vii) the time within which the chairman of the meeting or chairmen of the meetings are to report to the Court the result of the meeting or meetings as the case may be.

The order made on the summons shall be in Form No. 35 of the said rules, with such variations as may be necessary. Draft Notice, Explanatory statement under Section 393 of the Companies Act, 1956 and form of proxy are required to be filed and settled by the concerned High Court before they can be printed and dispatched to the shareholders.

After obtaining the court's order containing directions to hold meeting(s) of members/creditors, the company should make arrangement for the issue of notice(s) of the meeting(s). The notice should be in Form No. 36 of the said Rules and must be sent by the person authorised by the court in this behalf. The person authorised may be the person appointed by the court as chairman of the meeting, or if the court so directs by the company or its liquidator if the company is in liquidation, or by any other person as the court may direct. The court usually appoints an advocate to be the chairman of such a meeting.

Notice of the meeting should be sent under certificate of posting to the creditors/members of the company, at their last known addresses at least twenty-one clear days before the date fixed for the meeting. The notice must be accompanied by a copy of the scheme for the proposed compromise or arrangement and of the statement required to be furnished under Section 393 setting forth the terms of the proposed compromise or arrangement explaining its effects and an explanatory statement in terms of the provision of clause (a) of Sub-section (1) of Section 393 of the Companies Act.

A form of proxy in Form No. 37, as prescribed in the said rules, is also required to be sent to the shareholders/creditors to enable them to attend the meeting by proxy, if they so desire.

Notice by advertisement

Generally, the Court directs that the notice of meeting of the creditors and members or any class of them be given through newspapers advertisements also. Where the court has directed that the notice of the meetings should also be given by newspaper advertisements, such notices are required to be given in the prescribed Form No. 38 and published once in an English newspaper and once in the regional language of the state in which the registered office of the company is situated. The Court may also direct the notices of the meetings to be published in Official Gazette of the state. The notice of the advertisement will indicate that a copy of the notice is available free of charge to every member. It will also be made available within 24 hours of the requisition made by the creditor or shareholders.

The notice must particularly disclose any material interest of the directors, managing director or manager whether as shareholders or creditors or otherwise and the effect on their interests on the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons. Such information must also be included in the form of a statement in the notice convening the meeting, where such notice is given by a newspaper advertisement, or, if this is not practicable, such advertised notice must give notification of the place at and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement. If debenture holders are affected, the statement must give like information as far as it affects the trustees for the debenture holders. Statements which have to be supplied to creditors and members as a result of press notification must be supplied by the company to those entitled, free of charge [Refer Section 393]. The Chairman appointed by the High Court has to file an affidavit atleast 7 days before the meeting confirming that the direction relating to issue of notices and the advertisement has been duly complied with, as required under Rule 76 of the said Rules.

Information as to merger or amalgamation

Section 393(1) of the Companies Act, 1956 lays down that where a meeting of creditors or members or any class of them is called under Section 391:

- (a) with every notice calling the meeting which is sent to a creditor or a member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effects and in particular, stating any material interests of the directors, managing director or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise and the effect on those interests, of the compromise or arrangement, if, and in sofar as, it is different from the effect on the like interests of other persons; and
- (b) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

Sub-section (2) lays down that where the arrangement affects the rights of debenture holders of the company, the said statement should give the like

information and explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the companies directors.

According to Sub-section (3) of Section 393, where a notice given by advertisement includes a notification that copies of the statement setting forth the terms of the compromise or arrangement proposed and explaining its effect can be obtained by creditors or members entitled to attend the meeting, every creditor or member so entitled shall, on making an application in the manner indicated by the notice, be furnished by the company, free of charge, with a copy of the statement.

Every director, managing director or manager of the Company and every trustee for debentureholders of the company, must give notice to the company of such matter relating to himself as may be necessary for the purposes of this section. A failure to do so is an offence punishable under Section 393(5).

Holding meeting(s) as per Court's direction

The meetings are to be held as per directions of the Court under the chairmanship of the person appointed by the Court for the purpose. Normally, the Court appoints a Chairman and alternate Chairman of each meeting.

Convening of General Meeting

- At the General Meeting convened by the High Court, resolution will be passed approving the scheme of amalgamation with such modification as may be proposed and agreed to at the meeting. The Extraordinary General Meeting of the Company for the purpose of amendment of Object Clause (Section 17), commencement of new business [Section 149(2A)], consequent change in Articles (Section 31) and issue of shares [Section 81(1A)] can be convened on the same day either before or after conclusion of the meeting convened by the High Court for the purpose of approving the amalgamation.
- Following points of difference relating to the holding and conducting of the meeting convened by the High Court may be noted:
 - (a) Proxies are counted for the purpose of quorum;
 - (b) Proxies are allowed to speak;
 - (c) The vote must be put on poll [Rule 77 of the Companies (Court) Rules].

In terms of Section 391, the resolution relating to the approval of amalgamation has to be approved by a majority of members representing three-fourths in value of the creditors or class of creditors or members or class of members as the case may be present and voting either in person or by proxy. The resolution will be passed only if both the criteria namely, majority in number and three fourth in value vote for the resolution.

- The minutes of the meeting should be finalised in consultation with the Chairman of the meeting and should be signed by him once it is finalised and approved. Copies of such minutes are required to be furnished to the Stock Exchange in terms of the listing requirements.

Reporting of the Results

The chairman of the meeting will submit a report of the meeting indicating the results to the concerned High Court in Form 39 of the Court Rules within 7 days of the conclusion of the meeting or such other time as fixed by the Court. The Report must state accurately—

- (a) the number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present at the meeting;
- (b) the number of creditors or class of creditors or the number of members or class of members, as the case may be, who voted at the meeting either in person or by proxy;
- (c) their individual values; and
- (d) the way they voted.

Petition to court for confirmation of scheme

When the proposed scheme of compromise or arrangement is agreed to, with or without modifications, as provided in Section 391(2) of the Act, a petition must be made to the court for confirmation of the scheme of compromise or arrangement. The petition must be made by the company and if the company is in liquidation, by the liquidator, within seven days of the filing of the report by the chairman. The petition is required to be made in Form No. 40 of the said rules. On hearing the petition the Court shall fix the date of hearing and shall direct that a notice of the hearing shall be published in the same newspapers in which the notice of the meeting was advertised or in such other papers as the court may direct, not less than 10 days before the date fixed for hearing. (Rule 80) The court also directs that notices of petition be sent to the concerned Regional Director, Registrar of Companies and the official liquidator.

Obtaining order of the court sanctioning the scheme

An order of the court on summons for directions should be obtained which will be in Form No. 41 (Refer Rule 69).

Filing of copy of Court's order with ROC

According to the provisions of Section 391(3) and Section 394(3) of the Companies Act, a certified copy of the order passed by the Court under both the sub-sections is required to be filed with the concerned Registrar of Companies. This is required to be filed with e-Form No. 21 as prescribed in the Companies (Central Government's) General Rules and Forms, 1956.

Conditions precedent and subsequent to court's order sanctioning scheme of arrangement

The court shall not sanction a scheme of arrangement for amalgamation, merger etc. of a company which is being wound up with any other company or companies unless it has received a report from the Company Law Board (Central Govt. acting through Regional Director) or the Registrar of Companies to the effect that the affairs

of the company have not been conducted in a manner prejudicial to public interest. When an order has been passed by the court for dissolution of the transferor company, the transferor company is required to deliver to the Registrar a certified copy of the order for registration within thirty days and the order takes effect from the date on which it is so delivered.

Copies of the order of High Court are required to be affixed to all copies of Memorandum and Articles of Association of the transferee company issued after certified copy has been filed as aforesaid. The transferor company or companies will continue in existence till such time the court passes an order for dissolution without winding up, prior to which it must receive a report from the official liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interest of the members or to public interest. The practice in India is that in certain High Courts the Order on amalgamation is passed only after the Report of the Official Liquidator is received, whereas in certain cases the order of dissolution is passed after which amalgamation is approved by the concerned High Court.

The above sets out briefly the procedure relating to merger and amalgamation in India. It will be obvious from the foregoing that considerable amount of paper work and documents are required to be prepared during the course of the process of merger. Since the law requires approval of the shareholders both in majority in number and three-fourth in value, it has to be ensured that adequate number of shareholders, whether in person or by proxy attend the meeting so that the resolution can be passed by the requisite majority as mentioned above. Normally the time frame for such merger will depend on the opposition, if any, to the proposed merger from shareholders or creditors but in normal case it may take anything between six months to one year to complete the merger from the time the Board approves the scheme of amalgamation till the merger becomes effective on filing of the certified copies of the Court's Order.

Activity Schedule for planning a merger is placed as Annexure I at the end of this study. Annexure II, III, IV and IX form part of Annexure I.

Information required by the Advocates generally, Regional Director, Ministry of Corporate Affairs and Information furnished to Auditors appointed by Official Liquidator in connection with the Amalgamation is placed as Annexure V of study.

JUDICIAL PRONOUNCEMENTS AND IMPORTANT FACTORS

Broad Principles evolved by Courts in Sanctioning the Scheme

- (a) The resolutions should be passed by the statutory majority in accordance with Section 391(2) of Companies Act, at a meeting(s) duly convened and held. The court should not usurp the right of the members or creditors;
- (b) Those who took part in the meetings are fair representative of the class and the meetings should not coerce the minority in order to promote the adverse interest of those of the class whom they purport to represent;
- (c) the scheme as a whole, having regard to the general conditions and background and object of the scheme, is a reasonable one ; it is not for court to interfere with the collective wisdom of the shareholders of the company. If

the scheme as a whole is fair and reasonable, it is the duty of the court not to launch an investigation upon the commercial merits or demerits of the scheme which is the function of those who are interested in the arrangement;

- (d) There is no lack of good faith on the part of the majority;
- (e) The scheme is not contrary to public interest;
- (f) The scheme should not be a device to evade law.

In *Miheer H Mafatlal v. Mafatlal Industries Ltd.* (1996) 4 Comp. LJP. 124, The Supreme Court explained the contours of the court jurisdictions, as follows:

- (i) The sanctioning court has to see to it that all the requisite statutory procedures for supporting such a scheme have been complied with and that the requisite meetings as contemplated by Section 391(1)(a) of the Companies Act, 1956 have been held.
- (ii) That the scheme put up for sanction of the court is backed up by the requisite majority vote as required by Section 391(2) of the Act.
- (iii) That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.
- (iv) That all the necessary material indicated by the Section 393(1)(a) of the Act is placed before the voters at the concerned meetings as contemplated by Section 391(1) of the Act.
- (v) That all the requisite material contemplated by the proviso of Sub-section (2) of Section 391 of the Act is placed before the court by the concerned applicant seeking sanction for such a scheme and the court gets satisfied about the same.
- (vi) That the proposed scheme of compromise and arrangement is not found to be violative of any provision of law and is not contrary to public policy. For ascertaining the real purpose underlying the scheme with a view to be satisfied on this aspect, the court, if necessary, can pierce the veil of apparent corporate purpose underlying the scheme and can judiciously x-ray the same.
- (vii) That the Company Court has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were acting bona fide and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising of the same class whom they purported to represent.
- (viii) That the scheme as a whole is also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.
- (ix) Once the aforesaid broad parameters about the requirements of a scheme

for getting sanction of court are found to have been met, the court will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the court, there could be a better scheme for the company and its members or creditors for whom the scheme is framed. The court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction.

Judicial Interpretations of Mergers and Amalgamations

- Court will sanction the scheme if alteration of the memorandum is by reshuffling of the Objects Clause by shifting Other Objects to Main Objects, if transferee company has complied with provisions of Section 149(2A) [Re: Rangkala Investments Ltd. (1996) 1 Comp LJ 298 (Guj)].
- There need not be unison or identity between objects of transferor company and transferee company. Companies carrying entirely dis-similar businesses can amalgamate. [Re: PMP Auto Inds Ltd. (1994) 80 Comp Cas 291 (Bom); Re: EITA India Ltd. (ibid); Re: Mcleod Russel (India) Ltd. (1997) 13 SCL 126(Cal)].
- Scheme of amalgamation should provide that on amalgamation the main objects of the transferor company shall be deemed to be (additional) main objects of the transferee company. No need for compliance under Section 17 of the Companies Act [Vasant Investment Corporation Ltd. v. Official Liquidator (1981) 51 Comp Cas 20 (Bom)].
- Sanction to scheme of amalgamation cannot be refused on the ground that the transferee company does not have sufficient authorised capital on the appointed date. If the scheme is sanctioned, the transferee company can thereafter increase its authorised capital to give effect to the scheme [Re: Mahavir Weaves Pvt. Ltd. (1985) 83 Comp. Cas 180].
- The Supreme Court of India in Meghal Homes Private Limited v. Shreeniwas Girmikk Samiti and others (2007) 78 SCL 482 (SC) held that the company court could sanction a scheme even in the case of a company where an order of winding-up has been made and a liquidator has been appointed. The essential factors to be seen by the Court are whether the scheme is bonafide and whether there is a genuine attempt to revive the company and such attempt is in public interest.
- Where amalgamation involves reorganisation of capital by reduction thereof, the provisions of Sections 100 to 102 of Companies Act need to be complied with vide rule 85 of Companies (Court) Rules. However, it has been held that, if reduction of capital is a part of scheme of amalgamation, those provisions are substantially complied with when the scheme is approved by shareholders and court. Therefore, no separate compliance is necessary.
[Re: Maneckchowk and Ahmedabad Mfg. Co. Ltd. (1970) 40 Comp Cas 819 (Guj); Re: Asian Investments Ltd. (1992) 73 Comp Cas 517 (Mad); Re: Novopan India Ltd. (1997) 88 Comp Cas 596 (AP)].

- Post amalgamation events such as increase of capital or total number of members exceeding fifty (in case of a private company) cannot affect sanction of a scheme. [Re: Winfield Agro Services Pvt. Ltd. (1996) 3-Comp LJ 347 (AP)].
- In view of its wide powers, court may approve a change in the name of the transferee company as part of scheme of amalgamation. However, Mumbai High Court has held that change of name cannot be effected merely on amalgamation becoming effective; transferee company should independently comply with Section 21. [Re: Govind Rubber Ltd. (1995) 83 Comp Cas 556 (Bom)].
- Change of name of transferee company, independent of amalgamation after approval of the scheme is not invalid; hence no change in appointed date needed. [Re: Hipolin Products Ltd. (1996) 2 Comp LJ 61 (Guj)].

The Bombay High Court has held in *Sadanand S. Varde v. State of Maharashtra* [(2001) 30 SCL 268 (Bom.)] that Sections 391 to 394 of the Companies Act constitutes a complete code on the subject of amalgamation. The court has no special jurisdiction under Article 226 of the Constitution to sit in appeal over an order made under Section 391 of the Companies Act, 1956 which has become final, binding and conclusive. Ministry of Industry need not be impleaded or heard, on the ground that its approval for the transfer of letter of intent to the transferee company is required. [Re: Ucal Fuel Systems Ltd. (supra)].

Also in *PMP Auto Industries Ltd., S.S. Mirando Ltd. and Morarjee Goculdas Spg & Wvg Co. Ltd.*, (1994) 80 Comp Cases 289 (Bom) it has been held that not only is Section 391 a complete code (as is the view of various High Courts), it is intended to be in the nature of 'single window clearance' system to ensure that the parties are not put to avoidable, unnecessary and cumbersome procedure of making repeated applications to the court for various other alterations or changes which might be needed effectively to implement the sanctioned scheme whose overall fairness and feasibility has been judged by the court under Section 394.

There is a statutory power of amalgamation under the Act even if the objects of the company are construed as not specifically empowering companies to amalgamate [*Aimco Pesticides Ltd.* (2001) 103 Comp Cas 4163 (Bom)].

- No special notice need be given to Income Tax Dept. to find out whether there is a motive of tax evasion in the proposed amalgamation; general public notice in newspapers is sufficient. [Re: *Vinay Metal Printers Pvt. Ltd.* (1996) 87 Comp Cas 266 (AP)].
- The compromise or arrangement should be within the powers of the company and not ultra vires. If it is beyond the company's objects or power, the court will have no jurisdiction to sanction it. [*Oceanic Steam Navigation Co., Re.* (1939) Com Cases 229: (1938) 3 All ER 740 (Ch.D)]
- Approval of Central Government under MRTP Act is no longer required. MRTP Commission has no jurisdiction for pre-scrutiny of amalgamation scheme on the ground of potential monopolistic or restrictive trade practices. If working of the company is found to be prejudicial to the public interest or relates to adoption of monopolistic or restrictive trade practices, Central

Government or MRTP Commission will be entitled to act according to law. [Hindustan Lever Employees' Union v. Hindustan Lever Ltd. (1995) 83 Comp Cas 30 (1994) 15 CLA 318 (SC)].

- It is not necessary that the parties to the amalgamation need be financially unsound or under winding-up as per Section 390(a). For purposes of Section 391 'company' means "any company liable to be wound up". But it does not debar amalgamation of financially sound companies. [Re: Rossell Inds Ltd. (1995) 6 SCL 79 Cal].
- Section 390(a) is applicable to a company incorporated outside India. If court has jurisdiction to wind up such a company on any of the grounds specified in the Act, court has jurisdiction to sanction scheme of amalgamation if a company incorporated outside India is a transferor company. [Bombay Gas Co. Pvt. Ltd. v. Regional Director (1996) 21 CLA 269 (Bom)].
- There is no bar to a company amalgamating with a fifteen-day old company having no assets and business. [Re: Apco Industries Ltd. (1996) 86 Comp Cas 457 (Guj)].
- Amalgamation of a company licensed under Section 25 of the Companies Act with a commercial, trading or manufacturing company could be sanctioned under Section 391/394. [Re: Sir Mathurdas Vissanji Foundation (1992) 8 CLA 170 (Bom); Re: Walvis Flour Mills Company P. Ltd. (1996) 23 CLA 104]. There is nothing in law to prevent a company carrying on business in shares from amalgamating with one engaged in transport. [Re: EITA India Ltd. (1997) 24 CLA 37 (Cal)].

In Vishnu Chemicals (P) Limited, In re [2002] 35 SCL 459 (AP), the Andhra Pradesh High Court held that when a class of creditors does not agree to the proposed scheme of arrangement it is the duty of the court to examine whether the consent is unreasonably withheld or in the alternative if the sanction would prejudicially affect that set of creditors who have withheld their consent.

A scheme is a document of an arrangement of settlement or agreement which can be interpreted on the personal perception of each group or members of group of creditors, so it will not be legal to say at the preliminary stage, before the scheme comes up for the court's consideration after examination by the creditors and members, to go into the details of allegations made against the company or any of the transactions into which it had entered with the scheme till the preliminary formalities are completed and the scheme comes up for detailed consideration in the court. – Commerz Bank AG v. Arvind Mills Ltd. (2002) 49 CLA 392: (2002) CLC 1136: (2002) 39 SCL 9 (Guj).

Where the written consent to the proposed scheme is granted by all the members and secured and unsecured creditors, separate meeting of members and secured and unsecured creditors can be dispensed with. – Re Feedback Reach Consultancy Services (P) Ltd. (2003) 52 CLA 260: (2003) CLC 498: (2003) 42 SCL 82: (2003) 115 Comp Cas 897 (Del).

In Milind Holdings (P) Ltd. & Darshan Holdings (P) Ltd. v. Mihir Engineers Ltd.

(1996) 7 SCL 172 (Bom), it was held that the sanction of the court is necessary even where the petitioner company had no secured creditor and all unsecured creditors had accorded their approval to the proposed scheme along with the shareholders of both the companies and their official liquidator also did not raise any objections to the scheme

As per section 391(2), any compromise or arrangement approved by a majority of creditors will be binding on all the creditors only if the said compromise or arrangement is sanctioned by the Court. Till the time sanction is not granted by the Court to the scheme of arrangement, it cannot be said that the scheme is binding on all creditors or that the creditors are not entitled to file the individual application. Smt. Promila v. DCM Financial Services Ltd. (2001) 45 CLA 292 (Del.)

When the majority of the shareholders with their open eyes have given their approval to the scheme, even if in the view of the Court there would be a better scheme, for the company and its members, the Court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the Court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction. – Alembic Ltd. v. Dipak Kumar J. Shah (2003) 41 SCL 145: (2003) 52 CLA 272: (2002) 6 Comp LJ 513 (Guj).

In National Organic Chemical Industries Limited v. Miheer H.Mafatlal [JT 2004 (5) SC 612] / [2004] XXXIV CS LW 83, the question before Supreme Court was whether the company court can decide the issue of shareholding of a member when the issue was pending before a civil court. The Supreme Court held that there was no statutory need for the company court to decide this issue and the findings of the company court of the title of the appellant over the shares or beyond the jurisdiction of the company and on that ground the Supreme Court set aside the said findings.

The full bench of Punjab and Haryana High Court in Hind Lever Chemicals Limited In re [2004] 61 CLA 32 (P&H)/[2004] XXXIV CS LW 85, held that the words and phrases employed in Sub-section (2) of Section 391 clearly shows that the requirement of three-fourth majority relates to the value of shares/credit represented by the shareholders or creditors who are present and voting and not of the total value of shares or credit of the company.

In TCI Industries Limited In re [2004] 118 Comp Cas 373 (AP), the scheme was approved by the majority of the shareholders. The ROC representing the Central Government raised an objection that the purpose of the scheme is to buy shares and as such the company ought to have followed the provisions of Section 77A. The court held that Section 77A is merely an enabling provision and the court's powers under Section 391 is not in any way affected. Similarly, the conditions for a buy back under Section 77A cannot be applied to a scheme under Sections 100 to 104 and Section 391. The two provisions operate in independent fields.

In Larsen & Toubro Limited In re [2004] 60 CLA 335 (Bom) [2004] XXXIV CS LW 72 the Mumbai High Court held that a composite scheme could be made involving de-merger, of one of the undertakings of the transferor company, for the transfer of the demerged undertaking of a subsidiary company and for the reduction in the capital of the transferor-company.

In *Jaypee Cement Limited v. Jayprakash Industries Limited* [2004] 2 Comp LJ 105 (All) / [2004] XXXIV CS LW 50 the Allahabad High Court held that the combining of the authorised share capital of the transferor company with that of the transferee company resulting in increase in the authorised share capital of the transferee company does not require the payment of registration fee or the stamp duty because there is no reason why the same fee should be paid again by the transferee company on the same authorised capital.

In *SEBI/Union of India v. Sterlite Industries (India) Limited* [2002] 113 Comp Cas 273 (Bom), the division bench of the Bombay High Court held that the word arrangement is of a wider import and is not restricted to a compulsory purchase or acquisition of shares. There is no reason as to why a cancellation of shares and the consequent reduction of capital cannot be covered by Section 391 read with Section 100 merely because a shareholder is given an option to cancel or to retain his shares. In view of the foregoing discussion, the objection of the appellants based on Section 77A must be rejected.

VALUATION OF SHARES IN DIFFERENT SITUATIONS — JUDICIAL PRONOUNCEMENTS

Supreme Court in *CWT v. Mahadeo Jalan*

In *CWT v. Mahadeo Jalan* (1972) 86 ITR 621 (SC) the Supreme Court observed:

“An examination of the various aspects of valuation of shares in a limited company would lead us to the following conclusion:

- (1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.
- (2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company, then value is determined by reference to the dividends, if any, reflecting the profit earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value.

The dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

- (3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.
- (4) Where the dividend yield and earning method break down by reason of the

company's inability to earn profits and declare dividends, and if the set back is temporary, then it is perhaps possible to take the estimate of the value of the shares before set back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

- (5) Where the company is ripe for winding up, then the break-up value method determines what would be realised by that process. In setting out the above principles, we have not tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as applicable to the facts of each case. But, one thing is clear, the market value, unless in exceptional circumstances to which we have referred, cannot be determined on the hypothesis that because in a private limited company one holder can bring into liquidation, it should be valued as on liquidation, by the break-up method.

The yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but nonetheless is one of the methods."

Therefore, generally, in case of amalgamation, a combination of all or some of the well-accepted methods of valuation may be adopted for determining the exchange ratio of the shares of two companies.

The valuation of company shares is a highly technical matter which requires considerable knowledge, experience and expertise in the job. A ratio based on valuation of shares of both the companies done by experts, approved by majority of the shareholders of both the companies and sanctioned by court is an ideal exchange ratio.

Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*

The law on the subject has been well settled by the Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* (1996) 4 Comp LJ 124 (SC) where it was held that once the exchange ratio of the shares of the transferee company to be allotted to the holders of shares in the transferor company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest.

In *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* The Supreme Court further emphasized the complicated nature of the valuation process when the value has to be assigned to the shares of the transferor company for the company. The Court observed, inter alia (page 835 of Comp. Cas). "So many imponderables' enter the exercise of valuation of shares. It must at once be stated that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.

Supreme Court in Hindustan Lever Employees Union v. Hindustan Lever Ltd.

In *Hindustan Lever Employees Union v. Hindustan Lever Ltd.*, (1994) 4 Comp LJ 267 (SC) the Supreme Court held that it is not the part of the judicial process to examine entrepreneurial activities to point out flaws. The court is least equipped for such oversights, nor indeed is it a function of the judges in our constitutional scheme. It cannot be said that the internal management, business activity or institutional operation of public bodies can be subjected to inspection by the court. To do so is incompetent and improper and, therefore, out of bounds.

Nevertheless, the broad parameter of fairness in administration, bona fides in action and the fundamental rules of reasonable management of public business, if breached, will become justifiable. (The court's obligation is to satisfy that the valuation was in accordance with the law and the same was carried out by an independent body).

The Supreme Court had explained that the nature of jurisdiction by the court, while considering the question of sanctioning a scheme of arrangement or compromise, is of sentinel nature and is not of appellate nature of examine the arithmetical accuracy of scheme approved by majority of shareholders. While considering the sanction of a scheme of merger, the court is not required to ascertain with mathematical accuracy the terms and target set out in the proposed scheme. What is required to be evaluated is general fairness of the scheme.

The contention raised was that the High Court in exercise of the sentinel nature of jurisdiction in company matters is expected to act as a guardian of interest of the companies, the members and the public, complaint was made in the appeal that the High Court had failed to exercise its jurisdiction in that way but was swayed by considerations which were neither legal nor relevant. In making this contention with great vehemence, it was pointed out that exchange ratio was not correctly determined by placing before the court comparative figures of the assets of the two companies their market value, their holdings in the market, etc. Rejecting the plea the Supreme Court said:

“But what was lost sight of was that the jurisdiction of the court in sanctioning a scheme of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetical test. A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on failures. It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method would have been adopted. What is imperative is that such determination should not have been contrary to law and that it was not unfair for the shareholders of the company which was being merged. The court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body.”

On the facts of the case the court found that the proposed scheme was approved by more than 99% of the shareholders and the grievance voiced by the objector was not shared by them. The objection was raised by the objector on the availability of same facts which were with other shareholders. The same explanatory statement at once was sent to the objector and on the basis of which he had taken inspection of all

the relevant documents; the court took notice of the fact that the explanatory statement was approved by the Registrar as a relevant factor. The Supreme Court observed:

“In the facts of this case, considering the overwhelming manner in which the shareholders, the creditors, the debenture holders, the financial institutions who had 41% shares in TOMCO, have supported the scheme and have not complained about any lack of notice or lack of understanding of what the scheme was about, we are of the view, it will not be right to hold that the explanatory statement was not proper or was lacking in material particulars.”

In the matter of Carron Tea Co. Ltd.

Although the question of valuation of shares and fixation of exchange ratio is a matter of commercial judgement and the court should not sit in judgment over it, yet the court cannot abdicate its duty to scrutinise the scheme with vigilance. It is not expected of the court to act as a rubber stamp simply because the statutory majority has approved the scheme and there is no opposition to it. The court is not bound to treat the scheme as a fait accompli and to accord its sanction merely upon a casual look at it. It must still scrutinise the scheme to find out whether it is a reasonable arrangement which can, by reasonable people conversant with the subject, be regarded as beneficial to those who are likely to be affected by it. Where there is no opposition, the court is not required to go deeper. However, when there is opposition, the court not only will but must go into the question and if it is not satisfied about the fairness of the valuation, it would be justified in refusing to accord sanction to the scheme as was held by the court [Carron Tea Co. Ltd. (1966) 2 Comp LJ: 278 (Cal)].

In the matter of Bank of Baroda Ltd. v. Mahindra Ugin Steel Co. Ltd.

The jurisdiction of the court in inquiring into the fairness of the exchange ratio cannot be ousted by vote of majority shareholders on the ground that valuation of shares is a matter of commercial judgement - [Bank of Baroda Ltd. v. Mahindra Ugin Steel Co. Ltd. (1976) 46 Comp Cas 227 (Guj.)]

1. The Group Company submitted the High Court Order for Adjudication under the Bombay Stamp Act, to the Collector of Stamps, Pune with details of lands and buildings owned by the Transferor Company.
2. The Collector thereafter adjudicated the necessary stamp duty as ₹ 17, 04, 612.00 at 7% on determining the true market value of the immovable property at ₹ 2,43,51,600.00. The same was paid and the Order was registered with the Sub-Registrar of Assurances where the lands and buildings are located.

Other Judicial Pronouncements on Valuation

In New Savan Sugar and Gur Refining Co. Ltd. and Others, in re (2005) 6 CLC 1281, the Calcutta High Court held that generally, the Court would not interfere with the valuation and swaps ratio approved by all the shareholders. However, when it feels prima facie that valuation is without proper basis, it questions the valuation, or

on the ground of not proper valuation can reject the scheme. In this case, the Court rejected the scheme of amalgamation not due to valuation but because it was not possible for the Honorable Court to come to the conclusion whether the scheme is in public interest.

In Graceful Properties Ltd., and etc. in re-5 CLC 1573, the Allahabad High Court held that different methods of valuation could be adopted for valuing the shares of the respective companies. The Court further ruled that in the absence of fraud or malafides, the mere fact that the determination of the exchange ratio of the shares of the two companies could be done by a slighter different method which might have given a different exchange ratio could not justify interference unless it was found to be unfair.

A division bench of the Madras High Court in Re : Nods Worldwide Ltd. MANU/TN/0455/2000 observed as follows : "The valuation that has been proposed in the scheme is the value which is based upon an exercise carried out by persons having knowledge of the relevant methods of valuation, being professional Chartered Accountants. The methods adopted by them for arriving at the values have been set-out in the report, relevant parts of which have already been extracted above. The opinion given by the valuers therefore, must in the absence of any other compelling circumstance, be accepted affording a reasonable and proper basis for the valuation of the shares and the number of shares in the capital of the transferee company to be allotted to the shareholders of the transferor company".

CONFLICTING PRONOUNCEMENTS

There are two different opinions expressed by various courts as regard to question whether the Court can sanction an amalgamation when the Memorandum of Association of the company does not contain powers to amalgamate. It has been held by certain courts that there is no necessity to have special power in the objects clause of the memorandum of association of a company for its amalgamation with another company as to amalgamate with another company, is a power of the company and not an object of the company. In Marybong & Kyel Tea Estates Ltd., Re (1977) 47 Com Cases 802, a previous decision in Hari Krishan Lohia v. Hoolungoree Tea Company, (1970) 40 Com Cases 458: AIR 1969 Cal 312 (DB) was followed and it was asserted that where there is a statutory provision dealing with the amalgamation of companies, no special power in the objects clause of memorandum of association of a company is necessary for its amalgamating with another company. It is submitted that to amalgamate with another company is a power of the company and not an object of the company. Amalgamation may be effected by order of the court under Sections 391 and 394. Power of the court is not subject to any restrictions that the amalgamations etc must be within the object clause of both the companies.

Do the Authorised Capital of Companies Merge in a Scheme of Amalgamation – applicability of Sections 95 and 97

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 in the records and to effectuate the necessary alterations in the Memorandum and Articles of Association of the

company. Again, when the authorized capital of a company is increased, registration fee under the Act has to be paid on such increase in accordance with Schedule X to the Act. In normal circumstances every company complies with the above requirements. However, in the event of merger since the court sanctions the merger scheme, the requirement of sending notice of increase of capital to ROC has been well settled that in a scheme of merger involving increase of capital 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.

With respect to paying additional registration fee on the increase of authorised capital High Courts of Bombay, Delhi, Allahabad and Madras consistently hold the view that no additional registration fee under the Act is payable.

The Delhi High Court in the case of Hotline Hol Celdings P. Ltd., In Re. (2005) 127 Comp Cas 165 held as under:

“This contention is ill founded. In case of a merger like this where it is provided that the share capital of the transferor companies become the authorised capital of the transferee company, no such payment of fee to the Registrar of Companies or stamp duty to the State Government is payable.”

When there is a merger of subsidiary company and also there is clubbing of authorized share capital of the transferor and transferee company, there is no need to follow the provision of Section 94 and 97 of the Companies Act, 1956. The Company Court is duly empowered to sanction the same under Section 394. [Kemira Laboratories Ltd, In re (2007) 140 Comp Cas 817 (AP)].

The Bombay High Court in the case of YOU Telecom India Pvt. Ltd., In Re. (2008) 141 Comp Cas 43 held that no additional fee is payable upon the merger of the authorised capitals of the transferor and transferee companies.

The Allahabad High Court in Jaypee Greens Ltd., In re [2006] 134 Comp Cas 542 (ALL) held that the whole purpose of Section 391 is to reconstitute the company without the company being required to make a number of applications which may be required in the Memorandum of Association and Articles of Association for functioning as a reconstituted company under the scheme. The company therefore, not required to make a separate application under the Companies Act for alteration of its MOA to show the new share capital. Such alteration can be sanctioned under the scheme itself. It is found that combined authorised capital of the amalgamated company does not exceed the authorised capital of the two companies calling for any further fees or stamp duty to be paid.

The Calcutta High Court in Areva T&D India Ltd., (2007) 138 Comp Cas 834 holds an opposite view.

The Calcutta High Court had held that in merger of companies authorised capital of the transferor company does not merge with the authorised capital of the transferee company. This view is quite opposite to the view consistently taken by various other High Courts. The matter was argued before the Calcutta High Court in a totally different logic and premises.

In this case totally a new line of argument was advanced by the company for not paying the registration fee under the Act on the increased authorised capital.

It was contended by the company that the right to increase its paid up capital up to the limit of its authorised capital is a 'property' and as such this property vests in the transferee company upon merger, and therefore no additional fee is required to be paid as already the transferor company had paid the fee on its authorised capital. The sum and substance of the argument was that the merger of authorised capitals is nothing but vesting/merging of properties on which appropriate fee has already been paid.

Rejecting the contention, the court held that upon merger the names of the transferor and transferee company do not merge; Memorandum and Articles of Association of the transferor company does not merge with the Memorandum and Articles of Association of the transferee company; the name, MoA and AoA of the transferor company are left behind with the corporate shell of the transferor company which is dissolved with out winding up.

The Court turned its attention to Section 611 of the Act which prescribes fee for various purposes. It observed as under:

"Whether one sees the clubbing of the authorised capital of the transferor company and the transferee company as a merger of the notional capitals or whether one views it as an increase of the authorized capital of the transferee company by the amount of the authorized capital of the transferor company, it is only a question of form and of little practical consequence. But whether the authorised capital of the transferee company stands increased by merger of authorized capitals or de hors the merger of authorised capitals, there is an increase which will require fees for such increase to be paid.

If the Central Government is right in seeking fees on the basis of the authorised or notional capital of a company, it is equally right in insisting that the transferee company must pay the additional fee for the consequential increase of its authorised capital following the sanction of a scheme of amalgamation. The sanction accords the transferee company the approval to increase its authorised capital, it does not afford in the luxury of enjoying the enhanced limit without tendering the requisite fee."

While the High Courts of Bombay, Delhi, Madras and Allahabad had not considered the question as to whether authorised capital could be a property so as to get merged with the authorised capital of the transferee company, the Calcutta High Court had considered the same.

Since the assets and liabilities of the transferor company migrate to the transferee company and merge thereafter it is imperative to determine whether authorised capital either as an asset or liability, is capable of being merged with the authorised capital of the transferee company. In this vital aspect the judgement of the Calcutta High Court stands out from the rest of the judgements.

Since different courts have taken a contrary view, this issue might reach the Supreme Court for final determination.

Whether two or more companies may make a joint application?

As already seen, in the normal case, every company involved in a scheme should make an application to the respective high court. In other words, the high court under the jurisdiction of which the registered office of the company falls should be the appropriate high court. If both the companies are under jurisdiction of the same High Court, joint application may be made. [Mohan Exports Ltd. v. Tarun Overseas P. Ltd. (1994) 14 CLA 279 (Del) dissenting from Re Electro Carbonium P. Ltd. (1979) 49 Comp. Cas 825 (Kar)] wherein it was held that a joint application cannot be made.

In Chembra Orchard Produce Limited, In re 2004 120 Comp Cas 1, it was held by the Karnataka High Court in the absence of any specific provisions in Section 391/394 prohibiting a joint application/petition for sanctioning reconstruction and amalgamation and as the provisions of the Code of Civil Procedures, 1908 'CPC' are made applicable to the proceedings under Section 391/394 and in view of the express provisions of Rule 1 of Order 1 of the CPC providing for filing of one application, a joint application petition by both the transferor and transferee companies would be maintainable under Section 391/394 of the Companies Act, 1956.

In Nepura Motors Ltd., In re (2003) 45 SCL 143, reliance was placed on the case Re : Voltas International Limited, in which it was held that since the transferor company is 100 per cent subsidiary of the transferee company, there was no need to file a separate petition by the transferee company.

Where the registered offices of two or more companies are not situated in the same State

Anomaly may arise where the registered office of amalgamating companies are situated in different States. Generally respective High Courts are moved for appropriate orders under Sections 391 and 394 of the Act for sanction and approval of the scheme of amalgamation with or without modifications [Bank of Baroda Ltd. v. Mahindra UGINE Steel Co. Ltd. (1976) 46 Comp. Cas. 227 (Guj.)]. In this context the Gujarat High Court observed that if the registered offices of the transferor and transferee companies happen to be situated within the jurisdiction of two different High courts, the resultant situation in some cases might be embarrassing especially in those cases in which the court in invitum has to accord sanction to a scheme subject to the approval and sanction by another company and court."

The Gujarat High Court in Mafatlal Industries Ltd., In re. (1995) 84 Comp. Cas. 230, observed that the Court which is first moved for according sanction to a scheme of amalgamation, will if it sanctions the scheme, make a judicial order which will be conditional upon the approval of the scheme by the shareholders and creditors, if any of the other company as well as upon the sanction of the scheme by the High Court within whose jurisdiction the registered office of the other company is situated.

At the same time, the possibility of conflicting orders being passed by two courts with regard to the same scheme cannot be ruled out. One of the courts might sanction the scheme whereas the other might sanction it subject to certain modifications or it might altogether refuse to sanction.

Such a situation would result in complete deadlock and the situation can presumably be remedied only by way of an appeal to the higher court.

The Court further observed that even if both the amalgamating companies are required to initiate proceedings under Sections 391 and 394, would it not be conducive if the jurisdiction to sanction the scheme after following the prescribed procedure in relation to both the companies is exercised on a comprehensive view of the whole matter by one court along.

Whether separate compliance under Section 21 to change the name is required?

In *You Telecom India (P) Ltd. v. You Broadband Networks India (P) Ltd.*, (2008) 82 CLA 201 The Bombay High Court rules that the objection of the Regional Director that the name of the transferee company is to be changed and, therefore, a separate compliance with Section 21 in respect of the filing of necessary forms with the Registrar of Companies is mandatory will not survive in view of the Law laid down in *Vasant Investment Corporation Ltd.* case and *PMP Auto Industries Ltd.*, case. The furnishing of a notice to the Registrar of the scheme will in any case constitute substantial compliance with the provisions of Section 21. The objection in respect of the filing of the necessary forms with the Registrar of Companies is answered on the basis of the same principle.

In *Shero Investment and Finance Limited v. Registrar of Companies* (2006) 70 CLA 21 (Guj), the Gujarat High Court held that when the proposed scheme was approved on the basis of the resolution of the company, the same can be the basis for change of name also, together with the sanction passed by the High Court, while sanctioning the scheme under Section 394, mere reference to the order of the Court will be sufficient. It is not open to the Registrar of Companies to raise objection for change of name, which forms part of the scheme of amalgamation duly sanctioned by the High Court on the ground that separate procedure under Section 21 of the Act is not followed or is required to be followed. It is for the opponent Registrar of Companies to issue necessary certificate by implementing the order already passed by this Court.

OTHER IMPORTANT MATTERS

Jurisdiction for Foreign Companies

In case of a foreign company, if one applies the principle of determining jurisdiction based on the place where registered office of the company is located, the above provisions would become inapplicable. In such a case, 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.

Further, it was also held that in respect of a foreign company, merely because foreign court has made an order for liquidation, the Indian court is not bound to follow it and that it would have to consider the just rights of the Indian creditors. When, it is possible to have separate liquidation orders for each office of the foreign country in different countries, the principle applies for considering scheme also.

Court's Discretion in Sanctioning the Scheme

The court, even if the scheme is approved by the requisite majority, should ensure that the scheme must be a fair and equitable one. *Maneck Chowk and Ahmedabad Mfg. Co. Ltd. In re.* (1970) 40 Comp. Cas. 819 (Guj.). *Bank of Baroda Ltd. v. Mahindra UGINE Steel Co. Ltd.* (1976) 46 Comp. Cas. 227 (Guj.).

The court under Section 394A shall give notice of every application made to it under Section 391 or 394 to the Central Government and shall take into consideration the representations, if any, made to it by the Government before passing any order under any of these sections. However, the court is not bound to go by the opinion of the Central Government as to the matters of public interest rather it can form its independent opinion over the matter [In re. *Sakamari Steel & Alloys Ltd.* (1981) 51 Comp. Case 266 (Bom.)]. The powers and functions of the Central Government under this section have been delegated to the Regional Directors who exercise the same, subject to the control of the Central Government.

Protection of minority Interest

Section 394(1) authorises the court to make provision for those who dissent from a scheme. Thus, the courts have to play a very vital role. It is not only a supervisory role but also a pragmatic role which requires the forming of an independent and informed judgement as regards the feasibility or proper working of the scheme and making suitable modifications in the scheme and issuing appropriate directions with that end in view [*Mafatlal Industries Ltd. In re.* (1995) 84 Comp. Cas. 230 (Guj.)].

Notice to Central Government

Even though approval of Central Government is not required, notice is required to be given under Section 394A of the Act to the Regional Director (RD) having jurisdiction of the state concerned and RD report is normally to be submitted to the Court that they do not have any objection.

Central Government's Role in Amalgamation

- Notice of every application made to the Court under Section 391 or 394 must be given to the Central Government and Court should take into consideration the representations, if any, made by the Government before passing any order under any of these Acts. [Section 394A]
- No notice need be given to the Central Government once again when Court proceeds to pass final order to dissolve the transferor company. [*Vikram Organic P. Ltd. v. Airox Pigments Ltd.* (1997) 25 CLA 157 (Cal)].
- The Central Government's power under this section is delegated to Regional Directors of the Ministry of Corporate Affairs.
- The role played by Central Government is that of an impartial observer, who acts in public interest, but court would sanction the scheme if it is otherwise in the mutual interest of companies. [Re *Ucal Fuel System Ltd.* (1994) 3 Comp LJ 259 (Mad)]

Determination of Cut off Date

Amongst others, the foremost requirement is the determination of cut off date from which all properties, movable as well as immovable and rights attached thereto etc. are required to be transferred from amalgamating company to the amalgamated company. The date may be called transfer date or appointed date.

The scheme becomes effective only after a certified copy of the order of the High Court is filed with the concerned office of the Registrar of Companies.

The Supreme Court in *Marshal Sons & Co. (India) Ltd. v. ITO (1977) 1 Comp. LJ P.1* observed that “it is true that while sanctioning the scheme, it is open to the court to modify the said date. If the court so specifies a date, there is little doubt that such date would be the date of amalgamation/date of transfer. But where the court does not prescribe any specific date but merely sanctions the scheme presented to it, the date specified in the scheme is ‘the transfer date’. It cannot be otherwise.”

Valuation of Shares and Fixing up of Share Exchange Ratio

The Exchange Ratio, at which shareholders of amalgamating company will be offered shares in the amalgamated company, will have to be worked out based on the valuation of shares of the respective companies as per the accepted methods of valuation, guidelines and the audited accounts of the company. The value of each share of amalgamating company is fixed keeping in view the value of each share of amalgamated company to be allotted in exchange for the former shares. Share exchange ratio based on financial position of both Companies on a date later than appointed date is not objectionable since date of negotiations between two Companies cannot be ignored. [Re. *Sumitra Pharmaceuticals Ltd. (1997) 25 CLA 142 (AP)*]. When the shares in the capital of the amalgamating company are already held by the amalgamated company or its subsidiaries, the scheme must provide for the reduction of share capital to that extent and the manner in which the compensation for shares held in the amalgamating company shall be given.

Whether the arrangement necessarily involves all Shareholders and/or Creditors and all classes thereof

Section 391(1) places the word “or” at appropriate places and thus the compromise/arrangement may be in one or more of the following manner:

- (a) between a company and its creditors
- (b) between the company and any class of its creditors
- (c) between the company and its shareholders
- (d) between the company and any class of its shareholders.

It is therefore, not necessary to take the approval of all classes of shareholders and/or creditors.

Whether the Transferee Company is also required to Propose a Scheme

In case of amalgamation the shareholders of transferor company are required to

accept in substitution of their shares, the shares and/or other consideration provided by the transferee company and the creditors are required to substitute the transferee company as their debtor, it is clear that there is an arrangement with each of these classes. Therefore, the transferor company has to comply with the provisions of Sections 391-394 of the Companies Act.

As far as transferee company is concerned, in general arrangements, it depends on the facts of the case. But amalgamation is considered as a special arrangement therefore it will also require to comply with the provisions of Section 391-394. It was also held in *Electro Carbonium (P) Ltd., In re* (1979) 49 Comp Cas 825 (Kar) that each of the companies have to make a separate application to court.

Official Liquidator's Report

- No order for the dissolution of a transferor company can be made by the court, unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest. [Section 394(1) second proviso; for interpretation of the proviso, see *Webb's Farm Mechanisation P Ltd. v. Official Liquidator* (1966) 7 SCL 81 (Kar-FB)].
- This proviso talks of 'dissolution', unlike the second proviso which talks of amalgamation. It says 'no compromise or arrangement... can be sanctioned'. Hence, official liquidator's report under the second proviso can be obtained after the order sanctioning amalgamation is passed. [*Sugarcane Growers and Sakthi Sugars shareholders' Association v. Sakthi Sugars Ltd.* (1996) 2 Comp LJ 108 (Mad.)].
- This report is required in respect of the transferor company which is dissolved without winding up and loses entity on amalgamation.

Issue of Shares, Allotment, Stock Exchange Formalities

- Intimation as to the proposed amalgamation to the Stock Exchange should be given within fifteen minutes after the Board meeting where the proposal is approved. [Cl. 22(d), 29, LA, BSE].
- As per Clause 24(f) listed companies are required to file the scheme with all the stock exchanges where it is listed at least 1 month prior to filing it with the High Courts and obtain its No Objection Certificate to the Scheme.
- Amalgamation involves issue and allotment of shares of transferee company to shareholders of transferor company in exchange of shares held by them in transferor company as per share exchange ratio. This requires compliance with Section 81(1A) of Companies Act by the transferee company. But no separate resolution under the said section is passed and since the shareholders approve the scheme with majority in number and 3/4th in value, such requirement is incorporated in the scheme which the shareholders pass and hence Section 81(1A) is also passed. A clause on the following lines is inserted in the scheme:

“Approval to the Scheme by the shareholders of ABC Ltd. and by the Hon’ble High Court shall be deemed to be due compliance of the provisions of Section 81(1A) and other relevant provisions of the Act for the issue and allotment of shares to the shareholders of XYZ Ltd. as provided in the Scheme.”

- Intimation of the resolution passed at a general meeting approving the scheme of compromise or arrangement will be given to the stock exchange immediately after the meeting on the same day (Clauses 29 and 36 of LA).
- A copy of the report of the chairman prepared in Form No. 39 is also required to be filed with the stock exchange [Clause 31(c) of LA, BSE].
- Copies of notices, circulars, etc. issued/advertised concerning amalgamation to be forwarded to the Stock Exchange. [Clause 31(e), 29, LA, BSE].

AMALGAMATION THROUGH BIFR UNDER SICA, 1985

Under the Sick Industrial Companies (Special Provisions) Act, 1985, (SICA) amalgamation is a method of rehabilitation of the business and undertaking of a sick industrial company.

Section 18 of the Act contains the various matters that may be incorporated by the operating agency in any scheme proposed for rehabilitation of the sick industrial company for which a reference has been made to the BIFR. The sanction accorded by BIFR under Sub-section (4) shall be conclusive evidence that all the requirements of the scheme relating to the reconstruction or amalgamation, or any other measure specified therein have been complied with.

The Supreme Court of India in *State of Uttar Pradesh v. Uptron Employees CMDI* (2006) 72 CLA 385 (SC) held that in respect of a sick industrial company even if it is a subsidiary of a Government company, there is no obligation cast upon the State Government to pay the wages due to workmen. The rights of workmen are governed by the relevant provisions of the Companies Act, where their claims are accorded priority. Also there is nothing in SICA, 1985 which authorities Board for Industrial and Financial Reconstruction to pass an interim order directing the State Government to pay wages due to the employees of the Sick Industrial Company.

In *Pasupathi Spinning & Weaving Mills Ltd. v. Industrial Finance Corporation of India and Others* (2006) 134 Comp. Cas 600 (P&H). In this case, the petitioner company became sick company and was registered with BIFR operating agency was appointed and rehabilitation scheme was framed by the BIFR. Meanwhile, the company proposed a scheme of arrangement only with its lenders having first charge on its properties. The petitioner company sought directions from the High Court to hold the meeting of first charge holders.

In *Modern Syntax (India) Ltd., in re* (2007) 76 SCL 157 (Raj). In this case the petitioner company made a reference to the BIFR under the provisions of 1985 Act due to significant losses suffered by it. During the pendency of the said reference, it prepared a scheme of comprise for rescheduling and restructuring its existing departments which was approved by the requisite majority of the creditors, representing more than 3/4th in value of total debts. The petitioner field the petition

under Section 391(2) seeking sanction of the scheme. However, the petition was opposed by many banks, one of which was claiming ₹1508 lakhs towards principal and interest, on various grounds, inter alia, that the proposed scheme involved exercise sacrifice and was oppressive to the minority secured creditors. The High Court dismissed the petition on two grounds:

- (i) The BIFR had declared the petitioner as a sick industrial company under Section 3(1)(o) of the 1985 Act and opined the operating agency to devise a scheme for rehabilitation of the company. The High Court in its decision, also quoted the judgement of the Supreme Court in JGEF Ltd. v. Chandra Developers (2005) 64 SCL 1. In the said case the apex court held that SICA, 1985 is a complete code in itself and being a later enactment, it would prevail over the Companies Act in case of any inconsistency in view of Section 32 of that Act. The High Court should not interfere where the matter of rehabilitation of sick company is pending before the BIFR under the 1985 Act.
- (ii) Besides this the High Court also held that the proposed scheme was not just, fair and equitable to all the secured creditors. Under the options proposed in the scheme, there was a loss of 50 to 80% of the debts outstanding to the creditors. The High Court ruled that such a high sacrifice was oppressive to the objector and was unconscionable and unreasonable even from the point of view of a prudent man. Therefore, the High Court refused to sanction the scheme.

In matter of Tata Motors Ltd. v. Pharmaceuticals Products of India Ltd. and Another (2008) 144 Comp. Case 178 (SC), it was held High Court cannot sanction scheme proposed under section 391/394 of the Act during the pendency of the revival scheme before BIFR under SICA. In terms of Section 26 of SICA, a company court did not have jurisdiction to entertain any application of a sick industrial company for merger under s.391 to 394 of the Companies Act 1956, while the matter was pending before the BIFR or the AAIFR.

Reverse merger

Reverse merger takes place when a healthy company merges into a financially weak company. However, in the context of the Companies Act, there is no distinction between a merger or a reverse merger because in either case one company merges with another company irrespective of the fact whether the merging or the amalgamating company is weaker or stronger. Reverse merger like any amalgamation or merger is carried out through the High Court route under the provisions of Sections 391 to 394 of the Companies Act, 1956. However, if one of the companies in this exercise is a sick industrial company, its merger or reverse merger has necessarily to be under SICA and must take place through BIFR. On the reverse merger of a sick industrial company becoming effective, the name of the sick industrial company may be changed to that of the healthy company and the transferee company becomes entitled to the benefit of carry forward and set off of the accumulated losses and unabsorbed depreciation of the transferor company. As such, in a reverse merger of a sick industrial company, the compliance under Section 72A of the Income Tax Act, 1961 is not required.

The scheme relating to amalgamation has to be laid for approval in the general meeting of the shareholders of the company other than sick industrial

company. In other words, in the case of reverse merger it is the company, other than sick industrial company, which loses its legal identity through merger and which has to obtain approval of its shareholder by special resolution to the proposed scheme of amalgamation before such scheme is sanctioned by BIFR [Proviso to Section 18(3)(b)].

AMALGAMATION OF COMPANIES BY AN ORDER OF THE CENTRAL GOVERNMENT (SECTION 396)

Special Power of Central Government to Order Amalgamation

Section 396 of Companies Act, 1956 confers on 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.

This power is unaffected by, and can be exercised, notwithstanding anything contained in Sections 394 and 395 but subject to the provisions of Section 396. But this exclusion is only in respect of Sections 394 and 395 (including Section 392), and not any other provision of the Act.

However, 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 [Section 44A(7) of the Banking Regulation Act].

Manner in which Central Government should Exercise Power under Section 396

The power under Section 396 should be exercised by the Central Government only where 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.

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. There is no bar to the exercise of that power by the Government on such application.

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) 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. [Section 396(4)].

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. [Section 396(5)].

Interest and Rights of Members and Creditors

Every member or creditor (including a debenture holder) of each of the companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as he had in the company of which he was originally a member or creditor. [Section 396(3)].

If the interest or rights of such member or creditor in or against the company resulting from the amalgamation are less than his interest in or rights against the original company, he shall be entitled to compensation which shall be assessed by such authority as may be prescribed. [Section 396(3)].

The prescribed authority for this purpose is Joint Director (Accounts), Ministry of Corporate Affairs [Rule 12A, Companies (Central Government's) General Rules and Forms, 1956].

The assessment of compensation shall be published in the Official Gazette. [Section 396(3)].

The compensation so assessed shall be paid to the member or creditor concerned by the company resulting from the amalgamation. [Section 396(3)].

Any person aggrieved by any assessment of compensation made by the prescribed authority under Sub-section (3) may, within thirty days from the date of publication of such assessment in the official Gazette, prefer an appeal to the *Company Law Board and thereupon the assessment of the Compensation shall be made by the *'Company Law Board'. [Section 396(3A)]

* The power will vest with National Company Law Tribunal (NCLT) after the commencement of the Companies (Second Amendment) Act, 2002.

ECONOMIC ASPECTS OF MERGERS AND AMALGAMATIONS

Till some years ago, takeover of one company by another was viewed in India as a sign of failure of the former, and violent aggression of another. The acquisition was derived mostly by the tax benefits of the loss carry forward. There are now more economic reasons and wider choices of takeovers/mergers.

ECONOMIC CONSIDERATIONS

Globalisation

Competitive forces resulting from globalisation and deregulation in many industries across the border have forced most corporates to consolidate. European and Asian markets have become much more receptive to merger and amalgamation activity. The merger of Daimler-Benz and Chrysler is till date a good example of globalisation. There was an over-capacity of around 30 per cent in the global car industry. The merger aimed at helping the functional Chrysler cars to enter the prestigious Daimler Benz vehicles to cruise into the American market including access to the wide European and Asian network of Daimler-Benz and help the German car company, on its part to access the logistics and service support of Chrysler. With prices falling faster than productivity gains, volume producers in Europe were expected to face a yawning gap of \$18 billions between revenues and costs. So, a merger to globalise operations made sense.

Synergies through Consolidation

The second most important reason for mergers and amalgamations is to realise synergies; either through cheaper production bases as in the case of Jindal Strip's purchase of two units from Bethlehem in US, or by cost savings and pooling of resources in R&D, marketing and distribution as in the case of Astra's \$ 36 billion mergers with Zeneca, Hoechst's merger with Rhone Poulenc or other pharma mergers.

Most M&A take place with the aim to exploit economies of scale by attaining critical mass and achieving cost-savings. Research has also shown that return on capital goes up as the concentration index rises. This has been proved especially in the cases of pharmaceutical, pulping and air compressor industries.

Banking industry too has found global consolidation moves profitable. For the bleeding Deutsche Bank, consolidation of its investment banking activities by acquisition of Bankers Trust paid dividends.

The fact that size is becoming increasingly important, specially when it takes a line of capital involvement, has been one reason for the oil majors to merger and create big firms considering the bleak future facing the industry. Companies such as Shell and Exxon, with international businesses have clearly performed better than those with just domestic focus.

Many a times the merger takes place because of survival instincts and not because of synergies or because one wants to expand. The classical example of this trend is the Malaysia's Financial industry. After 8-9 years of wonderful growth and

plentiful of money, a regional economic slump fuelled by currency devaluation bit deeply into its growth prospects. Mindful of banking and finance companies' failure in Thailand and Indonesia - both of which received international financial aid - Malaysia sought to fortify its domestic companies in a move to rejuvenate the once booming industry. Malaysian Central Bank advised its 40 odd finance companies to merge and consolidate into 5 or 6 core finance companies.

Vertical Integration

One of the common reasons for mergers is to sustain growth. Growth could be achieved by increasing market share, gaining access to additional customers (as in the case of telecom and financial sector mergers). It could also result from better access to distribution and marketing through the partner. A most attractive mode for growth is by getting access to promising foreign markets. Infact, M&A is a favoured route to establish a foothold in foreign markets; to increase market share and also to exploit other country's resources. It could be that the acquired company is in the growth sector, and it seems attractive to the acquirer. In addition, it may be cheaper to acquire rather than to build.

AT&T - TCI and Time Warner - Turner mergers are good instances of vertical integration. Shunned by local distributors AT&T acquired cable operator TCI to link its long distance carrier lines to individual homes and businesses. It could now have access to home and business establishments without the aid of local distributors. Similarly, combining the production unit time Warner with the distribution network of Turner, broadcasting could create vertical integration.

Customer Demands

The Grand Metropolitan and Guinness merger to create Diageo was to increase the number of product offerings. The more such products, the greater the ability to fight retailers with the power to either make or break a brand. In an industry where there are no 'must-stock' spirit brands, including a number of in-demand products is the key to greater profitability. Companies can use this consumer pull to negotiate better deals with fewer retailers.

Technology

The inability to keep pace with technology or to graduate to a higher level of technology was the reasons for the merger of Digital and Compaq, and IBM and Lotus Corporation earlier. Compaq's hold in the lower-end products segment and Digital's strengths in mini-computers were brought together by the merger. Similarly, with the 123 spread sheets getting outsmarted by Microsoft's Excel, Lotus required a higher technology platform for its Smartsuit program to succeed. The IBM-Lotus Corporation merger aided that process.

Re-fashioning

Many companies have resorted to the merger and amalgamation route to change their business to high profile business. By acquiring Polygram from Philips, Seagram moved from the low-margin spirits business to the high-margin media segment. After

operating as an engineering conglomerate for 111 years, the US-based Westinghouse Electric suddenly transformed itself into a media company. Since 1994, low profitability had forced the company to sell its distribution and control unit, electrical supplies, office furniture business, defence and electronics business, security systems, refrigeration transport and power generation businesses. On the other hand, it acquired among others CBS, Infinity Broadcasting, Nashville Networks, Country Music Television and American Radio Systems to transform itself into just CBS Corporation.

Increased Market Share

Profitability can be improved by increasing the market share, may be by offering enhanced range of products offered. There appears to be a high degree of co-relation between increased market share and increased profitability. This motive is closely aligned to the economies of scale as increasing market share usually leads to higher level of production, thereby lowering unit costs.

The grand metropolitan Guinness merger to create size Diageo was to increase the number of product offering. Companies can negotiate better deals with fewer retailers and thereby increase their profitability.

Tax Considerations

The merging of a sick unit with a healthy unit, brings taxation advantages by allowing losses of the sick company to be set off against the profits of the healthy company. Also, vertical mergers i.e. with raw material suppliers or downstream units, could also reduce the incidence of sales tax and other levies. However, any merger conceived solely for the purpose of achieving tax advantages is likely to be disallowed.

Diversification

Merging could also be a strategy to diversify operations to increase returns or reduce risk. However, there is a school of thought which feels the diversification of companies is of no value to share holders as they can diversify their own portfolios more cheaply.

Acquisition and Mergers were identified as one of the key factor to overcome economic recession

2008 was a traumatic year for the global economy. A decade of global economic growth had come to a sudden, grinding halt. The flood of credit and funding to fuel the global economy had dried to a drip. Property prices had seen boom and bust. However, there has been a considerable improvement in the global economy since the last review in July 2009.

New Zealand Trade & Enterprise has conducted a research on corporates during world economic recession as to how they adopt strategies to survive during the recession and to succeed subsequently. This research focused primarily on 13 companies that are established members of the Global Fortune 500 index. They are examples of organisations that have adapted, survived, and prospered during

recessionary periods. All of the companies studied achieved dramatic increases in growth and profitability during the period of economic downturn or in the following recovery period. These companies were chosen because they exhibit characteristics and strategies that enabled them to achieve success from difficult economic periods. It has identified Seven key factors appeared to have the greatest impact on firms' ability to emerge strongly from recessionary periods. Among other key factors, they have identified Acquisitions and strategic alliances as a key factor to overcome economic recession to strengthen, re-focus, and position the company for increased growth and profitability. They have identified that Companies also made acquisitions to access new markets, products, technologies, customers and talent at an accelerated pace.

STRATEGIC MANAGEMENT OF MERGERS

Any company wishing to embark upon an acquisition or merger programme needs to have clearly defined objectives and an established strategy for pursuing them. Acquisition made on a random or speculative basis are rarely likely to be successful.

Merger in the Vision and Strategy

The first step of the model is to check whether the merger fits in to the vision and strategy of both/all the parties involved :

- (a) A typical merger is one where two (or more) parties come together and form a new entity. Neither is taking over or acquiring the other. The horizontal combination of the erstwhile Area, headquartered in Sweden, and Brown Boveri, headquartered in Switzerland, into Asea Brown Boveri (ABB), in the late 1980s is an example.
- (b) Even where company A takes over part or whole of company B, the result is a merger.
- (c) In either case, i.e. whether coming together, or whether there is a sale and purchase, it is desirable that the top managements of both A and B have evolved their own respective perspective visions and come to the considered conclusion that a merger is the best strategy. For A, takeover may be a useful strategy for entry into a new product, territory or segment; or a means for faster growth, in addition to internal, organic expansion; or access to resources like capacity, talent, technology, brands or funds. For B, selling out may be a good strategy to divest an unrelated business, focus on core businesses, and release resources for such concentration.

Strategic Search

Once the, in-principle, decision is made to seek a merger the next step is to institute a reasonably thorough search for the right candidate(s) :

- (a) The strategic planning cells, if any, at the Group level may be the champion for such search, in the event of an unrelated diversification. For related diversification or expansion, the planning cell of the concerned member company of the group may spearhead the search.
- (b) Where necessary, discrete, confidential, external consultancy assistance

may be taken.

- (c) In addition to the proactive search, be also open to unexpected, sudden offers and opportunities; but evaluate them on the same strategic criteria.

The aim is to achieve optimal, rather than just satisfactory results.

Evaluation and Choice

A good search should have scanned and thrown up a reasonable number of alternatives. They need to be evaluated on the basis of some key criteria, so as to arrive at the final choice. The following are some of the important criteria:

- (a) How far will the merger candidate contribute to the corporate objectives of profitability/shareholder value, growth/market share, image and long run vitality?
- (b) To what extent will it add to the core competence and competitive edge?
- (c) To what degree will it add to the resource base, as well as help improve the generation, mobilisation and utilisation of physical, financial, human, knowledge and other important tangible and intangible resources?

The Right Price

The above evaluation, hopefully, will throw up a shortlist of about three candidates. Which one is eventually chosen will depend on a combination of its merits and the price at which it can be settled.

Value to the Acquirer/Partner

The negotiations will need to start from the value of the proposition to the party taking the initiative for the transaction :

- (a) In case it is an acquisition, the acquirer will need to simulate and forecast the possible enhanced revenue streams, profits, and earnings per share.
- (b) The price will also be influenced by significant assets in the balance sheet, as well as undervalued physical or intangible assets.
- (c) It is also worth seeing if the merger will improve the quality of earnings, and, hence, the price-earnings ratio and the market capitalisation.

Value to the Acquiree/Partner

The eventual price will naturally, be also influenced by the value to the seller or the responding second party to the merger :

- (a) If he is a seller, he will usually try and get the maximum price for it. He can leave it to the acquiree to worry about the strategic fit.
- (b) If he is to be a partner in the merged entity, he will need to assess the value of staying alone, and the value of merging. The difference is an approximate measure of the value of the merger to him.
- (c) He will also need to take into account the undervalued assets, as well as the contingent liabilities of both.

Harmonising the Exchange

The right price will need to be negotiated around these two sets of values:

- (a) In case of a cooperative, agreed merger, it is better to arrive at a win-win valuation and share exchange, which is fair to both sets of shareholders.
- (b) In case of an acquisition based on income potential, one needs to be more careful in allowing for economic and competitive uncertainties.
- (c) In case of attractive assets, it may be possible to pay closer to the market value.

FINANCIAL ASPECTS OF MERGERS AND AMALGAMATIONS

Introduction

In any merger or amalgamation, 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.

Each amalgamation or merger is aimed at the following financial aspects:

- (a) To pool the resources of all the companies involved in the exercise of amalgamation or merger so as to achieve economies of production, administrative, financial and marketing management.
- (b) To secure the required credit on terms from financial institutions, banks, suppliers, job workers etc.
- (c) To cut down cost of production, management, marketing etc. by effecting savings in all spheres with the combined strength of qualified and competent technical and other personnel.
- (d) To reinforce the united research and development activities for product development to ensure a permanent, dominant and profit making position in the industry.
- (e) To improve productivity and profitability in order to maintain a regular and steady dividend to the shareholders.
- (f) To concentrate on the core competence of the merged or the amalgamated company.
- (g) To consolidate the resource base and improve generation, mobilisation and utilisation of physical, financial, human, knowledge, information and other important tangible and intangible resources.

An important aspect in the scheme of mergers and amalgamations relates to the valuation of shares to decide the exchange ratio. Objections have been raised about the method of valuation even in cases where the schemes had been approved by a large majority of shareholders and the lending Financial Institutions. The courts have declared their unwillingness to engage themselves on a study of the fitness of the mode of valuation.

According to a High Court statement : “The valuation of shares is a technical matter which requires considerable skill and expertise. There are bound to be differences of opinion as to the correct value of the shares of the company. Simply because it is possible to value the shares in a manner different from the one adopted in a given case, it cannot be said that the valuation agreed upon has been unfair”.

In the Hindustan Lever Ltd. case, the Supreme Court held that it would not interfere with the valuation of shares, when more than 99 per cent of the shareholders have approved the scheme, and with the valuation having been perused by the Financial Institutions.

Valuation and Acquisition Motives is an important aspect in the merger/amalgamation /takeover activity. The valuation of business, however, depends to a great extent on the acquisition motives. The acquisition activity is usually guided by strategic behavioural motives. The strategic reasons could be either purely financial (taxation, asset-stripping, financial restructuring involving an attempt to augment the resources base and portfolio-investment) or business related (expansion or diversification). The behavioural reasons have more to do with the personal ambitions or objectives (desire to grow big) of the top management. The expansion and diversification objectives are achievable either by building capacities on one's own or by buying the existing capacities. This would effectively mean a “make (build) or buy decision” of capital nature. The decision criteria in such a situation would be the present value of the differential cash flows. These differential cashflows would, therefore, be the limit on the premium which the acquirer would be willing to pay. On the other hand, if the acquisition is motivated by financial considerations (specifically taxation and asset-stripping), the expected financial gains would form the limit on the premium, over and above the price of physical assets in the company. The cashflow from operations may not be the main consideration in such situations. Similarly, a merger with financial restructuring as its objective will have to be valued mainly in terms of financial gains. It would, however, not be easy to determine the level of financial gains because the financial gains would be a function of the use to which these resources are put. Finally, the pricing of behaviourally motivated acquisitions is not really guided by the financial considerations. Since the acquisitions are not really the market driven transactions, a set of non-financial considerations will also affect the price. The price could be affected by the number and the motives of other bidders. The value of a target is effected not only by the motive of the acquiring company, but also by the target company's own objectives. The motives of the target company could also be viewed as to be strategic, financial or behavioural. In addition, if the target company is an unwilling dis-investor, the price of an acquisition may not have much to do with the potential financial benefits.

STAMP DUTY ASPECTS OF MERGERS AND AMALGAMATIONS

The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.

Constitutional background on levy of stamp duty on Amalgamation and Mergers

Article 265

Article 265 of the Constitution prohibits levy or collection of tax except by authority of law.

Article 246, read with the Seventh Schedule of the Constitution provides legislative powers to be exercised by the Parliament and the State Legislatures.

The Seventh Schedule consists of three viz., List I - Union List, List II - State List and List III - Concurrent List. List I is the exclusive domain of the Parliament to make laws in relation to that matter and it becomes a prohibited field for the State Legislature. List II is within the exclusive competence of the State Legislature and then the Parliament is prohibited to make any law with regard to the same except in certain circumstances. In List III, both Parliament and State Legislature can make laws subject to certain conditions. Matters not mentioned in any of the three lists fall within the exclusive domain of the Parliament.

Article 372

All the laws in force immediately before the commencement of the Constitution continue to be in force until altered or repealed or amended by a competent Legislature or other competent authority.

Accordingly, the Indian Stamp Act is continuing to this extent.

The relevant entries in the Seventh Schedule regarding stamp duty are as follows:

List I entry 91

“91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.”

List II entry 63

“63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to stamp duty.”

List III entry 44

“44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duties.”

In exercise of power conferred by Entry 63, List II the State Legislature can make amendment in the Indian Stamp Act under article 372, in regard to the rates of stamp duty in respect of documents other than those specified in provisions of List I.

Stamp duty is levied in India on almost all, except a few documents, by the

States and hence the rate and incidence of stamp in different states varies. The State Legislature has jurisdiction to levy stamp duty under entry 44, List III of the Seventh Schedule of the Constitution of India and prescribe rates of stamp duty under entry 63, List 11.

By sanctioning of amalgamation scheme, the property including the liabilities are transferred as provided in sub-section (2) of section 394 of the Companies Act and on that transfer instrument, stamp duty is levied.

Therefore, it cannot be said that the State legislature has no jurisdiction to levy such duty on an order of the High Court sanctioning a scheme of compromise or arrangement under section 394 of the Companies Act, 1956. [Li taka Pharmaceuticals Ltd. and another v. State of Maharashtra and others *ibid*].

Stamp Duty Payable on a High Court Order Sanctioning Amalgamation

1. In amalgamation the undertaking comprising property, assets and liabilities, of one (or more) company (amalgamating or transferor company) are absorbed by and transferred company merges into or integrates with transferee company. The former loses its entity and is dissolved (without winding up).
2. The transfer and vesting of transferor company's property, assets, etc. into transferee company takes place "by virtue of" the High Court's order. [Section 394(2)]. Thus, the vesting of the property occurs on the strength of the order of the High Court sanctioning the scheme of amalgamation, without any further document or deed. Property includes every kind of property, rights and powers of every description. [Section 394(4)(d)].
3. For the purpose of conveying to the transferee company the title to the immovable property of the transferor company, necessary registration in the lands records in the concerned office of the State in which the property is situated, will be done on the basis of the High Court order sanctioning the amalgamation. If any stamp duty is payable under the Stamp Act of the State in which the property is situated, it will be paid on the copy of the High Court order.
4. An order of the High Court under section 394 is founded and based on the compromise or arrangement between the two companies for transferring assets and liabilities of the transferor company to the transferee company and that order is an instrument as defined in Section 2(1) of the Bombay Stamp Act which included every document by which any right or liability is transferred [Li taka Pharmaceuticals Ltd. v. State of Maharashtra (1996) 22 CLA 154: AIR 1997 Bom 7].
5. Thus, an order of the High Court sanctioning a scheme of amalgamation under Section 394 of the Companies Act is liable to stamp duty only in those states where the states stamp law provides.

In *Hindustan Lever Ltd. v. State of Maharashtra* (2003)117 Comp Cas SC 758 the Supreme Court considered this issue. *Tata Oil Mills Company Ltd (TOMCO)* was merged with the *Hindustan Lever Ltd (HLL)*. The State

imposed stamp duty on the order sanctioning the scheme of merger. The demand was challenged by the company on two grounds that State Legislature is not competent to impose stamp duty on the order of amalgamation passed by a court and such order of the court is neither instrument nor document (transferring properties from transferor company to transferee company) liable to stamp duty.

The Supreme Court dismissed the appeal of the company on following reasons

Transfer of property has been defined to mean an act by which a living person conveys property, in present or in future, to one or more living persons. Companies or associations or bodies of individuals, whether incorporated or not, have been included amongst living persons. It clearly brings out that a company can effect transfer of property. The word *inter vivos* in the context of section 394 of the Companies Act would include, within its meaning, also a transfer between two juristic persons or a transfer to which a juristic person is one of the parties. The company would be a juristic person created artificially in the eyes of law capable of owning and transferring the property. The method of transfer is provided in law. One of the methods prescribed is dissolution of the transferee company along with all its assets and liabilities. Where any property passes by conveyance, the transaction is said to be *inter vivos* as distinguished from a case of succession or devise. The Supreme Court dismissed the appeal on following reasons.

The State Legislature would have the jurisdiction to levy the stamp duty under entry 44 List III of the Seventh Schedule of the constitution and prescribes rate of stamp duty under entry 63, List II. It does not in any way impinge upon any entry in List I. Entry 44 of List III empowers the State Legislature to prescribe rates of stamp duty in respect of documents other than those specified in List I. By sanctioning a scheme of amalgamation, the property including the liabilities are transferred as provided in Section 394 of the Companies Act and on that transfer instrument stamp duty is levied. It, is therefore, cannot be said that the State Legislature has no jurisdiction to levy such duty. Under the scheme of amalgamation, the whole or any part of the undertaking, properties or liability of any company concerned in the scheme are to be transferred to the other company. The intended transfer is a voluntary act of the contracting parties. The transfer is a voluntary act of the contracting parties. The transfer has all trappings of a sale. While exercising its power in sanctioning a scheme of arrangement, the court has to examine as to whether the provisions of the statute have been complied with. Once the court finds that the parameters set out in section 394 of the Companies Act have been met then the court would have no further jurisdiction to sit in appeal over the commercial wisdom of the lass of persons who with their eyes open give their approval, even if, in the view of the court a better scheme could have been framed. Two broad principles underlying a scheme of amalgamation are that the order passed by the court amalgamating the company is based on a compromise or arrangement arrived at between the parties; and that the jurisdiction of the company court while sanctioning the scheme is supervisory only. Both these principles indicate that there is no

adjudication by the court on merits as such.

The order of the court under sub-section (2) of section 391 has to be presented before the Registrar of Companies within 30 days for registration and shall not have effect till a certified copy of the order has been filed with the Registrar and the Registrar of Companies certifies that the transferor company stands amalgamated with the transferee company along with all its assets and liabilities. Thus, the amalgamation scheme sanctioned by the court would be an instrument within the meaning of section 2(i) of the Bombay Stamp Act, 1958. By the said instrument the properties are transferred from the transferor company to the transferee company, the basis of which is the compromise or arrangement arrived at between the two companies. A document creating or transferring a right is an instrument. An order effectuating the transfer is also a document.

6. The company will provide to the Collector of Stamps —
 - application for adjudication of the High Court order for determination of stamp duty payable;
 - proof of the market value of equity shares of the transferor company (Stock Exchange quotation or a certificate from Stock Exchange) as of the appointed day;
 - certificate from an approved valuer or valuation of the immovable property being transferred to the transferee company.
7. The Collector thereafter will adjudicate the order and determine stamp duty.
8. The stamp duty will be paid in the manner prescribed under the Stamp Rules. The duty-paid Order will be registered with the Sub-Registrar of Assurances where the lands and buildings are located.

INCIDENCE OF LEVY OF STAMP DUTY

Stamp duty is levied on “Instruments”. Section 3 of the Bombay Stamp Act, 1958 specifies the following essentials for the levy of stamp duty :

- (1) There must be an instrument
- (2) Such instrument is one of the instruments specified in Schedule I
- (3) Such instrument must be executed.
- (4) Such instrument must have either —
 - (a) not having been previously executed by any person is executed in the ‘state’ or
 - (b) having been executed outside the state, relates to any property situated in the State or any matter or thing done or be done in the state and is received in the state.

Instrument

The term ‘instrument’ is defined in Section 2(i) of the Bombay Stamp Act, 1958

as follows:

“Instrument” includes every document by which any right or liability is or purports to be created, transferred limited extended, extinguished or recorded but does not include a bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, debentures, proxy and receipt.”

An award is an instrument within the meaning of the Stamp Act and the same is required to be stamped as was decided in the case Hindustan Steel Ltd. v. Dilip Construction Co., AIR 1969 SC 1238 (at page 1240)

The scheme of amalgamation sanctioned by the court would be an instrument within the meaning of Section 2(1) where by the properties are transferred from the transferor company to the transferee company based on compromise arrived at between the two companies. The state legislature would have the jurisdiction to levy stamp duty under Entry 44, List II of the Seventh Schedule of the Constitution on the order of the court sanctioning scheme of amalgamation vide the case Hindustan Lever v. State of Maharashtra, AIR 2004 at pp. 335, 339.

This definition is an inclusive definition and any document which purports to transfer assets or liabilities considered as an instrument.

Order of Court under Section 394 of Companies Act, 1956 - A Transfer

It was earlier held that when transfer takes place by virtue of a court order to a scheme of amalgamation, stamp duty is leviable. By virtue of Section 2(g), 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. This definition of conveyance is given below:

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 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.

Transfer of the property of a partnership firm to a limited company on its conversion was held to be treated as a conveyance and, hence, chargeable to stamp duty, irrespective of the fact that the partners of the firm were the shareholders of the Company [In re The Kandoli Tea Company 13 Cal 43; Foster v. Commissioners, (1894) 1 QB 516].

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.

Stamp Duty on Other Documents

Usually, in a merger, several other documents, agreements, indemnity bonds, etc. are executed, depending on the facts of each case and requirements of the parties. Stamp duty would also be leviable as per the nature of the instrument and its contents.

No stamp duty is payable on an order issued by the Board for Industrial and Financial Reconstruction (BIFR), sanctioning an amalgamation, apparently on the ground that such an order aims at rehabilitating business and undertaking of a sick industrial company.

AMALGAMATION BETWEEN HOLDING AND SUBSIDIARY COMPANIES — EXEMPTION FROM PAYMENT OF STAMP DUTY

The Central Government has exempted the payment of stamp duty on instrument evidencing transfer of property between companies limited by shares as defined in the Indian Companies Act, 1913, in a case:

- (i) where at least 90 per cent of the issued share capital of the transferee company is in the beneficial ownership of the transferor company, or
- (ii) where the transfer takes place between a parent company and a subsidiary company one of which is the beneficial owner of not less than 90 per cent of the issued share capital of the other, or
- (iii) where the transfer takes place between two subsidiary companies each of which not less than 90 per cent of the share capital is in the beneficial ownership of a common parent company :

Provided that in each case a certificate is obtained by the parties from the officer appointed in this behalf by the local Government concerned that the conditions above prescribed are fulfilled.

Therefore, if property is transferred by way of order of the High Court in respect of the Scheme of Arrangement/Amalgamation between companies which fulfill any of the above mentioned three conditions, then no stamp duty would be levied provided a certificate certifying the relation between companies is obtained from the officer appointed in this behalf by the local Government (generally this officer is the Registrar of Companies).

However, stamp being a state subject, the above would only be applicable in those states where the State Government follows the above stated notification of the Central Government otherwise stamp duty would be applicable irrespective of the relations mentioned in the said notification.

TAXATION ASPECTS OF MERGERS AND AMALGAMATIONS

The word 'amalgamation' or 'merger' is not defined any where in the Companies Act, 1956. However, Section 2(1B) of the Income Tax Act, 1961 defines the term 'amalgamation' as follows:

"Amalgamation" in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company), in such a manner that—

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

Thus, for a merger to be qualified as an 'amalgamation' for the purpose of the Income Tax Act, the above three conditions have to be satisfied.

Carry forward and set off of accumulated loss and unabsorbed depreciation allowance

Under Section 72A, a special provision is made which relaxes the provision

relating to carrying forward and set off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation. Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company, or an amalgamation of a banking company referred to in clause (c) of Section 5 of the Banking Regulations Act, 1949 (10 of 1949) with a specified bank, or one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or; as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

It is to be noted that as Unabsorbed losses of the amalgamating company are deemed to be the losses for the previous year in which the amalgamation was effected, the amalgamated company will have the right to carry forward the loss for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year in which the amalgamation was effected.

However, the above relaxations shall not be allowed in the assessment of the amalgamated company unless :

- (a) the amalgamated company –
 - (i) has been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on date of the amalgamation at least three fourth of the book value of fixed assets held by it two years prior to the date of amalgamation;
- (b) the amalgamated company —
 - (i) holds continuously for a minimum of five years from the date of amalgamation at least three fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
 - (iii) fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

It further provides that in case where any of the above conditions are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of amalgamated company chargeable to tax for the year in which such conditions are not complied with.

For the purpose of this section, “accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or

demerged company, as the case may be, under the head "Profit and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the amalgamated company or demerged company, would have been entitled to carry forward and set off under the provisions of Section 72 if the reorganization of business or amalgamation or demerger had not taken place. Similarly "unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganization of business or amalgamation or demerger had not taken place.

Amendments in Finance Act 2010 which will be effective from 1-4-2011

In may be noted that under Finance Act 2010, the definition of accumulated loss and unabsorbed depreciation is as follows.

"accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

"unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

The following sub-section (6A) shall be inserted after sub-section (6) of section 72A by the Finance Act, 2010, w.e.f. 1-4-2011:

(6A) Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:

Provided that if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

Capital Gains Tax

Capital gains tax is leviable if there arises capital gain due to transfer of capital assets. The word 'transfer' under section 2(47) of the Act includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law or in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment or any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 (4 of 1882) or any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring or enabling the enjoyment of any immovable property.

Under section 47(vi) and (vii), transfer does not include any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the latter is an Indian company. From the assessment year 1993-94 any transfer of shares in an Indian company held by a foreign company to another foreign company in pursuance of a scheme of amalgamation between the two foreign companies will not be regarded as 'transfer' for the purpose of levying tax on capital gains. This provision will apply only if at least twenty five percent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company and such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

Further, the term transfer also does not include any transfer by a shareholder in a scheme of amalgamation of a capital asset being a share or the shares held by him in the amalgamating company if the transfer is made in consideration of the allotment to him of any share or the shares in the amalgamated company and the amalgamated company is an Indian company. Even in the absence of Section 47(vii) of the Act, a shareholder is not liable to pay any capital gains tax since an amalgamation does not include exchange or relinquishment of the assets. Amalgamation does not involve an exchange or relinquishment of shares by amalgamating company as held in CIT v. Rasik Lal Manek Lal (1975) 95 ITR 656. However, no benefit will be available under Section 47(vii) if the shareholders of amalgamating company are allotted something more than share in the amalgamated company viz. bonds or debentures [CIT v. Gautam Sarabhai Trust (1988) 173 ITR 216 (Guj.)].

Amortisation of Preliminary Expenses

The benefit of amortisation of preliminary expenses under section 35D are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled

to the amortisation is transferred to another Indian company in a scheme of amalgamation within the 10 years/5 years period of amortisation. In that event the deduction in respect of previous year in which the amalgamation takes place and the following previous year within the 10 years/5 years period will be allowed to the amalgamated company and not to the amalgamating company.

Capital Expenditure on Scientific Research

In the case of an amalgamation if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provision of section 35 would apply to the amalgamated company as they would have applied to amalgamating company if the latter had not transferred the asset.

Expenditure on Acquisition of Patent Right or Copyright

Where the assessee has purchased patent right or copyrights he is entitled to a deduction under Section 35A for a period of 14 years in equal instalments. The amalgamated company gets the right to claim the unexpired instalments as a deduction from its total income.

The deduction under this section is however available for expenditure incurred before 1st April, 1998 only.

Expenditure on Amalgamation

Section 35DD provides that where an assessee being an Indian company incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

Expenditure on know-how

Section 35AB(3) of the Income-tax Act provides that where there is a transfer of an undertaking under a scheme of amalgamation or demerger and the amalgamating or the demerged company is entitled to a deduction under this section, then the amalgamated or the resulting company, as the case may be, shall be entitled to claim deduction under this section in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the amalgamating company or the demerged company, as the case may be, had such amalgamation or demerger not taken place.

The deduction under this section is however available for any lump sum consideration paid in any previous year relevant to the assessment year commencing on or before 1.4.1998.

Expenditure for obtaining Licence to Operate Telecommunication Services (Section 35ABB)

The provisions of the section 35ABB of the Income Tax Act relating to deduction

of expenditure, incurred for obtaining licence to operate communication services shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

TAX ASPECTS ON SLUMP SALE

Section 293 of the Companies Act empowers the Board of Directors of a company, after obtaining the consent of the company in general meeting to sell lease or otherwise dispose off the whole or substantially the whole of the undertaking(s) of a company.

The transaction in this case, is normally of either of the following type:

- (a) Sale of a running concern.
- (b) Sale of a concern which is being wound up.

(a) Sale of a Running Concern

This type of sale as a going concern provides for the continuation of the running of the undertaking without any interruption. But there is always a problem of fixing a value in the case of a running concern for all tangible and intangible assets including fixing a value for the infrastructure and other environmental facilities available. In view of all this, the seller normally fixes a lump sum price called 'slump price'.

The noun 'slump' means 'a gross amount, a lump'. Similarly, 'slump sum' means a 'lump sum' [Chambers Twentieth Century Dictionary, 1983 Edn., p 1220]. A slump sale or a slump transaction would, therefore, mean a sale or a transaction which has a lump sum price for consideration.

(b) Sale of a concern which is being wound up

On the other hand a sale in the course of winding up, is nothing but a realisation sale aimed at collecting the maximum price for distributing to the creditors and the balance to the contributories (the shareholders). By the very nature of the transaction, this is a piecemeal sale and not a slump sale. In this case, there will be liability to tax as per the various provisions of the Income Tax Act and the criteria which is applicable to a slump sale is not applicable here.

Normally, any sale of a capital asset will give rise to a capital receipt and any profit derived may give rise to capital gains in certain cases. This is true in the case of sale of an undertaking also.

In *Doughty v. Commissioner of Taxes*, the Privy Council laid down the following principles: The sale of a whole concern engaged in production process, e.g. dairy farming or sheep rearing, does not give rise to a revenue profit. The same might be said of a manufacturing business which is sold with the lease holds and plant, even if there are added to the sale piece goods in stock and even if these piece goods form a very substantial part of the aggregate sold. Where, however, business consists entirely in buying and selling, it is difficult to distinguish for income tax purposes between an ordinary and realisation sale, the object in either case being to dispose of the goods at a profit. The fact that the stock is sold out in one sale does not render

the profit obtained any different in kind from the profit obtained by a series of gradual and smaller sales. In the case of such a realisation sale, if there is an item which can be traced as representing the stock-in-trade sold, the profit obtained by the sale of the stock-in-trade, though it is in conjunction with the sale of the whole concern, may be treated as taxable income. But where there is a sale of the whole concern and a transfer of all the assets for a single unapportioned consideration, there cannot be said to be any revenue profit realised on the sale of the stock-in-trade which is sold with all the other assets, although the business of the concern may consist entirely in buying and selling.

The Supreme Court, based on the above decision held in the following two cases that the price received on the sale of industrial undertaking is a capital receipt.

CIT v. West Coast Chemicals and Industries Ltd. – 46 ITR 135 — Where a slump price is paid and no portion is attributable to the stock-in-trade, it may not be possible to say that there is a profit other than what results from the appreciation of capital. The essence of the matter, however, is not that an extra amount has been gained by the selling out or the exchange but whether it can fairly be said that there was a trading, from which alone profit can arise in business.

CIT v. Mugneeram Bangur and Co. – 57 ITR 299 — In the case of a concern carrying on the business of buying land, developing it and then selling it, it is easy to distinguish a realisation sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realisation sale. The mere fact that in the schedule, the price of land was stated does not lead to the conclusion that part of the slump price is necessarily attributable to the land sold.

The same view was also reiterated by the Gujarat High Court in the following cases:

1. Sarabhai M. Chemicals Pvt. Ltd. v. P.M. Mittal, Competent Authority– 126 ITR 1.
2. Artex Manufacturing Co. v. CIT – 131 ITR 559.

At the same time, the Gujarat High Court also recognised that when an undertaking as a whole is sold as a going concern there will be liability under the head Capital Gains. In 126 ITR 1 the Gujarat High Court stated as follows:

It is well settled that business is property and the undertaking of a business is a capital asset of the owner of the undertaking. When an undertaking as a whole is transferred as a going concern together with its goodwill and all other assets, what is sold is not the individual itemised property but what is sold is the capital asset consisting of the business of the undertaking and any tax that can be attracted to such a transaction for a slump price at book value would be merely capital gains tax and nothing else but capital gains tax. Plant or machinery of any fixture or furniture is not being sold as such. What is sold is the business of undertaking for a slump price. If the capital asset, namely, the business of the undertaking, has a greater value than its original cost of acquisition, then, capital gains may be attracted in the ordinary case of a sale of an undertaking.

The Bombay High Court also recognised that there will be a capital gains tax

when a sale of business as a whole occurs (Refer *Killic Nixon and Co. v. CIT* 49 ITR 244).

ACCOUNTING ASPECTS OF AMALGAMATIONS

Accounting Standard-14 'Accounting for Amalgamations' lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves.

Exception:

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (acquired company) in consideration by payment in cash or by issue of shares or other. Securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

TYPES OF AMALGAMATION

Accounting Standard (AS)-14 recognizes two types of amalgamation:

- (a) Amalgamation in the nature of merger.
- (b) Amalgamation in the nature of purchase.

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
- (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

An amalgamation should be considered to be an amalgamation in the nature of

purchase, when any one or more of the conditions specified above is not satisfied. These amalgamations are in effect a mode by which one company acquires another company and hence, the equity shareholders of the combining entities do not continue to have a proportionate share in the equity of the combined entity or the business of the acquired company is not intended to be continued after amalgamation.

In Case of High Court of Gujarat, Gallops Realty (P.) Ltd., In re v. K.A. PUJ, J.(2010), under Section 391, read with sections 394 and 100, of the Companies Act, 1956 Petitioner-companies, i.e., demerged company and resulting company, sought for sanction of composite scheme of arrangement in nature of purchase of shares and demerger of hotel business of demerged company to resulting company and consequent reconstruction of share capital of demerged company under section 391, read with sections 394, 78 and 100 consisting of reduction of paid-up share capital as well as utilization of share premium account - Meetings of equity shareholders of both companies and unsecured creditors of demerged company had been dispensed with in view of their written consent - Regional Director stated that as per scheme, capital profit on demerger would be transferred to general reserve in books of resulting company which was not in consonance with generally accepted accounting principles as also Accounting Standard - 14 which provide that any profit arising out of a capital transaction, like merger or demerger, ought to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve –

Whether observation of Regional Director was not in consonance with accounting principles in general and Accounting Standard-14 in particular, as Accounting Standard-14 is applicable only in case of amalgamation and not in case of demerger, as envisaged in instant scheme - Held, yes

METHODS OF ACCOUNTING FOR AMALGAMATION

There are two main methods of accounting for amalgamations:

- (a) the pooling of interests method; and
- (b) the purchase method.

The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

The Pooling of Interest Method

Since merger is a combination of two or more separate business, there is no reason to restate carrying amounts of assets and liabilities. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the

transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

If, at the time of the amalgamation, the transferor and the transferee company having conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported in accordance with Accounting Standard (AS-5), Net Profit or Loss for the Period 'Prior Period Items and Changes in Accounting Policies'.

The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves. It has been clarified that the difference between the issued share capital of the transferee company and share capital of the transferor company should be treated as capital reserve. The reason given is that this difference is akin to share premium. Furthermore, reserve created on amalgamation is not available for the purpose of distribution to shareholders as dividend and/or bonus shares. It means that if consideration exceeds the share capital of the transferor company (or companies), the unadjusted amount is a capital loss and adjustment must be made, first of all in the capital reserves and in case capital reserves are insufficient, in the revenue reserves. However, if capital reserves and revenue reserves, are insufficient the unadjusted difference may be adjusted against revenue reserves by making addition thereto by appropriation from profit and loss account. There should not be direct debit to the profit and loss account. If there is insufficient balance in the profit and loss account also, the difference should be reflected on the assets side of the balance sheet in a separate heading.

The Purchase Method

In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as in case of statutory reserve.

Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve.

The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

The reserves of the transferor company, other than statutory reserve should not

be included in the financial statements of the transferee company. The statutory reserves refer to those reserves which are required to be maintained for legal compliance. The statute under which a statutory reserve is created may require the identity of such reserve to be maintained for a specific period.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with such statutory reserves of the transferor company should be recorded in the financial statements of the transferee company by crediting the relevant statutory reserve account. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of "miscellaneous expenditure" or other similar category in the balance sheet. When the identify the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reserved.

CONSIDERATION FOR AMALGAMATION

The consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. In determining the value of the consideration, assessment is made of the fair value of its various elements.

The consideration for the amalgamation should include any non-cash element at fair value. The fair value may be determined by a number of methods. For example, in case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up, and where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective book values.

While the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable.

Treatment of Reserves on Amalgamation

If the amalgamation is an 'amalgamation in the nature of merger'

If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of

preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

If the amalgamation is an 'amalgamation in the nature of purchase'

If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved, dealt within the certain circumstances mentioned below.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated below 'under' treatment of goodwill on amalgamation, . If the result of the computation is positive, the difference is credited to Capital Reserve.

GOODWILL ON AMALGAMATION

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to nature of goodwill, it is difficult to estimate its useful life, but estimation is done on a prudent basis. Accordingly, it should be appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

The following factors are to be taken into account in estimating the useful life of goodwill:

- (i) the forceable life of the business or industry;
- (ii) the effects of product obsolescence, changes in demand and other economic factors;
- (iii) the service life expectancies of key individuals or groups of employees;
- (iv) expected actions by competitors or potential competitors; and
- (v) legal, regulatory or contractual provisions affecting the useful life.

Balance of Profit and Loss Account

In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

Treatment of Reserves Specified in A Scheme of Amalgamation

The scheme of amalgamation sanctioned under the provisions of the Companies Act, 1956 or any other statute may prescribe the treatment to be given to the reserves of the transferor company after its amalgamation. Where the treatment is so prescribed, the same is followed. In some cases, the scheme of amalgamation sanctioned under a statute may prescribe a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

In such cases, the following disclosures are made in the first financial statements following the amalgamation:

- (a) A description of the accounting treatment given to the reserves and the reasons for following the treatment different from that prescribed in this Standard.
- (b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.
- (c) The financial effect, if any, arising due to such deviation.

MCA has issued new Indian Accounting Standard (Ind. AS-103) on business combinations which can be accessed at www.mca.gov.in

Disclosure Requirements

- (a) For amalgamations of every type of 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 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.

Amalgamation after the Balance Sheet Date

While an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made as per the provisions of AS-4, 'Contingencies and Events Occurring after the Balance Sheet Date', but the amalgamation should not be incorporated in that financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Requirement under listing agreement with respect to accounting treatment for amalgamations

While filing for approval any draft Scheme of amalgamation/merger/reconstruction, etc. with the stock exchange under the listing agreement, the company is also required to file an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government in Section 211(3C) of the Companies Act, 1956.

However, in case of companies where the respective sectoral regulatory authorities have prescribed norms for accounting treatment of items in the financial statements contained in the scheme, the requirements of the regulatory authorities shall prevail.

For this purpose, mere disclosure of deviations in accounting treatments shall not be deemed as compliance

THE HUMAN ASPECTS OF MERGERS AND AMALGAMATIONS

The merger is a period of great uncertainty for the employees of the merging organisations. The uncertainty relates to job security and status within the company leading to fear and hence low morale among the employees. It is natural for employees to fear the loss of their revenue or change in their status within the company after a merger since many of these employees literally invest their whole lives in their jobs. Hence the possibility of a change in their position is likely to be viewed with fear and resentment. The possibility of a change in compensation and benefits also creates a feeling of insecurity and unease. The influx of new employees into the organisation can create a sense of invasion at times and ultimately leads to resentment. Further, the general chaos which follows any merger results in disorientation amongst employees due to ill defined role and responsibilities. This further leads to frustrations resulting into poor performance and low productivity since strategic and financial advantage is generally a motive for any merger. Top executives very often fail to give attention to the human aspects of mergers by neglecting to manage the partnership in human terms. By failing to give attention to the problems faced by their employees, they fail to fully develop their companies' collaborative advantage.

In such cases what is normally forgotten is the centrality of cultural integration. The issues of cultural integration and the issues of human behaviour need to be addressed simultaneously if not well before the issues of financial and legal integration are considered. Implementation of structural nature may be financially and legally successful. But if cultural issues are ignored, the success may only be transient.

According to Studies 83% of all mergers and acquisitions failed to produce any benefit for the shareholders and over half actually destroyed value. It revealed that the overwhelming cause for failure is the people and cultural difference. Difficulties encountered in M & As are amplified in cross-cultural situations, when the companies involved are from two or more countries.

Culture of an organization means the sum total of things the people do and the things the people do not do. Behavioral patterns get set because of the culture. These patterns create mental blocks for the people in the organization. Pre-merger survey and summarization of varying cultures of different companies merging, needs to be carried out. People belonging to the each defined culture need to be acquainted with other cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of cultures and ethos easy and effective.

The successful merger demands that strategic planners are sensitive to the human issues of the organisations. For the purpose, following checks have to be made constantly to ensure that:

- sensitive areas of the company are pinpointed and personnel in these

- sections carefully monitored;
- serious efforts are made to retain key people;
 - a replacement policy is ready to cope with inevitable personnel loss;
 - records are kept of everyone who leaves, when, why and to where;
 - employees are informed of what is going on, even bad news is systematically delivered. Uncertainty is more dangerous than the clear, logical presentation of unpleasant facts;
 - training department is fully geared to provide short, medium and long term training strategy for both production and managerial staff;
 - likely union reaction be assessed in advance;
 - estimate cost of redundancy payments, early pensions and the like assets;
 - comprehensive policies and procedures be maintained up for employee related issues such as office procedures, new reporting, compensation, recruitment and selection, performance, termination, disciplinary action etc.;
 - new policies to be clearly communicated to the employees specially employees at the level of managers, supervisors and line manager to be briefed about the new responsibilities of those reporting to them;
 - family gatherings and picnics be organised for the employees and their families of merging companies during the transition period to allow them to get off their inhibitions and breed familiarity.

The classic examples of effective human resource management is the acquisition of Wellcome group by Glaxo.

GLAXO-WELLCOME GROUP ACQUISITION - HR MANAGEMENT

Wellcome and Glaxo were profoundly different companies, both structurally as well as culturally. Wellcome was more of an academic culture and Glaxo more of a commercial, business driven culture. Everything was different between the companies, from finance to information technology, the structure of sales representatives to legal side. Less diplomatic Glaxo staff saw Wellcome as an over-centralised organisation with employees who were unrealistic in their expectations for the business's financial success. Academia-like penny-pinching officials had saddled Wellcome with out-of-date information technology.

Wellcome staff, in contrast, saw Glaxo as overly commercial mercenaries assaulting their worthy enterprise and driven by cash. They argued, in its enthusiasm for the latest high-tech research gadgetry the Glaxo officials refused to study tropical diseases where sufferers could not afford western prices.

To try to combat such sentiments, management declared that both old companies were history and decreed that a new company was to be built in its place. But, the most difficult aspect of merger was to lay off staff both on account of closing down of certain manufacturing units as well as to cut down on excess costs. To

overcome the difficulties, management offered a very lucrative package. The solution was expensive but unavoidable, given that Glaxo management was trying not to give the impression that it was steamrolling Wellcome.

In France, the company established an organisation called Competence Plus, comprising employees who had been made redundant. They were guaranteed up to 15 months on full salary and given training courses on everything from “networking” to new skills. They were also the first to be interviewed for any vacancies that arose within the new group during that period. Employees hired by other companies for trial periods had their salaries paid by Glaxo-Wellcome. For those who remained, there were improvements too. Glaxo staff worked a 39-hour week, whereas Wellcome did 37 hours. Now Glaxo-Wellcome people work 37 hours. “We were concerned not to make mistakes in the social sphere,” said Mangeot, the Chairman of Glaxo-Wellcome, France.

HLL-TOMCO CASE

In Hindustan Lever Ltd.(HLL) and Tomco merger case, HLL had been known for its result oriented, systems driven work environment, where a strong emphasis is placed on performance. Accordingly, it always has/had and strives for a team of high performing and high profile executives, carefully selected from the best management institutes. Discussing product profitability and target achievement is the only language that its managers understand. The work culture is very demanding and only the best survive. In fact, about 100 managers at that time from Unilever group companies had quit their jobs, as they were unable to cope with the demanding work culture.

It was felt that the more difficult part would be the management of the two very different work cultures and ethos, after the merger. In TOMCO the employee productivity was only 60% of HLL. It was opined that HLL would have to rationalize TOMCO's work force. HLL itself had launched a voluntary retirement package, in order to get rid of about 500 workers, however only a few resigned. However TOMCO employees had been assured that their employment conditions were to be protected and service conditions would be honoured. All the employees of TOMCO were to be absorbed as HLL employees.

It is probably not an exaggeration to assert that most cross-border deals run into difficulties because of failures in the integration process. What is acquisition integration? First and foremost, it is the process of realizing the strategic benefits of a merger. In other words, it is everything merging companies must do to achieve synergies and position the new firm for growth. It requires effective interaction and coordination between merging firms to realize the strategic potential of the deal at the same time that it necessitates special attention to human resource concerns. Stated in this way, it is a tall order, and indeed seems absolutely critical to M&A success.

Differences among management and workers can sometimes spiral into broader community and political problems. Such was the case in the 1988 acquisition of Rowntree, headquartered in York, England by Nestle, the Swiss foods giant. Concerns about the future of Rowntree workers, facilities, and even the town of York

itself created an uproar in the UK, involving Members of Parliament, political parties, and the Archbishop of York. In the end, Nestle was forced to make several concessions to public opinion in its integration of Rowntree, including retaining York facilities and making certain guarantees with respect to the job security of Rowntree workers.

A Survey on culture and human issues in case of mergers, acquisitions and takeovers.

CULTURAL ISSUES ON MERGERS, ACQUISITIONS AND TAKE OVERS

Accenture and the Economist Intelligence Unit in the first half of 2006, surveyed senior executives in North America, Europe and Asia on their mergers and acquisitions (M&A) activities and their experience in integrating companies. Similar survey was also administered to 156 executives based in India during the fourth quarter of 2006.

Of the total respondents in India, 40% were senior-level. About 64% were from companies that had global annual revenues of US\$100m or more and 36% had revenues of US\$1bn or more. 45% executive mainly played roles in strategy and business development and 42% in general management. Their companies were from a wide range of industries, including financial services (25%), IT and technology (21%) and professional services (13%).

Following are the key findings of the survey on human and cultural factors.

Human and Cultural Factors

Accenture Survey points out that for integrating a cross border company, 43%, respondents found addressing cultural issues as critical. The real challenge, after an acquisition is, therefore, the integration of the two companies. That is why the integration should be given a focused attention. There should be a focus on aligning the acquired company's processes through the business excellence model.

Human Factor

Studies on post-acquisition performance have primarily been a centre of interest of researchers in strategy, economics and finance. The identified factors of performance variations have usually ranged from the industry match (complementary of assets, similarities of markets and products, synergies in production, strategic orientation, etc.), pricing policy, financing and size of the operation and type of the transaction, bidding conditions, etc.

By contrast to quantitative measurements from finance and economics, the research, which has focused on the organizational and human side of M&As, has mostly dealt with identifying factors that might have played a role in the integration process of the merging entities and led to successful outcomes. Despite the absence of a direct causal correlation, several dimensions have been identified as having an important impact on M&A performance, these include psychological, cultural and

managerial factors, knowing that the human factor covers at the same time employees and managers of the companies.

Psychological Factors

A large part of the existing research has looked at the psychological effects of M&A on employees. Scholars have pointed out that strong impact that the operations could have on employees, in particular the resulting increase in stress and anxiety due to changes in work practices and tasks, managerial routines, colleagues environment, the hierarchy, etc. Further, merger and acquisitions often introduce an environment of uncertainty among employees about job losses and future career development. It has been pointed out that stress and insecurity may lead to employee resistance to change, absenteeism and lack of commitment to work and the organisation. Employee resistance prevents the building up of a well functioning organisation and constructive cooperative environment. Lack of work commitments have a negative impact on individual and organizational performance measured in terms of productivity, quality, and service. Moreover, a relationship between organizational and financial performance has also been identified which may have consequences for the market value of company.

On the other hand, it has been argued that satisfied employees are presumed to work harder, better, and longer with higher productivity records. Even though a direct relationship between job satisfaction and corporate performance remains to be established with certainty, it appears that lower job satisfaction is a cause of higher absenteeism, which, in turn is shown to have a negative influence on organizational performance.

Cultural factors

Cultural differences look like playing both ways. Although distant cultural environments make the integration process harder, the lack of culture-fit or cultural compatibility has often been used to explain M&A failure. Cultural differences have also been considered a source of lower commitment to work, making co-operation more difficult, particularly from employees of the acquired company. In this regard, scholars have largely given account of the lack of co-operation momentum stemming from a "we" versus "them" attitude, resulting in hostility among employees.

It is, therefore, no surprise that strong cultural differences are usually associated with a negative impact on M&A performance, since the integration process is less easy and deals with higher employee resistance, communication problems, and lower interest in co-operation. Noticeably, cultural clashes are likely to be more prominent in cross-national than domestic acquisitions, since such mergers bring together not only two companies that have different organizational cultures but also organizational cultures rooted in national diversity. The scholars have identified building up of a common culture as essential for the success of merger and acquisitions. Researchers have found that high levels of employees' social identification with the organization's identity results in increased work effort, higher performance, reduced staff turnover and more frequent involvement in positive organizational citizenship.

FILING OF VARIOUS FORMS IN THE PROCESS OF MERGER/ AMALGAMATION

The following forms, reports, returns etc. are required to be filed with the Registrar of Companies, SEBI and stock exchanges at various stages of the process of merger/amalgamation:

1. (a) when the objects clause of the memorandum of association of the transferee company is altered to provide for amalgamation/merger, for which special resolution under Section 17 of the Companies Act, 1956, is passed;
- (b) the company's authorised share capital is increased to enable the company to issue shares to the shareholders of the transferor company in exchange for the shares held by them in that company for which a special resolution under Section 31 of the Act for alteration of its articles is passed;
- (c) a special resolution under Section 81(1A) of the Act is passed to authorise the company's Board of directors to issue shares to the shareholders of the transferor company in exchange for the shares held by them in that company; and
- (d) a special resolution is passed under Section 149(2A) of the Act authorising the transferee company to commence the business of the transferor company or companies as soon as the amalgamation/merger becomes effective;

the company should file with ROC within thirty days of passing of the aforementioned special resolutions, e-Form No. 23. The following documents should be annexed to the said e-form: (i) certified true copies of all the special resolutions; (ii) certified true copy of the explanatory statement annexed to the notice for the general meeting at which the resolutions are passed, for registration of the resolution under Section 192 of the Act. This e-form should be digitally signed by Managing Director/Director/Manager or Secretary of the Company duly authorized by Board of Directors. This e-form should also be certified by Company Secretary or Chartered Accountant or Cost Accountant (in whole time practice) by digitally signing the e-form.

2. When a special resolution is passed under Section 149(2A) of the Act, authorising the transferee company to commence the business of the transferor company or companies as soon as the amalgamation/merger becomes effective, the transferee company should also file with the Registrar of Companies, a duly verified declaration of compliance with the provisions of Section 149(2A) by one of the directors or the secretary or, where the company has not appointed a secretary, a secretary in whole-time practice in e-Form No. 20A. The original duly filled in and signed e-form 20A on stamp paper, of the value applicable in the State where declaration is executed, is also required to be sent to the concerned ROC office simultaneously, failing which the filing will not be considered and legal action will be taken.

3. In compliance with the listing agreement, the transferee company is required to give notice to the stock exchanges where the securities of the company are listed, and to the Securities and exchange Board of India (SEBI), of the Board meeting called for the purpose of discussing and approving amalgamation.
4. In compliance with the listing agreement, the transferee company is required to give intimation to the stock exchanges where the securities of the company are listed, of the decision of the Board approving amalgamation and also the swap ratio, before such information is given to the shareholders and the media.
5. The transferee company is required 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 of equity shareholders/creditors including debentures holders etc. as required under Section 391(3) of the Companies Act. This e-form should be digitally signed by the Managing Director or Director or Manager or Secretary of the Company duly authorized by the Board of Directors. However, in case of foreign company, the e-form should be digitally signed by an authorized representative of the company duly authorized by the Board of Directors.

The original certified copy of the Courts order is also required to be submitted at the concerned ROC office simultaneously of filing e-form 21, failing which the filing will not be considered and legal action will be taken.
6. In compliance with the listing agreement, the transferee company is required to simultaneously furnish to the stock exchanges where the securities of the company are listed, copy of every notice, statement, pamphlet etc. sent to members of the company in respect of a general meeting in which the scheme of arrangement of merger/amalgamation is to be approved.
7. In compliance with the listing agreement, the transferee company is required to furnish to the stock exchanges where the securities of the company are listed, minutes of proceedings of the general meeting in which the scheme of arrangement of merger/amalgamation is approved.
8. To file with ROC within thirty days of passing of the special resolution, e-Form No. 23. The following documents should be annexed to the said e-form: (i) certified true copy of the special resolution approving the scheme of arrangement of merger/amalgamation; (ii) certified true copy of the explanatory statement annexed to the notice for the general meeting at which the resolution is passed, for registration of the resolution under Section 192 of the Act. This e-form should be digitally signed by Managing Director/ Director/Manager or Secretary of the Company duly authorized by Board of Directors. The e-form should also be certified by Company Secretary or Chartered Accountant or Cost Accountant (in whole time practice) by digitally signing the e-form.
9. The transferee company is required to file with the Central Government notice of every application made to the court under Section 391 to 394 of the Companies Act, 1956. No notice need be given to the Central Government once again when the Court proceeds to pass final order to dissolve the

transferor company.

The Central Government has delegated its powers under the aforesaid sections to the Regional Director, Department of Company Affairs.

10. To file with the Registrar of Companies within thirty days of allotment of shares to the shareholders of the transferor company in lieu of the shares held by them in that company in accordance with the shares exchange ratio incorporated in the scheme of arrangement for merger/amalgamation, e-Form No. 2 the return of allotment along with the prescribed filing fee as per requirements of Sections 75 of the Act. This e-form should be digitally signed by Managing Director or Director or Manager or Secretary of the Company duly authorised by the Board of Directors. The e-form should also be certified by Company Secretary or Chartered Accountant or Company Secretary (in whole time practice) by digitally signing the e-form.

AMALGAMATION OF BANKING COMPANIES

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.

According to section 2(5) of the Companies Act, 1956 “Banking company” has the same meaning as in the Banking Companies Act, 1949. (now the Banking Regulation Act, 1949). 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 RBI’s power under section 44A shall not affect the power of the Central government to provide for the amalgamation of two or more banking companies under section 396 of the Companies Act, 1956. But, in such a case, the Central Government must consult the RBI before passing any order under Section 396. [Section 44A(7)].

Major Mergers of Last Decade

<i>Year</i>	<i>Transferor Bank</i>	<i>Transferee Bank</i>
2001	Bank of Madura	ICICI Bank Ltd.
2002	Benaras State Bank Ltd.	Bank of Baroda
2003	Bank Muscat	Centurion Bank of Punjab
2004	Global Trust Bank Ltd.	Oriental Bank of Commerce
2005	Bank of Punjab Ltd.	Centurion Bank of Punjab.
2006	Lord Krishna Bank	Centurion Bank of Punjab
2007	Sangli Bank	ICICI Bank Ltd.
2008	State Bank of Saurashtra	State Bank of India
2009	Centurion Bank of Punjab	HDFC Bank Ltd.
2010	Bank of Rajasthan	ICICI Bank Ltd.

GUIDELINES ISSUED BY RBI FOR MERGER /AMALGAMATION OF PRIVATE SECTOR BANKS

Amalgamation between two banking companies

- Section 44A of the Banking Regulation Act, 1949 requires that the draft scheme of amalgamation has to be approved by the shareholders of each banking company by a resolution passed by a majority in number representing two-thirds in value of the shareholders, present in person or by proxy at a meeting called for the purpose.
- Before convening the meeting for the purposes of obtaining the shareholders' approval, the draft scheme of amalgamation needs to be approved individually by the Boards of Directors of the two banking companies. When according this approval, the Boards need to give particular consideration to the following matters :-
 - (a) The values at which the assets, liabilities and the reserves of the amalgamated company are proposed to be incorporated into the books of the amalgamating banking company and whether such incorporation will result in a revaluation of assets upwards or credit being taken for unrealized gains.
 - (b) Whether due diligence exercise has been undertaken in respect of the amalgamated company.
 - (c) The nature of the consideration, which, the amalgamating banking company will pay to the shareholders of the amalgamated company.
 - (d) Whether the swap ratio has been determined by independent valuers having required competence and experience and whether in the opinion of the Board such swap ratio is fair and proper.
 - (e) The shareholding pattern in the two banking companies and whether as a result of the amalgamation and the swap ratio the shareholding of any individual, entity or group in the amalgamating banking company will be violative of the Reserve Bank guidelines or require its specific approval.
 - (f) The impact of the amalgamation on the profitability and the capital adequacy ratio of the amalgamating banking company.
 - (g) The changes which are proposed to be made in the composition of the board of directors of the amalgamating banking company, consequent upon the amalgamation and whether the resultant composition of the Board will be in conformity with the Reserve Bank guidelines in that behalf.
- Section 44A of the Banking Regulation Act, 1949 also requires that after the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of the Section, it shall be submitted to the Reserve Bank for sanction.
- To enable the Reserve Bank to consider the application for sanction, the amalgamating banking company should submit to the Reserve Bank the

information and documents specified below:

1. Draft scheme of amalgamation as placed before the shareholders of the respective banking companies for approval.
2. Copies of the notices of every meeting of the shareholders called for such approval together with newspaper cuttings evidencing that notices of the meetings were published in newspapers at least once a week for three consecutive weeks in two newspapers circulating in the locality or localities in which the registered offices of the banking companies are situated and that one of the newspapers was in a language commonly understood in the locality or localities.
3. Certificates signed by each of the officers presiding at the meeting of shareholders certifying the following:
 - (a) a copy of the resolution passed at the meeting;
 - (b) the number of shareholders present at the meeting in person or by proxy;
 - (c) the number of shareholders who voted in favour of the resolution and the aggregate number of shares held by them;
 - (d) the number of shareholders who voted against the resolution and the aggregate number of shares held by them;
 - (e) the number of shareholders whose votes were declared as invalid and the aggregate number of shares held by them;
 - (f) the names and ledger folios of the shareholders who voted against the resolution and the number of shares held by each such shareholder;
 - (g) the names and designations of the scrutineers appointed for counting the votes at the meeting together with certificates from such scrutineers confirming the information given in items (c) to (f) above;
 - (h) the name of shareholders who have given notice in writing to the Presiding Officer that they dissented from the scheme of amalgamation together with the number of shares held by each of them.
4. Certificates from the concerned officers of the banking companies giving names of shareholders who have given notice in writing at or prior to the meeting to the banking company that they dissented from the scheme of amalgamation together with the number of shares held by each of them.
5. The names, addresses and occupations of the Directors of the amalgamating banking company as proposed to be reconstituted after the amalgamation and indicating how the composition will be in compliance with Reserve Bank regulations.
6. The details of the proposed Chief Executive Officer of the amalgamating banking company after the amalgamation.

7. Copies of the reports of the valuers appointed for the determination of the swap ratios.
 8. Information which is considered relevant for the consideration of the scheme of amalgamation and the swap ratio.
 9. Information certified by the valuers as is considered relevant to understand the proposed swap ratio including in particular:
 - (a) the methods of valuation used by the valuers;
 - (b) the information and documents on which the valuers have relied and the extent of the verification, if any, made by the valuers to test the accuracy of such information;
 - (c) if the valuers have relied upon projected information, the names and designations of the persons who have provided such information and the extent of verification, if any, made by the valuers in relation to such information;
 - (d) details of the projected information on which the valuers have relied;
 - (e) detailed computations of the swap ratios containing explanations for adjustments made to the published financial information for the purposes of the valuation;
 - (f) if these adjustments are made based on valuations made by third parties, details regarding the persons who have made such valuations;
 - (g) capitalisation factor and weighted average cost of capital (WACC) used for the purposes of the valuation and justification for the same;
 - (h) if market values of shares have been considered in the computation of the swap ratio, the market values considered and the source from which such values have been derived;
 - (i) if there are more than one valuer, whether each of the valuers have recommended a different swap ratio and if so, the above details should be given separately in respect of each valuer and it may be indicated how the final swap ratio is arrived at.
 10. Such other information and explanations as the Reserve Bank may require.
- To enable the Reserve Bank to determine such value, the amalgamated banking company should submit the following:-
- (a) a report on the valuation of the share of the amalgamated company made for this purpose by the valuers appointed for the determination of the swap ratio
 - (b) detailed computation of such valuation
 - (c) where the shares of the amalgamated company are quoted on the stock exchange:-
 - (i) details of the monthly high and low of the quotation on the exchange

where the shares are most widely traded together with number of shares traded during the six months immediately preceding the date on which the scheme of amalgamation is approved by the Boards.

- (ii) the quoted price of the share at close on each of the fourteen days immediately preceding the date on which the scheme of amalgamation is approved by the Boards.

- (d) Such other information and explanations as the Reserve Bank may require.

Amalgamation of an NBFC with a banking company

Where the NBFC is proposed to be amalgamated into a banking company, the banking company should obtain the approval of the Reserve Bank of India after the scheme of amalgamation is approved by its Board but before it is submitted to the High Court for approval.

The following are ensured while granting the approval

- (a) The NBFC has violated / is likely to violate any of the RBI/SEBI norms and if so, ensure that these norms are complied with before the scheme of amalgamation is approved.
- (b) The NBFC has complied with the 'Know Your Customer' norms for all the accounts, which will become accounts of the banking company after amalgamation.
- (c) The NBFC has availed of credit facilities from banks/FIs and if so, whether the loan agreements mandate the NBFC to seek consent of the bank/FI concerned for the proposed merger/amalgamation.

Prior approval of RBI in cases of acquisition or transfer of control of deposit taking NBFCs

As per, Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009, any takeover or acquisition of control of a deposit taking NBFC, whether by acquisition of shares or otherwise, or any merger/amalgamation of a deposit taking NBFC with another entity, or any merger/amalgamation of an entity with a deposit taking NBFC, shall require prior written approval of Reserve Bank of India. The Reserve Bank of India may, if it considers necessary for avoiding any hardship or for any other just and sufficient reason, exempt any NBFC or class of NBFCs, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

Approval of Scheme of Amalgamation

- 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. [Section 44A(1)].

- The approval of the shareholders must be secured at an extraordinary general meeting of each of the concerned companies, specially convened for the purpose of approving the scheme.
- In the first instance, the scheme shall be placed before the Board of Directors of each of the concerned companies.
- 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.

Convening General Meeting

- 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 [section 44A(2)].
- The notice of the meeting must indicate the time, place and object of the meeting [section 44A(2)].
- 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 [section 44A(2)].
- 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.

Resolution for approval of the scheme

- The scheme of amalgamation must be approved by means of a resolution passed at the general meeting, by a majority in number representing two-third in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose [section 44A(1)].

Dissenting shareholders' right to claim return of capital

- 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 [section 44A(3)].

- The determination by the RBI regarding the value of the shares to be paid to the dissenting shareholders shall be final for all purposes [section 44A(3)].

Approval by Reserve Bank of India

- 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 [section 44A(4)].
- The RBI may sanction a scheme by an order in writing [section 44A(4)].
- A scheme sanctioned by the RBI shall be binding on the banking companies concerned and also on all the shareholders thereof [section 44A(4)].
- 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 [section 44A(6C)].
- 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 [section 44A(6C)].

Transfer of property

- 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 [section 44A(6)].
- Similarly, the liabilities of the transferor company shall, by virtue of the said order, be transferred to, and become the liabilities of the transferee company [section 44A(6)].

Dissolution of transferor company

- 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 [section 44A(6A)].
- 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. [section 44A(6B)].

MERGERS AND MINORITY INTEREST

Existing legal provisions of Companies Act, with respect to 'Minority interest in Mergers/ Amalgamation etc'.

Sections 391 to 396 of The Companies Act, 1956 guide the legal procedure for corporate strategies, including mergers, amalgamations and reconstructions.

Sections 391 to 394 inter-alia give the Court the power to sanction enforce and supervise a compromise or arrangement between a company and its creditors/members subject to certain conditions. These include providing for the availability of information required by creditors and members of the concerned company when acceding to such an arrangement and facilitating the reconstruction and amalgamation of companies, by making an appropriate application to the Court.

Section 395 gives the right to acquire the shares of dissenting shareholders from the scheme or contract, which has been approved by the majority. Section 396 deals with the powers of the Central Government to provide for an amalgamation of companies in the national interest.

In any scheme of amalgamation, both the amalgamating company and the amalgamated company are required to comply with the requirements specified in Sections 391 to 394 and submit the details of all the formalities for consideration of the Court.

Protection of minority Interest

Section 394(1) authorises the court to make provision for those who dissent from a scheme. Thus, the courts have to play a very vital role. It is not only a supervisory role but also a pragmatic role which requires the forming of an independent and informed judgement as regards the feasibility or proper working of the scheme and making suitable modifications in the scheme and issuing appropriate directions with that end in view [*Mafatlal Industries Ltd. In re.* (1995) 84 Comp. Cas. 230 (Guj.)].

The court considers Minority interest while approving the scheme of merger

As per existing provisions of the Act, approval of High Court / Tribunal is required in case of corporate restructuring (which, inter-alia, includes, mergers/amalgamations etc.) by a company. The Scheme is also required to be approved by shareholders, before it is filed with the High Court. The scheme is circulated to all shareholders along with statutory notice of the court convened meeting and the explanatory statement u/s 393 of the Act for approving the scheme by shareholders

Though there may not be any protection to any dissenting minority shareholders on this issue, the Courts, while approving the scheme, follow judicious approach by mandating publicity about the proposed scheme in newspaper to seek objections, if any, against the scheme from the shareholders. Any interested person (including a minority shareholder) may appear before the Court. There have been, however, occasions when shareholders holding miniscule shareholdings, have made frivolous objections against the scheme, just with the objective of stalling or deferring the implementation of the scheme. The courts have, on a number of occasions, overruled their objections.

Some Judicial Pronouncements

There have been occasions when the minority shareholders have raised objections and have succeeded in preventing the implementation of a scheme of arrangement. A lone minority shareholder of Tainwala Polycontainers Ltd (TPL), Dinesh V Lakhani, had apparently forced the company to call off its merger plans with Tainwala Chemicals and Plastics (India) Ltd (TCPL). Lakhani had opposed the proposed merger on several grounds including allegations of willful suppression of material facts and malafide intention of promoters in floating separate companies (TPL and TCPL).

A division bench of the Bombay High Court had stayed the proposed TPL-TCPL merger. After almost two years of courtroom battle, the company decided to withdraw the amalgamation petition without citing any reasons.

Frivolous objections by Minority shareholders are not entertained by Court

There have however been some instances when shareholders holding a small number of shares, have made frivolous objections against the scheme, just with the objective of deferring the implementation of the scheme. The courts have, on a number of occasions, overruled their objections. But Companies had to bear the consequences in the form of time and cost over-runs.

In case of Parke-Davis India Limited

In 2003, Parke-Davis India Limited and Pfizer Limited were considering implementation of a Scheme of Merger. The Minority shareholders of Parke-Davis India Ltd objected to the Scheme on the grounds that the approval from the requisite majority as prescribed under the Companies Act, 1956 had not been obtained. They filed an urgent petition before the division bench of the Bombay High Court. The division bench of the Bombay High Court by its order executed a stay order in March 2003 restraining the company from taking further steps in the implementation of the scheme of amalgamation, which was further extended till September 2003. The dissenting shareholders filed a Special Leave Petition with the Supreme Court. The turmoil came to an end when the Supreme Court dismissed the petition filed by the shareholders. Parke-Davis then proceeded to complete the implementation of the scheme of amalgamation with Pfizer.

In case of Tomco with HLL Merger

Similarly, in the case of the merger of Tomco with HLL, the minority shareholders put forward an argument that, as a result of the amalgamation, a large share of the market would be captured by HLL. However, the court turned down the argument and observed that there was nothing unlawful or illegal about it.

Fair and reasonable Scheme made in good faith

Any scheme which is fair and reasonable and made in good faith will be sanctioned if it could reasonably be supported by sensible people to be for the benefit to each class of the members or creditors concerned. In *Sussex Brick Co. Ltd., Re*, (1960) 1 All ER 772 : (1960) 30 Com Cases 536 (Ch D) it was held, inter alia, that

although it might be possible to find faults in a scheme that would not be sufficient ground to reject it. It was further held that in order to merit rejection, a scheme must be obviously unfair, patently unfair, unfair to the meanest intelligence. It cannot be said that no scheme can be effective to bind a dissenting shareholder unless it complies with the basic requirements to the extent of 100 per cent. It is the consistent view of the Courts that no scheme can be said to be fool-proof and it is possible to find faults in a particular scheme but that by itself is not enough to warrant a dismissal of the petition for sanction of the scheme. If the court is satisfied that the scheme is fair and reasonable and in the interests of the general body of shareholders, the court will not make any provision in favour of the dissentients. For such a provision is not a sine qua non to sanctioning a fair and reasonable scheme, unless any special case is made out which warrants the exercise of court's discretion in favour of the dissentients. *Re, Kami Cement & Industrial Co. Ltd.*, (1937) 7 Com Cases 348, 364-65 (Bom).

The Courts have gone further to say that a scheme must be held to be unfair to the meanest intelligence before it can be rejected. It must be affirmatively proved to the satisfaction of the Court that the scheme is unfair before the scheme can be rejected by the Court. *English, Scottish & Australian Chartered Bank, Re*, (1893) 3 Chancery 385.

A conjoint reading of sections 391 and 393 makes it clear at once that the Company Court which is called upon to sanction a scheme has not merely to go by the ipse dixit of the majority of the shareholders or creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the court has to consider the pros and cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it does not violate any public policy. This is implicit in the very concept of compromise or arrangement which is required to receive the imprimatur of a court of law. No court of law would ever countenance any scheme of compromise or arrangement arrived at between the parties and which might be supported by the requisite majority if the court finds that it is an unconscionable or an illegal scheme or is otherwise unfair or unjust to the class of shareholders or creditors for whom it is meant. It is trite to say that once the scheme gets sanctioned by the court it would bind even the dissenting minority shareholders or creditors. Therefore, the fairness of the scheme qua them also has to be kept in view by the Company Court while putting its seal of approval on the concerned scheme. *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, (1996) 87 Com Cases 792 at 812 (SC)

COMPETITION ASPECTS OF MERGERS AND AMALGAMATION

COMPETITION ASPECTS OF COMBINATIONS

INTRODUCTION

Antitrust law seeks to make enterprises compete fairly. It has had a serious effect on business practices and the organization of U.S. industry. Premised on the belief that free trade benefits the economy, businesses, and consumers alike, the law forbids several types of restraints of trade and monopolization. These cover areas such as agreements between or among competitors, contractual arrangements

between sellers and buyers, the pursuit or maintenance of monopoly power, and mergers.

The Sherman Anti-Trust Act of 1890 is the origin of Anti-trust/Competition Law in many countries. This legislation was the result of intense public opposition to the concentration of economic power in large corporations and in combinations of business concerns that had been taking place in the U.S. in the decades following the Civil War.

The Sherman Antitrust Act was the first measure enacted by the U.S. Congress. The Sherman Antitrust Act, was based on the constitutional power of Congress to regulate interstate commerce. In 1914, US Congress passed two measures that provided additional support for the Sherman Antitrust Act. One was the Clayton Antitrust Act, which elaborated on the general provisions of the Sherman Act and specified a number of illegal practices that either contributed to or resulted from monopolization. It explicitly outlawed commercial practices such as price discrimination (i.e., charging different prices to different customers), the buying out of competitors and interlocking boards of directors. The other was the establishment of the Federal Trade Commission, an agency with the power to investigate possible violations of antitrust laws and to issue orders forbidding unfair competitive practices. Gradually, competition law came to be recognized as one of the key pillars of a market economy. This recognition led to enactment of competition law in many countries including developing countries.

Competition Act, 2002

The Competition Bill, 2000 was introduced in Parliament which was later enacted as the Competition Act, 2002. The Act has been amended in the year 2007 and 2009.

Preamble

An act to provide for keeping in view of the economic development of the country, the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

Combination under Competition Act, 2002

Combination means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The threshold are unambiguously specified in the Act in terms of assets or turnover in India and abroad. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination would be void.

SECTIONS 5 AND 6 HAS COME INTO FORCE ON JUNE 01 2011.

The Ministry of Corporate Affairs has vide its notification dated March 04, for

effecting Section 5, 6, 20, 29, 30 & 31 of Competition Act with effect from June 01, 2011. The CCI (Procedure in regard to the transaction of business relating to combination) Regulations 2011- are also being inforce, with effect from June 01, 2011.

Combination – Thresholds under the Competition Act, 2002

THRESHOLDS FOR COMBINATIONS

IN INDIA	APPLICABLE TO	ASSETS	TURNOVER
	INDIVIDUAL PARTY	Rs 1000 Cr	Rs 3000 Cr
	GROUP	Rs 4000 Cr	Rs 12,000 Cr

IN INDIA & OUTSIDE	APPLICABLE TO	ASSETS		TURNOVER	
		TOTAL	INDIA	TOTAL	INDIA
	INDIVIDUAL PARTIES	\$ 500 M (aggregate)	500 Cr	\$ 1500 M (Aggregate)	1500 Cr
GROUP	\$ 2 Billion (aggregate)	1500 Cr	\$ 6 Billion (aggregate)	1500 Cr	

Combined assets of the enterprises value more than ₹ 1,000 crores or combined turnover is more than ₹ 3,000 crores. In case either or both of the enterprises have assets/turnover outside India also, then the combined assets of the enterprises value more than US\$ 500 millions, including at least ₹ 500 crores in India, or turnover is more than US\$1500 millions, including at least ₹ 1,500 crores in India .

Combined assets of the group to which the acquired enterprise would belong being more than ₹ 4,000 crores or such group having a joint turnover more than ₹12,000 crores after acquisition or merger. In case such group has assets/turnover outside India, then the combined assets of the group value more than US\$ 2 billion, including at least ₹ 500 crores in India or turnover is more than US\$6 billion including at least ₹ 1,500 crores in India.

Two enterprises belong to a “group” if one is in position to exercises at least 26% voting rights or appoint at least 50% of the directors or controls the management or affairs in the other.

It may be pointed out that “control” for the purposes of this section includes controlling the affairs or management by – (i) one or more enterprises, either jointly or singly, over another enterprise or group; (ii) one or more groups, either jointly or singly, over another group or enterprise.

The term “group” means two or more enterprises, which, directly or indirectly are in a position to –

- (i) exercise twenty six per cent, or more of voting rights in other enterprise; or
- (ii) appoint more than fifty per cent of the members of the board of directors in other enterprise; or
- (iii) control the management or affairs of the other enterprise.

It is further provided that the “value of the assets” shall be determined on the basis of the value of assets as shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, after deducting any depreciation therefrom. The value of assets shall also include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, geographical indications, design or layout design or similar other commercial rights, referred to in Section 3(5).

It is clear from the above that two kinds of norms have been prescribed which would attract Section 5. Firstly, the “value of asset” and secondly the “turnover” in India. In the case of a “group”, the “assets” or “turnover” of the “group” has to be aggregated and in the case of “merger” or “amalgamation”, the value of the “assets” or “turnover” of the resultant entity has to be computed in case the parties do not belong to a “group” and in case a par belongs to a “group” and in case a party belongs to a group, the assets or turnover of the group and the merged or amalgamated entity could belong. It is also noteworthy that the control may be either by one or more enterprises over another enterprises or a group or one or more groups singly or jointly over another group or enterprise. It is also significant to note that while computing the value of the assets both ‘physical assets’ and the intangible ones such as ‘goodwill’ or ‘trade mark’ etc. will be taken into account in determining whether reporting requirements get triggered or not.

Regulation of Combinations

Section 6 of the Competition Act prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void.

Notice to the Commission disclosing details of the proposed combination

Section 6(2) envisages that any person or enterprise, who or which proposes to enter into any combination, shall give a notice to the Commission disclosing details of the proposed combination, in the form prescribed and submit the form together with the fee prescribed by regulations. Such intimation should be submitted within 30 days of –

- (a) approval of the proposal relating to merger or amalgamation, referred to in Section 5(c), by the board of directors of the enterprise concerned with such merger or amalgamation, as the case may be;
- (b) execution of any agreement or other document for acquisition referred to in section 5(a) or acquiring of control referred to in section 5(b).

Compulsory Wait Period

A newly inserted sub-section (2A) of Section 6 envisaged that no combination shall come into effect until 210 days have passed from the day of notice or the Commission has passed orders, whichever is earlier.

The Competition Commission of India (CCI) has been empowered to deal with such notice in accordance with provisions of sections 29, 30 and 31 of the Act. Section 29 prescribes procedure for investigation of combinations. Section 30 empowers the Commission to determine whether the disclosure made to it under section 6(2) is correct and whether the combination has, or is likely to have, an appreciable adverse effect on the competition. Section 31 provides that the

Commission may allow the combination if it will not have any appreciable adverse effect on competition or pass an order that the combination shall not take effect, if in its opinion, such a combination has or is likely to have an appreciable adverse effect on competition.

Exemptions

The provisions of Section 6 do not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank venture capital fund, pursuant to any covenant of a loan agreement or investment agreement. This exemption appears to have been provided in the Act to facilitate raising of funds by an enterprise in the course of its normal business. Under section 6(5), the public financial institution, foreign institutional investor, bank or venture capital fund, are required to file in prescribed form, details of the control, the circumstances for exercise of such control and the consequences of default arising out of loan agreement or investment agreement, within seven days from the date of such acquisition or entering into such agreement, as the case may be.

As per the explanation appended to section 6(5)

- (a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to section 115AD of the Income-tax Act, 1961;
- (b) "venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23 FB) of section 10 of the Income-tax Act, 1961.

It may be noted that under the law, the combinations are only regulated whereas anti-competitive agreements and abuse of dominance are prohibited.

Inquiry into Combination by the Commission

The Commission under section 20 of the Competition Act may inquire into the appreciable adverse effect caused or likely to be caused on competition in India as a result of combination either upon its own knowledge or information (suo motu) or upon receipt of notice under section 6(2) relating to acquisition referred to in section 5(a) or acquiring of control referred to in section 5(b) or merger or amalgamation referred to in section 5(c) of the Act. It has also been provided that an enquiry shall be initiated by the Commission within one year from the date on which such combination has taken effect. Thus, the law has provided a time limit within which suo motu inquiry into combinations can be initiated. This provision dispels the fear of enquiry into combination between merging entities after the expiry of stipulated period.

On receipt of the notice under section 6(2) from the person or an enterprise which proposes to enter into a combination, it is mandatory for the Commission to inquire whether the combination referred to in that notice, has caused or is likely to cause an appreciable adverse effect on competition in India.

The Commission shall have due regard to all or any of the factors for the purposes of determining whether the combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, namely—

- (a) actual and potential level of competition through imports in the market;
- (b) extent of barriers to entry into the market;
- (c) level of combination in the market;

- (d) degree of countervailing power in the market;
- (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- (f) extent of effective competition likely to sustain in a market;
- (g) extent to which substitutes are available or are likely to be available in the market;
- (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- (j) nature and extent of vertical integration in the market;
- (k) possibility of a failing business;
- (l) nature and extent of innovation;
- (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
- (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

The above yardstick are to be taken into account irrespective of the fact whether an inquiry is instituted, on receipt of notice under section 6(2) upon its own knowledge. The scope of assessment of adverse effect on competition will be confined to the "relevant market". Most of the facts enumerated in section 20(4) are external to an enterprise. It is noteworthy that sub clause (n) of section 20(4) requires to invoke principles of a "balancing". It requires the Commission to evaluate whether the benefits of the combination outweigh the adverse impact of the combination, if any. In other words if the benefits of the combination outweigh the adverse effect of the combination, the Commission will approve the combination. Conversely, the Commission may declare such a combination as void.

Procedure for investigation of combination

The procedure for investigation by the Commission has been stipulated under section 29 of the Act. It involves the following stages –

- (i) The Commission first has to form a prima facie opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India. Further, when the Commission has come to such a conclusion then it shall proceed to issue a notice to the parties to the combination, calling upon them to show cause why an investigation in respect of such combination should not be conducted;
- (ii) After receipt of the response of the parties to the combination, the Commission may call for the report of the Director General.
- (iii) When pursuant to response of parties or on receipt of report of the Director General whichever is later, the Commission is, prima facie, of the opinion that the Combination is likely to cause an appreciable adverse effect on

competition in relevant market, it shall, within seven days, direct the parties to the combination to publish within ten working days, the details of the combination, in such a manner as it thinks appropriate so as to bring to the information of public and persons likely to be affected by such combination.

- (iv) The Commission may invite any person affected or likely to be affected by the said combination, to file his written objections within fifteen working days of the publishing of the public notice, with the Commission for its consideration.
- (v) The Commission may, within fifteen working days of the filing of written objections, call for such additional or other information as it deem fit from the parties to the said combination and the information shall be furnished by the parties above referred within fifteen days from the expiry of the period notified by the Commission.
- (vi) After receipt of all the information and within forty-five days from expiry of period for filing further information, the Commission shall proceed to deal with the case, in accordance with provisions contained in section 31 of the Act.

Thus, the provisions of section 29 provide for a specified timetable within which the parties to the combination or parties likely to be affected by the combination are required to submit the information or further information or to the Commission to ensure prompt and timely conduct of the investigation. It further imposes on Commission a time limit of forty-five working days from the receipt of additional or other information called for by it under sub-section (4) of section 29 for dealing with the case of investigation into a combination, which may have an adverse effect of the competition.

Inquiry into disclosures under section 6(2)

Section 6(2) casts an obligation on any person or enterprise, who or which proposes to enter into combination, to give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination within thirty days of –

- (i) approval of the proposal relating to merger or amalgamation by the board of directors of the enterprises concerned with such merger or amalgamation;
- (ii) execution of any agreement or other document for acquisition referred to in section 5(a) or acquiring of control referred to in section 5(b).

Non-filing of notice attracts penalty in terms of section 43A of the Act.

The newly inserted section 6(2A) envisages that no combination shall come into effect until two hundred and ten days have passed from the day on which notice has been given to Commission or the Commission has passed orders, whichever is earlier.

Upon receipt of such notice, the Commission shall examine such notice and form its prima facie opinion as to whether the combination has, or likely to have, an appreciable adverse effect on the competition in the relevant market in India.

Orders of Commission on Certain Combinations

The Commission, after consideration of the relevant facts and circumstances of the case under investigation by it under sections 28 or 30 and assessing the effect of any combination on the relevant market in India, may pass any of the written orders

indicated herein below. Where the Commission comes to a conclusion that any combination does not, or is likely to, have an appreciable adverse effect on the competition in relevant market in India, it may, approve that combination.

- (i) In the case where the Commission is of the opinion that the combination has, or likely to have an adverse effect on competition, it shall direct that the combination shall not take effect.
- (ii) Where the Commission is of the opinion that adverse effect which has been caused or is likely to be caused on competition can be eliminated by modifying such Combination then it shall direct the parties to such combination to carry out necessary modifications to the Combination.
- (iii) The parties accepting the proposed modifications shall carry out such modification within the period specified by the Commission.
- (iv) Where the parties who have accepted the modification, fail to carryout such modification within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition and shall be dealt with by the Commission in accordance with the provisions of the Act.
- (v) If the parties to the Combination do not accept the proposed modification such parties may within thirty days of modification proposed by the Commission, submit amendment to the modification proposed by the Commission.
- (vi) If the Commission agrees with the agreement submitted by the parties it shall, by an order approve the combination.
- (vii) If the Commission does not accept the amendment then, parties shall be allowed a further period of thirty days for accepting the amendment proposed by the Commission.
- (viii) Where the parties to the combination fail to accept the modification within thirty days, then it shall be deemed that the combination has an appreciable adverse effect on Competition and will be dealt with in accordance with the provisions of the Act.
- (ix) Where the Commission directs under section 31(2) that the combination shall not take effect or it has, or is likely to have an appreciable adverse effect, it may order that,
 - (a) the acquisition referred to in section 5(a); or
 - (b) the acquiring of control referred to in section 5(b); or
 - (c) the merger or the amalgamation referred to in section 5© shall not be given effect to by the parties.

As per proviso the Commission may, if it considers appropriate, frame a scheme to implement its order in regard to the above matters under section 31(10).

- (x) A deeming provision has been introduced by section 31(11). It provides that, if the Commission does not, on expiry of a period of two hundred ten days from the date of filing of notice under section 6(2) pass an order or issue any

direction in accordance with the provisions of section 29(1) or section 29(2) or Section 29(7), the combination shall be deemed to have been approved by the Commission. In reckoning the period of two hundred ten days, the period of thirty days specified in section 29(6) and further period of thirty working days specified in section 29(6) and further period of thirty working days specified in section 29(8) granted by Commission shall be excluded.

- (xi) Further more where extension of time is granted on the request of parties the period of two hundred ten days shall be reckoned after the deducting the extended time granted at the request of the parties.
- (xii) Where the Commission has ordered that a combination is void, as it has an appreciable adverse effect on competition, the acquisition or acquiring of control or merger or amalgamation referred to in section 5, shall be dealt with by other concerned authorities under any other law for the time being in force as if such acquisition or acquiring of control or merger or amalgamation had not taken place and the parties to the combination shall be dealt with accordingly.
- (xiii) Section 29(14) makes it clear that nothing contained in Chapter IV of the Act shall affect any proceeding initiated or may be initiated under any other law for the time being in force. It implies that provisions of this Act are in addition to and not in derogation of provisions of other Acts.

Thus, approval under one law does not make out a case for approval under another law.

Section 32 extends the jurisdiction of Competition Commission of India to inquire and pass orders in accordance with the provisions of the Act into an agreement or dominant position or combination, which is likely to have an appreciable adverse effect on competition in relevant market in India, notwithstanding that,

- (a) an agreement referred to in Section 3 has been entered into outside India; or
- (b) any party to such agreement is outside India; or
- (c) any enterprise abusing the dominant position is outside India; or
- (d) a combination has taken place outside India; or
- (e) any party to combination is outside India; or
- (f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

The above clearly demonstrates that the acts taking place outside India but having an effect on competition in India will be subject to the jurisdiction of Commission. The Competition Commission of India will have jurisdiction even if both the parties to an agreement are outside India but only if the agreement, dominant position or combination entered into by them has an appreciable adverse effect on competition in the relevant market in India.

Power to impose penalty for non-furnishing of information on combination

Section 43A provides that if any person or enterprise who fails to give notice to the Commission under sub-section (2) of section 6, the Commission shall impose on

such person or enterprise a penalty which may extend to one per cent of the total turnover or the assets, whichever is higher, of such a combination.

Thus, failure to file notice of combination falling under section 5 attracts deterrent penalty.

PROCEDURE FOR MERGER AND AMALGAMATION RELATED TO GOVERNMENT COMPANIES (vide circular dated 20.04.2011)

The Ministry of Corporate Affairs (MCA) have been dealing with the amalgamation of Government Companies in the Public Interest under section 396 of the Companies Act, 1956 by following the procedures prescribed under Companies (Court) Rules, 1959 which are applicable to amalgamation under Sections 391-394 of the Companies Act, 1956. Without prejudice to the generality of Section 396, it has now been decided that, in appropriate cases, simpler procedures shall be adopted for the amalgamation of Government Companies under section 396 of the Companies Act, 1956 as given below:-

- (1) (a) Every Central Government Company which is applying to the Central Government for amalgamation with any other Government Company or Companies under the simplified procedure prescribed in this circular, shall obtain approval of the Cabinet i.e. Union Council of Ministers to the effect that the proposed amalgamation is essential in the 'public interest'.
- (b) In the case of State government companies, the approval of the State Council of Ministers would be required.
- (c) Where both central and state government companies are involved, approval of both State Cabinet(s) and Central Cabinet shall be necessary.
- (2) (i) A Government Company may, by a resolution passed at its general meeting decide to amalgamate with any other Government Company, which agrees to such transfer by a resolution passed at its general meeting;
- (ii) Any two or more Government Companies may, by a resolution passed at any general meetings of its Members, decide to amalgamate and with a new Government Company.
- (3) Every resolution of a Government Company under this section shall be passed at its general meeting by members holding 100% of the voting power and such resolution shall contain all particulars of the assets and liabilities of amalgamating government companies.
- (4) Before passing a resolution under this section, the Government Company shall give notice thereof of not less than 30 days in writing together with a copy of the proposed resolution to all the Members and creditors.
- (5) A resolution passed by a Government Company under this section shall not take effect until (i) the assent of all creditors has been obtained, or (ii) the assent of 90% of the creditors by value has been received and the company certifies that there is no objection from any other creditor.

- (6) The resolutions passed by the transferor and transferee companies along with written confirmation of the Cabinet decision referred to in para (i) shall then be submitted to the Central Government which shall, if it is satisfied that all the requirements of Section 396 and of this circular, have been fulfilled, order by notification in the Gazette that the said amalgamation shall take effect.
- (7) The order of the Central Government shall provide:-
 - (a) for the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company
 - (b) that the amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.
 - (c) for such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out
- (8) The Cabinet decision referred to in para (1) above may precede or follow the passing of the resolution referred to in para (2).
- (9) When an order has been passed by the Central Government under this section, it shall be a sufficient conveyance to vest the assets and liabilities in the transferee.
- (10) Where one government company is amalgamated with another government company, under these provisions, the registration of the first-mentioned Company i.e. transferor company, shall stand cancelled and that Company shall be deemed to have been dissolved and shall cease to exist forthwith as a corporate body.
- (11) Where two or more Government Companies are amalgamated into a new Government Company in accordance with these provisions and the Government Company so formed is duly registered by the Registrar, the registration of each of the amalgamating companies shall stand cancelled forthwith on such registration and each of the Companies shall thereupon cease to exist as a corporate body.
- (12) The amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations, and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.
- (13) The Registrar shall strike off the names of every Government Company deemed to have been dissolved under sub-sections (10) to (11).
- (14) Government companies are not prevented from applying for amalgamation before the Central Government under Sections 391-394 of the Companies Act.

ACTIVITY SCHEDULE FOR PLANNING A MERGER

<i>Sl.</i>	<i>Activity</i>	<i>Action to be taken for completion of activity</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>
1.	Objects clause to be examined	<p>Check the object clause of the transferor and transferee company with regard to the power of amalgamation.</p> <p>Check the object clause of the transferee company regarding power to carry on the business of the transferor company; if not, it is necessary to amend the Objects Clause</p> <p>Check if authorised capital of the transferee company is sufficient; if not it is to be amended (various activities in this regard are as per Annexure II).</p>
2.	Preparation of Scheme of Amalgamation	Ref. Annexure III.
3.	Board meeting of both the transferor and transferee companies to be held.	<p>Notice, Agenda of the Board Meeting to be sent.</p> <p>Board Meeting to be held.</p> <p>Agenda for Board Meeting will include the following items: Effective date to be announced:</p> <p>Approval of the scheme of amalgamation</p> <p>Approval of Ratio</p> <p>Directors/Officers to be empowered to make application to appropriate High Courts and to take necessary action.</p>

(1)	(2)	(3)	(4)
4.	Stock Exchange	Immediately after the board meeting approving the scheme/ exchange ratio, both companies will have to inform the respective stock exchanges.	
5.	Press Release	The news may be released to the press for information and others.	-do-
6.	Financial Institutions/ Banks/Trustees to Debentureholders, if any, to be formally advised their consent sought.	Financial institutions/trustees to Debentureholders, if any to be formally advised and their consent sought.	
7.	Application to the High Court	An application to the High Court concerned both to the transferor and transferee companies will have to be made under Companies (Court) Rules, 1959, for summons for direction to convene the meeting in Form No. 33 of the Companies (Court) Rules, 1959.	
		Affidavit in support of summons will be in Form 34 of the Companies (Court) Rules, 1959.	
		Appointing chairman of the meeting.	
		Fix quorum of the meeting.	
		An order by judge in summons convening meeting of the members of the transferor and transferee companies to approve the scheme and for approval. This will be in Form No. 35 of Companies (Court) Rules, 1959.	

(1)	(2)	(3)	(4)
	<p>If the transferee/transferor company is a potentially sick company, the provisions of SICA to be borne in mind.</p> <p>If there are any calls in arrears of transferor company, the High Court direction to be sought specifically.</p> <p>In case of a merger of a potentially sick company with a healthy company, the possibility of reducing the share capital of the sick company to the extent of losses to be considered and procedure for reduction to be undertaken. This would have an effect on the EPS of the merged company.</p>	<p>8. Notices of Extra Ordinary General Meeting.</p> <p>Notices and Statements under Section 393 of the Act will have to be printed. It will be in Form No. 36 of Companies (Court) Rules, 1959. (For specimen, please refer Annexure V).</p> <p>Take approval of the draft of notice from Registrar of High Court - period involved 5 days.</p> <p>Proxy Forms in Form No. 37 will have to be sent along with the notice.</p> <p>Hall for the meetings to be finalised.</p> <p>Notices will be in Form No. 36 and will be sent to individual members in the name of the Chairman of the meeting concerned, as required by Rule 73.</p>	

(1)	(2)	(3)	(4)
		<p>Notice should be accompanied with</p>	
		<p>— the statement (For specimen, please refer Annexure VI).</p>	
		<p>— a copy of the scheme (For specimen, please refer Annexure VII).</p>	
		<p>— form of proxy (For specimen, please refer Annexure VIII).</p>	
		<p>The Notice will be advertised in the newspapers in such manner as the court may direct not less than 21 clear days before the meeting. The advertisement will be in Form No. 38.</p>	
9.	Meetings of Members	<p>The meetings will be held as scheduled. The management will answer the queries of the members, permitted by the Chair.</p>	
		<p>The decision of the meeting will be ascertained by poll only (Rule 77).</p>	
		<p>Approval is required of a majority in number of persons present and voting representing three-fourths in value of the members.</p>	
		<p>Chairman of each meeting will within the time fixed by the Judge (or within 7 days of the meeting) submit a report in Form No. 39.</p>	
10	Petition to Court	<p>Where the scheme is approved by members, the companies will within 7 days of filing of the report by the Chairman present a petition to the Court for confirmation of the scheme. The petition will be in Form No. 40.</p>	

(1)	(2)	(3)	(4)
		A copy of the petition will be served on the Regional Director, Company Law Board and others as directed by the Court.	
11.	Directions on the Petition.	The Court will fix a date for the hearing of the petition. The Court will also direct official liquidator to scrutinize the books of the transferor company and submit a report thereon in terms of Section 394 of the act.	
12.	Notice of the hearing	Notice of the hearing will be advertised in the same papers as the Court may direct not less than 10 days before the date fixed for the hearing.	
13.	Official Liquidator's Report.	The Official liquidator upon directions of the Court will be required to inspect the books of the transferor company and report that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest. The official liquidator may nominate a chartered accountant from his panel to conduct the inspection and report to him. He may direct that inspection should cover 3-5 years. The fees payable will also be fixed. The official liquidator's representative will visit the company's office and particulars required will be furnished to him. On the basis of the reports of the representatives, the official liquidator will submit his report to the court. Thereupon the Court will order dissolution.	

(1)	(2)	(3)	(4)
14.	Hearing and Order.	<p>Any person interested including creditors and employees may appear before the Court and make submissions.</p> <p>The order of the Court may include such directions with regard to any matter and such modifications in the scheme as the Judge may think fit to make for the proper working of the Scheme.</p> <p>The order will direct that a certified copy of the same should be filed with the Registrar of companies within 14 days from the date of the order or such other time as may be fixed by the Court.</p> <p>The order will be in Form 41 with such variations as may be necessary.</p> <p>The order may include order for dissolution of the transferor company if the Official Liquidator has submitted the report.</p> <p>The Court may make any provision for any person who dissents from the scheme.</p> <p>The order will not have any effect till a certified copy is filed with the Registrar.</p>	
15	Filing/Annexing	<p>Within 30 days of the making of the order, a certified copy thereof will be filed with the Registrar of Companies.</p> <p>In computing the period of 30 days the time taken in obtaining certified copy has to be excluded.</p> <p>A copy of the Court's order will be annexed to every copy of the memorandum and articles of association of the transferee company.</p>	

(1)	(2)	(3)	(4)
16.	FEMA	Approval of Reserve Bank of India will be obtained for allotment of shares to non-residents under FEMA.	
17.	Effective Date	As soon as the scheme has become effective, particulars will be intimated through press and to the government authorities, banks, creditors, customers and others. Certified copy of the Court order will be given where necessary.	

ANNEXURE II

(Please refer Point 1 of Annexure I)

TIME SCHEDULE FOR INCREASE OF AUTHORISED CAPITAL

Activity	1st Month	2nd Month	3rd Month	4th Month
Capital Clause Amend ment	(1) Consult Articles to see whether company is authorised to increase share capital. - If not alter Articles of Association (2) Call board meeting to decide about increase and to fix date, time, place and agenda for convening necessary meeting to pass order resolution Special Resolution if required by Articles) (3) Inform SEs where listed about Board decision.	Issue Notice for general meeting with explanatory statement	(1) Hold AGM and pass ordinary/special resolution. (2) Forward to SEs where listed copy of notice and proceedings of meeting	(1) If special resolution is passed, file it with ROC within 30 days. (2) File the notice of increase with ROC within 30 days. (3) Pay the necessary fees for authorised capital. (4) Make necessary changes in memorandum.

*ANNEXURE III**(Please refer Point 2 of Annexure I)***PREPARATION OF SCHEME OF AMALGAMATION**

The scheme of amalgamation to be prepared by the company should contain *inter-alia* the following information:

1. Definitions of transferor and transferee as well as the definition of the undertaking of the transferor company.
2. Authorised, issued and subscribed capital of transferor and transferee companies.
3. Basis of scheme should be explained briefly on the recommendation of valuation report, covering transfer of assets/liabilities, specified date, reduction or consolidation of capital, application to financial institutions as lead institution for permission, etc.
4. Change of name, object and accounting year.
5. Protection of employment.
6. Dividend position and prospects.
7. Management structure, indicating the number of directors of the transferee company and the transferor company.
8. Applications under Sections 391 and 394 of the Companies Act, 1956 to obtain approval from the High Court.
9. Expenses of amalgamation.
10. Conditions of the scheme to become effective and operative and the effective date of amalgamation.

The basis of the scheme should be framed on the reports of valuers, auditors and chartered accountants of assets of both the merger partner companies. The underlying idea is to ensure that the scheme is just and equitable to the shareholders and employees of each of the amalgamating companies and to the public at large. It should be ensured that common yardstick is adopted for valuation of shares of each of the amalgamating company for fixing rate of exchange of shares on merger.

*ANNEXURE IV***PRACTICAL APPROACH****A. Information Required by the Advocates Generally****Cross holding of the Directors of the Transferee and Transferor Companies**

1. Relationship between the directors of the transferee and transferor companies under the Companies Act, 1956.
2. Names of the officers of both the transferee and transferor companies who are to be authorised to sign the Application, Affidavit and Petition. (The companies concerned can authorise any one person to act on behalf of

them, who may be from either of the companies).

3. Names of the English and regional language newspapers in which notices are to be published.
4. Names in preferential order as to the chairmen of the meetings of the transferee and transferor companies. (The chairman in this case need not be a director on the board of directors of the company concerned or even a member of the company).
5. List of creditors and their dues. List of individual cases to be given, as well as categorisation in various slabs.

B. Information/Documents Required by the Regional Director, Department of Company Affairs, in Connection With Amalgamation

1. Balance sheets for last five years of the transferee company.
2. Balance sheets for last five years of the transferor company.
3. Two copies of the valuation report of the chartered accountants.
4. List of top fifty shareholders of the transferee company.
5. List of top fifty shareholders of the transferor company.
6. List of directors of the transferor company and their other directorships.
7. List of directors of the transferee company and their other directorships.
8. Number and percentage of NRI and foreign holding in the transferee and transferor companies.
9. Rights/Bonus/Debentures Issues made by the transferee and the transferor companies in the last five years.

C. The Following Information is Required to be Furnished to the Auditors Appointed by the Official Liquidator

From the transferor company

1. Certified true copy of the scheme of amalgamation alongwith the petition.
2. Certified true copy of the Memorandum and Articles of Association of the company.
3. List of shareholders of the company with their shareholding. Any changes during the last five years to be indicated.
4. Accounts of the company made upto the appointed day of amalgamation.
5. Address of the registered office of the company.
6. Present authorised and paid-up share capital of the company.
7. Changes in the Board of directors during the last five years alongwith list of present Board of directors.
8. List of associated concern in which directors are interested.

9. List of various appeals pending under Income-tax, Sale Tax, Excise Duty, Custom Duty, FEMA, etc.
10. Details of loans and advances given to the associated concern/companies under the same management during the last five years.
11. Details of revaluation of assets.
12. Details of any allegations and/or complaints against the company.
13. Details of amount paid to the managing director, directors or any relative of the directors during the last five years.
14. Comparative statement of profit and loss account and balance sheet for the last five years.
15. Details of bad debts written off during the last five years.
16. List of all charges registered with the Registrar of Companies and the amount secured against the same.
17. Copy of the latest annual return filed with the Registrar of Companies alongwith Annexures.
18. Details of all the subsidiary companies as under:
 - (a) Authorised and paid-up share capital of the company.
 - (b) List of present shareholders alongwith details of changes in the shareholding patterns during the last five years.

The following information of the transferee company is required by the auditor :

1. Names of the existing directors of the company.
2. List of common shareholders of the companies involved in the amalgamation with individual shareholding.
3. Authorised and paid up capital of the company.
4. Copy of latest audited balance sheet.

The auditors may also require the following records of the transferor company for examination :

1. Books of accounts and relevant records for the last five years.
2. Minutes book of Board and General Meetings.

ANNEXURE V
(As per Point 8 of Annexure I)

Notice Convening meeting of equity shareholder
IN THE HIGH COURT OF JUDICATURE AT MUMBAI ORDINARY ORIGINAL
CIVIL JURISDICTION COMPANY APPLICATION NO. 310 OF 2001

In the matter of Companies Act, 1956;

AND

In the matter of Sections 391 to 394 of the Companies Act, 1956.

AND

In the matter of A (India) Limited

AND

In the matter of Scheme of Amalgamation of
L (India) Limited with A (India) Limited

A (India) Limited, a company incorporated under the Indian Companies Act, VII of 1913 and an existing company under the Companies Act, 1956 and having its registered office at Mumbai Pune Road, Pune ...Applicant

NOTICE CONVENING MEETING

To

The Members holding Equity Shares of A (India) Limited

TAKE NOTICE that by an Order made on the 27th day of June, 2007, the High Court of Judicature at Mumbai has directed that a Meeting of the Equity Shareholders of A (India) Limited, the Applicant Company be held at Taj Hotel, Pune-411 001, on Monday, the 30th day of July, 2007 at 4.00 p.m. for the purpose of considering and, if thought fit, approving, with or without modification the arrangement embodied in the Scheme of Amalgamation proposed to be entered into between L (India) Limited, the Transferor Company and A (India) Limited, the Applicant Company.

TAKE FURTHER NOTICE that in pursuance of the said Order, a Meeting of the Equity Shareholders of the Applicant Company will be held at Taj Hotel, PUNE-411 001, on Monday, 30th day of July, 2007 at 4.00 p.m. when you are requested to attend.

TAKE FURTHER NOTICE that you may attend and vote at the said Meeting in person or by proxy, provided that the proxy in the prescribed form duly signed by you, is deposited at the Registered Office of the Applicant Company situate at Mumbai Pune Road, PUNE not later than forty-eight hours before the Meeting.

TAKE FURTHER NOTICE that Members entitled to attend and vote at the Meeting may, instead of attending and voting at the Meeting personally or through proxies, elect to vote by postal ballot in which case they may send their assent or dissent in writing to the Company by postal ballot in the prescribed postal ballot form attached hereto. A self addressed postage prepaid envelope is also attached hereto for sending the complete postal ballot form.

The Court has appointed Mr. Jai Raj and failing him Mr. Ashok Jain to be the Chairman of the said Meeting.

A copy each of the Scheme of Amalgamation, Statement under Section 393 of the Companies Act, 1956 and a form of proxy is enclosed.

Dated this 29th day of June 2002.

Jai Raj
Chairman appointed for the Meeting

Registered Office:
Mumbai Pune Road,
PUNE

NOTES:

1. The postal ballot form, duly completed and signed, should reach the Registered Office of the Company at Mumbai Pune Road, Pune on or before 8th August, 2007.
2. There shall be one Postal Ballot for every folio client ID Number irrespective of the number of joint holders thereunder.
3. The Postal Ballot shall not be exercised by a Proxy.
4. Shareholders of the Company may either vote at the Meeting or by Postal Ballot. If a vote is delivered by Postal Ballot and also cast at the General Meeting as above, by the same shareholder under the same Folio Number/Client ID Number on the Resolution placed before this Meeting, the later vote shall invalidate the earlier vote.
5. Postal Ballots received after 8th August 2007 shall not be considered and shall be rejected.
6. Incomplete, unsigned or incorrectly ticked Postal Ballot will be rejected.
7. Shareholders of the Company from whom either no Postal Ballot is received or who have not recorded their presence in person or through proxy at the General Meeting shall not be counted for the purposes of passage of this Resolution.
8. Chairman's decision on the validity of the Postal Ballots shall be final.

ANNEXURE VI
(Refer Point 8 of Annexure I)

**IN THE HIGH COURT OF JUDICATURE AT MUMBAI ORDINARY ORIGINAL
CIVIL JURISDICTION COMPANY APPLICATION NO.____ OF 2005**

In the matter of Companies Act, 1956;

AND

In the matter of Sections 391 to 394 of the Companies Act, 1956.

AND

In the matter of A (India) Limited

AND

In the matter of Scheme of Amalgamation of
L (India) Limited with A (India) Limited

A (India) Limited, a company incorporated under the Indian Companies Act, VII of 1913 and an existing company under the Companies Act, 1956 and having its registered office at Mumbai Pune Road, Pune ...Applicant

STATEMENT/EXPLANATORY STATEMENT UNDER SECTION 393 OF THE COMPANIES ACT, 1956

1. Pursuant to an Order dated 27th June, 2005 passed by the Hon'ble High Court of Judicature at Mumbai in the Company Application referred to above, a Meeting of the Members holding equity shares of A (India) Limited, the Transferee-Applicant Company, has been convened for the purpose of considering and, if thought fit, approving with or without modifications, the arrangement embodied in the Scheme of Amalgamation of L (India) Limited, the Transferor Company, with A (India) Limited, the Transferee-Applicant Company. A certified copy of the said Order is available for inspection at the Registered Office of the Transferee Company at Mumbai Pune Road, Pune between 11.00 a.m. and 1.00 p.m. on any working day except Saturday till 27th July, 2005.
2. In this Statement, the Applicant, A (India) Limited is hereinafter referred to as "the Transferee Company" and L (India) Limited is hereinafter referred to as "the Transferor Company".
3. The Resolution to be submitted at the said Meeting will read as follows:

"RESOLVED that the arrangement as embodied in the Scheme of Amalgamation of L (India) Limited, the Transferor Company with A (India) Limited, the Transferee Company, placed before the Meeting and initialled by the Secretary of the Transferee Company for the purpose of identification, be and is hereby approved;

RESOLVED FURTHER that the Board of Directors of the Transferee Company be and they are hereby authorised to do all such acts, deeds, matters and things as are considered requisite or necessary to effectively implement the said Scheme of Amalgamation and to accept such modifications and/or conditions, if any, which may be required and/or imposed by the Hon'ble High Court of Judicature at Mumbai and/or by any other authority while sanctioning said Scheme of Amalgamation".
4. The Transferee Company was incorporated on 15th December, 1957 in the State of Maharashtra as a private limited company under the name V.T. Company Ltd. and commenced business shortly thereafter. In 1960 or there about the Transferee Company became a public limited company. With effect from 1st October, 1965, its name was changed to V.L. Limited. It acquired its present name on 12th May, 1987. The present authorised issued, subscribed and the paid up share capital of the Transferee Company is as under:

Authorised Share Capital	2,00,000.00 Equity Shares of ₹10/- each aggregating ₹20,00,00,000/-
Issued Share Capital	1,81,60,567 Equity Shares of ₹10/- each aggregating ₹18,16,05,670/-.
Subscribed and paid up Share Capital	1,81,60,483 Equity Shares of ₹10/- each fully paid aggregating ₹18,16,04,830/-

5. The Transferor Company, L (India) Limited was incorporated on 6th May, 1992 in the State of Maharashtra under the Companies Act, 1956 (the "Act"). The registered office of the Transferor Company is situated at A Premises, Mumbai Pune Road, Pune. The present authorised, issued, subscribed and the paid up share capital of the Transferor Company is as under:

Authorised Share Capital	1,90,00,000 Equity Shares of ₹10/- each aggregating ₹ 19,00,00,000/-
Issued and Subscribed Share Capital	₹1,90,00,000 Equity Shares of ₹10/- each aggregating ₹19,00,00,000/-
Paid up Share Capital	1,90,00,000 Equity Shares of ₹10/- each fully paid-up aggregating ₹19,00,00,000/-

6. The Transferor Company is a wholly owned subsidiary of the Transferee Company. The entire issued, subscribed and paid-up equity share capital of the Transferor Company is held by the Transferee Company and five directors are the Transferee Company's nominee, each of whom hold one equity share of ₹10/- each.
7. The Transferee Company is engaged in the business of manufacture and sale of industrial machinery. The Transferee Company offers core technologies in the areas of Centrifugal Separation, Heat Transfer and Fluid Handling. It also has expertise and experience in Process Equipment Fabrication and Complete Project handling. Project Engineering competence is special as it leverages the strength from the core technologies to offer turnkey solutions to its customers. The equipment and machinery manufactured by the Transferee Company are extensively used in Industries such as Power, Marine, Pharmaceutical, Biotechnology, Vegetable Oil Processing, Brewery, Industrial and Municipal waste handling, Pulp and Paper etc.
8. The Transferor Company commenced the business in Flow Equipment including an assortment of pumps, plug-cocks, valves etc. on 18th May, 1992 and has since been carrying on the business of manufacturer of a comprehensive range of flow equipment of stainless steel or other material including an assortment of pumps, valves, tank equipment, agitators and all types of components, spare parts etc. The Transferor Company has its factory at Gate Nos. 60 to 64, Sarole, Tal. Bhor, Dist. Pune. The business of the Transferor Company now forms a part of the Equipment division of the

Transferee Company. It has, therefore, become necessary to integrate the operations of the Transferor Company with that of the Transferee Company. The business of the Transferor Company and that of the Transferee Company have considerable synergy in many of their functions and this synergy can be best exploited when the operations of both the companies are integrated and are carried on within one organisation. Considering the market presence, asset structure and other financial considerations of the Transferee Company, it is necessary and desirable that the Transferor Company be merged with the transferee Company.

9. On considering the facts, circumstances and benefits, the Board of Directors of the Transferee Company and that of the Transferor Company approved the said Scheme of Amalgamation of the Transferor Company with the Transferee Company. A copy of the said Scheme of Amalgamation is enclosed.
10. The Board of Directors of the Transferee Company and that of the Transferor Company believe that the proposed Scheme of Amalgamation will result in the following benefits:
 - (a) The proposed amalgamation will lead to the combined business of the Transferee Company and the Transferor Company being carried on more advantageously and economically and conveniently resulting in lower cost and better customer service.
 - (b) The proposed amalgamation would result in increased opportunity to grow the business of the Transferor Company with a marked improvement in the utilisation of available resources.
 - (c) The unified and combined organisation, besides enabling the Transferee Company to submit integrated business proposals thereby rendering its business more competitive, would also make for efficient marketing of the products of the Transferor Company.
 - (d) The proposed amalgamation would provide synergistic linkages besides economies in costs by combining the business functions and the related activities and operations and thus contribute to the profitability of the Transferee Company.
11. The salient features of the said Scheme of Amalgamation of the Transferor Company with the Transferee Company are as follows:-
 - (a) With effect from the commencement of the 1st day of April, 2005 (hereinafter called "the Appointed Date") the entire business and the whole of the Undertaking of the Transferor Company in terms of clause 1.6 of the Scheme of Amalgamation annexed hereto shall, without any further act or deed, be and the same shall stand transferred to and vested in or deemed to have been transferred to or vested in the Transferee Company pursuant to the provisions of Section 394 and other applicable provisions of the Act. PROVIDED ALWAYS that this Scheme shall not operate to enlarge the security for any loan, deposit or facility created by or available to the Transferor Company which shall vest in the Transferee Company by virtue of the amalgamation and the

Transferee Company shall not be obliged to create any further or additional security therefore after the amalgamation has become effective or otherwise. The transfer/vesting as aforesaid shall be subject to the existing charges/hypothecation over or in respect of the Assets or any part thereof of the Transferor Company.

- (b) It is expressly provided that in respect of such of the assets of the Undertaking as are moveable in nature or are otherwise capable of transfer by manual delivery or by endorsement and delivery, the same shall be so transferred by the Transferor Company, and shall become the property of the Transferee Company in pursuance of the provisions of Section 394 of the Act as an integral part of the Undertaking.
- (c) In respect of such of the assets other than those referred to in the preceding paragraph, they shall, without any further act, instrument or deed, be transferred to and vested in and/or be deemed to be transferred and vested in the Transferee Company pursuant to the provisions of Section 394 of the Act as an integral part of the Undertaking.
- (d) With effect from the Effective Date (as defined in para (r) below) and subject to any corrections and adjustments as may, in the opinion of the Board of Directors of the Transferee Company be required, the reserves of the Transferor Company will be merged with those of the Transferee Company in the same form as they appeared in the financial statements of the Transferor Company.
- (e) Further, in case of any differences in accounting policy between the Companies, the impact of the same till the amalgamation will be quantified and adjusted in the Revenue Reserve(s) mentioned earlier to ensure that the financial statements of the Transferee Company reflect the financial position on the basis of consistent accounting policy.
- (f) With effect from the Appointed Date, all the liabilities shall, without any further act or deed, be and stand transferred, to the Transferee Company, pursuant to the applicable provisions of the Act, so as to become as from the Appointed Date, the debts, liabilities, duties and obligations of the Transferee Company.
- (g) Subject to other provisions contained in the Scheme, all contracts, deeds, bonds, agreements and other instruments of whatever nature to which the Transferor Company is a party or to the benefit of which the Transferor Company may be eligible, and which are subsisting or having effect immediately before the Effective Date shall remain in full force and effect against or in favour of the Transferee Company.
- (h) If any suit, writ petition, appeal revision or other proceedings of whatever nature (hereinafter called "the Proceedings") by or against the Transferor Company be pending, the same shall not abate, be discontinued or be in any way prejudicially affected by reason of the transfer of the Undertaking of the Transferor Company or of anything contained in the Scheme, but the Proceedings may be continued,

prosecuted and enforced by or against the Transferee Company in the same manner and to the same extent as it would be or might have been continued, prosecuted and enforced by or against the Transferor Company.

- (i) All the permanent staff, workmen and other employees in the service of the Transferor Company immediately before the transfer of the Undertaking under the Scheme shall become the staff, workmen and employees of the Transferee Company on the basis that their service shall have been continuous and shall not have been interrupted by reason of the transfer of the Undertaking and the terms and conditions of service applicable to the said staff, workmen or employees after such transfer shall not in any way be less favourable to them than those applicable to them immediately before the transfer.
- (j) As far as Provident Fund, Gratuity Fund, Superannuation Fund or any other Special Fund created or existing for the benefit of the staff, workmen and other employees of the Transferor Company are concerned, upon the Scheme becoming effective, the Transferee Company shall stand substituted for the Transferor Company for all purposes whatsoever related to the administration or operation of such Funds or in relation to the obligation to make contributions to the said Funds in accordance with provisions of such Funds as per the terms provided in the respective Trust Deeds. It is the aim and intent that all the rights, duties, powers and obligations of the Transferor Company in relation to such Funds shall become those of the Transferee Company and all the rights, duties and benefits of the employees employed in different units of the Transferor Company under such Funds and Trusts shall be protected.
- (k) With effect from the Appointed Date and upto the Effective Date, the Transferor Company —
 - (i) shall carry on and be deemed to carry on all its business and activities and shall be deemed to have held and stood possessed of its properties and assets for and on account of and in trust for the Transferee Company and all the profits or incomes accruing to the Transferor Company or expenditure or losses arising or incurred by it shall, for all purposes, be treated and be deemed to be and accrue as the profits or incomes or expenditure or losses of the Transferee Company as the case may be.
 - (ii) hereby undertakes to carry on its business until the Effective Date with reasonable diligence and business prudence and shall not alienate, charge, mortgage, encumber or otherwise deal with the said Undertaking or any part thereof except in the ordinary course of its business or pursuant to any pre-existing obligation undertaken by the Transferor Company prior to the Appointed Date. PROVIDED that the restrictions thereunder shall be applicable from the date of acceptance of the present Scheme by the respective Boards of Directors of the Transferor and the Transferee Companies even if the

same be prior to the Appointed Date;

- (iii) shall not vary the terms and conditions of the employment of its employees except in the ordinary course of business; and
- (iv) shall not, without the written consent of the Transferee Company, undertake any new business.
- (l) Since the Transferor Company is wholly owned subsidiary of the Transferee Company, no separate consideration shall be paid by the Transferee Company to the shareholders of the Transferor Company and no shares shall be issued by the Transferee Company to any person in consideration of or consequent upon the amalgamation and the entire equity share capital of the Transferor Company shall be, extinguished.
- (m) The Transferor Company and the Transferee Company shall be entitled to declare and pay dividend, if any, to their respective shareholders prior to the Effective Date.
- (n) The Transferor Company and the Transferee Company hereto shall, with all reasonable despatch, make applications under Sections 391 and 394 of the said Act to the High Court of Judicature at Mumbai for sanctioning the Scheme and for dissolution of the Transferor Company without winding up.
- (o) The Transferor Company (by its Directors) and the Transferee Company (by its Directors) may assent to any modification or amendment to the Scheme or agree to any terms and/or conditions which the Courts and/or any other authorities under law may deem fit to direct or impose or which may otherwise be considered necessary or desirable for putting the Scheme into effect.
- (p) The Scheme is conditional on and subject to:
 - (i) the approval to the Scheme by the requisite majority of the members of the Transferor Company and of the members and secured and unsecured creditors of the Transferee Company.
 - (ii) the requisite resolution under the applicable provisions of the Act being passed by the Shareholders of the Transferee Company for any of the matters provided for or relating to the Scheme as may be necessary or desirable.
 - (iii) the sanction of the High Court of Judicature at Mumbai under Sections 391 and 394 of the Act, in favour of the Transferor Company and the Transferee Company and to the necessary Order or Orders under Section 394 of the Act, being obtained.
 - (iv) any other sanction or approval of the Appropriate Authorities concerned, as may be considered necessary and appropriate by the respective Board of Directors of the Transferor Company and the Transferee Company, being obtained and granted in respect of any of the matters for which such sanction or approval is required.

- (q) In the event of any of the said sanctions and approvals not being obtained and/or the Scheme not being sanctioned by the High Court and/or the Order or Orders not being passed as aforesaid on or before 31st March, 2006 or within such further period or periods as may be agreed upon between the Transferor Company and the Transferee Company through their respective Board of Directors, the Scheme shall become null and void and each party shall bear and pay its respective costs, charges and expenses for and/or in connection with the Scheme.
- (r) This Scheme, although operative from the Appointed Date shall take effect finally, upon and from the date on which any of the aforesaid sanctions or approvals or orders shall be last obtained which shall be the Effective Date for the purposes hereof.
- (s) The Transferor Company shall be dissolved without winding up, subject to an order to be made by the High Court of Judicature at Mumbai under Section 394 of the Companies Act, 1956.
12. The said Scheme of Amalgamation will not affect the Creditors of the Transferor Company as the Transferee Company will take over all the debts, liabilities, duties and obligations of the Transferor Company.
13. The copies of the latest audited accounts of both the Companies can be inspected at the Registered Office of the Transferee Company.
14. Mr. Rajiv Tandon and Mr. Satish Joshi, the Managing Director and Director-Finance of the Transferee Company are also Directors of the Transferor Company. Upon the said Scheme of Amalgamation becoming effective, the Directors of the Transferor Company will cease to be its Directors. Hence, the said Scheme of Amalgamation of the Transferor Company with the Transferee Company will have no effect on the material interests of the Directors of the Transferee Company.
15. None of the Directors of the Transferee/Transferor Company have any material interest in the Scheme except to the extent of their shareholding in the Transferee/Transferor Company as set out hereinbelow:

<i>Names of the Directors of the Transferee Company</i>	<i>Number of Equity shares of ₹ 10/- each fully paid-up in the Transferee Company</i>	<i>Number of equity shares of ₹ 10/- each fully paid up in the Transferor Company</i>
<i>1</i>	<i>2</i>	<i>3</i>
Mr. Jai Raj	Nil	Nil
Mr. Ashok Jain	10571	Nil
Mr. Manoj Chatterjee	Nil	Nil
Mr. Joseph Paul	7979	Nil
Mr. Rajiv Tandon	2900	1*
Mr. Satish Jain	200	1*
Mr. Peter Brocha	Nil	Nil

Mr. Rajiv Tandon	2900	1*
Mr. Fredrick D' Souza	Nil	Nil
Mr. Huigh McGrath	Nil	Nil
Mr. Satish Joshi	200	1*
Mr. G. Shah (Alternate Director to Mr. Fredrick D' Souza)	1480	Nil
Mr. K. Rao (Alternate Director to Mr. Hugh McGrath)	116	1*
*As nominees of the Transferee Company		

16. The said amalgamation will not adversely affect the material interests of the creditors of the Transferee Company. The Transferee Company is in a sound financial position and has sufficient funds as can be seen from the Audited Accounts of the Transferee Company as at 31st December, 2004. Under the said Scheme of Amalgamation, all the debts and liabilities of the Transferor Company will be taken over by the Transferee Company.
17. No investigation proceedings have been instituted and/or pending under Sections 235 to 251 of the Act, in respect of either Company.
18. The provisions of the Monopolies and Restrictive Trade Practices Act, 1969 and the Foreign Exchange Management Act, 1999 are not applicable to the Scheme.
19. This statement may also be treated as an Explanatory Statement under Section 173 of the Companies Act, 1956.

Dated the 29th day of June, 2005.

Jai Raj
Chairman appointed for the Meeting

The following documents will be open for inspection at the Registered Office of the Transferee Company between 11.00 a.m. and 1.00 p.m. on working day except Saturday till 27th July, 2005.

1. Memorandum and Articles of Association of A (India) Limited
2. Memorandum and Articles of Association of L (India) Limited
3. Balance Sheet and Profit and Loss Account of A (India) Limited for the year ended 31st December, 2004.
4. Balance Sheet and Profit and Loss Account of L (India) Limited for the year ended 31st December, 2004.
5. Certified copy of the Order dated 27th June, 2005 passed by the Hon'ble High Court of Judicature at Mumbai in case of Application Nos.- of 2005 and No. of 2005.

ANNEXURE VII
(Refer Point 8 of Annexure I)

SCHEME OF AMALGAMATION OF L (INDIA) LIMITED WITH A (INDIA) LIMITED

1. DEFINITIONS

In this Scheme, unless inconsistent with the subject or context, the following expressions shall have the following meanings:

- 1.1 "The Transferor Company" means L (India) Limited, a company incorporated under the Companies Act, 1956, whose Registered Office is situated at premises, Mumbai-Pune Road, Pune.
- 1.2 "The Transferee Company" means A (India) Limited, a company incorporated under the Indian Companies Act VII of 1913, whose Registered Office is situated at Mumbai Pune Road, Pune.
- 1.3 "The Act" means the Companies Act, 1956, including any statutory modifications, re-enactments or amendments thereof.
- 1.4 "The Appointed Date" means 1st April, 2005 or such other date as the High Court at Mumbai may direct.
- 1.5 "The Effective Date" means the later of the dates on which certified copies of the Order(s) of the High Court at Mumbai vesting the assets property, liabilities, rights, duties, obligations and the like of the Transferor company in the Transferee Company are filed with the Registrar of Companies, Pune after obtaining the consents, approvals, permissions, resolutions, agreements, sanctions and orders necessary therefor.
- 1.6 "Undertaking" means
 - (a) all the assets and properties of the Transferor Company as on the Appointed Date (hereinafter referred to as "the Assets")
 - (b) all the debts, liabilities, duties and obligations of the Transferor Company as on the Appointed Date (hereinafter referred to as "the liabilities").
 - (c) without prejudice to the generally of sub-clause (a) above, the Undertaking of the Transferor Company shall include all the Transferor Company's Reserves, movable and immovable properties, assets, including lease-hold rights, tenancy rights, industrial and other licenses, permits, authorisations, quota rights, trade marks, patents and other industrial and intellectual properties, import quotas, telephones, telex, facsimile and other communication facilities and equipments, rights and benefits of all agreements and all other interests, rights and powers of every kind, nature and description whatsoever privileges, liberties, easements, advantages, benefits and approvals of whatsoever nature and wheresoever situate, belonging to or in the ownership, power or possession of control of the Transferor Company.
- 1.7 "The Scheme" means this Scheme of Amalgamation in its present form

submitted to the High Court of Judicature at Mumbai for sanction or with any modification(s) approved or imposed or directed by the said High Court at Mumbai.

2. SHARE CAPITAL

- 2.1 The Authorised Share Capital of the Transferor Company is ₹19,00,00,000/- divided into 1,90,00,000 Equity Shares of ₹10/- each. The Issued, Subscribed and Paid up Share Capital is ₹19,00,00,000/-, divided into 1,90,00,000 Equity shares of ₹10/- each.
- 2.2 The Authorised Share Capital of the Transferee Company is ₹20,00,00,000/- divided into 2,00,00,000 Equity Shares of ₹10/- each. The Issued Share Capital is ₹18,16,05,670/- divided into 1,81,60,567 Equity shares of ₹10/- each. The Subscribed and Paid up Share Capital is ₹18,16,04,830/- divided into 1,81,60,483 Equity shares of ₹10/- each.

3. TRANSFER OF UNDERTAKING

- 3.1 With effect from the Appointed Date, the entire business and the whole of the Undertaking of the Transferor Company shall, without any further act or deed, be and the same shall stand transferred to and vested in or deemed to have been transferred to or vested in the Transferee Company pursuant to the provisions of Section 394 and other applicable provisions of the Act PROVIDED ALWAYS that this Scheme shall not operate to enlarge the security for any loan, deposit or facility created by or available to the Transferor Company which shall vest in the Transferee Company by virtue of the amalgamation and the Transferee Company shall not be obliged to create any further or additional security therefor after the amalgamation has become effective or otherwise. The transfer/vesting as aforesaid shall be subject to the existing charges/hypothecation over or in respect of the Assets or any part thereof of the Transferor Company.
- 3.2 It is expressly provided that in respect of such of the assets of the Undertaking as are movable in nature or are otherwise capable of transfer by manual delivery or by endorsement and delivery, the same shall be so transferred by the Transferor Company, and shall become the property of the Transferee Company in pursuance of the provisions of Section 394 of the Act as an integral part of the Undertaking.
- 3.3 In respect of such of the assets other than those referred to in Sub-clause 3.2 above, they shall, without any further act, instrument or deed, be transferred to and vested in and/or be deemed to be transferred and vested in the Transferee Company pursuant to the provisions of Section 394 of the Act as an integral part of the Undertaking.
- 3.4 With effect from the Effective Date, and subject to any corrections and adjustments as may, in the opinion of the Board of Directors of the Transferee Company be required, the reserves of the Transferor Company will be merged with those of the Transferee Company in the same form as they appeared in the financial statements of the Transferor Company.

- 3.5 Further, in case of any differences in accounting policy between the Companies, the impact of the same till the amalgamation, will be quantified and adjusted in the Revenue Reserve(s) mentioned earlier to ensure that the financial statements of the Transferee Company reflect the financial position on the basis of consistent accounting policy.
- 3.6 With effect from the Appointed Date, all the Liabilities shall, without any further act or deed, be and stand transferred, to the Transferee Company, pursuant to the applicable provisions of the Act, so as to become as from the Appointed Date, the debts, liabilities, duties and obligations of the Transferee Company.

4. CONTRACTS, DEEDS, BONDS AND OTHER INSTRUMENTS

Subject to other provisions contained in the Scheme, all contracts, deeds, bonds, agreements and other instruments of whatever nature to which the Transferor Company is a party or to the benefit of which the Transferor Company may be eligible, and which are subsisting or having effect immediately before the Effective Date shall remain in full force and effect against or in favour of the Transferee Company, as the case may be, and may be enforced as fully and as effectually as if, instead of the Transferor Company, the Transferee Company had been a party thereto or beneficiary thereto.

5. LEGAL PROCEEDINGS

If any suit, writ petition, appeal, revision or other proceedings of whatever nature (hereinafter called "the Proceedings") by or against the Transferor Company be pending, the same shall not abate, be discontinued or be in any way prejudicially affected by reason of the transfer of the Undertaking of the Transferor Company or of anything contained in the Scheme, but the Proceedings may be continued, prosecuted and enforced by or against the Transferee Company in the same manner and to the same extent as it would be or might have been continued, prosecuted and enforced by or against the Transferor Company as if the Scheme had not been made. On and from the Effective Date, the Transferee Company shall and may initiate any legal proceedings for and on behalf of the Transferor Company.

6. OPERATIVE DATE OF THE SCHEME

The Scheme, although operative from the Appointed Date, shall become effective from the Effective Date.

7. TRANSFEROR COMPANY'S STAFF, WORKMEN AND EMPLOYEES

All the permanent staff, workmen and other employees in the service of the Transferor Company immediately before the transfer of the Undertaking under the Scheme shall become the staff, workmen and employees of the Transferee Company on the basis that:

- 7.1 Their service shall have been continuous and shall not have been interrupted by reason of the transfer of the Undertaking;

- 7.2 The terms and conditions of service applicable to the said staff, workmen or employees after such transfer shall not in any way be less favourable to them than those applicable to them immediately before the transfer; and
- 7.3 It is expressly provided that as far as Provident Fund, Gratuity Fund, Superannuation Fund or any other Special Fund created or existing for the benefit of the staff, workmen and other employees of the Transferor Company are concerned, upon the Scheme becoming effective, the Transferee Company shall stand substituted for the Transferor Company for all purposes whatsoever related to the administration or operation of such Funds or in relation to the obligation to make contributions to the said Funds in accordance with provisions of such Funds as per the terms provided in the respective Trust Deeds. It is the aim and intent that all the rights, duties, powers and obligations of the Transferor Company in relation to such Funds shall become those of the Transferee Company and all the rights, duties and benefits of the employees employed in different units of the Transferor Company under such Funds and Trusts shall be protected. It is clarified that the services of the employees of the Transferor Company will also be treated as having been continuous for the purpose of the aforesaid Funds or provisions.

8. CONDUCT OF BUSINESS BY TRANSFEROR COMPANY TILL EFFECTIVE DATE

With effect from the Appointed Date and upto the Effective Date, the Transferor Company —

- 8.1 shall carry on and be deemed to carry on all its business and activities and shall be deemed to have held and stood possessed of its properties and assets for and on account of and in trust for the Transferee Company and all the profits or incomes accruing to the Transferor Company or expenditure or losses arising or incurred by it shall, for all purposes, be treated and be deemed to be and accrue as the profits or incomes or expenditure or losses of the Transferee Company s the case may be;
- 8.2 hereby undertakes to carry on its business until the Effective Date with reasonable diligence and business prudence and shall not alienate, charge, mortgage, encumber or otherwise deal with the said Undertaking or any part thereof except in the ordinary course of its business or pursuant to any pre-existing obligation undertaken by the Transferor Company prior to the Appointed Date PROVIDED that the restrictions thereunder shall be applicable from the date of acceptance of the present scheme by the respective Boards of Directors of the Transferor and the Transferee Companies even if the same be prior to he Appointed Date;
- 8.3 shall not vary the terms and conditions of the employment of its employees except in the ordinary course of business; and
- 8.4 shall not, without the written consent of the Transferee Company, undertake any new business.

9. NO ISSUE OF EQUITY SHARES

- 9.1 Since the Transferor Company is a wholly owned subsidiary of the Transferee Company, no separate consideration shall be paid by the Transferee Company to the shareholders of the Transferor Company and no shares shall be issued by the Transferee Company to any person in consideration of or consequent upon the amalgamation and the entire equity share capital of the Transferor Company shall be extinguished.

10. DIVIDEND

- 10.1 The Transferor Company and the Transferee Company shall be entitled to declare and pay dividend, if any, to their respective shareholders prior to the Effective Date.

11. APPLICATION TO HIGH COURT

- 11.1 The Transferor Company and the Transferee Company hereto shall, with all reasonable despatch, make applications under Sections 391 and 394 of the said Act to the High Court of Judicature at Mumbai for sanctioning the Scheme and for dissolution of the Transferor Company without winding up.

12. MODIFICATIONS/AMENDMENTS TO THE SCHEME

- 12.1 The Transferor Company (by its Directors) and the Transferee Company (by its Directors) may assent to any modification or amendment to the Scheme or agree to any terms and/or conditions which the Courts and/or any other authorities under law may deem fit to direct or impose or which may otherwise be considered necessary or desirable for settling any question or doubt or difficulty that may arise for implementing and/or carrying out the Scheme and do all acts, deeds and things as may be necessary, desirable or expedient for putting the Scheme into effect.
- 12.2 For the purpose of giving effect to the Scheme or to any modification thereof, the Directors of the Transferee Company are hereby authorised to give such directions and/or to take such steps as may be necessary or desirable including any directions for settling any question or doubt or difficulty whatsoever that may arise.

13. DIRECTORS

- 13.1 Upon the Scheme finally coming into effect, the Directors of the Transferor Company shall cease to be the Directors of the Transferor Company.

14. SCHEME CONDITIONAL ON APPROVALS/SANCTIONS

The Scheme is conditional on and subject to:

- 14.1 the approval to the Scheme by the requisite majorities of the members of the Transferor Company and of the members and secured and unsecured creditors of the Transferee Company.
- 14.2 the requisite resolution(s) under the applicable provisions of the Act being

passed by the Shareholders of the Transferee Company for any of the matters provided for or relating to the Scheme as may be necessary or desirable.

- 14.3 the sanction of the High Court of Judicature at Mumbai under Sections 391 and 394 of the Act, in favour of the Transferor Company and the Transferee Company and to the necessary Order or Orders under Section 394 of the Act, being obtained.
- 14.4 Any other sanction or approval of the Appropriate Authorities concerned, as may be considered necessary and appropriate by the respective Board of Directors of the Transferor Company and the Transferee Company, being obtained and granted in respect of any of the matters for which such sanction or approval is required.

15. EFFECTIVE DATE OF THE SCHEME

- 15.1 This Scheme, although operative from the Appointed Date shall take effect finally upon and from the date on which any of the aforesaid sanctions or approvals or orders shall be last obtained which shall be the Effective Date for the purposes hereof.

16. EFFECT ON NON RECEIPT OF APPROVALS/SANCTIONS

- 16.1 In the event of any of the said sanctions and approvals not being obtained and/or the Scheme not being sanctioned by the High Court and/or the Order or Orders not being passed as aforesaid on or before 31st March, 2006 or within such further period or periods as may be agreed upon between the Transferor Company and the Transferee Company through their respective Board of Directors, the Scheme shall become null and void and each party shall bear and pay its respective costs, charges and expenses for and/or in connection with the Scheme.

17. EXPENSES CONNECTED WITH THE SCHEME

- 17.1 All costs, charges and expenses of the Transferor Company and the Transferee Company respectively in relation to or in connection with this Scheme shall be borne and paid by the Transferee Company.

ANNEXURE VIII
(Refer Point 8 of Annexure I)

IN THE HIGH COURT OF JUDICATURE AT MUMBAI
ORDINARY ORIGINAL CIVIL JURISDICTION
COMPANY APPLICATION OF 2005

In the matter of Companies Act, 1956;

AND

In the matter of Sections 391 to 394 of the Companies Act, 1956;

PP-CRI-3

170

AND

In the matter of A(India) Limited;

AND

In the matter of Scheme of Amalgamation of
L (INDIA) LIMITED WITH A (INDIA) LIMITED

A (India) Limited, a company incorporated under the Indian Companies Act, VII of 1913 and an existing company under the Companies Act, 1956 and having its registered office at Mumbai Pune Road, Pune. ...Applicant

FORM OF PROXY

I/We.....
the undersigned, the Equity Shareholders of A (India) Limited, the Applicant Company, hereby appoint.....
of..... and
failing him/her.....
of.....
as my/our Proxy to act for me/us at the Extraordinary General Meeting of the Equity Shareholders of the Applicant Company to be held at Taj Hotel, PUNE-411 001 on Monday, the 30th July, 2005 at 4.00 p.m. for the purpose of considering and, if thought fit, approving, with or without modifications, the arrangement embodied in the Scheme of Amalgamation proposed to be entered into between L (India) Limited and A (India) Limited, the Applicant Company and at such meeting and any adjournment/adjournments thereof, to vote, for me/us and in my/our name(s).
.....
..... (here, "if for" insert "for" "if against" insert "against" and in the latter case, strike out the words below after "Scheme of Amalgamation") the said Scheme of Amalgamation either with or without modifications as my/our proxy may approve.

Dated thisday of.....2005

Signature.....

Folio No./I.D.No.:

Address:



NOTE: The Proxy must be deposited at the Registered Office of the Company at Mumbai-Pune Road, PUNE, not less than 48 hours before the time of the Meeting.

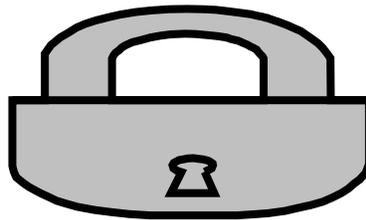
LESSON ROUND UP



- A merger can be defined as the fusion or absorption of one company by another. In a merger, one of the two existing companies merges its identity into another existing company. Also, one or more existing companies may form a new company and merge their identities into a new company by transferring their assets and liabilities to the new company.
- Amalgamation is a legal process by which two or more companies are joined together to form a new entity.
- Merger and amalgamation have various advantages e.g. synergy, economies of scale, reduction in production and other expenses, tax advantages, competitive advantage etc.
- Amalgamation can be effected in various ways viz., transfer of undertaking by order of the High Court, purchase of shares of one company by another company, amalgamation of companies in national interest, amalgamation of companies under Section 494 of the Companies Act, where the liquidator of a company transfers its assets and liabilities to another company and amalgamation for revival and rehabilitation under the provisions of SICA, 1985.
- For mergers and amalgamations, the procedure as detailed in the chapter needs to be complied with.
- There are two main methods of accounting for amalgamation – the pooling of interests method and the purchase method. They have been suitably illustrated under the chapter.
- Financial aspects of merger/amalgamation include valuation of shares and selection of ideal method for valuation.
- Human aspects of mergers and amalgamations have been nicely elucidated by way of two classic cases – acquisition of Welcome group by Glaxo and HLL and Tomco merger.
- Taxation aspects of merger and acquisition especially come into play during the merger of a sick industrial company with another company in order to reap the benefits of the facility for carrying forward and setting off of accumulated losses and unabsorbed depreciation.
- Stamp duty is required to be paid on High Court's Order sanctioning amalgamation.
- Various e-forms are filed in the process of merger/amalgamation viz. e-form No. 23, 20A and 21.

- Amalgamation of Banking Companies have been briefly explained in the chapter.
- Cross border mergers are the recent phenomenon today. Most of the cross border mergers are unsuccessful. Therefore, it is imperative that proper preparation and evaluation before merger takes place which includes market evaluation, operational evaluation and financial evaluations.
- The term 'combination' is used for merger and amalgamation in the Competition Act. The combinations are regulated under the Act if the combining entities cross the threshold limit of assets and turnover and the Competition Commission is to be informed in this regard.
- Procedure of merger and amalgamation related to Government Companies has been explained in detail in the chapter.

SELF TEST QUESTIONS



(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What do you mean by 'amalgamation'?
2. What are the underlying objectives in merger?
3. Briefly explain the various categories of merger.
4. What are the procedural steps involved in a merger?
5. Enumerate the financial aspects of a merger.
6. Discuss the role of courts in approving a scheme of reconstruction or restructuring under Sections 391–394 of the Companies Act, 1956 based on decided cases from the standpoint of shareholders and employees.
7. "The provisions of Sections 391 and 394 of the Companies Act, 1956 constitute a complete code of the subject of amalgamation." Discuss the statement detailing the salient features of Sections 391 and 394 and explain the powers of the court in sanctioning a scheme of amalgamation in the light of the principles laid down by the Supreme Court in *Mihir H. Mafatlal Industries Ltd.*
8. ABC & Co (P) Ltd. and XYZ Ltd. have finalized a scheme of arrangement. The registered offices of both the companies are located in Delhi. A joint-petition is proposed to be filed before the High Court for sanction of the scheme.

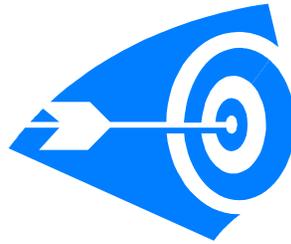
Give your brief opinion in the light of the provisions of the Companies Act,

1956 and the Companies (Court) Rules, 1959 whether such a joint-petition can be filed.

9. Discuss the law as laid down by the Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* with regard to the role of the court in sanctioning scheme of arrangement under Section 391 of the Companies Act, 1956.
 10. Elucidate with the help of decided cases that Sections 391 and 394 of the Companies Act, 1956 is a complete code in itself.
-

STUDY IV TAKEOVERS

LEARNING OBJECTIVES



This chapter will enable the students to understand:

- Concept of takeover
- Kinds of takeover
- Takeover bids
- Legal aspects of takeover
- Bail out takeover and takeover of sick units
- Takeover Defenses
- Cross Border Takeovers

1. MEANING AND CONCEPT OF TAKEOVER

A high level of competitive pressure and an increasing appetite for growth have led firms across geographies and industries to choose the inorganic growth path. Mergers & Acquisitions and Takeovers provide a robust growth vehicle often best suited for such firms seeking an entry into a market, geography, product category or broadening its product and / or client base.

Takeover, an inorganic corporate growth device whereby one company acquires control over another company, usually by purchasing all or a majority of its shares.

Takeover implies acquisition of control of a company, which is already registered, through the purchase or exchange of shares. Takeovers usually take place when shares are acquired or purchased from the shareholders of a company at a specified price to the extent of at least controlling interest in order to gain control of that company.

Takeover of management and control of a business enterprise could take place in different modes. The management of a company may be acquired by acquiring the majority stake in the share capital of a company. A company may acquire shares of an unlisted company through what is called the acquisition under Section 395 of the

Companies Act, 1956. Where the shares of the company are closely held by a small number of persons, a takeover may be effected by agreement with the holders of those shares. However, where the shares of a company are widely held by the general public, it involves the process as set out in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Ordinarily, a larger company takes over a smaller company. In a reverse takeover, a smaller company acquires control over a larger company.

The takeover strategy has been conceived to improve corporate value, achieve better productivity and profitability by making optimum use of the available resources in the form of men, materials and machines.

Company Secretaries have important role to play in the take over process especially with regard to compliances under the Companies Act, SEBI (SAST) Regulations 2011, Competition Law aspects, FEMA regulations etc. The role would be with respect to preparation of checklist, drafting of documents, obtaining of necessary approvals etc. The advisory role of company secretaries in the effective execution of takeover deals is vital throughout the takeover process.

Emergence of concept of takeover

Corporate Sector is an attractive medium for carrying on business as it offers a lot of benefits. Raising money from public has its own positive features and it helps setting up big projects. When promoters of a company desire to expand, they take a quick view of the industrial and business map. If they find there are opportunities, they will always yearn for capitalizing such opportunities. Compared to the efforts required, cost and time needed in setting up a new business, it would make sense to them to look at the possibilities of acquiring an existing entity.

While the possibility of takeover of a company through share acquisition is desirable for achieving certain strategic objectives, there has to be well defined regulations so that the interests of all concerned are not jeopardized by sudden takeover threats. In this perspective, if one were to analyse, it would be clear that there has to be a systematic approach enabling and leading the takeovers, while simultaneously providing adequate opportunity to the original promoters to protect/counter such moves. Thus, while the acquirer should adopt a disciplined method with proper disclosure of intentions so that not only the original promoters who are in command are protected but also the investors. It would be in the interests of all concerned that the takeover is carried out in a transparent manner.

When adequate checks and balances are introduced and ensured, takeovers become a good tool. That is the reason why regulations have been put in place and these regulations require sufficient disclosures at every stage of acquisition. These regulations take so much care that they cover not only direct acquisition of the acquirer but also includes acquisitions through relatives and associates and group concerns.

In India, the process of economic liberalisation and globalisation ushered in the early 1990's created a highly competitive business environment, which motivated many companies to restructure their corporate strategies. The restructuring process

led to an unprecedented rise in strategies like amalgamations, mergers including reverse mergers, demergers, takeovers, reverse takeovers and other strategic alliances.

The concept of takeover picked up and in the meantime the Securities and Exchange Board of India (SEBI) also notified the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 which laid down a procedure to be followed by an acquirer for acquiring majority shares or controlling interest in another company. The main objective is to ensure equal opportunity to all shareholders and offer protection to them, in the event of substantial acquisition of shares and takeovers.

Objects of takeover

The objects of a takeover may *inter alia* be

- (i) To effect savings in overheads and other working expenses on the strength of combined resources;
- (ii) To achieve product development through acquiring firms with compatible products and technological/manufacturing competence, which can be sold to the acquirer's existing marketing areas, dealers and end users;
- (iii) To diversify through acquiring companies with new product lines as well as new market areas, as one of the entry strategies to reduce some of the risks inherent in stepping out of the acquirer's historical core competence;
- (iv) To improve productivity and profitability by joint efforts of technical and other personnel of both companies as a consequence of unified control;
- (v) To create shareholder value and wealth by optimum utilisation of the resources of both companies;
- (vi) To achieve economy of numbers by mass production at economical costs;
- (vii) To secure advantage of vertical combination by having under one command and under one roof, all the stages or processes in the manufacture of the end product, which had earlier been available in two companies at different locations, thereby saving loading, unloading, transportation costs and other expenses and also by affecting saving of time and energy unnecessarily spent on excise formalities at different places and stages;
- (viii) To secure substantial facilities as available to a large company compared to smaller companies for raising additional capital, increasing market potential, expanding consumer base, buying raw materials at economical rates and for having own combined and improved research and development activities for continuous improvement of the products, so as to ensure a permanent market share in the industry;
- (ix) To increase market share;
- (x) To achieve market development by acquiring one or more companies in new geographical territories or segments, in which the activities of acquirer are absent or do not have a strong presence.

KINDS OF TAKEOVER

Takeovers may be broadly classified into three kinds:

- (i) **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.
- (ii) **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.
- (iii) **Bail Out Takeover:** Takeover of a financially sick company by a profit earning company to bail out the former is known as bail out takeover. There are several advantages for a profit making company to takeover a sick company. The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible. Banks and other lending financial institutions would evaluate various options and if there is no other go except to sell the property, they will invite bids. Such a sale could take place in the form by transfer of shares. While identifying a party (acquirer), lenders do evaluate the bids received, the purchase price, the track record of the acquirer and the overall financial position of the acquirer. Thus a bail out takeover takes place with the approval of the Financial Institutions and banks.

TAKEOVER BIDS

“Takeover bid” is an offer to the shareholders of a company, whose shares are not closely held, to buy their shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquiring sufficient number of shares to give the offeror company, voting control of the target company.

A takeover bid is a technique, which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

Type of takeover bids

A takeover bid may be a “friendly takeover bid” or a “hostile takeover bid”. Bids may be mandatory/competitive bids.

Mandatory Bid

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, require acquirers to make bids for acquisition of certain level of holdings subject to certain conditions. A takeover bid is required to be introduced through a public announcement through newspapers. Such requirements arise in the following cases:

- (a) for acquisition of 25% 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 25% but not more than 75% or 90% of the shares or voting rights in a company as the case may be;
- (c) for acquiring control over a company.

Factors Determining Vulnerability of Companies to Takeover Bids

The enquiry into such strategies is best initiated by an analysis of factors, which determine the “vulnerability” of companies to takeover bids. It is possible to identify such characteristics that make a company a desirable candidate for a takeover from the acquirer’s point of view. Thus, the factors which make a company vulnerable are:

- Low stock price with relation to the replacement cost of assets or their potential earning power;
- A highly liquid balance sheet with large amounts of excess cash, a valuable securities portfolio, and significantly unused debt capacity;
- Good cash flow in relation to current stock prices;
- Subsidiaries and properties which could be sold off without significantly impairing cash flow; and
- Relatively small stockholdings under the control of an incumbent management.

A combination of these factors can simultaneously make a company an attractive proposition or investment opportunity and facilitate its financing. The company’s assets may act as collateral for an acquirer’s borrowings, and the target’s cash flows from operations and divestitures can be used to repay the loans.

5. LEGAL ASPECTS OF TAKEOVER

The legislations/regulations that mainly govern takeover is as under

1. SEBI (SAST) Regulations 2011
2. Companies Act, 1956
3. Listing Agreement

SEBI (SAST) Regulations 2011 lays down the procedure to be followed by an acquirer for acquiring majority shares or controlling interest in another company.

As far as Companies Act is concerned, the provisions of Section 372A apply to the acquisition of shares through a Company. Section 395 of the Companies Act lays down legal requirements for purpose of take-over of an unlisted company through transfer of undertaking to another company.

The takeover of a listed company is regulated by clause 40A and 40B of the Listing Agreement. These clauses in the Listing Agreement seek to regulate takeover

activities independently and impose certain requirements of disclosure and transparency.

Takeover of Unlisted and Closely Held Companies

Section 395 of the Companies Act contains a compulsory acquisition mode for the transferee company to acquire the shares of minority shareholders of Transferor Company.

Where the scheme has been approved by the holders of not less than nine tenth (90%) in value of the shares of the transferor company whose transfer is involved, the transferee company, may, give notice to any dissenting shareholders that transferee company desires to acquire their shares. The scheme shall be binding on all the shareholders of the transferor company (including dissenting shareholders), unless the Court Orders otherwise (i.e. that the scheme shall not be binding on all shareholders).

When the scheme is binding on minority shareholders including dissenting shareholders?

When the scheme is approved by the holders of not less than nine tenth (90%) in value of the shares of the transferor company whose transfer is involved, it shall be binding on all the shareholders of the transferor company (including dissenting shareholders), unless the Court Orders otherwise.

Case Law 1: Power of Acquisition of Shares of dissentient minority shareholders is not *ultra vires* the constitution of India. *S Viswanathan V East India Distilleries & Sugar Factories Limited*(1957) 27 Com Cases 175:AIR 1957 Mad 341.

Case Law 2: Where the scheme or contract has been approved by 90% of the shareholders, the offer of the transferee company will be treated as prima-facie a fair one and the onus will be on the dissentients to show the contrary. *Benarasi Das Saraf V dalmia Dadri Cement Ltd*(1958)28 Com cases 435(Punj)

Accordingly, the transferor company shall be entitled and bound to acquire these shares on the terms on which it acquires under the scheme (the binding provision).

The advantage of going through the route contained in Section 395 of the Act is the facility for acquisition of minority stake. The transferee company shall give notice to the minority dissenting shareholders and express its desire to acquire their shares within 2 months of the expiry of the period of 4 months envisaged under Section 395 of the Act.

When a Company intends to take over another Company through acquisition of 90% or more in value of the shares of that Company, the procedure laid down under Section 395 of the Act could be beneficially utilized. When one Company has been able to acquire more than 90% control in another Company, the shareholders holding the remaining control in the other Company are reduced to a miserable minority. They do not even command a 10% stake so as to make any meaningful utilization of the power. Such minority can not even call an extra-ordinary general meeting under

Section 168 of the Act nor can they constitute a valid strength on the grounds of their proportion of issued capital for making an application to Company Law Board under Section 397 and 398 of the Act alleging acts of oppression and/or mismanagement. Hence the statute itself provides them a meaningful exit route.

The advantage of going through the route is the facility for acquisition of minority stake. But even without going through this process, if an acquirer is confident of acquiring the entire control, there is no need to go through Section 395 of the Act. It is purely an option recognized by the statute.

The merit of this scheme is that without resort to tedious court procedures the takeover is affected. Only in cases where any dissentient shareholder or shareholders exist, the procedures prescribed by this section will have to be followed. It provides machinery for adequately safeguarding the rights of the dissentient shareholders also.

Section 395 lays down two safeguard in respect of expropriation of private property (by compulsory acquisition of majority shares). First the scheme requires approval of a large majority of shareholders. Second the Court's discretion to prevent compulsory acquisition.

Section 395 requires mandatory compliance of certain formalities including registration of a scheme or contract for acquisition of shares of Transferor Company. The scheme or contract between the Transferee Company and Transferor Company is solemnized with blessings of the Board of Directors of both the companies.

The following are the important ingredients of the Section 395 route:

- The Company, which intends to acquire control over another Company by acquiring share, held by shareholders of that another Company is known under Section 395 of the Act as the "Transferee Company".
- The Company whose shares are proposed to be acquired is called the "Transferor Company".
- The "Transferee Company" and "Transferor Company" join together at the Board level and come out with a scheme or contract.
- Every offer or every circular containing the terms of the scheme shall be duly approved by the Board of Directors of the companies and every recommendation to the members of the transferor Company by its directors to accept such offer. It shall be accompanied by such information as provided under the said Act.
- Every offer shall contain a statement by or on behalf of the Transferee Company, disclosing the steps it has taken to ensure that necessary cash will be available. This condition shall apply if the terms of acquisition as per the scheme or the contract provide for payment of cash in lieu of the shares of the Transferor Company which are proposed to be acquired.
- Every circular containing or recommending acceptance of the offer made by the transferee Company shall be duly accompanied by e-Form No. 35A of

the Companies (Central Govt.'s) General Rules and Forms, 1956. They shall be filed with the Registrar for registration. Only after such registration can the Transferee Company arrange for circulation of the scheme or contract or the recommendatory letter, if any, of the directors of the transferor company to the shareholders of the Transferor Company.

- The Registrar may refuse to register any such circular, which does not contain the prescribed information, if such information is given in a manner likely to give a false impression.
- An appeal shall lie to the Court against an order of the Registrar refusing to register any such circular.
- Any person issuing a circular containing any false statement or giving any false impression or containing any omission shall be punishable with fine, which may extend to five hundred rupees.
- After the scheme or contract and the recommendation of the Board of Directors of the transferor Company, if any, shall be circulated and approval of not less than 9/10th in value of "Transferor Company" should be obtained within 4 months from the date of circulation. It is necessary that the Memorandum of Association of the transferee company should contain as one of the objects of the company, a provision to takeover the controlling shares in another company. If the memorandum does not have such a provision, the company must alter the objects clause in its memorandum, by convening an extra ordinary general meeting. The approval is not required to be necessarily obtained in a general meeting of the shareholders of the Transferor Company.
- Once approval is available, the 'Transferee Company' becomes eligible for the right of compulsory acquisition of minority interest.
- The Transferee Company has to send notice to the shareholders who have not accepted the offer (i.e. dissenting shareholders) intimating them the need to surrender their shares.
- Once the acquisition of shares in value, not less than 90% has been registered in the books of the transferor Company, the transferor Company shall within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration representing the price payable to them by the transferee Company.
- The transferee Company having acquired shares in value not less than 90% is under an obligation to acquire the minority stake as stated aforesaid and hence it is required to transfer the amount or other consideration equal to the amount or other consideration required for acquiring the minority stake to the transferee Company. The amount or consideration required to be so transferred by the transferee Company to the transferor company, shall not in any way, less than the terms of acquisition offered under the scheme or contract.

- Any amount or other consideration received by the Transferor Company in the manner aforesaid shall be paid into a separate bank account. Any such sums and any other consideration so received shall be held by the transferor Company in trust for the several persons entitled to the shares in respect of which the said sums or other consideration were respectively received.

The takeover achieved in the above process through this Section 395 of the Act will not fall within the meaning of amalgamation under the Income Tax Act and as such benefits of amalgamation provided under the said Act will not be available to the acquisition under consideration. The takeover in the above process will not enable carrying forward of unabsorbed depreciation and accumulated losses of the transferor Company in the transferee Company for the reason that the takeover does not result in the transferor Company losing its identity.

Check list

Transferor Company

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, see Part B of the Company Secretarial Practice Study]
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.

Transferee Company

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

1. Offer made to the transferor company.
2. Copy of notice for the general meeting along with a copy of e-form No. 35A circulated by the transferor company to its members.
3. Intimation received from the transferor company in respect of approval of the offer by the requisite majority of the shareholders of that company.
4. Notice as prescribed in Section 395 of the Companies Act, 1956 given by the company to dissenting shareholders of the transferor company for the purpose of acquiring their shares.

5. If there is any Court order in favour of the dissenting shareholders of the transferor company, terms of the same has been complied with.
6. If Sub-section (2) is attracted, the company must ensure that the prescribed notice has been sent to those shareholders of the transferor company who have not assented to the transfer of the shares and that such shareholders have agreed to transfer their shares to the company.
7. To ensure that a copy of the notice has been sent to the dissenting shareholders of the transferor company and duly executed instrument(s) of transfer together with the value of the shares have been sent to the transferor company.

Documents etc. involved in this process

1. Minutes of Board meeting containing consideration and approval of the offer sent to the transferor company.
2. Offer of a scheme or contract sent to the transferor company.
3. Notice to dissenting shareholders if any, of the transferor company.
4. Notice to the remaining shareholders of the transferor company, who have not assented to the proposed acquisition, if any.
5. e-form No. 35A received from the transferor company, which has been circulated to its members by that company.
6. Minutes of general meeting of the company containing approval of the shareholders to the offer of scheme or contract sent to the transferor company.
7. Court order, if any.
8. Copy of e-form No. 21 which has been filed with the Registrar along with a copy of the Court Order.
9. Register of Investments.
10. Duly filled in and executed instrument(s) of transfer for shares held by the dissenting shareholders.
11. Balance Sheets showing investments in the shares of the transferor company.

TAKEOVER OF LISTED COMPANIES

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Regulations).

Frequently Asked Questions on takeovers are enclosed at Annexure 1.

Therefore, before planning a takeover of a listed company, any acquirer should understand the compliance requirements under the Regulations and also the requirements under the Listing Agreement and the Companies Act. There could also be some compliance requirements under the Foreign Exchange Management Act if acquirer were a person resident outside India.

Listing Agreement

Conditions for continued listing

Clauses 40A and 40B of the listing agreement were amended to bring them in consonance with the Regulations. These clauses are placed under the heading "Conditions for Continued Listing".

40A. – Minimum level of public shareholding

(i) The issuer company agrees to comply with the requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957.

(ii) Where the issuer company is required to achieve the minimum level of public shareholding specified in Rule 19(2)(b) and/or Rule 19A of the Securities Contracts (Regulation) Rules, 1957, it shall adopt any of the following methods to raise the public shareholding to the required level:-

- (a) issuance of shares to public through prospectus; or
- (b) offer for sale of shares held by promoters to public through prospectus; or
- (c) sale of shares held by promoters through the secondary market.

Provided that for the purpose of adopting the method specified at sub-clause (c) above, the issuer company agrees to take prior approval of the Specified Stock Exchange (SSE) which may impose such conditions as it deems fit.

Explanation: For the purposes of this clause the term "Specified Stock Exchange (SSE)" shall mean: -

- (a) where the issuer company is listed on one stock exchange only, then that stock exchange;
- (b) where the issuer company is listed on one or more stock exchange(s) having nationwide trading terminal(s) and / or on one or more stock exchange(s) not having nationwide trading terminal(s), then all such stock exchange(s) having nationwide trading terminal(s); and
- (c) where the issuer company is listed on one or more stock exchange(s) and none of those stock exchanges have nationwide trading terminals, then the stock exchange which was chosen as the Designated Stock Exchange by the company for the previous issue of its shares, or the regional Stock Exchange, as the case may be."

40 B – Take Over Offer

A company agrees that it is a condition for continued listing that whenever the

take-over offer is made or there is any change in the control of the management of the company, the person who secures the control of the management of the company and the company whose shares have been acquired shall comply with the relevant provisions of the SEBI (Substantial Acquisition of Shares and Take-overs) Regulations, 2011.

REQUIREMENTS UNDER SEBI REGULATIONS

Introduction

The earliest attempts at regulating takeovers in India can be traced back to the 1990s with the incorporation of Clause 40 in the Listing Agreement.

- While, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 which were notified in November 1994 made way for regulation of hostile takeovers and competitive offers for the first time; the subsequent regulatory experience from such offers brought out certain inadequacies existing in those Regulations. As a result, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were introduced and notified on February 20, 1997, pursuant to repeal of the 1994 Regulations.
- Owing to several factors such as the growth of Mergers & Acquisitions activity in India as the preferred mode of restructuring, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations 1997. Accordingly, SEBI formed a Takeover Regulations Advisory Committee (TRAC) in September 2009 under the Chairmanship of (Late) Shri. C. Achuthan, Former Presiding Officer, Securities Appellate Tribunal (SAT) for this purpose. After extensive public consultation on the report submitted by TRAC, SEBI came out with the SAST Regulations 2011 which were notified on September 23, 2011. The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.

Meaning of certain terms

Acquirer

Acquirer means any person who, whether by himself, or through, or with persons acting in concert with him, directly or indirectly, acquires or agrees to acquire shares or voting rights in, or control over a target company. An acquirer can be a natural person, a corporate entity or any other legal entity.

Person Acting in Concert (PACs)

PACs are individual(s)/company (ies) or any other legal entity (ies) who, with a common objective or purpose of acquisition of shares or voting rights in, or exercise of control over the target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly cooperate for acquisition of shares or voting

rights in, or exercise of control over the target company. SAST Regulations, 2011 define various categories of persons who are deemed to be acting in concert with other persons in the same category, unless the contrary is established.

Target Company

The company / body corporate or corporation whose equity shares are listed in a stock Exchange and in which a change of shareholding or control is proposed by an acquirer, is referred to as the 'Target Company'.

Control

“control” includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:

Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;

Disclosures related provisions

It may be noted that the word “shares” for disclosure purposes include convertible securities also.

Event based Disclosures

(a) Any person, who along with PACs crosses the threshold limit of 5% of shares or voting rights, has to disclose his aggregate shareholding and voting rights to the Target Company at its registered office and to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI.

(b). Any person who holds 5% or more of shares or Voting rights of the target company and who acquires or sells shares representing 2% or more of the voting rights, shall disclose details of such acquisitions/sales to the Target company at its registered office and to every Stock Exchanges where the shares of the Target Company are listed within 2 working days of such transaction, as per the format specified by SEBI.

Shares taken by way of encumbrance shall be treated as an acquisition and on release of such encumbrances it is a disposal.

Continual Disclosures

Continual disclosures of aggregate shareholding shall be made within 7 days of financial year ending on March 31 to the target company at its registered office and every stock exchange where the shares of the Target Company are listed by:

(a) Shareholders (along with PACs, if any) holding shares or voting rights

entitling them to exercise 25% or more of the voting rights in the target company.

- (b) Promoter (along with PACs, if any) of the target company irrespective of their percentage of holding.

Disclosures of encumbered shares

The promoter (along with PACs) of the target company shall disclose details of shares encumbered by them or any invocation or release of encumbrance of shares held by them to the target company at its registered office and every stock exchange where shares of the target company are listed, within 7 working days of such event.

As per Regulation 28(3), the term “encumbrance” shall include a pledge, lien or any such transaction, by whatever name called.” The promoters have to understand the nature of encumbrance and those encumbrances which entail a risk of the shares held by promoters being appropriated or sold by a third party, directly or indirectly, are required to be disclosed to the stock exchanges in terms of the Takeover Regulations, 2011.

Computation of trigger limits for disclosures.

The word “shares” for disclosure purposes include convertible securities also. Hence for computation of trigger limits for disclosures given above, percentage w.r.t shares shall be computed taking in to account total number of equity shares and convertibles and the percentage w.r.t voting rights shall be computed after considering voting rights on equity shares and other securities (like GDRs, if such GDRs carry voting rights)

Illustration

An illustration is provided below for the calculation of trigger limits for disclosures.

Total Shares/voting capital of the company

- Company A has 100 equity shares, 50 partly convertible Debentures (PCDs) and 10 GDRs. 1 GDR carries 1 voting right.
- Total shares of company A= $100+50+10 = 160$
- Total voting capital of Company A= $100+10=110$

Persons B's holding of shares and voting rights

- Person B has 8 equity shares, 7 PCDs and 1 GDR.
- Person B has $8+7+1 = 16$ shares (shares for disclosure purpose includes convertible securities)
- Person B's holding in terms of shares= $16/160=10\%$ of shares
- Person B's voting rights= $8+1= 9$ voting rights

- Person B's holding in terms of voting rights = $9/110=8\%$ of voting rights

Since person B is holding more than 5% of shares or voting rights, he is required to make disclosures for any acquisition/ sale of 2% or more of shares or voting rights.

Acquisition by Person B

Scenario I

- Person B acquires 2 equity shares and 2 PCDs.
- In terms of shares, person B has acquired $4/160=2.5\%$ of shares
- In terms of voting rights, person B has acquired $2/110= 1.8\%$ of voting rights
- Since acquisition done by person B represents 2 % or more of shares, the disclosure obligation is triggered.

Scenario II

Person B acquires 20 PCDs

In terms of shares, person B has acquired 20 shares, i.e. $20/160$ i.e. 12.5% shares.

In terms of voting rights, he has not acquired a single voting right i.e. 0 voting right

However, since acquisition done by person B represents 2% or more of shares (though no voting rights), the disclosure obligations is triggered.

Open offer thresholds (Regulation 3)

The following are the threshold limits for acquisition of shares/voting rights, beyond which an obligation to make an open offer is triggered

Acquisition of 25% or more shares or voting rights: An acquirer, who (along with PACs, if any) holds less than 25% shares or voting rights in a target company and agrees to acquire shares or acquires shares which along with his/PAC's existing shareholding would entitle him to exercise 25% or more shares or voting rights in a target company, will need to make an open offer before acquiring such additional shares.

Acquisition of more than 5% shares or voting rights in a financial year: An acquirer who (along with PACs, if any) holds 25% or more but less than the maximum permissible non-public shareholding in a target company, can acquire additional shares in the target company as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31, only after making an open offer.

Maximum Permissible non-Public Shareholding means Such percentage shareholding in the target Company excluding the minimum Public Shareholding required under Securities Contracts Regulation (Rules) 1957. The SCRR requires minimum Public Shareholding in case of every listed company other than Public Sector Company to be at least 25%. In case of listed public sector company minimum Public Shareholding to be maintained at least 10%. Thus maximum permissible non public Share holder may be 75% and in case of Public Sector company 90%.

Voluntary Offer (Regulation 6)

A voluntary open offer under Regulation 6, is an offer made by a person who himself or through Persons acting in concert ,if any, holds 25% or more shares or voting rights in the target company but less than the maximum permissible non-public shareholding limit.

Restrictions on voluntary open offer

A voluntary offer cannot be made if the acquirer or PACs with him has acquired any shares of the target company in the 52 weeks prior to the voluntary offer. The acquirer is prohibited from acquiring any shares during the offer period other than those acquired in the open offer. The acquirer is also not entitled to acquire any shares for a period of 6 months, after completion of open offer except pursuant to another voluntary open offer.

Exemptions from open offer (Regulation 10)

Exemption may be

Automatic Exemption (under Regulation 10)

Exemption by SEBI (Regulation 11)

Exemption under Regulation 10 (Automatic exemption)

The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 subject to fulfillment of the conditions stipulated therefor,—

- (a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being,—
 - (i) immediate relatives;
 - (ii) persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;
 - (iii) a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons

hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;

- (iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement;
- (v) shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company:

Provided that for purposes of availing of the exemption under this clause,—

- (i) If the shares of the target company are frequently traded, the acquisition price per share shall not be higher by more than twenty-five per cent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed *inter se* transfer under sub-regulation (5), as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, and if the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than twenty-five percent of the price determined in terms of clause (e) of sub-regulation (2) of regulation 8; and
 - (ii) the transferor and the transferee shall have complied with applicable disclosure requirements set out in Chapter V.
- (b) acquisition in the ordinary course of business by,—
- (i) an underwriter registered with the Board by way of allotment pursuant to an underwriting agreement in terms of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (ii) a stock broker registered with the Board on behalf of his client in exercise of lien over the shares purchased on behalf of the client under the bye-laws of the stock exchange where such stock broker is a member;
 - (iii) a merchant banker registered with the Board or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

- (iv) any person acquiring shares pursuant to a scheme of safety net in terms of regulation 44 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (v) a merchant banker registered with the Board acting as a stabilizing agent or by the promoter or pre-issue shareholder in terms of regulation 45 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (vi) by a registered market-maker of a stock exchange in respect of shares for which he is the market maker during the course of market making;
 - (vii) a Scheduled Commercial Bank, acting as an escrow agent; and
 - (viii) invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee.
- (c) acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement:
- Provided that,—**
- (i) both the acquirer and the seller are the same at all the stages of acquisition; and
 - (ii) full disclosures of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.
- (d) acquisition pursuant to a scheme,—
- (i) made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) or any statutory modification or re-enactment thereto;
 - (ii) of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign; or
 - (iii) of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign, subject to,—
 - (A) the component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme; and
 - (B) where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent 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.

- (e) acquisition pursuant to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);
- (f) acquisition pursuant to the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
- (g) acquisition by way of transmission, succession or inheritance;
- (h) acquisition of voting rights or preference shares carrying voting rights arising out of the operation of sub-section (2) of section 87 of the Companies Act, 1956 (1 of 1956).

(2) The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India vide circular no. B.P.BC 15/21.04, 114/2001 dated August 23, 2001, or any modification or re-notification thereto provided such scheme has been authorised by shareholders by way of a special resolution passed by postal ballot, shall be exempted from the obligation to make an open offer under regulation 3.

(3) An increase in voting rights in a target company of any shareholder beyond the limit attracting an obligation to make an open offer under sub-regulation (1) of regulation 3, pursuant to buy-back of shares shall be exempt from the obligation to make an open offer provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold referred to in sub-regulation (1) of regulation 3 within ninety days from the date on which the voting rights so increase.

(4) The following acquisitions shall be exempt from the obligation to make an open offer under sub-regulation (2) of regulation 3,—

- (a) acquisition of shares by any shareholder of a target company, upto his entitlement, pursuant to a rights issue;
- (b) acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfillment of the following conditions,—
 - (i) the acquirer has not renounced any of his entitlements in such rights issue; and
 - (ii) the price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of,—
 - (A) the volume weighted average market price of the shares of the target company during a period of sixty trading days ending on the day prior to the date of determination of the rights issue price, multiplied by the number of shares outstanding prior to the rights issue, divided by the total number of shares outstanding after allotment under the rights issue:

Provided that such volume weighted average market price shall be determined on the basis of trading on the stock exchange where the maximum volume of trading in the shares of such target company is recorded during such period; and

- (B) the price at which the shares are offered in the rights issue, multiplied by the number of shares so offered in the rights issue divided by the total number of shares outstanding after allotment under the rights issue:
- (c) increase in voting rights in a target company of any shareholder pursuant to buy-back of shares:

Provided that,—

- (i) such shareholder has not voted in favour of the resolution authorising the buy-back of securities under section 77A of the Companies Act, 1956 (1 of 1956);
- (ii) in the case of a shareholder resolution, voting is by way of postal ballot;
- (iii) where a resolution of shareholders is not required for the buyback, such shareholder, in his capacity as a director, or any other interested director has not voted in favour of the resolution of the board of directors of the target company authorising the buy-back of securities under section 77A of the Companies Act, 1956 (1 of 1956); and
- (iv) the increase in voting rights does not result in an acquisition of control by such shareholder over the target company:
- Provided further that where the aforesaid conditions are not met, in the event such shareholder reduces his shareholding such that his voting rights fall below the level at which the obligation to make an open offer would be attracted under sub-regulation (2) of regulation 3, within ninety days from the date on which the voting rights so increase, the shareholder shall be exempt from the obligation to make an open offer;
- (d) acquisition of shares in a target company by any person in exchange for shares of another target company tendered pursuant to an open offer for acquiring shares under these regulations;
- (e) acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter;
- (f) acquisition of shares in a target company from a venture capital fund or a foreign venture capital investor registered with the Board, by promoters of the target company pursuant to an agreement between such venture capital fund or foreign venture capital investor and such promoters.

(5) In respect of acquisitions under clause (a) of sub-regulation (1), and clauses (e) and (f) of sub-regulation (4), the acquirer shall intimate the stock exchanges where the shares of the target company are listed, the details of the proposed

acquisition in such form as may be specified, at least four working days prior to the proposed acquisition, and the stock exchange shall forthwith disseminate such information to the public.

(6) In respect of any acquisition made pursuant to exemption provided for in this regulation, the acquirer shall file a report with the stock exchanges where the shares of the target company are listed, in such form as may be specified not later than four working days from the acquisition, and the stock exchange shall forthwith disseminate such information to the public.

(7) In respect of any acquisition of or increase in voting rights pursuant to exemption provided for in clause (a) of sub-regulation (1), sub-clause (iii) of clause (d) of sub regulation (1), clause (h) of sub-regulation (1), sub-regulation (2), sub-regulation (3) and clause (c) of sub-regulation (4), clauses (a), (b) and (f) of sub-regulation (4), the acquirer shall, within twenty-one working days of the date of acquisition, submit a report in such form as may be specified along with supporting documents to the Board giving all details in respect of acquisitions, along with a non-refundable fee of rupees twenty five thousand by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.

Explanation.— For the purposes of sub-regulation (5), sub-regulation (6) and sub regulation (7) in the case of convertible securities, the date of the acquisition shall be the date of conversion of such securities.

Exemptions by the SEBI (Regulation 11)

(1) SEBI(The Board) may for reasons recorded in writing, grant exemption from the obligation to make an open offer for acquiring shares under these regulations subject to such conditions as the Board deems fit to impose in the interests of investors in securities and the securities market.

(2) The Board may for reasons recorded in writing, grant a relaxation from strict compliance with any procedural requirement under Chapter III and Chapter IV subject to such conditions as the Board deems fit to impose in the interests of investors in securities and the securities market on being satisfied that,—

- (a) the target company is a company in respect of which the Central Government or State Government or any other regulatory authority has superseded the board of directors of the target company and has appointed new directors under any law for the time being in force, if,—
 - (i) such board of directors has formulated a plan which provides for transparent, open, and competitive process for acquisition of shares or voting rights in, or control over the target company to secure the smooth and continued operation of the target company in the interests of all stakeholders of the target company and such plan does not further the interests of any particular acquirer;
 - (ii) the conditions and requirements of the competitive process are reasonable and fair;

(iii) the process adopted by the board of directors of the target company provides for details including the time when the open offer for acquiring shares would be made, completed and the manner in which the change in control would be effected; and

(b) the provisions of Chapter III and Chapter IV are likely to act as impediment to implementation of the plan of the target company and exemption from strict compliance with one or more of such provisions is in public interest, the interests of investors in securities and the securities market.

(3) For seeking exemption under sub-regulation (1), the acquirer shall, and for seeking relaxation under sub-regulation (2) the target company shall file an application with the Board, supported by a duly sworn affidavit, giving details of the proposed acquisition and the grounds on which the exemption has been sought.

(4) The acquirer or the target company, as the case may be, shall along with the application referred to under sub-regulation (3) pay a non-refundable fee of rupees fifty thousand, by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.

(5) The Board may after affording reasonable opportunity of being heard to the applicant and after considering all the relevant facts and circumstances, pass a reasoned order either granting or rejecting the exemption or relaxation sought as expeditiously as possible:

Provided that the Board may constitute a panel of experts to which an application for an exemption under sub-regulation (1) may, if considered necessary, be referred to make recommendations on the application to the Board.

(6) The order passed under sub-regulation (5) shall be hosted by the Board on its official website.

Open offer Process

1. Appointment of Manager to the offer

Prior to making of a public announcement, the acquirer shall appoint Merchant Banker registered with the Board, who is not an associate of the acquirer, as manager to the offer.

2. The public announcement of the open offer for acquiring shares required under these regulations shall be made by the acquirer through such manager to the open offer.

3. Public announcement.

SEBI (SAST) Regulation, 2011 provides that whenever Acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under Regulation 3 and 4, then the Acquirer is required to give a Public Announcement of an Open Offer to the shareholders of the Target Company. During the process of making the Public Announcement of an Open Offer, the Acquirer is

required to give Public Announcement and publish Detailed Public Statement. The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement.

- (i) Public Announcement
- (ii) Detailed Public Statement

Publication and Timing of Public Announcement (Regulation 13 and Regulation 14)

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed. Further, a copy of the same shall also be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement. The time within which the Public Announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below:

<i>Applicable Regulation</i>	<i>Particulars</i>	<i>Time of making Public Announcement to Stock Exchange</i>
13(1)	Agreement to Acquirer Shares or Voting Rights or Control Over The Target Company	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares	Prior to the placement of purchase order with the stock broker.
13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion	On the second working day preceding the scheduled date of conversion of such securities into shares.
13(2)(d)	In case of disinvestment	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.

13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier: a. When the primary acquisition is contracted; And b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date when the Special Resolution is passed for allotment of shares under Section 81(1A) of Companies Act 1956.
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of increase in voting rights.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.
13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer

Timing of Detailed Public Statement

In terms of Regulation 13(4) of SEBI (SAST) Regulations, 2011, a Detailed Public Statement shall be published by the acquirer through the Manager to the Open Offer within maximum **5 working days from the date of Public Announcement.**

However in case of Indirect Acquisition where none of condition specified in Regulation 5(2) are satisfied, the Detailed Public Statement shall be published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.

Publication of Public Announcement and Detailed Public Statement

Regulation 14 of SEBI (SAST) Regulation, 2011 provides the requirements relating to publication of Public Announcement and Detailed Public Statement which are tabulated below:

<i>Regulation</i>	<i>Particulars</i>	<i>Time</i>	<i>To whom</i>
14(1)	Public Announcement	On the same day	All the stock exchanges on which the shares of the target company are listed. The stock exchanges shall forthwith disseminate such information to the public.
14(2)	Public Announcement	One working day of the date of the public announcement	Board and to the target company at its registered office
14(3)	Detailed Public Statement	5 working days from the date of Public Announcement.	Publication in the following newspaper: (a) One Hindi national language daily with wide circulation (b) One English national language daily with wide circulation

			<p>(c) One regional national language daily with wide circulation language at a place where registered office of the company is situated.</p> <p>(d) One regional language daily with wide circulation at the place of the stock exchange where the maximum volume of trading in the shares of the target company is recorded during the sixty trading days preceding the date of the public announcement.</p>
14(4)	Detailed Public Statement		<p>A copy of 'Detailed Public Statement shall be sent to followings:</p> <p>(a) Board</p> <p>(b) All the stock exchanges in which the shares of the target company are listed</p> <p>(c) The target company at its registered office</p>

Contents of Public announcement (Regulation 15)

The public announcement shall contain such information as may be specified, including the following,—

- (a) name and identity of the acquirer and persons acting in concert with him;
- (b) name and identity of the sellers, if any;
- (c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;
- (d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;

- (e) the offer price, and mode of payment of consideration; and
- (f) offer size, and conditions as to minimum level of acceptances, if any.

(2) The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.

(3) The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information, or contain any misleading information.

Filing Draft Letter of offer (Regulation 16)

Within 5 working days of publication DPS, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations.

The Board shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by the Board within such period, it shall be deemed that the Board does not have comments to offer:

Provided that in the event the Board has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

Provided further that in the event the Board specifies any changes, the manager to the open offer and the acquirer shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

4. Escrow account (Regulation 17)

Escrow Account means a bank account which is required to be opened by an acquirer who proposes to make public announcement of offer in pursuance of regulation 3, 4, 5 and 6 of SEBI (SAST) Regulations, 2011. The Regulations have made detailed provisions regarding the Escrow Account. These provisions are contained in regulation 17 of SEBI (SAST) Regulations, 2011. Regulation 17(1) of SEBI (SAST) Regulations, 2011 provides that "Not later than two working days prior to the date of the detailed public statement of open offer for acquiring shares, the acquirer shall create an escrow account towards security for performance of his obligations under these regulations, and deposit in escrow account such aggregate amount as specified. The purpose of these provisions is to ensure that the acquirer has sufficient funds to pay the consideration under the offer and he has secured sufficient financial arrangement.

I. Timing of opening of Escrow Account: [Regulation 17(1)]

The Acquirer shall open an escrow account *atleast two working days* prior to the date of Detailed Public Statement.

II. Amount to be deposited in Escrow Account: [Regulation 17(1)]

<i>Sl. No.</i>	<i>Consideration payable under the Open Offer</i>	<i>Escrow Amount</i>
a.	On the first Rs. 500 Crores	25% of the consideration
b.	On the balance consideration	An additional amount equal to 10%

It is further provided that where offer is made conditional upon minimum level of acceptance, then higher of following two shall be deposited in the Escrow Account:

Hundred percent of the consideration payable in respect of minimum level of acceptance	Fifty per cent of the consideration payable under the open offer
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If the Acquirer makes any upward revision in the open offer, whether by way of increase in offer price, or of the offer size, then the Acquirer shall make corresponding increases to the amount kept in escrow account prior to making such revision. [Regulation 17(2)]

III. Mode of Deposit in Escrow Account: [Regulation 17(3)]

(a) **Cash Deposit** with any scheduled commercial bank

(b) **Bank guarantee** issued in favor of the manager to the open offer by any scheduled commercial bank

(c) Deposit of **frequently traded and freely transferable equity shares** or other freely transferable securities with appropriate margin subject to compliance with regulation 9(2).

Important Points:

<i>Applicable Regulation</i>	<i>Details</i>	
17(4)	Bank Guarantee or Deposit of Security	Deposit at least 1% of the total consideration payable in cash with schedule commercial bank as part of Escrow Account.
17(5)	Cash deposit	Empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account lying to the credit of the escrow account

17(6)	Bank Guarantee	The bank guarantee shall be in the favor of manager to the offer and shall be kept valid throughout the offer period and additional 30 days after the payment to the shareholders who have tendered their shares have been made.
17(7)	Securities	<p>Manager to the Open Offer shall be empowered to realize the value of escrow account by way of sale or otherwise.</p> <p>Further in case of any shortfall in the amount in the escrow account, such shortfall shall be made good by the Manager.</p>

IV. Release of amount from Escrow Account [Regulation 17(10)]

The amount lying in escrow account can be released in the following cases only:

1. In case of withdrawal of offer, the entire amount can be released only after certification by the managers to the open offer.
2. The amount deposited in special escrow account is transferred to special bank account opened with the Bankers to an issue; however the amount so transferred shall not exceed 90% of the cash deposit.
3. The balance 10% is released to the acquirer on the expiry of thirty days from the completion of all obligations under the offer.
4. The entire amount to the acquirer on the expiry of thirty days from the completion of all obligations under the offer where the open offer is for exchange of shares or other secured instruments.
5. In the event of forfeiture of amount, the entire amount is distributed in the following manner:
 - 5.1. One third of the amount to Target Company;
 - 5.2. One third of the escrow account to the Investor Protection and Education Fund established under SEBI (Investor Protection and Education Fund) Regulations, 2009;
 - 5.3. Residual one third is to be distributed to the shareholders who have tendered their shares in the offer.

Draft Letter of offer to Target Company and stock exchanges [Regulation 18(1)]

Simultaneously with the filing of the draft letter of offer with the Board under sub-

regulation (1) of regulation 16, the acquirer shall send a copy of the draft letter of offer to the target company at its registered office address and to all stock exchanges where the shares of the target company are listed.

Dispatch of letter of offer to share holders [Regulation 18(2)]

The letter of offer shall be dispatched to the shareholders whose names appear on the register of members of the target company as of the identified date, not later than seven working days from the receipt of comments from the Board or where no comments are offered by the Board, within seven working days from the expiry of the stipulated period in sub-regulation (4) of regulation 16:

Provided that where local laws or regulations of any jurisdiction outside India may expose the acquirer or the target company to material risk of civil, regulatory or criminal liabilities in the event the letter of offer in its final form were to be sent without material amendments or modifications into such jurisdiction, and the shareholders resident in such jurisdiction hold shares entitling them to less than five per cent of the voting rights of the target company, the acquirer may refrain from dispatch of the letter of offer into such jurisdiction:

Provided further that every person holding shares, regardless of whether he held shares on the identified date or has not received the letter of offer, shall be entitled to tender such shares in acceptance of the open offer.

Letter of offer to the custodian of shares underlying depository receipts (Regulation 18(3))

Simultaneously with the dispatch of the letter of offer in terms of sub-regulation (2), of regulation 18 the acquirer shall send the letter of offer to the custodian of shares underlying depository receipts, if any, of the target company.

Offer Price

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SEBI (SAST) Regulations, 2011 for frequently or infrequently traded shares.

Revision of offer price [Regulation 18(4&5)]

Irrespective of whether a competing offer has been made, an acquirer may make upward revisions to the offer price, and subject to the other provisions of these regulations, to the number of shares sought to be acquired under the open offer, at any time prior to the commencement of the last three working days before the commencement of the tendering period.

In the event of any revision of the open offer, whether by way of an upward revision in offer price, or of the offer size, the acquirer shall,—

- (a) make corresponding increases to the amount kept in escrow account under regulation 17 prior to such revision;
- (b) make an announcement in respect of such revisions in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and

- (c) simultaneously with the issue of such an announcement, inform the Board, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

Size of an Open Offer

An open offer, other than a voluntary open offer under Regulation 6, must be made for a minimum of 26% of the target company's share capital. The size of the voluntary open offer under Regulation 6 must be for at least 10% of the target company's share capital. Further the offer size percentage is calculated on the fully diluted share capital of the target company taking into account potential increase in the number of outstanding shares as on 10th working day from the closure of the open offer.

Disclosure of acquisition during offer period [Regulation 18(6)]

The acquirer shall disclose during the offer period every acquisition made by the acquirer or persons acting in concert with him of any shares of the target company in such form as may be specified, to each of the stock exchanges on which the shares of the target company are listed and to the target company at its registered office within twenty-four hours of such acquisition, and the stock exchanges shall forthwith disseminate such information to the public:

Provided that the acquirer and persons acting in concert with him shall not acquire or sell any shares of the target company during the period between three working days prior to the commencement of the tendering period and until the expiry of the tendering period.

Advertisement before the tendering period [Regulation 18(6)]

The acquirer shall issue an advertisement in such form as may be specified, one working day before the commencement of the tendering period, announcing the schedule of activities for the open offer, the status of statutory and other approvals, if any, whether for the acquisition attracting the obligation to make an open offer under these regulations or for the open offer, unfulfilled conditions, if any, and their status, the procedure for tendering acceptances and such other material detail as may be specified:

Provided that such advertisement shall be,—

- (a) published in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
- (b) simultaneously sent to the Board, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

Offer period and tendering period

The term 'offer period' pertains to the period starting from the date of the event triggering open offer till completion of payment of consideration to shareholders by the acquirer or withdrawal of the offer by the acquirer as the case may be.

The term 'tendering period' refers to the 10 working days period falling within the offer period, during which the eligible shareholders who wish to accept the open offer can tender their shares in the open offer.

Tenure of tendering period [Regulation 18(8)]

The tendering period shall start not later than twelve working days from date of receipt of comments from the Board under sub-regulation (4) of regulation 16 and shall remain open for ten working days.

Tendered shares shall not be withdrawn [Regulation 18(9)]

Shareholders who have tendered shares in acceptance of the open offer shall not be entitled to withdraw such acceptance during the tendering period.

Completion of requirements [Regulation 18(10&11)]

The acquirer shall, within ten working days from the last date of the tendering period, complete all requirements under these regulations and other applicable law relating to the open offer including payment of consideration to the shareholders who have accepted the open offer.

The acquirer shall be responsible to pursue all statutory approvals required by the acquirer in order to complete the open offer without any default, neglect or delay:

Provided that where the acquirer is unable to make the payment to the shareholders who have accepted the open offer within such period owing to non-receipt of statutory approvals required by the acquirer, the Board may, where it is satisfied that such non-receipt was not attributable to any willful default, failure or neglect on the part of the acquirer to diligently pursue such approvals, grant extension of time for making payments, subject to the acquirer agreeing to pay interest to the shareholders for the delay at such rate as may be specified:

Provided further that where the statutory approval extends to some but not all shareholders, the acquirer shall have the option to make payment to such shareholders in respect of whom no statutory approvals are required in order to complete the open offer.

Post offer Advertisement [Regulation 18(12)]

The acquirer shall issue a post offer advertisement in such form as may be specified within five working days after the offer period, giving details including aggregate number of shares tendered, accepted, date of payment of consideration.

(b) Such advertisement shall be,—

- (i) published in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
- (ii) simultaneously sent to the Board, all the stock exchanges on which the

shares of the target company are listed, and the target company at its registered office.

Conditional offer (Regulation 19)

An offer in which the acquirer has stipulated a minimum level of acceptance is known as a 'conditional offer'.

'Minimum level of acceptance' implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer.

In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

Competing offer (Regulation 20)

Competitive offer is an offer made by a person, other than the acquirer who has made the first public announcement. A competitive offer shall be made within 15 working days of the date of the Detailed Public Statement (DPS) made by the acquirer who has made the first PA.

If there is a competitive offer, the acquirer who has made the original public announcement can revise the terms of his open offer provided the revised terms are favorable to the shareholders of the target company. Further, the bidders are entitled to make revision in the offer price up to 3 working days prior to the opening of the offer. The schedule of activities and the offer opening and closing of all competing offers shall be carried out with identical timelines.

Payment of consideration: (Regulation 21)

The acquirer shall complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange/transfer of Securities, to all shareholders who have tendered shares in acceptance of the open offer within 10 working days of the expiry of the tendering period, by transferring the consideration to a Special Escrow Account.

Withdrawal of open offer (Regulation 23)

An open offer once made cannot be withdrawn except in the following circumstances:

- Statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer have been refused subject to such requirement for approvals having been specifically disclosed in the DPS and the letter of offer;
- Any condition stipulated in the SPA attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, subject to such conditions having been specifically disclosed in the DPS and the letter of offer;
- Sole acquirer being a natural person has died;

- Such circumstances which in the opinion of SEBI merit withdrawal of open offer.

Obligations of the acquirer.(Regulation 25)

(1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period:

Provided that in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall *inter alia* contain reasons as to why such alienation is necessary.

(3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.

(4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations.

Obligations of the target company.(Regulation 26)

(1) Upon a public announcement of an open offer for acquiring shares of a target company being made, the board of directors of such target company shall ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice.

(2) During the offer period, unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not,—

- alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefor outside the ordinary course of business;
- effect any material borrowings outside the ordinary course of business;
- issue or allot any authorised but unissued securities entitling the holder to voting rights:

Provided that the target company or its subsidiaries may,—

- (i) issue or allot shares upon conversion of convertible securities issued prior to the public announcement of the open offer, in accordance with pre-determined terms of such conversion;
 - (ii) issue or allot shares pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies prior to the public announcement of the open offer; or
 - (iii) issue or allot shares pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement of the open offer;
- (d) implement any buy-back of shares or effect any other change to the capital structure of the target company;
- (e) enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, outside the ordinary course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person; and
- (f) accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise.

(3) In any general meeting of a subsidiary of the target company in respect of the matters referred to in sub-regulation (2), the target company and its subsidiaries, if any, shall vote in a manner consistent with the special resolution passed by the shareholders of the target company.

(4) The target company shall be prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

(5) The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any, for registration of transfer of shares are pending with the target company:

Provided that the acquirer shall reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.

(6) Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations:

Provided that such committee shall be entitled to seek external professional advice at the expense of the target company.

(7) The committee of independent directors shall provide its written reasoned recommendations on the open offer to the shareholders of the target company and such recommendations shall be published in such form as may be specified, at least

two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to,—

- (i) the Board;
- (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and
- (iii) to the manager to the open offer, and where there are competing offers, to the manager to the open offer for every competing offer.

(8) The board of directors of the target company shall facilitate the acquirer in verification of shares tendered in acceptance of the open offer.

(9) The board of directors of the target company shall make available to all acquirers making competing offers, any information and co-operation provided to any acquirer who has made a competing offer.

(10) Upon fulfillment by the acquirer, of the conditions required under these regulations, the board of directors of the target company shall without any delay register the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

Obligations of the manager to the open offer.(Regulation 27)

(1) Prior to public announcement being made, the manager to the open offer shall ensure that,—

- (a) the acquirer is able to implement the open offer; and
- (b) firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

(2) The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.

(3) The manager to the open offer shall furnish to the Board a due diligence certificate along with the draft letter of offer filed under regulation 16.

(4) The manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board.

(5) The manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with these regulations.

(6) The manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.

(7) The manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

DEFENSE STRATEGIES TO TAKEOVER BIDS

A hostile tender offer made directly to a target company's shareholders, with or without previous overtures to the management, has become an increasingly frequent means of initiating a corporate combination. As a result, there has been considerable interest in devising defense strategies by actual and potential targets.

Defenses can take the form of fortifying one self, i.e., to make the company less attractive to takeover bids or more difficult to take over and thus discourage any offers being made. These include, inter alia, asset and ownership restructuring, anti-takeover constitutional amendments, adoption of poison pill rights plans, and so forth. Defensive actions are also resorted to in the event of perceived threat to the company, ranging from early intelligence that a "raider" or any acquirer has been accumulating the company's stock to an open tender offer. Adjustments in asset and ownership structures may also be made even after a hostile takeover bid has been announced.

Defensive Measures

Adjustments in Asset and Ownership Structure

Firstly, consideration has to be given to steps, which involve defensive restructuring that create barriers specific to the bidder. These include purchase of assets that may cause legal problems, purchase of controlling shares of the bidder itself, sale to the third party of assets which made the target attractive to the bidder, and issuance of new securities with special provisions conflicting with aspects of the takeover attempt.

A second common theme is to create a consolidated vote block allied with target management.

Thus, securities were issued through private placements to parties friendly or in business alliance with management or to the management itself. Moreover, another method can be to repurchase publicly held shares to increase an already sizable management-allied block in place.

A third common theme is the dilution of the bidder's vote percentage through issuance of new equity claims. However, this option in India is strictly regulated vide Section 81A and Regulation 23 of the Takeover Code, 1997. A hostile bidder in these circumstances usually fails in the bid if the bidder has resource constraints in increasing its interest proportionately.

The "Crown Jewel" Strategy

The central theme in such a strategy is the divestiture of major operating unit most coveted by the bidder—commonly known as the "crown jewel strategy". Consequently, the hostile bidder is deprived of the primary intention behind the takeover bid. A variation of the "crown jewel strategy" is the more radical "scorched earth approach". Vide this novel strategy, the target sells off not only the crown jewel but also properties to diminish its worth. Such a radical step may however be, self-destructive and unwise in the company's interest. 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. However, the SEBI (Substantial Acquisitions and Takeover) Regulations, 1997 vide Regulation 23 prescribes general obligations for the Board of Directors of the target company. Under the said regulation, it will be difficult for any target company to sell, transfer, encumber or otherwise dispose of or enter into an agreement to sell, transfer, encumber or for dispose of assets once the predator has made a public announcement. Thus, the above defense can only be used before the predator/bidder makes the public announcement of its intention to takeover the target company.

The "Packman" Defence

This strategy, although unusual, is called the packman strategy. Under this strategy, the target company attempts to purchase the shares of the raider company. This is usually the scenario if the raider company is smaller than the target company and the target company has a substantial cash flow or liquidable asset.

Targeted Share Repurchase or "Buyback"

This strategy is really one in which the target management uses up a part of the assets of the company on the one hand to increase its holding and on the other it disposes of some of the assets that make the target company unattractive to the raider. The strategy therefore involves a creative use of buyback of shares to reinforce its control and detract a prospective raider. But "buyback" the world over is used when the excess money with the company neither gives it adequate returns on reinvestment in production or capital nor does it allow the company to redistribute it to shareholders without negative spin offs.

An example that demonstrates this contention is the distribution of high dividends in a particular year if not followed in the next sends the share prices spiraling down. Also the offer once made cannot be withdrawn unlike a public offer under the Takeover Regulations. This means that if the raider withdraws its public offer it would imply that the target company would still have to go through with the buyback. This is an expensive proposition if the only motivation to go for the buyback was to dissuade the raider.

"Golden Parachutes"

Golden parachutes refer to the "separation" clauses of an employment contract that compensate managers who lose their jobs under a change-of-management scenario. The provision usually calls for a lump-sum payment or payment over a specified period at full and partial rates of normal compensation. The provisions which would govern a "golden parachute" employment contract in India would be Sections 318-320 of the Companies Act, 1956 which govern the provisions compensation for loss of office. Thus, a perusal of the said provisions would show that payments as compensation for the loss of office is allowed to be made only to the managing director, a director holding an office of manager or a whole time director. Therefore, "golden parachute" contracts with the entire senior management, as is the practice in the U.S., is of no consequence in India. Moreover, payment of compensation is expressly disallowed if in the case of a director resigning as a consequence of reconstruction of the company, or its amalgamation with any other corporate bodies. Furthermore, there exists a maximum limit as to the quantum of the compensation, subject to the exclusionary categories, to the total of the remuneration the director would have earned for the unexpired residue of term of office, or three years, whichever is less.

Anti-takeover amendments or “shark repellants”

An increasingly used defense mechanism is anti-takeover amendments to the company's constitution or articles of association, popularly called “shark repellants”. Thus, as with all amendments of the charter/articles of association of a company, the anti-takeover amendments have to be voted on and approved by the shareholders. The practice consists of the companies changing the articles, regulations, bye-laws etc. to be less attractive to the corporate bidder.

Anti takeover amendments generally impose new conditions on the transfer of managerial control of the firm through a merger, tender offer, or by replacement of the Board of Directors. In India every company has the clear power to alter its articles of association by a special resolution as provided under Section 31 of the Companies Act. The altered articles will bind the members just in the same way as did the original articles. But that will not give the altered articles a retrospective effect. The power of alteration of the articles as conferred by Section 31 is almost absolute. It is subject only to two restrictions. In the first place, the alteration must not be in contravention of the provisions of the Act, i.e. should not be an attempt to do something that the Act forbids. Secondly, the power of alteration is subject to the conditions contained in the memorandum of association i.e. alter only the articles of the company as relate to the management of the company but not the very nature and constitution of the company. Also the alteration should not constitute a ‘fraud on the minority’.

Types of Anti-Takeover Amendments

There are four major types of anti-takeover amendments.

Supermajority Amendments

These amendments require shareholder approval by at least two thirds vote and sometimes as much as 90% of the voting power of outstanding capital stock for all transactions involving change of control. In most existing cases, however, the supermajority agreements have a board-out clause which provides the board with the power to determine when and if the supermajority provisions will be in effect. Pure or inflexible supermajority provisions would seriously limit the management's scope of options and flexibility in takeover negotiations.

Fair-Price Amendments

These are supermajority provisions with a board out clause and an additional clause waiving the supermajority requirement if a fair-price is paid for the purchase of all the shares. The fair price is normally defined as the highest priced paid by the bidder during a specified period. Thus, fair-price amendments defend against two-tier tender offers that are not approved by the target's board.

Classified Boards

Another major type of anti-takeover amendments provides for a staggered, or classified, Board of Directors to delay effective transfer and control in a takeover. The much touted management rationale in proposing a classified board is to ensure continuity of policy and experience. In the United States, the legal position of such classified or staggered boards is quite flexible. An ideal example is when a nine-member board may be divided into 3 classes, with only three members

standing for election to a three year term each, such being the modalities of the retirement by rotation. Thus, a new majority shareholder would have to wait for at least two annual general meetings to gain control of the Board of Directors. In the Indian company law regime, the scope for such amendments is highly restricted. Section 255 of the Companies Act, 1956 is designed to eradicate the mischief caused by perpetual managements. At an AGM only one-third of the directors of the company, whose offices are determinable by retirement, will retire. Therefore putting the example in the Indian context, in case of 9 directors, 3 can be made permanent directors by amending the articles i.e. one-third can be given permanent appointment, under Section 255. Thus the acquirer would have to wait for atleast three annual general meetings before he gains control of the board. But this is subject to Section 284, which provides that the company may by an ordinary resolution, remove a director before the expiration of his period of office. Thus any provision in the articles of the company or any agreement between a director and a company by which the director is rendered irremovable from office by an ordinary resolution would be void, being contrary to the Act. Therefore, to ensure domination of the board of the target management, there needs to be strength to defeat an ordinary resolution.

Authorization of Preferred Stock

Vide such provisions, the Board of Directors is authorized to create a new class of securities with special voting rights. This security, typically preferred stock, may be issued to a friendly party in a control contest. Thus, this device is a defense against hostile takeover bids, although historically it was used to provide the Board of Directors with flexibility in financing under changing economic conditions.

Refusal to Register Transfer of Shares

Refusal by the Board of Directors to register a transfer is an important strategy to avert a takeover.

Poison Pill Defenses

A controversial but 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. Usually the rights provided by the poison pill can be altered quickly by the board or redeemed by the company anytime after they become exercisable following the occurrence of the triggering event. These provisions force the acquirer to negotiate directly with the target company's board and allow some takeover bids to go through. Proponents of the poison pill argue that poison pills do not prohibit all takeovers but enhance the ability of the Board of Directors to bargain for a "fair price".

Legal Issues Concerning Poison Pill Devices

The legality of poison pills has been questioned in courts of law because they alter the relationships among the principals (shareholders) without their approval by vote. In most poison pills, the agents (Board of Directors) adopt rights plans which

treat shareholders of the same class unequally in situation involving corporate control. Thus poison pills have been vulnerable to court review especially in the United States.

Corporate restructuring through the M&A route is here to stay. The defenses mentioned above are only enumerative of the fast evolving corporate practice in this regard. This kind of corporate synergy requires that the legal paradigm so adjust itself, that it is in a position to optimize the benefits that accrue from such restructuring.

Globalization of the Indian economy started changing the landscape of the Indian industry. Following economic reforms, there was a discernible trend among promoters and established corporate groups towards consolidation of market share and diversification into new areas, in a limited way through acquisition of companies, but in a more pronounced manner through mergers and amalgamations.

Perhaps the biggest facilitators for Indian businessmen were the most flexible norms and terms announced by the Indian government, which had announced that the companies with a proven track would be allowed to make acquisitions abroad in non-related areas as well as their major fields. In addition, the government removed the \$100 million cap on foreign investment by Indian companies and raised it to the net worth of the companies. The Reserve Bank of India (RBI), also stipulated that the local companies could raised external commercial borrowings for overseas direct investments in their joint ventures and wholly owned subsidiaries, including mergers and acquisitions overseas.

As a direct result of such liberal regulations, Indian companies, including branches of multinational, became more adventurous in their business forays.

CROSS BORDERS TAKEOVERS

Cross Border Takeover is a much sort after term in recent years. Competitiveness among the domestic firms forces many businesses to go global. There are various factors which motivate firms to go for global takeovers. Apart from personal glory, global takeovers are often driven by market consolidation, expansion or corporate diversification motives. Also, financial, accounting and tax related matters inspire such takeovers.

The firms engaged in Cross borders takeovers can be of three types:

- First, firm incorporated in one country listed in different countries including its own e.g. ARCELOR.
- Second, firm incorporated in one country listed exclusively in a foreign country e.g. TELVENT.
- And lastly, firms incorporated in one country listed in more than one foreign country e.g. EADS.

Expansion and diversification are one of the primary reasons to cross the border as the domestic markets usually do not provide the desired growth opportunities. One has to look outside its boundaries and play out in the global arena to seek new opportunities and scale new heights. Such companies have already improved profitability through better cost management and diversification at the national field.

Another main reason for cross border takeovers is to attain monopoly. Acquirer company is always on the look out for companies which are financially vulnerable but have untapped resources or intellectual capital that can be exploited by the purchaser.

Globalization has certainly helped in the recent spurt in cross border takeovers. The key feature of globalization is that it integrates world economies together. Many nations have opened their economies and made laws and regulations that attract new companies to come into the country.

What are the legal implications to a cross border merger and takeover? International law prescribes that in a cross-border merger, the target firm becomes a national of the country of the acquirer. Among other effects, the change in nationality implies a change in investor protection, because the law that is applicable to the newly merged firm changes as well. More generally, the newly created firm shares features of the corporate governance systems of the two merging firms. Therefore, Cross-border mergers provide a natural experiment to analyse the effects of changes-both improvements and deteriorations, in corporate governance on firm value.

There are various benefits of cross border takeovers. Firstly, they provide newer and better technology. It also provides employment opportunities as the firm is bigger than before and more employees are to be inducted in the merged company. It generally enhances the market capitalization of the combined entity.

Global takeovers are complex processes. Despite some harmonized rules, taxation issues are mainly dealt within national rules, and are not always fully clear or exhaustive to ascertain the tax impact of a cross-border merger or acquisition. This uncertainty on tax arrangements sometimes require seeking of special agreements or arrangements from the tax authorities on an ad hoc basis, whereas in the case of a domestic deal the process is much more deterministic.

Gross-border takeover bids are complex transactions that may involve the handling of a significant number of legal entities, listed or not, and which are often governed by local rules (company law, market regulations, self regulations, etc.). Not only a foreign bidder might be hindered by a potential lack of information, but also some legal complexities might appear in the merger process resulting in a deadlock, even though the bid would be 'friendly'. This legal uncertainty may result in a significant execution risk and act as a major hurdle to cross-border consolidation.

There are various challenges to cross border takeovers. Global takeovers may result into a skyrocketing share prices because merger and acquisition have a substantial effect on the whole economy. Management also faces a big challenge as there is explosion of new services, new products, new industries and new markets and new technological innovations as well.

But the biggest challenge to a cross border merger and takeover are the cultural issues. According to KPMG study, "83% of all the mergers and acquisitions failed to produce any benefit for the shareholders and over half actually destroyed value". Interviews of over 100 senior executives involved in these 700 deals over a two year period revealed that the overwhelming cause of failure is the people and the cultural differences. So, the cultural issues are to be aptly dealt with.

It is expected that the cross borders takeovers will increase in the near future. The companies will have to keep in mind that global takeovers are not only business

proposals but also a corporate bonding for which both the entities have to sit and arrive at a meaningful and deep understanding of all the issues as mentioned above. It will also help them to get meaningful solutions.

There has been a substantial increase in the quantum of funds flowing across nations in search of takeover candidates. The UK has been the most important foreign investor in the USA in recent years, with British companies making large acquisitions. With the advent of the Single Market, the European Union now represents the largest single market in the world. European as well as Japanese and American companies have sought to increase their market presence by acquisitions.

Many cross-border deals have been in the limelight. The biggest were those of Daimler Benz-Chrysler, BP-Amoco, Texas Utilities-Energy Group, Universal Studios-Polygram, Northern Telecom-Bay Networks and Deutsche Bank-Bankers Trust. Nearly 80 per cent of the transactions were settled in stock rather than through cash.

The going global is rapidly becoming Indian Company's mantra of choice. Indian companies are now looking forward to drive costs lower, innovate speedily, and increase their International presence. Companies are discovering that a global presence can help insulate them from the vagaries of domestic market and is one of the best ways to spread the risks. Indian Corporate sector has witnessed several strategical acquisitions. Tata Motors acquisition of Daewoo Commercial Vehicle Company, Tata Steel acquisition of Singapore's NatSteel, Reliance's acquisition of Flag is the culmination of Indian Company's efforts to establish a presence outside India.

Students may note that the economic, accounting, taxation, financial, stamp duty aspects are explained in Chapter 3.



Activities to do

1. Reading and referring to open offer document filed with SEBI/published in the news paper
2. Reading various case studies on Indian and overseas takeovers.
3. Reading of SEBI (SAST) Regulation 2011

Annexure -I

FREQUENTLY ASKED QUESTIONS ON SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011*

These FAQs offer only a simplistic explanation/clarification of terms/concepts related to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ["SAST Regulations, 2011"]. Any such explanation/clarification that is provided herein should not be regarded as an interpretation of law nor be treated as a binding

*Source: www.sebi.gov.in

opinion/guidance from the Securities and Exchange Board of India ["SEBI"]. For full particulars of laws governing the substantial acquisition of shares and takeovers, please refer to actual text of the Acts/Regulations/Circulars appearing under the Legal Framework Section on the SEBI website.

1. Please provide details as to how the regulatory framework governing Takeovers has evolved over a period?

- The earliest attempts at regulating takeovers in India can be traced back to the 1990s with the incorporation of Clause 40 in the Listing Agreement.
- While, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 which were notified in November 1994 made way for regulation of hostile takeovers and competitive offers for the first time; the subsequent regulatory experience from such offers brought out certain inadequacies existing in those Regulations. As a result, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were introduced and notified on February 20, 1997, pursuant to repeal of the 1994 Regulations.
- Owing to several factors such as the growth of Mergers & Acquisitions activity in India as the preferred mode of restructuring, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations 1997. Accordingly, SEBI formed a Takeover Regulations Advisory Committee (TRAC) in September 2009 under the Chairmanship of (Late) Shri. C. Achuthan, Former Presiding Officer, Securities Appellate Tribunal (SAT) for this purpose. After extensive public consultation on the report submitted by TRAC, SEBI came out with the SAST Regulations 2011 which were notified on September 23, 2011. The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.

2. What is the significance of the notification related to SAST Regulations, 2011 published on September 23, 2011?

Vide the said notification dated September 23, 2011, the SAST Regulations, 2011 were notified to replace SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, since repealed.

SAST Regulations, 2011 come into force with effect from October 22, 2011.

SAST Regulations, 2011 are available on SEBI's website under the section legal framework.

3. When the Takeover Regulations, 2011 have come in to force?

October 22, 2011 i.e. 30th day from the date of notification. (September 23, 2011 i.e. date of notification has been taken as the first day for computing 30 days).

4. What is meant by Takeovers & Substantial acquisition of shares?

When an "acquirer" takes over the control of the "Target Company", it is termed as Takeover. When an acquirer acquires "substantial quantity of shares or voting rights" of the Target Company, it results into substantial acquisition of shares.

5. Who is an 'Acquirer'?

Acquirer means any person who, whether by himself, or through, or with persons acting in concert with him, directly or indirectly, acquires or agrees to acquire shares or voting rights in, or control over a target company. An acquirer can be a natural person, a corporate entity or any other legal entity.

6. What is meant by Persons acting in Concert or 'PAC' in the context of SAST Regulations, 2011?

PACs are individual(s)/company (ies) or any other legal entity (ies) who, with a common objective or purpose of acquisition of shares or voting rights in, or exercise of control over the target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly cooperate for acquisition of shares or voting rights in, or exercise of control over the target company.

SAST Regulations, 2011 define various categories of persons who are deemed to be acting in concert with other persons in the same category, unless the contrary is established.

7. What is a 'Target Company'?

The company/body corporate or corporation whose equity shares are listed in a stock Exchange and in which a change of shareholding or control is proposed by an acquirer, is referred to as the 'Target Company'.

8. What is an open offer under the SAST Regulations, 2011?

An open offer is an offer made by the acquirer to the shareholders of the target company inviting them to tender their shares in the target company at a particular price. The primary purpose of an open offer is to provide an exit option to the shareholders of the target company on account of the change in control or substantial acquisition of shares, occurring in the target company.

9. Under which situations is an open offer required to be made by an acquirer?

If an acquirer has agreed to acquire or acquired control over a target company or shares or voting rights in a target company which would be in excess of the threshold limits, then the acquirer is required to make an open offer to shareholders of the target company.

10. Can the acquisitions, resulting from any agreement attracting the obligation to make an open offer, be completed by way of transactions settled on stock exchange such as bulk/block deals?

No. Regulation 22(1) of Takeover Regulations 2011 specifically provides that the acquirer shall not complete the acquisition of shares and voting rights in, or control over, the target company, whether by way of subscription of shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period.

In cases where acquisitions, resulting from any agreement triggering open offer are sought to be completed through transactions such as bulk/block deals, settled on a recognized stock exchange, the same would get completed/settled on T+2 basis i.e. within 2 days after the date

of such transaction. Therefore such acquisitions, if done, will not be in line with the provisions of Regulation 22(1) since the same would result in completion of the triggering acquisition before the expiry of the offer period. Hence the acquisition resulting from any agreement attracting the obligation to make an open offer cannot be executed through transactions such as block/bulk deal.

11. What are the threshold limits for acquisition of shares/voting rights, beyond which an obligation to make an open offer is triggered?

- Acquisition of 25% or more shares or voting rights: An acquirer, who (along with PACs, if any) holds less than 25% shares or voting rights in a target company and agrees to acquire shares or acquires shares which along with his/ PAC's existing shareholding would entitle him to exercise 25% or more shares or voting rights in a target company, will need to make an open offer before acquiring such additional shares.
- Acquisition of more than 5% shares or voting rights in a financial year: An acquirer who (along with PACs, if any) holds 25% or more but less than the maximum permissible non-public shareholding in a target company, can acquire additional shares in the target company as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31, only after making an open offer.

12. How is the maximum permissible non-public shareholding in a listed company defined?

Maximum permissible non-public shareholding is derived based on the minimum public shareholding requirement under the Securities Contracts (Regulations) Rules 1957 ("SCRR"). Rule 19A of SCRR requires all listed companies (other than public sector companies) to maintain public shareholding of at least 25% of share capital of the company. Thus by deduction, the maximum number of shares which can be held by promoters i.e. Maximum permissible non-public shareholding) in a listed companies (other than public sector companies) is 75% of the share capital.

13. What is the basis of computation of the creeping acquisitions limit under Regulation 3(2) of Takeover Regulations 2011?

For computing acquisitions limits for creeping acquisition specified under regulation 3(2), gross acquisitions/ purchases shall be taken in to account thereby ignoring any intermittent fall in shareholding or voting rights whether owing to disposal of shares or dilution of voting rights on account of fresh issue of shares by the target company.

14. Whether for the purpose of the creeping acquisition in terms of the

Takeover Regulations, 2011, the Creeping Acquisition made during the period 01.04.2011 to 22.10.2011 will be considered?

The Takeover Regulations, 2011 have clearly defined the financial year as the period of 12 months commencing on the first day of the month of April.

Thus, for the purpose of the creeping acquisitions under Regulation 3(2) of Takeovers Regulations 2011, shares acquired during 1/4/2011 to 22/10/2011 will be taken in to account.

15. Whether hostile offers/bids are permitted under the new regulations?

There is no such term as hostile bid in the regulations. The hostile bid is generally understood to be an unsolicited bid by a person, without any arrangement or MOU with persons currently in control.

Any person with or without holding any shares in a target company, can make an offer to acquire shares of a listed company subject to minimum offer size of 26%.

16. What is a voluntary open offer?

A voluntary open offer under Regulation 6, is an offer made by a person who himself or through Persons acting in concert ,if any, holds 25% or more shares or voting rights in the target company but less than the maximum permissible non-public shareholding limit.

17. What are the restrictions on acquirers making a voluntary open offer?

A voluntary offer cannot be made if the acquirer or PACs with him has acquired any shares of the target company in the 52 weeks prior to the voluntary offer. The acquirer is prohibited from acquiring any shares during the offer period other than those acquired in the open offer. The acquirer is also not entitled to acquire any shares for a period of 6 months, after completion of open offer except pursuant to another voluntary open offer.

18. Can a person holding less than 25% of the voting rights/ shares in a target company, make an offer?

Yes, any person holding less than 25% of shares/ voting rights in a target company can make an open offer provided the open offer is for a minimum of 26% of the share capital of the company.

19. How is the voluntary offer made by a person holding less than 25% of shares/ voting rights in a target company different from the voluntary offer made by a person holding more than 25% of shares/ voting rights of the target company?

Voluntary offer by a person holding less than 25%	Voluntary offer by a person holding more than 25%
Minimum offer size of 26%.	Minimum offer size of 10%.
Maximum can be for entire share capital of the target company.	The maximum offer size is linked to maximum permissible non public shareholding permitted under Securities Contracts (Regulations) Rules 1957.
No such conditions	<ul style="list-style-type: none"> Acquirer should not have acquired any shares during 52 weeks period prior to Public Announcement.

	<ul style="list-style-type: none"> • Acquirer is not entitled to acquire any shares of the target company for a period of 6 months after the completion of the open offer except for a voluntary open offer.
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20. Proposed acquisition of which type of securities, beyond the stipulated thresholds, leads to an obligation of making an open offer?

Acquisition of equity shares carrying voting rights or any security which entitles the holder thereof to exercise voting rights, beyond the prescribed threshold limits, leads to the obligation of making an open offer. GDR (Global Depository Receipts) which by virtue of depository agreement or otherwise, carrying voting rights is an example of a security which entitles the holder to exercise voting rights but is not an equity share.

21. Do all acquisitions of shares in excess of the prescribed limits and / or control lead to an open offer?

No. In respect of certain acquisitions, SAST Regulations, 2011 provide exemption from the requirements of making an open offer, subject to certain conditions being fulfilled. For example, acquisition pursuant to interse transfer of shares between certain categories of shareholders; acquisition in the ordinary course of business by entities like Underwriter registered with SEBI, stock brokers, merchant bankers acting as stabilizing agent, Scheduled Commercial Bank (SCB), acting as an escrow agent; etc. For more details, please refer to regulation 10 of SAST Regulations, 2011.

22. Does SEBI have the power to grant exemption to an acquirer from making an open offer or grant relaxation from the strict compliance with prescribed provisions of the open offer process, even if the proposed acquisition of shares or control is not covered under the exemptions prescribed in SAST Regulations,2011?

Yes. In the interest of the securities market, upon an application made by the acquirer, SEBI has the power to grant exemption from the requirements of making an open offer or grant a relaxation from strict compliance with prescribed provisions of the open offer process.

Before undertaking such acquisition, SEBI may at its discretion refer the application to a panel of experts constituted by SEBI. The orders passed in such matters would be uploaded on SEBI's website.

23. Do only direct acquisitions of shares or control of the target company lead to the requirement of making an open offer?

No. The requirement to make an open offer arises even if there is an indirect acquisition of shares and/or control of the target company. An indirect acquisition would be the acquisition of shares or control over another entity by an acquirer that would enable the acquirer to exercise or direct to exercise voting rights beyond the stipulated thresholds or control over the target company.

24. What is a competitive offer?

Competitive offer is an offer made by a person, other than the acquirer who has made the first public announcement. A competitive offer shall be made within 15 working days of the date of the Detailed Public Statement (DPS) made by the acquirer who has made the first PA.

25. What happens if there is a competitive offer?

If there is a competitive offer, the acquirer who has made the original public announcement can revise the terms of his open offer provided the revised terms are favorable to the shareholders of the target company. Further, the bidders are entitled to make revision in the offer price up to 3 working days prior to the opening of the offer. The schedule of activities and the offer opening and closing of all competing offers shall be carried out with identical timelines.

26. What is a conditional offer?

An offer in which the acquirer has stipulated a minimum level of acceptance is known as a 'conditional offer'.

27. What is meant by the term 'minimum level of acceptance'?

'Minimum level of acceptance' implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer.

28. If the minimum level of acceptance is not reached, can the acquirer acquire shares under the Share Purchase Agreement, which triggered the offer?

In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

29. What is the stipulated size of an open offer?

An open offer, other than a voluntary open offer under Regulation 6, must be made for a minimum of 26% of the target company's share capital. The size of voluntary open offer under Regulation 6 must be for at least 10% of the target company's share capital. Further the offer size percentage is calculated on the fully diluted share capital of the target company taking in to account potential increase in the number of outstanding shares as on 10th working day from the closure of the open offer.

30. What is 'offer price' and can the acquirer revise the offer price?

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

Acquirer can make an upward revision to the offer price at any time up to 3

working days prior to the opening of the offer.

31. How do you determine whether the shares of the target company are frequently traded or infrequently traded?

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

32. How is the offer price calculated in case shares are frequently traded on the stock exchange?

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement
- ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- Volume weighted average market price for sixty trading days preceding the PA.

33. How is the offer price calculated in case shares are infrequently traded on the stock exchange?

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of such companies.

It may be noted that the Board may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

34. Will the promoter be entitled to non-compete or any other fees other than the offer price?

As per the SAST Regulations, 2011, all shareholders will be given equitable treatment and no Promoter or shareholder can be paid any extra price, by whatever name it may be called.

35. Are there special provisions for determining the offer price in case of open offer arising out of indirect acquisition of a target company?

Yes. Since indirect acquisitions involve acquiring the target company as a part of a larger business, SAST Regulations, 2011 have prescribed additional parameters to be taken into account for determination of the offer price. If the size of the target company exceeds certain thresholds as compared to the size of the entity or business being acquired then the acquirer is required to compute and disclose in the letter of offer, the per share value of the target company taken into account for the acquisition, along with the methodology. (Kindly refer to Regulation 5). Further, in indirect acquisitions which are not in the nature of deemed direct acquisition, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of 10% per annum for the period between the date on which primary acquisition was contracted and the date of Detailed Public Statement.

36. What is the difference between 'offer period' and 'tendering period'?

The term 'offer period' pertains to the period starting from the date of the event triggering open offer till completion of payment of consideration to shareholders by the acquirer or withdrawal of the offer by the acquirer as the case may be.

The term 'tendering period' refers to the 10 working days period falling within the offer period, during which the eligible shareholders who wish to accept the open offer can tender their shares in the open offer.

37. Who are eligible shareholders?

All shareholders of the target company other than the acquirer, persons acting in concert with him and the parties to underlying agreement which triggered open offer including persons deemed to be acting in concert with such parties, irrespective of whether they are shareholders as on identified date or not.

38. What are the typical steps and corresponding timelines, in an open offer process?

Under most scenarios (except in certain types of indirect acquisitions) on the day of the triggering event, the acquirer is required to make a Public Announcement to the stock exchanges where shares of Target Company are listed and to SEBI. Within 5 working days thereafter, the acquirer is required to publish a Detailed Public Statement (DPS) in newspapers and also submit a copy to SEBI, after creation of an escrow account.

Within 5 working days of publication DPS, the acquirer through the manager to the offer is required to file a draft letter of offer with SEBI for its observations. The letter of offer is dispatched to the shareholders of the target company, as on the identified date, after duly incorporating the changes indicated by SEBI, if there are any.

The offer shall open not later than 12 working days from the date of receipt of SEBI's observations. The acquirer is required to issue an advertisement announcing the final schedule of the open offer, one working day before opening of the offer. The offer shall remain open for 10 working days from the date of opening of the offer. Within 10 working days after the closure of the offer, the acquirer shall make payments to the shareholders whose shares have been accepted. A post offer advertisement, giving details of the acquisitions, is required to be published by the acquirer within 5 working days of the completion of payments under the open offer.

39. What is 'identified date' in the context of SAST Regulations, 2011?

Identified date means the date 10 working days prior to the commencement of the tendering period, for the purposes of determining the shareholders of the target company to whom the letter of offer along with the form of acceptance shall be sent.

40. What is the purpose of the escrow account in the open offer process?

The acquirer is required to deposit some percentage of the offer price, in an escrow account before issuing a Detailed Public Statement. This serves as a security for performance of acquirer's obligations under the open offer.

41. At what point of time in the process does a Merchant Banker need to be appointed and what is its role in the open offer process?

The Acquirer is required to appoint a Merchant Banker, registered with SEBI, as manager to the open offer before making the PA. The PA is required to be made through the said manager to the open offer.

The manager to the open offer has to exercise due diligence and ensure compliance with SAST Regulations, 2011. The manager to the open offer has to ensure that the contents of the PA, DPS, letter of offer and the post offer advertisement are true, fair and adequate in all material aspects and are in compliance with the requirements of SAST Regulations, 2011. Further, the manager to the open offer has to ensure that the acquirer is able to implement the open offer and firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

42. What is a letter of offer? Does SEBI approve the draft Letter of Offer?

The letter of offer is a document which is dispatched to all shareholders of the target company as on identified date. This is also made available on the website of SEBI.

Prior to dispatch of letter of offer to shareholders, a draft letter of offer is submitted to SEBI for observations. SEBI may give its comments on the draft letter of offer as expeditiously as possible, but not later than 15 working days of the receipt of the draft letter of offer. SEBI may also seek clarifications and additional information from the manager to the offer and in such a case the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarifications or additional information sought.

Filing of draft Letter of Offer with SEBI should not in any way be deemed or construed to mean that the same has been cleared, vetted or approved by SEBI. The draft Letter of Offer is submitted to SEBI for the limited purpose of overseeing whether the disclosures contained therein are generally adequate and are in conformity with the Regulations. SEBI does not take any responsibility either for the truthfulness or correctness of any statement, financial soundness of acquirer, or of PACs, or of the Target Company, whose shares are proposed to be acquired or for the correctness of the statements made or opinions expressed in the Letter of Offer.

43. How do I find the status of the draft letter of offer filed with SEBI?

SEBI updates the processing status of draft letter of offers filed with it on its website on a periodic basis under the section “offer documents”.

44. What are the disclosures required under the Public Announcement?

Public Announcement contains minimum details about the offer, the transaction that triggered the open offer obligations, acquirer, selling shareholders (if any), offer price and mode of payment. SEBI has prescribed format of Public Announcement, which is available in the SEBI website.

45. What are the disclosures required under the Detailed Public Statement?

Detailed Public Statement contains disclosure in more detail about the acquirer/PACs, target company, financials of the acquirers/PACs/target company, the offer, terms & conditions of the offer, procedure for acceptance and settlement of the offer, escrow account etc. SEBI has prescribed the format for Detailed Public Statement. The same is available in the SEBI website.

46. What are the disclosures required under the Letter of offer?

Letter of offer contains details about the offer, background of Acquirers/PACs, financial statements of Acquirer/ PACs, escrow arrangement, background of the target company, financial statements of the target company, justification for offer price, financial arrangements, terms and conditions of the offer, procedure for acceptance and settlement of the offer. SEBI has prescribed the format for Letter of offer, which enumerates minimum disclosure requirements. The Manager to the offer/ acquirer is free to add any other disclosures which in his opinion are material for the shareholders. The format is available in the SEBI website.

47. Is the financial disclosure standard as outlined in the Format for Detailed Public Statement (DPS) to the Shareholders of the Target Company (TC) in terms of Regulation 15(2) in point I(A) applicable to PACs too since the above clause refers just to the Acquirer ?

Yes, as clearly indicated in the format, the details of financial disclosure are required to be given for the acquirer as well Persons acting in concert with Acquirers.

48. If an acquirer enters into a SPA and triggers an open offer, when can the acquirer acquire shares proposed to be transferred under the SPA?

The acquirer can acquire shares under the SPA only after payment in respect of shares accepted under the open offer is complete but not later than 26 weeks from the expiry of the offer period.

49. What is the role of the target company in the open offer process?

- Once a PA is made, the board of directors of the Target Company is expected to ensure that the business of the target company is conducted in the ordinary course. Alienation of material assets, material borrowings, issue of any authorized securities, announcement of a buyback offer etc. is not permitted, unless authorized by shareholders by way of a special resolution by postal ballot.
- The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders and a list of persons whose applications, if any, for registration of transfer of shares, in case of physical shares, are pending with the target company.
- After closure of the open offer, the target company is required to provide assistance to the acquirer in verification of the shares tendered for acceptance under the open offer, in case of physical shares.
- Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations and such committee shall be entitled to seek external professional advice at the expense of the target company. The recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer. The recommendation will also be sent to SEBI, Stock Exchanges and the Manager to the offer.

50. What is the manner in which the acquirer decides the acceptances from each shareholder?

The registrar to the open offer validates all the tenders in the open offer and creates a basis of acceptance in consultation with the manager to the open offer detailing validly and invalidly tendered shares received in the open offer.

In case, the valid shares tendered are less than the offer size, all the valid tendered shares are accepted. If the validly tendered shares in the open offer are more than the offer size, then the valid tenders are accepted on a proportionate basis. This is illustrated as below:

The company has a paid up share capital of Rs, 10,000/- (1000 shares of Rs. 10/- each) and shareholder A is holding 50 shares totaling to Rs. 500. In case an open offer is made for 26% of the share capital and the shares tendered are 300 which are in excess of the 26% shareholding, the shares will be accepted by the acquirer on a proportionate basis.

No of shares of A accepted =

$$\frac{(\text{total number of shares offered} \times \text{no. of shares tendered by A})}{\text{Total shares tendered in the open offer by all investors}}$$

$$= \frac{260}{300} \times 50 = 43.33 \text{ shares} \sim 43 \text{ shares}$$

Shares which are invalid or are rejected due to the valid acceptances being more than the offer size are subsequently returned to the respective shareholders within 10 working days of the closure of the open offer.

51. What are the modes of payment under the open offer?

Payment considerations by the acquirer under the open offer can be made by cash and/or by issue of equity shares and/or secured debt instruments (investment grade) and / or convertible debt instruments (convertible to equity shares) of acquirer (or PACs, if any) if such equity shares and secured debt instruments are listed.

The chosen mode of payment is required to be disclosed in the open offer document meant for shareholders of the target company.

52. Can an acquirer withdraw the open offer once made?

An open offer once made cannot be withdrawn except in the following circumstances:

- Statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer have been refused subject to such requirement for approvals having been specifically disclosed in the DPS and the letter of offer;
- Any condition stipulated in the SPA attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, subject to such conditions having been specifically disclosed in the DPS and the letter of offer;
- Sole acquirer being a natural person has died;
- Such circumstances which in the opinion of SEBI merit withdrawal of open offer.

53. If post open offer the shareholding of the acquirer goes beyond the maximum permissible non public shareholding limit, can the acquirer immediately make a delisting offer in terms of Delisting Regulations. ?

No. The acquirer cannot launch a voluntary delisting offer in terms of Delisting Regulations of SEBI, unless a period of twelve months has elapsed from the date of the completion of the offer period.

54. I was not holding shares on the identified date but acquired shares subsequently. Am I eligible to participate in the open offer?

Yes. Shareholders who acquire shares after the identified date are eligible to

participate in the open offer provided they submit their valid tenders before the end of the tendering period.

You may send a request to the registrar to the open offer or manager to the open offer for obtaining the letter of offer including the form of acceptance. Alternately, you can make an application on plain paper giving certain specific details. Please refer to the Detailed Public Statement of the acquirer for instructions in this regard.

55. How will shareholder of the target company know that an open offer is made by the acquirer?

SAST Regulations, 2011 provides for wide dissemination of the information related to an open offer. The DPS and pre-offer announcements before commencement of the tendering period are published in national newspapers as well as in one newspaper of the regional language of the place where registered office of the target company is located.

The final letter of offer is required to be dispatched to all shareholders whose names appear as shareholders as on the identified date. Further, the PA, the DPS and other announcements are also filed with the stock exchange and SEBI, and are uploaded on their respective websites for information dissemination.

56. For how many days is an open offer required to be kept open?

The offer is required to be kept open for ten working days.

57. How do I get the Letter of Offer and tender my shares under the open offer?

The letter of offer along with form of acceptance is sent to all eligible shareholders of the target company, who are shareholders of the target company as on the identified date. The eligible shareholder has to fill in the form of acceptance sent along the letter of offer and submit the same to the registrar to the open offer or the manager to the open offer. In case the shareholder has not received the letter of offer, such shareholder can request the registrar to the open offer or manager to the open offer for the same. Further, the letter of offer along with the form of acceptance will also be available on SEBI's website.

58. What are the documents that the shareholders should go through before tendering their shares pursuant to the open offer?

Before tendering their shares pursuant to the open offer, the shareholders are advised to go through the Detailed Public Statement, Letter of offer and also the recommendations and observations of the Committee of Independent Directors on the offer. It may be noted that all the aforesaid documents are available on SEBI website. Further the recommendations of the Independent Directors are published in the same newspaper where the Detailed Public Statement is published by the acquirer and are published at least 2 working days before opening of the offer.

59. Do I need to convert my physical shares into demat before tendering in the open offer?

Shareholders need not convert their physical shares into demat form before tendering shares in the open offer. Physical shares can be tendered in an open offer along with the form of acceptance and such documents as mentioned in the section 'Procedure for acceptance and settlement of the Offer' in the letter of offer.

60. Can I withdraw or revise my tender?

No. Once a shareholder has tendered his shares in the open offer made by the acquirer, he/ she cannot withdraw/ revise his/her request.

61. Can I tender my shares after the closure of the tendering period?

No. Your acceptance for tendering shares in the offer should reach the collection center on or before the last date of tendering period.

62. I hold shares which are partly paid-up. Can I tender these shares in the open offer?

Yes, partly paid-up shares can be tendered in the open offer. The letter of offer contains the offer price of the partly paid up share, which can be different from the offer price for fully paid up share.

63. When will the shareholder receive (i) intimation about acceptance/rejection of his shares tendered under the open offer or (ii) consideration for shares accepted by the acquirer?

The shareholder shall receive (i) intimation about acceptance/ rejection of his shares tendered under the open offer or (ii) consideration for shares accepted by the acquirer, within 10 working days of the closure of the open offer.

64. What happens if regulatory approvals are delayed?

If the regulatory approvals required for completing the open offer and acquisition are delayed, the acquirer may be unable to make the payment within 10 working days of closure of open offer. In such an event, SEBI may grant extension of time for making payments, subject to the acquirer agreeing to pay interest to the shareholders of the target company for the delay at such rate as may be specified by SEBI.

If statutory approvals are required for some but not all shareholders, the acquirer can make payment to such shareholders in respect of whom no statutory approvals are required in order to complete the open offer.

65. If the payment is delayed beyond 10 working days of the closure of the tendering period (closure of open offer), will the acquirer be required to compensate the public shareholders who have participated under the offer?

Acquirer is required to complete the payment of consideration to shareholders who have accepted the offer within 10 working days from the date of closure of the open offer. If there is a delay in payment of consideration (not due to non receipt of statutory approvals), it would be treated as a violation of the SAST Regulations, 2011 and SEBI may issue direction to such acquirer including direction to pay interest.

66. Whom do I approach if I have any grievance in respect of the open offer, delay in receipt of consideration / unaccepted shares etc.?

The shareholder of the target company should approach the manager to the open offer or the registrar to the open offer for any grievance. However, if the shareholder is not satisfied or does not receive a satisfactory response to his / her grievance, he may approach SEBI through online SEBI Complaint Redressal System (SCORES) at www.scores.gov.in.

In case, during the open offer or before the starting of the open offer, any investor has any comment/ complaint about the disclosures given by the acquirer in Public Announcement or in Detailed Public statement or in draft Letter of offer information, he can write to Corporate Finance Department, Division of Corporate Restructuring at SEBI Bhavan, Plot No.C4-A, 'G' Block, Bandra Kurla Complex, Bandra (E), Mumbai 400 051. Please note that PA/DPS, Draft Letter of offer are also available on website of SEBI.

67. Where can an investor get more information related to the SAST Regulations, 2011?

An investor can get more information related to the SAST Regulations, 2011 from the SEBI website and from the Investors website of SEBI.

68. What are the disclosures (other than the ones given in PA/ DPS/ Letter of offer for the open offer) required to be made in terms of SAST Regulations, 2011, by whom, when and to whom?

Event based Disclosures

(Please note the word "shares" for disclosure purposes include convertible securities also.)

- (a) Any person, who along with PACs crosses the threshold limit of 5% of shares or voting rights, has to disclose his aggregate shareholding and voting rights to the Target Company at its registered office and to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI.
- (b) Any person who holds 5% or more of shares or Voting rights of the target company and who acquires or sells shares representing 2% or more of the voting rights, shall disclose details of such acquisitions/sales to the Target company at its registered office and to every Stock Exchanges where the shares of the Target Company are listed within 2 working days of such transaction, as per the format specified by SEBI. Continual disclosures of aggregate shareholding shall be made within 7 days of financial year ending on March 31 to the target company at its registered office and every stock exchange where the shares of the Target Company are listed by:
 - (i) Shareholders (along with PACs, if any) holding shares or voting rights entitling them to exercise 25% or more of the voting rights in the target company.
 - (ii) Promoter (along with PACs, if any) of the target company irrespective of their percentage of holding.

Disclosures of encumbered shares

- (a) The promoter (along with PACs) of the target company shall disclose details of shares encumbered by them or any invocation or release of encumbrance of shares held by them to the target company at its registered office and every stock exchange where shares of the target company are listed, within 7 working days of such event.

69. How to compute trigger limits specified above for disclosures.

The word “shares” for disclosure purposes include convertible securities also. Hence for computation of trigger limits for disclosures given above, percentage w.r.t shares shall be computed taking in to account total number of equity shares and convertibles and the percentage w.r.t voting rights shall be computed after considering voting rights on equity shares and other securities (like GDRs, if such GDRs carry voting rights)

An illustration is provided below for the calculation of trigger limits for disclosures given in point (b) of the reply to query (13).

Total Shares/ voting capital of the company

- Company A has 100 equity shares, 50 partly convertible Debentures (PCDs) and 10 GDRs. 1 GDR carries 1 voting right.
- Total shares of company A= $100+50+10 = 160$
- Total voting capital of Company A= $100+10=110$

Persons B's holding of shares and voting rights

- Person B has 8 equity shares, 7 PCDs and 1 GDR.
- Person B has $8+7+1 =16$ shares (shares for disclosure purpose includes convertible securities)
- Person B's holding in terms of shares= $16/160=10\%$ of shares
- Person B's voting rights= $8+1= 9$ voting rights
- Person B's holding in terms of voting rights = $9/110=8\%$ of voting rights

Since person B is holding more than 5% of shares or voting rights, he is required to make disclosures for any acquisition/ sale of 2% or more of shares or voting rights.

Acquisition by Person B

Scenario I

- Person B acquires 2 equity shares and 2 PCDs.
- In terms of shares, person B has acquired $4/160=2.5\%$ of shares
- In terms of voting rights, person B has acquired $2/110= 1.8\%$ of voting rights

Since acquisition done by person B represents 2 % or more of shares, the disclosure obligation as stated at Reply of Q-13(b) is triggered.

Scenario II

Person B acquires 20 PCDs

In terms of shares, person B has acquired 20 shares, i.e. 20/160 i.e. 12.5% shares.

In terms of voting rights, he has not acquired a single voting right i.e. 0 voting right

However, since acquisition done by person B represents 2% or more of shares (though no voting rights), the disclosure obligations as stated at (b) in reply 13 is triggered.

70. Whether promoters are required to disclose details of arrangements which place encumbrances on shares like lock-in stipulations, non-disposal undertaking, right of first refusal etc?

As per Regulation 28(3), the term “encumbrance” shall include a pledge, lien or any such transaction, by whatever name called.” The promoters have to understand the nature of encumbrance and those encumbrances which entail a risk of the shares held by promoters being appropriated or sold by a third party, directly or indirectly, are required to be disclosed to the stock exchanges in terms of the Takeover Regulations, 2011.

71. If the shares of the holding company of a target company are pledged, whether the same would be covered under disclosures of “Encumbered shares” by promoters of the Target Company?

Yes, details of such pledge would be covered under disclosure of “encumbrance” as required under the Regulations

72. Whether furnishing of a Non Disposal Undertaking (NDU) by promoters to the lenders would be covered under disclosures of “Encumbered shares” by promoters of the Target Company?

No, mere NDU by promoters will not be covered under the scope of disclosures of “Encumbrance” under the Regulations. However if NDUs are given along with side-agreements which may entail the risk of shares held by the promoters being appropriated or sold by a third party, directly or indirectly, the same needs to be disclosed.

73. What happens if the Acquirer/Target Company / Merchant Banker or the Manager to the open offer violates the provisions of the SAST Regulations, 2011?

SAST Regulations, 2011 have laid down the general obligations of acquirer, Target Company and the manager to the open offer. For failure to carry out these obligations as well as for failure/non-compliance of other provisions of these Regulations, penalties have been laid down there under. These penalties include:

- directing the divestment of shares acquired;
- directing the transfer of the shares/proceeds of a directed sale of shares to the investor protection fund;
- directing the target company/any depository not to give effect to any

- transfer of shares;
- directing the acquirer not to exercise any voting or other rights attached to shares acquired;
 - debarring person(s) from accessing the capital market or dealing in securities;
 - directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
 - directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
 - directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
 - directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;
 - directing the acquirer to pay interest of for delayed payment of the open offer consideration;
 - directing any person to cease and desist from exercising control acquired over any target company;
 - directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

74. What is the procedure for a company or an intermediary in case it needs clarification or an interpretation of some provisions of SAST Regulations, 2011?

SEBI updates its FAQs section based on the queries received. You are advised to see the FAQs section. However for seeking interpretation of a particular provision or a no action letter pertaining to a particular transaction, the applicant is advised to apply under the provisions of SEBI (Informal Guidance) Scheme, 2003, details of which are available on the SEBI website.

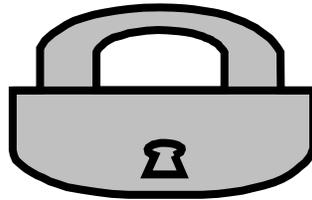
LESSON ROUND UP



- Takeover is a corporate device whereby one company acquires control over another company, usually by purchasing all or a majority of its shares.
- Takeovers may be classified as friendly takeover, hostile takeover and bail out takeover.
- Takeover bids may be mandatory, partial or competitive bids.

- Consideration for takeover could be in the form of cash or in the form of shares.
- When a company intends to take over another company through acquisition of 90% or more in value of the shares of that company, the procedure laid down under Section 395 of the Act could be beneficially utilised.
- Transferor and transferee companies are required to take care of the check points as specified in the chapter.
- Takeover of companies whose securities are listed or one or more stock exchanges is regulated by the provisions of listed agreements and SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011.
- Financial, accounting, taxation and legal aspects are vital in planning a takeover and hence covered in detail in the chapter.
- An increasingly used defense mechanism is anti takeover amendments, which is called "Shark Repellants".

SELF TEST QUESTIONS

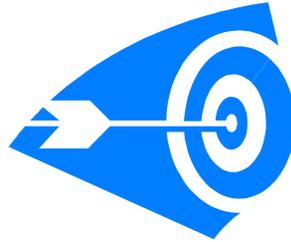


(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What do you mean by the term 'Takeover'? What are the objectives which takeover seeks to achieve?
 2. Explain the meaning of and different types of takeover bids.
 3. Can unlisted companies affect takeovers? If so, how?
 4. "SEBI has formulated a comprehensive code for takeover of listed companies" Do you agree?
 5. What are the general obligations of 'Acquirer' and 'Merchant Banker' as under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?
 6. What does the term 'offer price' and 'persons acting in concert' mean under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?
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STUDY V
FUNDING OF MERGERS AND TAKEOVERS

LEARNING OBJECTIVES



At the end of lesson, you should be able to understand:

- Financial alternatives
- Considerations for the selection of financial package
- Process of funding
- Funding through
 - Equity shares
 - Preference shares
 - Options and securities with differential rights
 - Swaps
 - Employees stock option scheme
 - External commercial borrowings (ECBs)
 - Financial institutions and banks
 - Rehabilitation finance
 - Leveraged buyouts

FINANCIAL ALTERNATIVES

Financing of mergers and takeovers involve payment of consideration money to the acquire shares for acquiring the undertaking or assets or controlling power of the shareholders as per valuation done and exchange ratio between shares of acquiring and merging company arrived at. Payment of consideration by the acquirer company to the acquiree company amounts to be the investment which is done on commercial basis with an aim to optimize return and to keep the cost of investment minimum. Care should be taken to select an optimum mix of the available modes of payment of purchase consideration such that the financial package chosen suits the financial structures of both the acquirer and acquiree companies, and also provide a desirable gearing level thereby proving economical to the acquirer. The cost of capital or investment shall differ as per different financial packages selected.

Selection of financial package shall depend upon many factors as mentioned below:

- (i) It should suit to the financial structures of both the acquirer and the acquiree companies.

- (ii) It should provide a desirable gearing level which may suit to the financial structure of the acquirer.
- (iii) The package should be found acceptable by the vendors.
- (iv) The package should also prove economical to the acquirer.

Financial Package

The acquirer can select a suitable financial package to make payment of consideration to acquiree from the following alternatives:

- (i) Payment of cash or by issue of securities.
- (ii) Financial package of loans etc. involving financial institutions and banks.
- (iii) Rehabilitation finance.
- (iv) Management buyouts/Leveraged buy-outs.

PROCESS OF FUNDING

Mergers and takeovers may be funded by a company (i) out of its own funds, comprising increase in paid up equity and preference share capital, for which shareholders are issued equity and preference shares or (ii) out of borrowed funds, which may be raised by issuing various financial instruments. (iii) A company may borrow funds through the issue of debentures, bonds, deposits from its directors, their relatives, business associates, shareholders and from public in the form of fixed deposits, (iv) external commercial borrowings, issue of securities, loans from Central or State financial institutions, banks, (v) rehabilitation finance provided to sick industrial companies under the Sick Industrial Companies (Special Provisions) Act, etc.

Form of payment may be selected out of any of the modes available such as (a) cash payment, (b) issue of equity shares, (c) mix of equity and cash, (d) debt or loan stock, (e) preference shares, convertible securities, junk bonds etc.

Well-managed companies make sufficient profits and retain them in the form of free reserves, and as and when their Board of Director propose any form of restructuring, it is financed from reserves, i.e. internal accruals.

Where available funds are inadequate, the acquirer may resort any one or more of the options available for the purpose of raising the required resources. The most prominent routes are the borrowing and issue of securities. The required funds could be raised from banks and financial institutions or from public by issue of debentures or by issue of shares depending upon the quantum and urgency of their requirements.

Generally a cash rich company use their surplus funds for taking over the control of other companies, often in the same line of business, to widen their product range and to increase market share.

FUNDING THROUGH VARIOUS TYPES OF FINANCIAL INSTRUMENTS

A. FUNDING THROUGH EQUITY SHARES

Equity share capital can be considered as the permanent capital of a company.

Equity needs no servicing as a company is not required to pay to its equity shareholders any fixed amount return in the form of interest which would be the case if the company were to borrow issue of bonds or other debt instruments. In issue of shares, the commitment will be to declare dividends consistently if profits permit. Raising moneys from the public by issue of shares to them is a time consuming and costly exercise. The process of issuing equity shares or bonds/debentures by the company takes a lot of time. It would require several things to be in place and several rounds of discussion would take place between the directors, and key promoters having the controlling stake, between the Board of Directors and consultants, analysts, experts, company secretaries, chartered accountants and lawyers. Moreover it requires several legal compliances. Therefore planning an acquisition by raising funds through a public issue may be complicated and a long drawn process. One cannot think of raising moneys through public issue without identifying the company to be acquired.

B. PREFERENTIAL ALLOTMENT

Private placement in the form of a preferential allotment of shares is possible and such issues could be organized in a much easier way rather than an issue of shares to public.

C. FUNDING THROUGH PREFERENCE SHARES

Another source of funding a merger or a takeover may be through the issue of preference shares, but unlike equity capital, issue of preference share capital as purchase consideration to shareholder of merging company involves the payment of fixed preference dividend (like interest on debentures or bonds or) at a fixed rate. Therefore, before deciding to raise funds for this purpose, by issue of preference shares, the Board of directors of a company has to make sure that the merged company or the target company would be able to yield sufficient profits for covering discharging the additional liability in respect of payment of preference dividend.

Burden of preference dividend

A company funding its merger or takeover proposal through the issue of preference shares is required to pay dividend to such shareholders as per the agreed terms. While raising funds through this mode, the management of the company has to take into consideration the preference dividend burden, which the profits of the company should be able to service.

D. FUNDING THROUGH OPTIONS OR SECURITIES WITH DIFFERENTIAL RIGHTS

Companies can restructure its capital through derivatives and options as a means of raising corporate funds. Indian companies are allowed to issue derivatives or options as well as shares and quasi-equity instruments with differential rights as to dividend and/or voting.

Companies may also issue non-voting shares or shares with differential voting rights to the shareholders of transferor company. Such issue gives the companies an additional source of fund without interest cost and without an obligation to repay, as these are other forms of equity capital. The promoters of companies may be interested in this form of consideration as it does not impose any obligation and there is no loss of control in the case of non-voting shares.

E. FUNDING THROUGH SWAPS OR STOCK TO STOCK MERGERS

In stock swap mergers, or stock-for-stock mergers, the holders of the target company's stock receive shares of the acquiring company's stock. The majority of mergers during the past few years have been stock-for-stock deals. A merger arbitrage specialist will sell the acquiring company's stock short, and will purchase a long position in the target company, using the same ratio as that of the proposed transaction. (If the purchasing firm is offering a half share of its stock for every share of the target company, then the merger arbitrageur will sell half as many shares of the purchasing firm as he or she buys of the target company.) By going long and short in this ratio, the manager ensures that the number of shares for which the long position will be swapped is equal to the number of shares sold short. When the deal is completed, the manager will cover the short and collect the spread that has been locked in.

As with all mergers, stock swap mergers may involve event risk. In addition to the normal event risks, stock swap mergers involve risks associated with fluctuations in the stock prices of the two companies.

The terms of the deal involve an exchange of shares and are predicted on the prices of the two companies' stock at the time of the announcement, drastic changes in the shares prices of one or both of the companies can cause the entire deal to be re-evaluated. Merger arbitrageurs derive returns from stock swap mergers when the spread or potential return justifies the perceived risk of the deal's failing.

F. FUNDING THROUGH EMPLOYEES STOCK OPTION SCHEME

This option may be used along with other options. 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. Merits and demerits of funding of merger or takeover through the equity issue have already been discussed earlier under the heading "Funding through equity issue".

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. Equitable distribution of shares among the employees will contribute to the smooth working of the scheme.

Only bona-fide employees of the company are eligible for shares under scheme

The offer of shares to the employees on preferential basis has been misused by some companies by allotting shares to non-employees or in the joint names of employees and non-employees.

The companies are therefore, advised to ensure that the shares reserved under the employees' quota be allotted only to the bona fide employees, subject to the SEBI

guidelines issued in this regard and the shares remaining unsubscribed by the employees may be offered to the general public through prospectus in terms of the issue, if any [Press release dated 30.1.1996]. The option granted to any employee is not transferable to any person.

SEBI (Employee Stock Option Purchase Scheme) Guidelines, 1999

The Securities and Exchange Board of India (SEBI) has issued the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, which are applicable to companies whose shares are listed on any recognised stock exchange in India.

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.

The lock in period and rights of the option holder are as specified in the guidelines.

The Board of Directors have to *inter alia*, disclose either in the Directors' Report or in the annexure to the Directors' Report, the details of the ESOS, as specified in the regulations.

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.*

Issue of Sweat Equity Shares

A company whose shares are listed on a recognised stock exchange can also issue sweat equity shares in accordance with the provisions of Section 79A of the Companies Act, 1956 and the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

G. FUNDING THROUGH EXTERNAL COMMERCIAL BORROWINGS (ECBs)

At present, Indian companies are allowed to access funds from abroad in the following methods:

(a) External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years.

(b) Foreign Currency Convertible Bonds (FCCBs) mean a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency. Further, the bonds are required to be issued in accordance with the scheme viz., "Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme,

1993”, and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments. The ECB policy is applicable to FCCBs.

(c) Preference shares (i.e. non-convertible, optionally convertible or partially convertible) for issue of which, funds have been received on or after May 1, 2007 would be considered as debt and should conform to policy. Accordingly, all the norms applicable for ECBs, viz. eligible borrowers, recognised lenders, amount and maturity, end use stipulations, etc. shall apply. Since these instruments would be denominated in Rupees, the rupee interest rate will be based on the swap equivalent of LIBOR plus the spread as permissible for ECBs of corresponding maturity.

(d) Foreign Currency Exchangeable Bond (FCEB) means a bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident outside India, in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments.

ENTRY ROUTES

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route).

I.(A) AUTOMATIC ROUTE

(i) Eligible Borrowers

(a) Corporates, including those in the hotel, hospital, software sectors (registered under the Companies Act, 1956) and Infrastructure Finance Companies (IFCs) except financial intermediaries, such as banks, financial institutions (FIs), Housing Finance Companies (HFCs) and Non-Banking Financial Companies (NBFCs) are eligible to raise ECB. Individuals, Trusts and Non-Profit making organizations are not eligible to raise ECB.

(b) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area. ECB by units in SEZ are also governed by the Press Release F.No.4 (2) / 2002-ECB dated September 15, 2002 issued by Government of India, Ministry of Finance (MOF).

(c) Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail of ECB. Such NGOs (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange in India and (ii) would require a certificate of due diligence on ‘fit and proper’ status of the Board/ Committee of management of the borrowing entity from the designated AD bank.

(ii) Recognised Lenders

Borrowers can raise ECB from internationally recognized sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial

institutions (such as IFC, ADB, CDC, etc.) / regional financial institutions and Government owned development financial institutions, (iv) export credit agencies, (v) suppliers of equipments, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile Overseas Corporate Bodies (OCBs)).

A "foreign equity holder" to be eligible as "recognized lender" under the automatic route would require minimum holding of paid-up equity in the borrower company as set out below:

- (i) For ECB up to USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender,
- (ii) For ECB more than USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB not exceeding four times the direct foreign equity holding)

Overseas organizations and individuals complying with following safeguards may provide ECB to Non-Government Organizations (NGOs) engaged in micro finance activities.

- (i) Overseas Organizations proposing to lend ECB would have to furnish to the AD bank of the borrower a certificate of due diligence from an overseas bank, which in turn is subject to regulation of host-country regulator and adheres to the Financial Action Task Force (FATF) guidelines. The certificate of due diligence should comprise the following (i) that the lender maintains an account with the bank for at least a period of two years, (ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community and (iii) that there is no criminal action pending against it.
- (ii) Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return which the overseas lender may furnish need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

(iii) Amount and Maturity

- The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors is USD 500 million or its equivalent during a financial year.
- Corporates in the services sector viz. hotels, hospitals and software sector are allowed to avail of ECB up to USD 100 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.
- ECB above USD 20 million or equivalent and up to USD 500 million or its equivalent with a minimum average maturity of five years.

- NGOs engaged in micro finance activities can raise ECB up to USD 5 million or its equivalent during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is fully hedged.
- ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.

(iv) All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time. The following ceilings are valid until reviewed:

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR
Three years and up to five years	300 basis points
More than five years	500 basis points

V. End-use

- ECB can be raised for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units] in real sector - industrial sector including small and medium enterprises (SME), infrastructure sector and specified service sectors namely hotel, hospital, software in India. Infrastructure sector is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) roads including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.
- Overseas direct investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad.
- Utilization of ECB proceeds is permitted for first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
- For lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.
- Payment for Spectrum Allocation.
- Infrastructure Finance Companies (IFCs) i.e. Non Banking Financial Companies (NBFCs) categorized as IFCs by the Reserve Bank, are permitted to avail of ECBs, including the outstanding ECBs, up to 50 per cent

of their owned funds, for on-lending to the infrastructure sector as defined under the ECB policy.

End-uses not permitted

- (a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc., are also considered as investment in capital markets).
- (b) for real estate sector,
- (c) for working capital, general corporate purpose and repayment of existing Rupee loans.

Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above, and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

ECB funds may also be repatriated to India for credit to the borrowers' Rupee accounts with AD Category I banks in India, pending utilization for permissible end-uses.

Prepayment

Prepayment of ECB up to USD 500 million may be allowed by AD banks without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

APPROVAL ROUTE

Eligible Borrowers

The following types of proposals for ECB are covered under the Approval Route:

- ECB beyond 50 per cent of the owned funds by financial institutions which are classified as Infrastructure Finance Companies are considered on a case to case basis.
- Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by the Reserve Bank based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.
- ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional

financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.

- Infrastructure Finance Companies (IFCs) i.e. Non-Banking Financial Companies (NBFCs), categorized as IFCs, by the Reserve Bank, are permitted to avail of ECBs, including the outstanding ECBs, beyond 50 per cent of their owned funds, for on-lending to the infrastructure sector as defined under the ECB policy, subject to their complying with the following conditions: (i) compliance with the norms prescribed in the DNBS Circular DNBS.PD.CCNo.168/03.02.089/2009-10 dated February 12, 2010 (ii) hedging of the currency risk in full. Designated Authorised Dealer should ensure compliance with the extant norms while certifying the ECB application.
- Foreign Currency Convertible Bonds (FCCBs) by Housing Finance Companies satisfying the following minimum criteria: (i) the minimum net worth of the financial intermediary during the previous three years shall not be less than ₹ 500 crore, (ii) a listing on the BSE or NSE, (iii) minimum size of FCCB is USD 100 million and (iv) the applicant should submit the purpose/plan of utilization of funds.
- Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, will be treated as Financial Institutions and ECB by such entities will be considered under the Approval Route.
- Multi-State Co-operative Societies engaged in manufacturing activity and satisfying the following criteria i) the Co-operative Society is financially solvent and ii) the Co-operative Society submits its up-to-date audited balance sheet.
- SEZ developers can avail of ECBs for providing infrastructure facilities within SEZ, as defined in the extant ECB policy like (i) power, (ii) telecommunication, (iii) railways, (iv) roads including bridges, (v) sea port
- and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.
- Corporates which have violated the extant ECB policy and are under investigation by the Reserve Bank and / or Directorate of Enforcement are allowed to avail of ECB only under the approval route.
- Cases falling outside the purview of the automatic route limits and maturity period.

Recognised Lenders

- Borrowers can raise ECB from internationally recognised sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.), (iv) export credit agencies, (v) suppliers' of equipment, (vi) foreign collaborators and (vii) foreign equity

holders (other than erstwhile OCBs).

- From 'foreign equity holder' where the minimum paid-up equity held directly by the foreign equity lender is 25 per cent but ECBs: equity ratio exceeds 4:1 (i.e. the proposed ECB exceeds four times the direct foreign equity holding).

Amount and Maturity

Corporates can avail of ECB of an additional amount of USD 250 million with average maturity of more than 10 years under the approval route, over and above the existing limit of USD 500 million under the automatic route, during a financial year. Other ECB criteria, such as end-use, recognized lender, etc., need to be complied with. Prepayment and call/put options, however, would not be permissible for such ECB up to a period of 10 years.

All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost.

The all-in-cost ceilings for ECB are reviewed from time to time. The following ceilings are valid until reviewed:

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR
Three years and up to five years	300 basis points
More than five years	500 basis points

End-use

- ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), implementation of new projects, modernization/expansion of existing production units] in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector is defined as (i) power (ii) telecommunication (iii) railways (iv) roads including bridges (v) sea port and airport (vi) industrial parks (vii) urban infrastructure (water supply, sanitation and sewage projects) (viii) mining, exploration and refining and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.
- Overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.
- The payment by eligible borrowers in the Telecom sector, for spectrum allocation may, initially, be met out of Rupee resources by the successful bidders, to be refinanced with a long-term ECB, under the approval route, subject to the following conditions:
 - (i) The ECB should be raised within 12 months from the date of payment of the final installment to the Government;

- (ii) The designated AD - Category I bank should monitor the end-use of funds;
 - (iii) Banks in India will not be permitted to provide any form of guarantees; and
 - (iv) All other conditions of ECB, such as eligible borrower, recognized lender, all-in-cost, average maturity, etc, should be complied with.
- The first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
 - Corporates engaged in the development of integrated township as defined by Ministry of Commerce and Industry, DIPP, SIA (FC Division), Press Note 3 (2002 Series) dated January 4, 2002. Integrated township includes housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities, such as roads and bridges, mass rapid transit systems and manufacture of building materials. Development of land and providing allied infrastructure forms an integrated part of township's development. The minimum area to be developed should be 100 acres for which norms and standards are to be followed as per local bye-laws/rules. In the absence of such bye-laws/rules, a minimum of two thousand dwelling units for about ten thousand population will need to be developed.

End-uses not permitted

- For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate except Infrastructure Finance Companies (IFCs), banks and financial institutions eligible under paragraph I (B) (i) (a), (b) and (c).
- For real estate. However, the term real estate excludes development of integrated township as defined by the Ministry of Commerce and Industry.
- For working capital, general corporate purpose and repayment of existing Rupee loans.

Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

ECB funds may also be repatriated to India for credit to the borrowers' Rupee accounts with AD Category I banks in India pending utilization for permissible end-uses.

Prepayment

- (a) Prepayment of ECB up to USD 500 million may be allowed by the AD bank without prior approval of the Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.
- (b) Pre-payment of ECB for amounts exceeding USD 500 million would be considered by the Reserve Bank under the Approval Route.

For further details please refer to Master Circular issued by RBI on External Commercial Borrowings and Trade Credits

H. DEPOSITORY RECEIPTS (DRs)

A DR is a foreign currency denominated instrument tradeable on a stock exchange generally in Europe or U.S.A. The major benefit that accrues to an investor from DRs is the collection of issue proceeds in foreign currency which may be utilized for meeting foreign exchange component of project cost, repayment of foreign currency loans, meeting commitments overseas and similar purposes.

The other benefits accruing to an investor from GDR issue are firstly, that investor does not have to bear any exchange risk as a GDR is denominated in US dollar with equity shares comprised in each GDR denominated in Rupees. Secondly, investor reserves the right to exercise his option to convert the GDR and hold the equity shares instead.

It facilitates raising of funds of market related prices of minimum cost as compared to a domestic issue and permits raising of further equity on a future date for funding of projects like expansion or diversification through mergers and takeovers etc. It also helps to expand investor base with multiple risk preferences, improves marketability of the issue, and enhances prestige of the company and credibility with international investors.

I. FUNDING THROUGH FINANCIAL INSTITUTIONS AND BANKS

Funding of a merger or takeover with the help of loans from financial institutions, banks etc, has its own merits and demerits. Takeover of a company could be achieved in several ways and while deciding the takeover of a going concern, there are matters such as the capital gains tax, stamp duty on immovable properties and the facility for carrying forward of accumulated losses. With parameters playing a critical role, the takeover should be organized in such a way that best suits the facts and circumstances of the specific case and also it should meet the immediate needs and objectives of the management. While discussing modes of acquisition, certainly there would be a planning for organizing the necessary funding for the acquisition. If borrowings from domestic banks and financial institutions have been identified as the inevitable choice, all the financial and managerial information must be placed before the banks and financial institutions for the purpose of getting the necessary resources.

The advantage of funding is that the period of such funds is definite which is fixed at the time of taking such loans. Therefore, the Board of the company is assured about continued availability of such funds for the pre-determined period. On the negative side, the interest burden on such loans, is quite high which must be kept in

mind by the Board while deciding to use borrowed funds from financial institution. Such funding should be thought of and resorted to only when the Board is sure that the merged company or the target company will, give adequate returns i.e., timely payment of periodical interest on such loans and re-payment of the loans at the end of the term for which such loans have been taken.

However, in the developed markets, funding of merger or takeover is not a critical issue. There are various sources of finance available to an acquirer. In the Indian market, it was not easy to obtain takeover finance from financial institutions and banks because they are not forthcoming to finance securities business. Takeover involves greater risk. There is no other organised sector to provide finance for takeover by a company.

Justice P.N. Bhagwati Committee on takeovers in its report of May 2002 has recommended that Banks/Financial Institutions are to be encouraged to consider financial takeovers.

There are two aspects in it. (i) The first one relates to cost of acquiring ownership over the assets. If it is a going concern, the shares of the company could be purchased. In that process, the acquired entity might become a wholly owned subsidiary. Funding the acquisition would mean the funds required for paying up the consideration payable to the sellers of those shares. This will be worked on the basis of the net worth of the acquired entity. In addition to the said cost, there might be a huge requirement for funding the operations, modernization, upgradation, installing balancing equipments, removal of bottlenecks and a host of other requirements. Hence the borrowings would be required for meeting such cost also.

The acquisition may also require a rehabilitation or restructuring scheme implying a meeting with existing secured creditors and major unsecured creditors. As a whole, borrowing would be a major exercise involving a lot of study of the actual financial support needed. Care must be taken to ensure that the existing revenue streams are not affected due to the proposed acquisition. The combined net worth, combined financial projections and revenue streams might also be needed for persuading the banks and financial institutions to pick up a stake in the acquisition.

J. FUNDING THROUGH REHABILITATION FINANCE

Sick industries get merged through BIFR with healthy units with financial package to the acquirer from the financial institutions and banks having financial stakes in the acquiree company to ensure rehabilitation and recovery of dues from the acquirer. BIFR has been arranging such takeover from time to time in which creditor financial institutions and banks have been providing consortium financial packages in promoting mergers.

Merger or takeover may be provided for in a scheme of rehabilitation under the Sick Industrial Companies (Special Provisions) Act, 1985.

The Sick Industrial Companies (Special Provisions) Act, 1985 provides for reference to the Board for Industrial and Financial Reconstruction (BIFR) of a sick industrial company. Once a reference is made, BIFR will cause an enquiry, appoint an operating agency for determination of measures necessary for rehabilitation of the sick company, direct the preparation of a rehabilitation scheme, which may provide,

inter alia, for

- (i) rehabilitation finance for the sick company;
- (ii) merger of the sick company with a healthy company or merger of a healthy company with the sick company;
- (iii) takeover of the sick company by a healthy company;
- (iv) such other preventive, ameliorative and remedial measures as may be appropriate.

The scheme is prepared by the operating agency, and after the same is sanctioned becomes operative and binding on all the concerned parties including the sick company and other companies – amalgamating, merging, the amalgamated or the merged companies.

K. FUNDING THROUGH LEVERAGED BUYOUTS

A leveraged buyout (LBO), is the acquisition of a company or division of another company, financed with a substantial portion of borrowed funds. The acquirer resorts to a combination of a small investment and a large loan to fund the acquisition. Typically, the loan capital is availed through a combination of repayable bank facilities and/or public or privately placed bonds, which may be classified as high-yield debt. The debt will appear on the acquiring company's balance sheet and the acquired company's free cash flow will be used to repay the debt. Otherwise, the acquiring company could float a Special Purpose Vehicle ("SPV") as a 100% subsidiary with a minimum equity capital. The SPV can leverage this equity to gear up significantly higher debt to buyout the target company. The target company's assets can be used as collaterals for availing the loan and once the debt is redeemed, the acquiring company has the option to merge with the SPV. The debt will be paid off by the SPV using the cash flows of the target company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

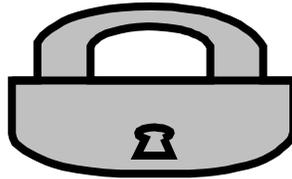
LESSON ROUND UP



- Mode of payment for mergers and acquisition to be selected from an optimum mix of available modes of payment of consideration.
- *Selection of financial package depend on many considerations* such as: to suit the financial structure of acquirer and acquiree, to provide a desirable gearing level, to be acceptable to vendors. Further it should prove economic to acquirer.
- *Funding through preference share capital*, unlike equity share capital, involves the payment of fixed preference dividend like interest on debentures or bonds or a fixed rate of dividend.

- *Funding through shares with differential voting rights* gives the companies an additional source of fund without interest cost and without an obligation to repay, as these are other form of equity capital.
- *Funding can also be done through swaps* and employees stock option scheme. The share capital that may be raised through the scheme of employees stock option can only be a fraction of the entire issue.
- *External commercial borrowings* are permitted by the Government as a source of finance for Indian corporates for expansion of existing capacity as well as for fresh investment.
- *The other modes of funding are through financial institutions and banks, rehabilitation finance and management and leveraged buy outs.* All these have got its own merits and demerits.

SELF TEST QUESTIONS

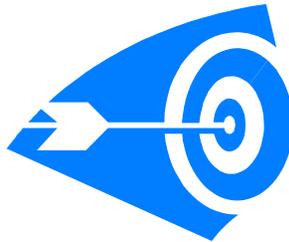


(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. 'Financing of mergers and acquisitions is a crucial exercise requiring utmost care'. Elaborate.
 2. Discuss funding through Rehabilitation Finance as a source of finance for mergers/takeovers.
 3. Describe a takeover that has opted for 'leveraged buy out ' for the funding.
 4. Describe Depository Receipts as a funding options for merger..
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STUDY VI
VALUATION OF SHARES, BUSINESS AND BRANDS

LEARNING OBJECTIVES



After going through this chapter, you will be able to understand:

- Need and purpose of valuation
- When valuation is required
- Factors influencing valuation
- Valuation motives
- Valuation of private, listed and unlisted companies
- Valuation methods
- Valuation by team of experts
- Dividend discount models
- Valuation of brands
- Non financial consideration in valuation
- Judicial pronouncements.

1. INTRODUCTION

Valuation is an exercise to assess the worth of an enterprise or a property. In a merger or amalgamation or demerger or acquisition, valuation is certainly needed. It is essential to fix the value of the shares to be exchanged in a merger or the consideration payable for an acquisition.

As per Section 82 of the Companies Act, 1956, the shares or debentures or other interest of any member in a company shall be movable property. A share carries with itself a bundle of rights such as the right to elect directors, the right to vote on resolutions in general meetings of a the company, the right to share in the surplus, if any, on liquidation etc.

2. NEED AND PURPOSE

There are a number of situations in which a business or a share or any other

property may be required to be valued. Valuation is essential for (i) strategic partnerships, (ii) mergers or acquisitions of shares of a company and/or acquisition of a business. (iii) Valuation is also necessary for introducing employee stock option plans (ESOPs) and joint ventures. From the perspective of a valuer, a business owner, or an interested party, a valuation provides a useful base to establish a price for the property or the business or to help determine ways and means of enhancing the value of his firm or enterprise.

The main objective in carrying out a valuation is conclude a transaction in a reasonable manner without any room for any doubt or controversy about the value obtained by any party to the transaction. Acquisition of Business or Investment in the Equity of an enterprise could be understand by the following two illustrations in this regard.

A Party who enters into a transaction with another for acquiring a business would like to acquire a business as a going concern for the purpose of continuing to carry the same business, he might compute the valuation of the target company on a going concern basis. On the other hand if the intention of the acquirer is to acquire any property such as land, rights, or brands, the valuation would be closely connected to the market price for such property or linked to the possible future revenue generation likely to arise from such acquisition. In every such transaction, therefore the predominant objective in carrying out a valuation is to put parties to a transaction in a comfortable position so that no one feels aggrieved.

When Valuation is required?

The following are some of the usual circumstances when valuation of shares or enterprise becomes essential:

1. When issuing shares to public either through an initial public offer or by offer for sale of shares of promoters or for further issue of shares to public.
2. When promoters want to invite strategic investors or for pricing a first issue or a further issue, whether a preferential allotment or rights issue.
3. In making investment in a joint venture by subscription or acquisition of shares or other securities convertible into shares.
4. For making an 'open offer for acquisition of shares'.
5. When company intends to introduce a 'buy back' or 'delisting of share'.
6. If the scheme of merger or demerger involve issue of shares. In Schemes involving Mergers/Demergers, share valuation is resorted to in order to determine the consideration for the purpose of issue of shares or any other consideration to shareholders of transferor or demerged companies.
7. On Directions of Company Law Board or any other Tribunal or Authority or Arbitration Tribunals directs.
8. For determining fair price for effecting sale or transfer of shares as per Articles of Association of the Company.
9. As required by the agreements between two parties.

10. For purposes of arriving of Value of Shares for purposes of assessments under the Wealth Tax Act.
11. To determine purchase price of a 'block of shares', which may or may not give the holder thereof a controlling interest in the company.
12. To value the interest of dissenting shareholders under a scheme of Amalgamation merger or reconstruction.
13. Conversion of Debt Instruments into Shares.
14. Advancing a loan against the security of shares of the company by the Bank/Financial Institution.
15. As required by provisions of law such the Companies Act, 1956 or Foreign Exchange Management Act, 1999 or Income Tax Act, 1961 or the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 [the Takeover Code] or SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 or SEBI (Buy Back of Securities) Regulations, 1998 or Delisting Guidelines.

Valuation/Acquisition Motives

An important aspect in the merger/amalgamation/takeover activity is the valuation aspect. The method of valuation of business, however, depends to a great extent on the acquisition motives. The acquisition activity is usually guided by strategic behavioural motives. The reasons could be (a) either purely financial (taxation, asset-stripping, financial restructuring involving an attempt to augment the resources base and portfolio-investment) or (b) business related (expansion or diversification). The (c) behavioural reasons have more to do with the personnel ambitions or objectives (desire to grow big) of the top management. The expansion and diversification objectives are achievable either by building capacities on one's own or by buying the existing capacities. (d) a "make (build) or buy decision" of capital nature.

The decision criteria in such a situation would be the present value of the differential cash flows. These differential cash flows would, therefore, be the limit on the premium which the acquirer would be willing to pay. On the other hand, if the acquisition is motivated by financial considerations (specifically taxation and asset-stripping), the expected financial gains would form the limit on the premium, over and above the price of physical assets in the company. The cash flow from operations may not be the main consideration in such situations. Similarly, a merger with financial restructuring as its objective will have to be valued mainly in terms of financial gains. It would, however, not be easy to determine the level of financial gains because the financial gains would be a function of the use of which these resources are put.

The acquisitions are not really the market driven transactions, a set of non-financial considerations will also affect the price. The price could be affected by the motives of other bidders. The value of a target gets affected not only by the motive of the acquirer, but also by the target company's own objectives.

METHOD OF VALUATION – A Brief

The valuation methods can be divided into three broad categories depending on the main premise on which the specific valuation model is based. None of these models can qualify as the most appropriate model for all the situations. It is just that some of the models have come to be used more often than the others.

Assets Basis

A starting point is usually the target company's financial statements which comprise, among other elements, a balance sheet, setting out the company's assets and liabilities. Although a balance sheet usually gives an accurate indication of short-term assets and liabilities, this is not the case for long-term ones. Liabilities may be hidden by numerous techniques known collectively as "off balance sheet financing". Assets are carried in the balance sheet according to accounting convention. For example, fixed tangible assets are stated at their original cost of purchase, less accumulated depreciation (their so called net book value). If the target company owns substantial property assets, then the balance sheet may well understate their true current value. Moreover, intangible assets (such as brands or goodwill) have until very recently been excluded from the balance sheet owing to difficulties of attribution a sensible carrying value to them. A balance sheet is simply not a statement of a company's economic value, but more a historical record of previous expenditure and existing liabilities. Since a valuation is essentially a forward-looking exercise, it is no surprise that acquisition purchase prices generally bear no relation to published balance sheet statements of net assets. Indeed, considerations are generally much higher than net book values (the excess being called goodwill on acquisition, which rarely appears on the new group's balance sheet), since most business valuations are based on estimates of the future income the assets can generate, rather than what they once cost. Nevertheless, a company's net book value is still taken into account in the valuation process for two principal reasons:

- (i) If the seller is another company, then any price below its residuary net book value will result in it stating a loss in its reported earnings. Thus, net book values have a tendency to become minimum prices (unless one is dealing with a seller in distress).
- (ii) The greater the proportion of the target's purchase price which is represented by its tangible assets, the less risky its acquisition is perceived to be. In fact, in the case of the purchase of private companies, it is common practice to ask the seller to warrant a minimum figure of net assets (or shareholder's funds) at the date of acquisition.

Price/Earnings Ratios

If an asset is to be valued on its income-earning potential, it may seem that a valuation based on reported accounting profits is a sound approach. After all, financial markets are consistently interested in forecasting and interpreting company profits. Price/earnings ratios (P/E ratios) are a popular and commonly used method for assessing the value of companies listed on a Stock Exchange.* Thus, one method of deriving a share price is to calculate a company's reported

accounting earnings per share (EPS) and multiply that by an appropriate factor or multiple. It is important to note that the method is based on an accounting measure of earnings. Thus, if a company's EPS is ₹ 30 and the appropriate P/E ratio is 10, then its share price ought to be ₹ 300. The higher the P/E ratio, the higher the value that is placed on the company. If company X has a higher P/E ratio than Company Y, it generally means that the stock market expects Company X to have better growth prospects and believes its earnings are of a "better quality" (i.e. less risky). However, it might also simply mean that Company X is seen as a more stable investment from which investors are happy to receive a lower prospective dividend yield. P/E ratios can provide a useful rule of thumb in making an initial estimate of a company's value, especially unquoted ones. If it is possible to compare an unquoted, private business with a quoted one of equivalent or similar risk and earnings potential, then an initial estimate of the private company's value can be made. The value of the P/E approach is that it uses actual market transactions between independent third parties as its base, although it must be said that no two companies are ever exactly alike.

Although P/E ratios can be a useful rule of thumb, great care must be exercised in using them and in interpreting the results. The first point to note is that they are based on accounting earnings. The reported profits may vary from company to company, depending on their chosen accounting policies in a number of areas. Such areas may include different policies on depreciation of fixed assets, stock valuations, deferred tax, extraordinary items and accounting for mergers and acquisitions. Reported earnings are therefore the result of a number of subjective judgments taken by a company's accountants.

It is also essential to note the nature of a company's quoted share price. It is the result of the supply and demand for a particular share on a particular day. The price set is thus a marginal one in that it reflects trading in small parcels of shares representing small percentages of the company's share capital. Thus, such a price does not reflect the premium over the current price required to obtain full control of a quoted company. Nor does it reflect the fact that an unquoted company's shares are likely to be less marketable (and thus less valuable) than its quoted counterpart.

Stock markets are generally regarded as operating efficiently, so that their valuations can be taken as a very important guide. Consequently, P/E ratios are an essential source of information if properly used and interpreted. However even the Stock Exchange itself states that quoted share prices are the result of hope, fear, guesswork (intelligent or otherwise), good or bad investment policy, and many other considerations. The quotations that result do not necessarily represent a valuation of a company by reference to its assets and its earnings potential. Such a caveat is particularly apposite when the target company to be acquired is listed on the Stock Exchange. Overall stock market levels can change very quickly, radically affecting the "value" of a listed company without any apparent change in its underlying profitability or performance. Accordingly, the price a purchaser will need to pay to gain control may be geared as much to market sentiment and political shifts as to the intrinsic worth of the business.

Discounted Cash Flow Techniques

Net Present Value (NPV)

It is now appropriate to consider another family of valuation techniques, known as discounted cash flow methods (DCF), of which there are two main variants, net present value and the internal rate of return. The net present value (NPV) approach is a theoretically more rigorous approach to the valuation of corporate assets. The NPV method is based on the assumption that the value of any asset is the sum of the future cash benefits of ownership converted to a single present value. Consequently, it concentrates on the capacity of a business or asset to generate cash, rather than on accounting profits. An acquisition involves an immediate outflow of funds in the hope of receiving greater cash flows in the future. However, cash flows arising at different points of time cannot be compared directly, since to do so would be to ignore a fundamental concept generally referred to as the "time value of money". The time value of money is taken into account by converting all the cash flows relating to an acquisition to a common reference point in time (usually the present). This is achieved by applying a simple mathematical technique known as "discounting". The time value of money is related to the existence of interest rates (and not inflation, although the latter can affect the level of interest rates).

The NPV of a project effectively represents the increase in the value of a company (and, therefore, of the shareholders' investment) which results from accepting an investment opportunity rather than returning the money to shareholders by way of dividends. The advice given by the NPV method is directly linked to the most widely accepted objective of financial management (the maximisation of shareholder wealth) and explains its theoretical superiority over other investment appraisal methods.

Internal Rate of Return

The other main DCF technique which is employed is the internal rate of return (IRR). This technique involves finding that discount rate which, when applied to a project's cash flows, results in an NPV of zero. Thus, Project B which has an outlay today of ₹100 and a return of ₹120 in one year's time, has an IRR of 20%, i.e. ₹120 divided by 1.2, less ₹100 equals an NPV of zero. Clearly, in order that a decision can be made as to whether a project should be accepted or rejected, the IRR approach presupposes that the company has a firm opinion of what its minimum acceptable return should be (generally known as the "hurdle rate"). The company should thus accept all investments with an IRR over the hurdle rate. Since the hurdle rate should really be the company's opportunity cost of capital, the IRR rate will give the same result as the NPV approach when examining investment opportunities in isolation. There would thus appear to be little point in calculating it. The IRR does have some potential use as a cost of capital sensitivity in that the IRR represents the maximum level to which the company's opportunity cost of capital can rise before the project ceases to be worthwhile.

Discount Rates

Capital markets not only offer a wide variety of different investment opportunities,

but each one offers a different rate of return. Shares generally offer a higher rate of return than bank deposits or government stocks, while shares in some industry sectors offer higher returns than others. The main determinant of the return on an investment is its associated risk. Risk can be defined as variability or uncertainty of outcome. The more difficult it is to predict the future benefits of owning an asset, the riskier it is and therefore the higher the prospective return the asset must offer if investors are to be persuaded to part with their funds. Consequently, the appropriate discount rate to use when evaluating an investment or acquisition is the rate of return offered by the capital markets for similar investments of equivalent risk. Thus, although a company may be justified in using its current cost of capital in evaluating an acquisition in the same business area as it now operates, this approach may not be justified if it considers diversifying its activities by acquisition into new business areas. It would thus be incorrect for an engineering company to use its own cost of capital to evaluate the acquisition of an electronics firm, if the capital markets consider both activities to have different risk profiles and thus requires a higher rate of return from an electronics company than from a "safer" engineering firm. Thus, the appropriate discount rate will be determined by the nature of the investment being contemplated.

Relevant Cash Flows

A proper valuation of a company's worth can only be derived from a detailed analysis of its future cash flows. Economic theory usually requires that any investment project should be evaluated over its useful economic life. The selection of the forecast period will need to reflect a number of factors viz. nature of business in question, length of its business cycles, rate of technological change, current economic climate, interest rates, stock market buoyancy, individual corporate philosophy etc. However, 10 years appears to be a popular choice, although both longer and shorter periods are not uncommon.

Having selected the forecast period, it will then be necessary to forecast the company's operating cash flow (sometimes referred to as its "free cash flow"). This is usually defined as profit before interest, less tax, capital expenditure and changes in operating working capital, but adjusted for any non-cash items deducted in arriving at profit, such as depreciation. The net operating cash flow is then discounted at an appropriate discount rate in order to arrive at a present value of the business.

These cash flows are discounted at a rate appropriate to the level of risk implied by the company's operating assets. The result will, therefore, be the total value of the company's assets, irrespective of the target company's capital structure. (The result is often referred to as an "all equity base case").

The importance of such a valuation model is difficult to over-emphasise. In practice, such models can become very sophisticated, involving detailed assumptions on market shares, sales volumes, average selling prices, unit costs and so forth. However, such sophistication can be spurious unless the data and the assumptions which underlie the model are valid. This is particularly true of the additional benefits (sometimes known as "synergies") expected to accrue to the purchaser from the acquisition. These synergy benefits often represent the added value necessary to provide a respectable NPV for an acquisition, and which can justify the payment of a

premium over the value attributed to the company by an efficient stock market. Great caution must, however, be exercised so that a realistic judgment is made of what additional benefits can be achieved and when. Over-optimism on this score will lead a company to pay too high a price.

Inflation

A valuation model as described above should also take account of inflation. There is a strong body of evidence to suggest that many companies fail to take inflation into account correctly. The existence of inflation in an economy erodes the purchasing power of the currency concerned, since a single unit of that currency buys an ever-decreasing quantity of goods and services. Therefore, when forecasting future cash flows it is important to ensure that not only are all cash flows converted to a common reference point in time, but also that they are expressed in equivalent units of purchasing power. It is thus important to draw a distinction between “money” (or nominal) cash flows and “real” cash flows. Money cash flows represent the physical cash amounts actually received or paid, whereas real cash flows are the money cash flows adjusted for the general level of inflation.

There are two approaches to incorporating inflation in an NPV analysis and both approaches will give the same answer if followed properly :

- (i) to discount money cash flows at nominal (or money) rates of interest; or
- (ii) to discount real cash flows at real interest rates.

A common error is to discount real cash flows at nominal interest rates, since nominal interest rates implicitly reflect market expectations for inflation.

Pricing in Public Issue as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

Pricing

(1) An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.

(2) An issuer may determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.

Differential pricing

An issuer may offer specified securities at different prices, subject to the following:

- (a) retail individual investors or retail individual shareholders [or employees of the issuer entitled for reservation made under regulation 42 making an application for specified securities of value not more than one lakh rupees,] may be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants:

Provided that such difference shall not be more than ten per cent of the price at which specified securities are offered to other categories of applicant;

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;
- (c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document.

Price and price band

(1) The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specified coupon rate, as the case may be.

(2) If the floor price or price band is not mentioned in the red herring prospectus, the issuer shall announce the floor price or price band at least two working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.

(3) The announcement referred to in sub-regulation (2) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.

(4) The cap on the price band shall be less than equal to one hundred and twenty per cent of the floor price.

(5) The floor price or the final price shall not be less than the face value of the specified securities.

Explanation: For the purpose of sub-regulation (4) the "cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

Face value of equity shares

(1) Subject to the provisions of the Companies Act, 1956, the Act and these regulations, an issuer making an initial public offer may determine the face value of equity shares in the following manner:

- (a) if the issue price per equity share is five hundred rupees or more, the issuer shall have the option to determine the face value at less than ten rupees per equity share;

Provided that the face value shall not be less than one rupee per equity share;

- (b) if the issuer price per equity share is less than five hundred rupees, the face value of the equity shares shall be ten rupees per equity share:

Provided that nothing contained in this sub-regulation shall apply to initial public offer made by any government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

(2) The disclosure about the face value of equity shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisements, offer documents and application forms in identical font size as that of issue price or price band.

(a) If listed for more than 6 months

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:

- (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the six months preceding the relevant date; or
- (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(b) If listed for less than 6 months

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than six months as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

(a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be;

or

(b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or

(c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

This price shall be recomputed by the issuer on completion of six months from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these six months and if such recomputed price

is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

Valuation for the purpose of Issue of Sweat Equity Shares

Under the SEBI (Issue of Sweat Equity) Regulations, 2002, the price of sweat equity shares shall not be less than the higher of the following:

- (a) The average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date; or
- (b) The average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

"Relevant date" for this purpose means the date which is thirty days prior to the date on which the meeting of the General Body of the shareholders is convened, in terms of clause (a) of Sub-section (1) of Section 79A of the Companies Act.

1. If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on the given date, then the price on that stock exchange shall be considered.
2. If the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.
3. If shares are not quoted on the given date, then the share price on the next trading day shall be considered.

As per the sweat equity regulations, the intellectual property or the value addition in respect of which the company intends to issue the sweat equity should also be valued in accordance with the valuation requirements contained in the said regulations.

Valuation of Stock Options under the SEBI (ESOP) Guidelines, 1999

Under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme), Guidelines, 1999, it has been stated that the fair value of a stock option is the price that shall be calculated for that option in an arm's length transaction between a willing buyer and a willing seller. The fair value shall be estimated using an option-pricing model (for example, the Black-Scholes* or a binomial model) that takes into account as of the grant date the exercise price and expected life of the option, the current price in the market of the underlying stock and its expected volatility, expected dividends on the stock, and the risk-free interest rate for the expected term of the option.

* This formula is nothing but a mathematical formula suggested for being used to value the cost of issue of employee stock options. The said formula considers factors such as the volatility of returns on the underlying securities, the risk-free interest rate, the expected dividend rate, the relationship of the option price to the price of the underlying securities and the expected option life. This is scientific method deployed for arriving at the actual compensation cost.

Valuation under SEBI (Delisting of equity shares) Regulations 2009.

The offer price shall be determined through book building in the manner specified in Schedule II of these regulations, after fixation of floor price . The final offer price shall be determined as the price at which the maximum number of equity shares is tendered by the public shareholders. If the final price is accepted, then, the promoter shall accept all shares tendered where the corresponding bids placed are at the final price or at a price which is lesser than the final price. The promoter may, if he deems fit, fix a higher final price.

- (2) The floor price shall not be less than,
- (a) where the equity shares are frequently traded in all the recognised stock exchanges where they are listed, the average of the weekly high and low of the closing prices of the equity shares of the company during the twenty six weeks or two weeks preceding the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, whichever is higher, as quoted on the recognised stock exchange where the equity shares of the company are most frequently traded;
 - (b) where the equity shares of the company are infrequently traded in all the recognised stock exchanges where they are listed, the floor price determined in accordance with the provisions of sub-regulation (3); or,
 - (c) where the equity shares are frequently traded in some recognised stock exchanges and infrequently traded in some other recognised stock exchanges where they are listed, the highest of the prices arrived at in accordance with clauses (a) and (b) above.

Explanation: For the purposes of this sub-regulation, equity shares shall be deemed to be infrequently traded, if on the recognised stock exchange, the annualised trading turnover in such shares during the preceding six calendar months prior to month in which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, is less than five per cent. (by number of equity shares) of the total listed equity shares of that class and the term 'frequently traded' shall be construed accordingly.

- (3) The floor price shall be determined by the promoter and the merchant banker taking into account the following factors:
- (a) the highest price paid by the promoter for acquisitions, if any, of equity shares of the class sought to be delisted, including by way of allotment in a public or rights issue or preferential allotment, during the twenty six weeks period prior to the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered and after that date upto the date of the public announcement; and,
 - (b) other parameters including return on net worth, book value of the shares of

the company, earning per share, price earning multiple vis-à-vis the industry average.

Valuation of Shares under the Sweat Equity Unlisted Companies (Issue of Shares) Rules, 2003

Under the Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003, the price of sweat equity shares to be issued to employees and directors shall be at a fair price calculated by an independent valuer. The valuation of the intellectual property or of the know-how provided or other value addition to consideration at which sweat equity capital is issued, shall be carried out by a valuer. The valuer should consult such experts, as he may deem fit, having regard to the nature of the industry and the nature of the property or the value addition. The valuer should submit a valuation report to the company giving justification for the valuation. A copy of the valuation report of the valuer should be sent to the shareholders with the notice of the general meeting;

Issue price of shares under FDI Policy:

Price of shares issued to persons outside India under FDI Policy shall not be less than

- (a) Price worked out as per SEBI Regulations if shares are listed
- (b) The fair valuation of shares done by SEBI category I Merchant Banker or a Chartered Accountant as per Discounted free cash flow method, if the shares are not listed.
- (c) The price as applicable to transfer from resident to non-resident as per the pricing guidelines laid down by RBI from time to time, in case of preferential allotment.

Valuation for Slump Sale (Sale of business as a going concern) under Income Tax Act

As the subject under discussion pertains to valuation of business for acquisitions and other such transactions, it would be necessary to apply appropriate mode of valuation so that the parties to a transaction are able to assess the likely tax impact from such transaction.

One of frequently considered method of sale of business as a going concern is what is known under the Income Tax Act as "Slump Sale". A direct sale of business, assets and liabilities entirely from one person (the Seller) to another (the Acquirer) on a lock, stock and barrel basis can be described as a "Slump Sale" within the meaning of Section 50B of the Income Tax Act. Section 50B of the Income Tax Act is a special provision for computation of capital gains arising to a seller in a slump sale. In a "Slump Sale", the consideration for the transaction should be fixed up for the whole deal without assigning values for individual assets or identifying the extent of individual liability. If the sale consideration exceeds the 'net worth' of the business being transferred (as on the date of transfer), then the Seller would suffer capital gains tax on such transfer to the extent of such excess. 'Net worth' for the purposes

of computing capital gains shall be the aggregate of the total assets of the Undertaking/Business under acquisition after deducting the value of liabilities of that Undertaking/Business as appearing in the books of accounts of the Seller.

The Explanation 1 given under Section 50B of the Income Tax Act, 1961 reads as under:

Explanation 1:

“For the purposes of this section, “net worth” shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account:

Provided that any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

Explanation 2:

“For computing the net worth, the aggregate value of total assets shall be—

- (a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of sub-clause (c) of clause (6) of Section 43; and
- (b) in the case of other assets, the book value of such assets.

A bare look at the above provisions reveals as follows:

- (i) these are special provisions for computing capital gains chargeable to tax in case of slump sale and, therefore, would prevail over the general provisions in case of any conflict;
- (ii) net worth of the undertaking transferred shall be deemed to be the cost of acquisition and cost of improvement for the purpose of Sections 48 and 49, and
- (iii) net worth shall be computed in accordance with the provisions of Explanations 1 and 2.

In the matter of Foster’s Australia Limited, A.A.R. No. 736 of 2006, the Authority for Advance Rulings (AAR) under the Income Tax Act considered the question whether the applicant is justified in contending the tax should be computed based on the consideration as per the independent valuation obtained by the applicant. The AAR observed that it is the case of the applicant that it has obtained an independent valuation report relating to trademarks and Foster’s brand intellectual property as on 30th April, 2006 and the Applicant contended that the Income Tax Department should rely upon the independent valuation obtained by the applicant. In the said case, the AAR held in Para 15.2 that “that ‘independent valuation report’ can certainly be relied upon by the applicant. It is for the concerned Income-tax Authority to examine whether it represents true and correct value and apply such relevant factors that have material bearing on quantification of the consideration related to the taxable items.

Thus for the purpose of determining the consideration for any transaction, a valuation is absolutely necessary. Where parties to a transaction arrive a valuation in a reasonable manner by adopting recognized modes of valuation, the Income Tax Department may accept such valuation and proceed to assess the capital gains arising on that basis if such valuation represents true and correct value. Valuation helps determination of tax liability arising from a transaction.

SHRI SHARDUL SHROFFS EXPERT GROUP REPORT ON VALUERS AND VALUATIONS, 2002

The Ministry of Corporate Affairs (the Department of Company Affairs) constituted an Expert Group in October 2002 under the chairmanship of Shri Shardul S Shroff, for recommending valuation guidelines in the context of corporate assets (such as businesses comprised within a company) and shares. The expert group recommended that the valuation principles shall apply to the following companies:

- (i) all listed companies;
- (ii) all unlisted public companies accepting public deposits and having a networth (i.e. paid-up capital and free reserves) in excess of ₹ 25 crores or a turnover in excess of ₹ 150 crores;
- (iii) all unlisted public companies not falling in (ii) above and all private companies having a networth in excess of ₹ 100 crores or a turnover in excess of ₹ 500 crores; and
- (iv) all companies under the Control of the companies described in (i), (ii) or (iii) above and including but not limited to the Group companies of the same and which have a networth (comprising paid-up capital and free reserves) in excess of ₹ 5 crores or a turnover in excess of ₹ 30 crores;

The Expert Group said that 'Value' means different things to different people and also that Value means different things in different contexts. Value of a particular business or asset may also be different for different parties depending upon strategic intent, synergies or for other reasons. Value must be clearly distinguished from price and businesses may justifiably undertake to consummate a transaction at a price which does not fall within an assessed fair value range. The Expert Group recognized and admitted that on valuations or valuation range / band suggested by valuers, the prerogative to decide upon a specific price is finally with the management and the Board of Directors of the Company. The valuation is only a tool to aid management in decision-making. Valuations need to be just and equitable in order to protect stakeholder interests. However, a valuation conclusion requires the exercise of expert judgement on a range of issues examined and is not merely a matter of applying a mathematical formula to given data.

The expert group was in favour of engaging independent valuers. It recommended certain qualifications and qualifying exams for being registered as valuers.

As per the recommendations of the expert group, the following are the transactions

for which independent valuation by the Registered Valuer(s) is mandatory:

- (a) All schemes of Compromise and Arrangement under Sections 391 to 394 of the Companies Act, with an exemption to:
 - (i) Scheme of Compromise and Arrangement of a wholly owned subsidiary of a company with itself and vice versa; and
 - (ii) Compromise with creditors not amounting to either a business combination or a spin-off;
- (b) Sale of a business including investment business and disposal of a Controlling interest over an undertaking or a company through disposal of shares, an undertaking or a substantial part thereof including a slump sale/itemised sale under Section 293(i)(a) of the Companies Act;
- (c) All equity and equity linked investments where shareholder approval is required under Section 372(A) of the Companies Act;
- (d) Purchases, combinations and restructuring entailing acquisition of business, undertaking or substantial part of an undertaking, equity and preference capital, and outstanding debt and liabilities, where Related Parties are involved;
- (e) Recapitalisation of companies including but not limited to situations where the company's proposed capital reduction by buy-back or petitioning the Court under Section 100 of the Companies Act.
- (f) Preferential allotments made to Related Parties and Persons controlling the company under Section 81(1A) under the Companies Act, 1956.

As per the recommendations of the expert group, in respect of Purchases, combinations and restructurings not covered above and which entail acquisition of business, an undertaking or substantial part of an undertaking, equity and preference capital, and outstanding debt and liabilities, where the investment exceeds 15% of networth of the acquirer; or the investment exceeds 25% of equity of the acquiree, provided overall consideration exceeds ₹10 crores, an independent valuation may be desirable.

[The expert group has also given a suggestion that valuation reports should include certain matters. They are given in Annexure 2 at the end of this study]

FACTORS INFLUENCING VALUATION

Many factors have to be assessed to determine fair valuation for an industry, a sector, or a company. The key to valuation is finding a common ground between all of the companies for the purpose of a fair evaluation.

Determining the value of a business is a complicated and intricate process. Valuing a business requires the determination of its future earnings potential, the risks inherent in those future earnings, Strictly speaking, a company's fair market value is the price at which the business would change hands between a willing buyer

and a willing seller when neither are under any compulsion to buy or sell, and both parties have knowledge of relevant facts.

The question that then arises is “How do buyers and sellers arrive at this value?”

Arriving at the transaction price requires that a value be placed on the company for sale. The process of arriving at this value should include a detailed, comprehensive analysis which takes into account a range of factors including the past, present, and most importantly, the future earnings and prospects of the company, an analysis of its mix of physical and intangible assets, and the general economic and industry conditions.

The other salient factors include:

- (1) The stock exchange price of the shares of the two companies before the commencement of negotiations or the announcement of the bid.
- (2) Dividends paid on the shares.
- (3) Relative growth prospects of the two companies.
- (4) In case of equity shares, the relative gearing of the shares of the two companies.

(‘gearing’ means ratio of the amount of Issued preference share capital and debenture stock to the amount of issued ordinary share capital.)

- (5) Net assets of the two companies.
- (6) Voting strength in the merged (amalgamated) enterprise of the shareholders of the two companies.
- (7) Past history of the prices of shares of the two companies.

Also the following key principles should be kept in mind:

- (1) There is no method of valuation which is absolutely correct. Hence a combination of all or some may be adopted.
- (2) If possible, the seller should evaluate his company before contacting potential buyers. In fact, it would be wiser for companies to evaluate their business on regular basis to keep themselves aware of its standing in the corresponding industry.
- (3) Go for a third party valuation if desirable to avoid over—valuation of the company which is a common tendency on the seller’s part.
- (4) Merger and amalgamation deals can take a number of months to complete during which time valuations can fluctuate substantially. Hence provisions must be made to protect against such swings.

VALUATION OF PRIVATE COMPANIES

While the principles of valuation of private companies are the same as for public companies, an important difference is that for private company targets we do not have the benchmark valuation provided by the stock market. And also that

a public company is often widely researched by investment analysts, information about the private target may be sparse. Forecasting the future cash flows is thus a more difficult exercise. Offsetting this disadvantage is the fact that private company bids are almost always friendly, with easier access to the target's management information.

VALUATION OF LISTED COMPANIES

Shares of listed companies, which are traded, are quoted on the stock exchange and are freely available. These shares can be sold or bought at the stock exchanges. The market price of the shares reflects their value.

However, there cannot be complete reliance on the market value of shares because of two short comings viz. firstly, at times, correct information about a company is not available to the investors, and, secondly, due to insider trading, there are distortions, which are reflected in the market price of shares.

VALUATION OF UNLISTED COMPANIES

The P/E ratio cannot be calculated in the case of unlisted companies, as the market price of the shares is not available. Hence, a representative P/E ratio of a group of comparable quoted companies can be taken after suitable adjustments. Generally, for private limited companies or small companies, which are not quoted and are closely held, a discount is applied for valuation to the prevalent P/E ratio of comparable listed company.

The other factors to be taken into consideration while following earning approach to valuation of an unlisted company are:

1. Company analysis — shareholding pattern, voting powers, rights and obligations of shareholders in addition to other data.
2. Industry analysis — whether it is high or low growth industry, nature of industry and influence on it of seasonal, volatile or cyclical business fluctuations, major competitors and their market share, etc.

VALUATION METHODS – DETAILED STUDY

I. Valuation based on assets

This valuation method is based on the simple assumption that adding the value of all the assets of the company and subtracting the liabilities, leaving a net asset valuation, can best determine the value of a business. However, for the purposes of the amalgamation the amount of the consideration for the acquisition of a business may be arrived at either by valuing its individual assets and goodwill or by valuing the business as a whole by reference to its earning capacity. If this method is employed, the fixed assets of all the amalgamating companies should preferably be valued by the same professional valuer on a going concern basis. The term 'going concern' means that a business is being operated at not less than normal or reasonable profit and valuer will assume that the business is earning reasonable profits when

appraising the assets. If it is found when all the assets of the business, both fixed and current, have been valued that the profits represent more than a fair commercial return upon the capital employed in the business as shown by such valuation the capitalised value of the excess (or super profits) will be the value of the goodwill, which must be added to the values of the other assets in arriving at the consideration to be paid for the business. This method may be summarized thus: The procedure of arriving at the value of a share employed in the equity method is simply to estimate what the assets less liabilities are worth, that is, the net assets lying for a probable loss or possible profit on book value, the balance being available for shareholders included in the liabilities may be debentures, debenture interest, expenses outstanding and possible preference dividends if the articles of association stipulate for payment of shares in winding up.

However, although a balance sheet usually gives an accurate indication of short-term assets and liabilities, this is not the case of long-term ones as they may be hidden by techniques such as "off balance sheet financing". Moreover, a balance sheet is a historical record of previous expenditure and existing liabilities. As a valuation is a forward looking exercise, acquisition purchase prices generally do not bear any relation to published balance sheet. Nevertheless a company's net book value is still taken into account as net book values have a tendency to become minimum prices and the greater the proportion of purchase price is represented by tangible assets, the less risky it's acquisition is perceived to be.

Valuation of a listed and quoted company has to be done on a different footing as compared to an unlisted company. The real value of the assets may or may not reflect the market price of the shares; however, in unlisted companies, only the information relating to the profitability of the company as reflected in the accounts is available and there is no indication of the market price. Using existing public companies as a benchmark to value similar private companies is a viable valuation methodology.

The comparable public company method involves selecting a group of publicly traded companies that, on average, are representative of the company that is to be valued. Each comparable company's financial or operating data (like revenues, EBITDA or book value) is compared to each company's total market capitalization to obtain a valuation multiple. An average of these multiples is then applied to derive the company's value.

An asset-based valuation can be further separated into four approaches:

1. Book value

The tangible book value of a company is obtained from the balance sheet by taking the adjusted historical cost of the company's assets and subtracting the liabilities; intangible assets (like goodwill) are excluded in the calculation.

Statutes like the Gift Tax Act, Wealth Tax Act, etc., have in fact adopted *book value* method for valuation of unquoted equity shares for companies other than an investment company. Book value of assets does help the valuer in determining the useful employment of such assets and their state of efficiency. In turn, this leads the

valuer to the determination of rehabilitation requirements with reference to current replacement values.

In all cases of valuation on assets basis, except book value basis, it is important to arrive at current replacement and realization value. It is more so in case of assets like patents, trademarks, know-how, etc. which may possess value, substantially more or less than those shown in the books.

Using book value does not provide a true indication of a company's value, nor does it take into account the cash flow that can be generated by the company's assets.

2. Replacement cost

Replacement cost reflects the expenditures required to replicate the operations of the company. Estimating replacement cost is essentially a make or buy decision.

3. Appraised value

The difference between the appraised value of assets, and the appraised value of liabilities is the net appraised value of the firm.

This approach is most commonly used in a liquidation analysis because it reflects the divestiture of the underlying assets rather than the ongoing operations of the firm.

4. Excess earnings

In order to obtain a value of the business using the excess earnings method, a premium is added to the appraised value of net assets. This premium is calculated by comparing the earnings of a business before a sale and the earnings after the sale, with the difference referred to as excess earnings.

In this approach, it is assumed that the business is run more efficiently after a sale; the total amount of excess earnings is capitalized (e.g., the difference in earnings is divided by some expected rate of return) and this result is then added to the appraised value of net assets to derive the value of the business.

II. Open market valuation

Open market value refers to a price of the assets of the company which could be fetched or realized by negotiating sale provided there is a willing seller, property is freely exposed to market, sale could materialize within a reasonable period, orders will remain static throughout this period and without interruption from any purchaser giving an extraordinarily higher bid. Each asset of the company is normally valued on the basis of liquidation as resale item rather than on a going-concern basis. The assets of the company, which are not subject to regular sale, could be assessed on depreciated or replacement cost. Besides, intangible assets like goodwill are also assessed as per normal practices and recognized conventions.

III. Valuation based on earnings

The normal purpose of the contemplated purchase is to provide for the buyer the annuity for his outlay. He will expect yearly income, return great or small, stable or

fluctuating but nevertheless some return which is commensurate with the price paid therefore. Valuation based on earnings based on the rate of return on capital employed is a more modern method being adopted. From the last earnings declared by a company, items such as tax, preference dividend, if any, are deducted and net earnings are taken.

An alternate to this method is the use of the price-earning (P/E) ratio instead of the rate of return. The P/E ratio of a listed company can be calculated by dividing the current price of the share by earning per share (EPS). Therefore, the reciprocal of P/E ratio is called earnings - price ratio or earning yield.

$$\text{Thus P/E} = \frac{P}{\text{EPS}}$$

Where P is the current price of the shares

The share price can thus be determined as

$$P = \text{EPS} \times \text{P/E ratio}$$

[Case studies on valuation are given in Annexure 3 and Annexure 4]

IV. Merger negotiations: Significance of P/E ratio and EPS analysis

In practice, investors attach a lot of importance to the earnings per share (EPS) and the price-earnings (P/E) ratio. The product of EPS and P/E ratio is the market price per share.

Exchange Ratio

The current market values of the acquiring and the acquired firms may be taken as the basis for exchange of shares. The share exchange ratio (SER) is given as follows:

$$\text{Share Exchange Ratio} = \frac{\text{Share price of the acquired firm}}{\text{Share price of the acquiring firm}}$$

$$\text{SER} = \frac{P_b}{P_a}$$

The exchange ratio in terms of the market value of shares will keep the position of the shareholders in value terms unchanged after the merger since their proportionate wealth would remain at the pre-merger level. There is no incentive for the shareholders of the acquired firm, and they would require a premium to be paid by the acquiring company. Could the acquiring company pay a premium and be better off in terms of the additional value of its shareholders? In the absence of net economic gain, the shareholders of the acquiring company would become worse-off unless the price-earnings ratio of the acquiring company remains the same as before the merger. For the shareholders of the acquiring firm to be better off after the merger without any net economic gain either the price-earnings ratio will have to increase sufficiently higher or the share exchange ratio is low, the price-earnings ratio remaining the same. Let us consider the example in Illustration given below:

Illustration. Enterprise is considering the acquisition of Enterprise. The following

are the financial data of two companies:

	<i>Shyama Enterprise</i>	<i>Rama Enterprise</i>
Profit after tax (₹)	80,000	16,000
Number of shares	20,000	8,000
EPS (₹) 4	2	
Market value per share (₹)	120	30
Price earnings ratio (times)	30	15
Total market capitalization (₹)	1,20,000	1,20,000

Shyama Enterprise is thinking of acquiring Rama Enterprises through exchange of shares in proportion of the market value per share. If the price-earnings ratio is expected to be (a) pre-merger P/E ratio of Rama i.e. 7.5 (b) pre-merger P/E ratio of Shyama i.e. 15, (c) weighted average of pre-merger P/E ratio of Shyama and Rama i.e. 13.75, what would be the impact on the wealth of shareholders after merger?

Solution:

Since the basis of exchange of shares is the market value per share of the acquiring (Shyama Enterprise) and the acquired (Rama Enterprises) firms, then Shyama would offer 0.25 of its shares to the shareholders of Rama:

$$\frac{P_b}{P_a} = \frac{30}{120} = 0.25$$

In terms of the market value per share of the combined firm after the merger, the position of Rama's shareholders would remain the same; that is, their per share value would be: $120 \times .25 = ₹ 30$. The total number of shares offered by Shyama (the acquiring firm) to Rama's (the acquired firm) shareholders would be:

No. of shares exchanged = SER \times Pre-merger number of shares of the acquired firm.

$$\begin{aligned} &= (P_b/P_a) N_b \\ &= 0.25 \times 8000 = 2,000 \end{aligned}$$

and the total number of shares after the merger would be: $N_b + (SER) N_m = 20,000 + 2,000 = 22,000$. The combined earnings (PAT) after the merger would be: ₹ 80,000 + ₹ 16,000 = 96,000 and EPS after the merger would be:

$$\begin{aligned} \text{Post-merger combined EPS} &= \frac{\text{Post-merger combined PAT}}{\text{Post-merger combined shares}} \\ &= \frac{PAT_a + PAT_b}{N_a + (SER)N_b} \\ &= \frac{80,000 + 16,000}{20,000 + (0.25) 8,000} \end{aligned}$$

$$= \frac{96,000}{22,000} = 4.36$$

The earnings per share of Shyama (the acquiring firm) increased from ₹4 to ₹4.36, but for Rama's (the acquired firm) shareholders it declined from ₹ 2 to ₹4.36 x .25 = ₹1.09.

Given the earnings per share after the merger, the post-merger market value per share would depend on the price-earnings ratio of the combined firm. How would P/E ratio affect the wealth of shareholders of the individual companies after the merger?

The shareholders of both the acquiring and the acquired firms neither gain nor lose in value terms if post-merger P/E ratio is merely a weighted average of pre-merger P/E ratios of the individual firms. The post-merger weighted P/E ratio is calculated as follows:

Post-merger weighted P/E ratio:

(Pre-merger P/E ratio of the acquiring firm) x (Acquiring firm's pre-merger earnings + Post-merger combined earnings) + (Pre-merger P/E ratio of the acquired firm) x (Acquired firm's pre-merger earnings ÷ Post merger combined earnings).

$$P/E_w = (P/E_a) (PAT_a/PAT_c) + (P/E_b) x (PAT_b/PAT_c)$$

Using Equation in our example we obtain:

$$(30) x (80,000/96,000) + (15) (16,000/96,000) = 25 + 2.5 = 27.5$$

The acquiring company would lose in value if post-merger P/E ratio is less than the weighted P/E ratio. Any P/E ratio above the weighted P/E ratio would benefit both the acquiring as well as the acquired firms in value terms. An acquiring firm would always be able to improve its earnings per share after the merger whenever it acquires a company with a P/E ratio lower than its own P/E ratio. The higher EPS need not necessarily increase the share price. It is the quality of EPS rather than the quantity which would influence the price.

An acquiring firm would lose in value if its post-merger P/E ratio is less than the weighted P/E ratio. Shyama Enterprise would lose ₹27.30 value per share if P/E ratio after merger was 15. Any P/E ratio above the weighted P/E ratio would benefit both the acquiring as well as the acquired firm in value terms. When the post-merger P/E ratio is 30, Shyama gains ₹5.40 value per share and Rama ₹1.35.

Why does Shyama Enterprise's EPS increase after merger? Because it has a current P/E ratio of 30, and it is required to exchange a lower P/E ratio, i.e.

$$\begin{aligned} P/E \text{ exchanged} &= \frac{SER \times P_a}{EPS_b} \\ &= \frac{0.25 \times 120}{2} = 15 \end{aligned}$$

Shyama Enterprise's EPS after merger would be exactly equal to its pre-merger EPS if P/E ratio paid is equal to its pre-merger P/E ratio of 30. In that case, given

Rama's EPS of ₹2, the price paid would be ₹60 or a share exchange ratio of .5. Thus Shyama Enterprise would issue $.5 \times 8,000 = 4,000$ shares to Rama Enterprise. The acquiring firm's EPS after merger would be: $\text{₹}96,000/24,000 = \text{₹}4$. It may be noticed that at this P/E ratio, Shyama's shareholders would have the same EPS as before the merger: $.5 \times \text{₹}4 = \text{₹}2$. It can be shown that if the acquiring firm takes over another firm by exchanging a P/E ratio higher than its P/E ratio, its EPS will fall and that of the acquired firm would increase after the merger.

The limitation of this methods is that it is based on past performance whereas for a fair valuation, a reliable estimate of future earnings is necessary.

In view of this, discounted cash flow (DCF) is often a preferred tool to value businesses. What sets this approach apart from other approaches is that it is based on projected, future operating results rather than on historical operating results. As a result, companies can be valued based on their future cash flows, which may be somewhat different from historical results.

V. Discounted cash flows

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. This detailed analysis depends on accurate financial projections and discount rate assumptions. The resulting company valuation is the sum of discounted future cash flows and the discounted 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) and is best thought of as a percentage, which represents the return, expected by an owner of the company commensurate with the risk associated with the investment.

Thus, a company with little in the way of a demonstrated track record, would receive a higher discount rate than a company with a long history of growth and profitability and more obvious future prospects. 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 assumption underlying this step is that a company is a going concern and that its value is embedded in its ability to generate value not just today, but also in the future. 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.

Together with an analysis of the company's operating history, business, industry and competitive environment, the results from one or more of these valuation methodologies are combined to form the basis of a comprehensive business valuation.

To be accurate, this comprehensive business valuation should take into account all aspects of the company's business, including factors which may be difficult to value and that do not show up on financial statements.

VI. Valuation based on super profits

This approach is based on the concept of the company as a going concern. The value of the net tangible assets is taken into consideration and it is assumed that the business, if sold, will in addition to the net asset value, fetch a premium. *The super profits are calculated as the difference between maintainable future profits and the return on net assets.* In examining the recent profit and loss accounts of the target, the acquirer must carefully consider the accounting policies underlying those accounts. Particular attention must be paid to areas such as deferred tax provision, treatment of extraordinary items, interest capitalisation, depreciation and amortisation, pension fund contribution and foreign currency translation policies. Where necessary, adjustments for the target's reported profits must be made, so as to bring those policies into line with the acquirer's policies. For example, the acquirer may write off all R&D expenditure, whereas the target might have capitalised the development expenditure, thus overstating the reported profits.

VII. Discounted cash flow valuation method

Discounted cash flow valuation is based upon expected future cash flows and discount rates. This approach is easiest to use for assets and firms whose cash flows are currently positive and can be estimated with some reliability for future periods.

Discounted cash flow valuation, relates the value of an asset to the present value of expected future cash flows on that asset. In this approach, the cash flows are discounted at a risk-adjusted discount rate to arrive at an estimate of value. The discount rate will be a function of the riskiness of the estimated cash flows, with lower rates for safe projects and higher rate for riskier assets.

This approach has its foundation in the 'present value' concept, where the value of any asset is the present value of the expected future cash flows on it. Essentially,

DCF looks at an acquisition as a pure financial investment. The buyer will estimate future cash flows and discount these into present values. Why is future cash flow discounted? The reason is that a rupee in future is at risk of being worth less than a rupee now. There are some business based real risks like acquired company losing a contract, or new competitor entering the market or an adverse regulation passed by government, which necessitated discounting of cash flows.

The discounted cash flow (DCF) model is applied in the following steps:

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.

VIII. Valuation by team of experts

Valuation is an important aspect in merger and acquisition and it should be done by a team of experts keeping into consideration the basic objectives of acquisition. Team should comprise of financial experts, accounting specialists technical and legal experts who should look into aspects, of valuation from different angles.

Accounting expert has to foresee the impact of the events of merger on profit and loss account and balance sheet through projection for next 5 years and economic forecast. Using the accounting data he must calculate performance ratios, financial capacity analysis, budget accounting and management accounting and read the impact on stock values, etc. besides, installing accounting and depreciation policy, treatment of tangible and intangible assets, doubtful debts, loans, interests, maturities, etc.

Technician has its own role in valuation to look into the life and obsolescence of depreciated assets and replacements and adjustments in technical process, etc. and form independent opinion on workability of plant and machinery and other assets.

Legal experts advice is also needed on matters of compliance of legal formalities in implementing acquisition, tax aspects, review of corporate laws as applicable, legal procedure in acquisition strategy, laws affecting transfer of stocks and assets, regulatory laws, labour laws preparing drafts of documents to be executed or entered into between different parties, etc.

Nevertheless, the experts must take following into consideration for determining exchange ratio.

A. Market Price of Shares

If the offeree and offeror are both listed companies, the stock exchange prices of the shares of both the companies should be taken into consideration which existed before commencement of negotiations or announcement of the takeover bid to avoid distortions in the market price which are likely to be created by interested parties in pushing up the price of the shares of the offeror to get better deal and vice versa.

B. Dividend Payout Ratio (DPR)

The dividend paid in immediate past by the two companies is important as the shareholders want continuity of dividend income. In case offeree company was not paying dividend or its DPR was lower than the offeror's, then its shareholders would opt for share exchange for the growth company by sacrificing the current dividend income for prospects of future growth in income and capital appreciation.

C. Price Earning Ratio (PER)

Price earning ratios of both the offeror and offeree companies be compared to judge relative growth prospects. Company with lower PER show a record of low growth in earning per share which depresses market price of shares in comparison to high growth potential company. Future growth rate of combined company should also be calculated.

D. Debt Equity Ratio

Company with low gearing offers positive factor to investors for security and stability rather than growth potential with a geared company having capacity to expand equity base.

E. Net Assets Value (NAV)

Net assets value of the two companies be compared as the company with lower NAV has greater chances of being pushed into liquidation.

Having taken all the above factors into consideration, the final exchange ratio may depend upon factors representing strength and weakness of the firm in the light of merger objectives including the following:

Liquidity, strategic assets, management capabilities, tax loss carry overs, reproduction costs, investment values, market values (combined companies shares) book values, etc.

Valuation by experts: effect

It is well settled that the valuation of shares is a technical matter, requiring considerable skill and expertise. If the same has been worked out and arrived at by experts then the same should be accepted, more so, if the same has the approval of the shareholders. That is to say, where the valuation done by the company's auditors is approved by the majority of shareholders and is also confirmed by eminent experts, who are appointed by the court to examine the valuation so made, as fair, and the valuation is not shown to be patently unfair or unjust, it would be extremely difficult to hold that the valuation so made is unfair, and, then, the court shall have to be slow to set at naught the entire scheme of amalgamation. The court does not go into the matter of fixing of exchange ratio in great detail or to sit in appeal over the decision of

the chartered accountant. If a chartered accountant of repute has given the exchange ratio as per valuation made by him and the same is accepted by the requisite majority of the shareholders, the court will only see whether there is any manifest unreasonableness or manifest fraud involved in the matter.

So, the exchange ratio of shares in the case of scheme of amalgamation, when supported by an opinion of accounting, technicians & legal experts and approved by a very large number of shareholders concerned, is prima facie to be accepted as fair, unless proved otherwise by the objectors. It is also well established, that there are number of bases on which valuation or the offered exchange ratio, which ultimately is a matter of opinion, can be founded and final determination can be made by accepting one of amalgamation of various consideration. It is also well settled by the Supreme Court in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, that mathematical precision is not the criterion for adjudging the fair exchange ratio.

Thus, now, the law has been well settled by the Supreme Court in *Miheer H. transferee company to be allotted to the holders of the transferor company* has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest. It is not the part of the judicial process, said the Supreme Court in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, to examine entrepreneurial activities to ferret out flaws. The court is least equipped for such oversights, nor indeed is it a function of the judges in our constitutional scheme. It cannot be said that the internal management, business activity or institutional operation of public bodies, can be subjected to inspection by the court. To do so is incompetent and improper and, therefore, out of bounds.

Where the determination of the market price has been entrusted to a reputed valuer, there no reason to doubt his competence unless mala fides are established against him. Allegations of mala fides are easy to make but difficult to substantiate. Unless the person who challenges the valuation satisfies the court that the valuation arrived at is grossly unfair, the court will not disturb the scheme of amalgamation which has been approved by the shareholders of two companies, who are, by and large well informed men of commercial world. It is difficult to set aside the valuation of experts in the absence of fraud or mala fides on the part of the experts.

IX. Fair value of shares

Valuation can be done on the basis of fair value also. However, resort to valuation by fair value is appropriate when market value of a company is independent of its profitability.

The fair value of shares is arrived at after consideration of different modes of valuation and diverse factors. There is no mathematically accurate formula of valuation. An element of guesswork or arbitrariness is involved in valuation. The following four factors have to be kept in mind in the valuation of shares. These are:

- (1) Capital cover,
- (2) Yield,

- (3) Earning capacity, and
- (4) Marketability.

For arriving at the fair value of share, three well-known methods are applied:

- (1) the manageable profit basis method (the earning per share method).
- (2) the net worth method or the break-up value method, and
- (3) the market value method.

The fair value of a share is the average of the value of shares obtained by the net assets method and the one obtained by the yield method. This is, in fact not a valuation, but a compromise formula for bringing the parties to an agreement.

The average of book value and yield-based value incorporates the advantages of both the methods and minimizes the demerits of both the methods. Hence, such average is called the fair value of share or sometimes also called the dual method of share valuation.

The fair value of shares can be calculated by using the formula:

$$\text{Fair value of shares} = \frac{\text{Value by net assets method} + \text{Value by yield method}}{2}$$

Valuation of equity shares must take note of special features, if any, in the company or in the particular transaction. These are briefly stated below:

(a) Importance of the size of the block of shares:

Valuation of the identical shares of a company may vary quite significantly at the same point of time on a consideration of the size of the block of shares under negotiation.

The holder of 75% of the voting power in a company can always alter the provisions of the articles of association; a holder of voting power exceeding 50% and less than 75% can substantially influence the operations of the company even to alter the articles of association or comfortably pass a special resolution.

A controlling interest therefore, carries a separate substantial value.

(b) Restricted transferability:

Along with principal consideration of yield and safety of capital, another important factor is easy exchangeability or liquidity. Holders of shares of unquoted public companies or of private companies do not enjoy easy marketability; therefore, such shares, however good, are discounted for lack of liquidity at rates, which may be determined on the basis of circumstances of each case.

The discount may be either in the form of a reduction in the value otherwise determined or an increase in the normal rate of return.

(c) Dividends and valuation:

Generally, companies paying dividends at steady rates enjoy greater popularity and the prices of their shares are high while shares of companies with unstable dividends do not enjoy confidence of the investing public as to returns they expect to get and, consequently, they suffer in valuation.

(d) Bonus and rights issue:

Share values have been noticed to go up when bonus or rights issues are announced, since they indicate an immediate prospect of gain to the holder although in the ultimate analysis, it is doubtful whether really these can alter the valuation.

Statutory valuation

Valuation of shares may be necessary under the provisions of various enactments like the Wealth tax Act, Companies Act, Income-tax Act, etc. e.g. valuation is necessary under the Companies Act in the case of an amalgamation and under the Income-tax Act for the purposes of capital gains.

Some of the other enactments have laid down rules for valuation of shares. The rules generally imply acceptance of open market price i.e. stock exchange price for quoted shares and asset based valuation for unquoted equity shares and average of yield and asset methods i.e. fair value, in valuing shares of investment companies.

X. Free cash-flows (FCF)

FCF is a financial tool mainly used in valuation of a business. It will be close to the profits after tax without taking into account depreciation. Depreciation is neither a source of money nor an application of the funds available at the disposal of a company. FCF of a company is determined by the after tax operating cash flow minus interest paid/payable duly taking into account the savings arising out of tax paid/payable on interest and after providing for certain fixed commitments such as preference shares dividends, redemption commitments and investments in plant and machinery required to maintain cash flows. Please refer to *Annexure 3* for a case study involving the acquisition of a firm as a going concern where valuation has been done on the basis of estimated free cash flows.

VALUATION OF SECURITIES IN A TAKEOVER

A takeover, like any other contract of purchase and sale, involves the striking of a bargain between the buyer and the shareholders of the seller in regard to the price. With a range between the maximum price which the buyer is prepared to pay and the minimum price which a sufficient number of the shareholders of the seller are prepared to accept, the price actually paid will depend on such factors as (a) the eagerness of the buyer to buy and whether there are competing bidders; (b) the eagerness of the shareholders of the seller to sell and, in case of a share for share offer, the willingness of the shareholders of the seller to become the shareholders of the buyer; (c) the skill, judgement and timing of the buyer's campaign, including the persuasiveness with which the buyer's case is expressed in the offer documents and other circulars to shareholders, (d) the willingness of the buyer to structure the offer in the light of the particular financial and tax considerations of the shareholders of the seller; (e) if the directors of the seller resist the bid, the skill, judgement and timing of the defensive campaign and degree of support, they receive from their merchant bankers, associates and other financial institutions; (f) whether the directors of the seller hold a large block of effectively controlled shares or the shares are widely dispersed; (g) fortuitous factors, such as the behaviors during the offer period of the stock exchange in general, economic developments, and sometimes even political events which affect investment sentiment. The decision as to what price the transferee company should be prepared to pay to acquire the transferor company should be determined by precisely the same

financial analysis as the decision whether the transferee company should erect a new factory or purchase a large item of plant.

Thus the motivation for buying and selling companies varies considerably, but it is important that both parties understand what they want from one another. First, what is the buyer looking for? It could be:

- An opportunity to grow faster, with a ready-made market share.
- To eliminate a competitor by buying it out.
- Better integration – horizontal or vertical.
- Diversification with minimum cost and immediate profit.
- To improve dividend yield, earnings or book value.
- To forestall the company's own takeover by a third party
- To enjoy the prospect of turning around a sick company.

On the other hand, why are companies available for sale? Some of the reasons are:

- Declining sales or earnings.
- An uncertain future.
- Owner wants to slow down or retire with no successor.
- Desire to maximise growth under the umbrella of a larger company.
- To raise cash for a more promising line of business.
- Lack of adequate financial and management skills.
- To concentrate time and effort on what it can do best.

The stages that have to be gone through in order to conclude a deal, either directly or through an intermediary, include:

- Search and exchange of information about each other.
- Preliminary investigation followed by serious negotiation.
- Contract development and closing the deal.

In the case of a share-for-share takeover (including cases where the consideration consists of loan stock convertible into or with subscription rights for equity capital of transferee company) the value of transferee company's existing operations should be ideally valued on the same basis, so as to determine the maximum number of shares that the transferee company should be prepared to offer.

NON-FINANCIAL CONSIDERATIONS IN VALUATION

Howsoever sophisticated the financial techniques applied to evaluate the worth of a business, and however accurate the assumption, it is more than likely that intangible (and perhaps irrational) factors will ultimately determine the amount the purchaser is prepared to pay. While it is arguable that any acquisition should be justifiable in a financial context, the motives for an acquisition may often be purely defensive, for example, to make the combined company less attractive to acquisition by a third party, to prevent an outsider getting a toe-hold in the industry, to prevent a competitor from acquiring the same business, or to diversify out of a manifestly

declining industry. In such circumstances the financial benefits of the acquisition are much more difficult to quantify. Worse still, the motives may simply involve empire-building or personal aggrandisement on the part of the directors or owners of the acquiring company.

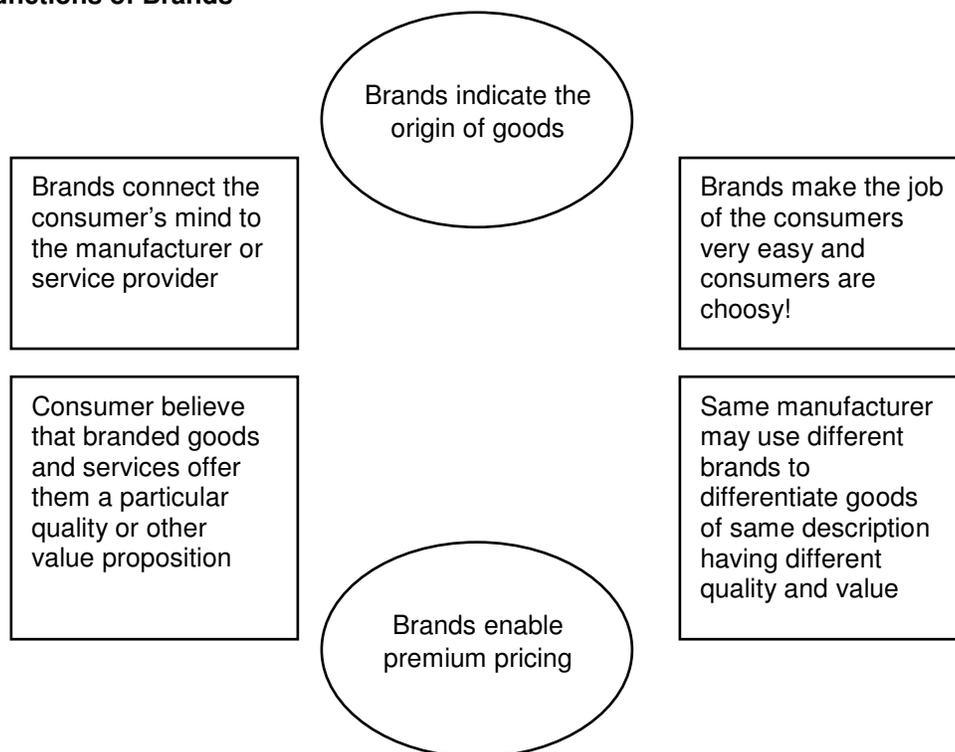
The foreign currency acquisition makes the valuation a still more complex and difficult exercise. It is suggested that the acquisition in another country may be evaluated in that country's currency. In addition, the cost of capital estimate for discounting should also be from the target company's country only. The reason for using the acquirer's cost of capital in the target's country is that the product pricing decisions in the acquired company will have to be based on the local market conditions.

VALUATION OF BRANDS

Black's Dictionary defines it 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.

It is the hallmark of a shrewd businessman to commence his business with a roadmap of his plans. In the course of his business, he applies a unique mark or symbol or word to his goods. When his customer base increases, his goods acquire reasonable reputation and his customers begin identifying his goods by the unique mark or symbol or word he had so adopted, his goods earn the reputation of being branded goods. What applies to goods applies to services also. When brands take charge of consumers' minds, the name of its proprietor takes the backseat. There lies the power of brands.

Functions of Brands



The Importance of Brand valuation

Think for a moment as to how much investment one has to make by means of money and others resources to adopt, develop and popularize a brand or a mark during the course of his business. Brands/marks are a class of assets like human resource, knowledge etc. They create a value premium for the goods and services. Therefore, without the brand/mark, the goods/services may be address less. In order to market it or use this asset wisely valuing the same is essential. But remember, valuing a brand is a very difficult task. There is no prescribed manner to value a brand. But all knows that brands connect markets with products and thereby they create value.

Brands do not command any value unless they are able bring cash flows to the Company that has adopted the same. With incremental cash flows increasing, value of brand increases proportionately. 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.

Protect the Value of the Brand

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.
- To secure registration of the Brand in all 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 and 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. For such enquiry, the following questionnaire may prove to be helpful:

<i>Sl. No.</i>	<i>Query</i>
1.	What are the brands requiring valuation? Please mention all its variants and styles also.
2.	What is the date of adoption of each brand?
3.	Does the company use the brand owned by any third party?
4.	What are goods or products that are sold under those brands?
5.	For how long they have been in use?
6.	Whether the use of brands has been continuous?
7.	Whether use of any brand has been stopped?
8.	Whether the brands of the company have been registered under the Trademarks Act, 1999?
9.	Whether there has been any opposition to registration of the any of the Brands of your company?
10.	What are the Brands/Trademarks which have not yet been registered though necessary applications have been filed already with the Registrar of Trademarks?
11.	Whether the artistic works contained in the brands of the company have been registered under the Copyrights Act, 1957?
12.	Whether your company has adopted any slogan or catchy phrase to highlight the policy of your company or its branded goods?
13.	What is the turnover of the company from goods sold under brand? (Brand-wise data from three financial years (04-05, 05-06, 06-07) may be provided)
14.	Whether the company has a website of its own? Give details.
15.	Whether the company has dealer/agent network?
16.	How does the company take its products to its ultimate customers?
17.	Has the company any brand adoption policy? Please furnish a copy of the policy.

18.	Has the company granted any permission to any party for brand use? Please provide a copy of Licence agreement if any.
19.	Has the company a marketing division of its own?
20.	Has there been any advertisement about the brands? Please furnish complete details regarding advertisements in the print media/electronic media?
21.	Whether there have been any radio commercial programmes of your company's brands?
22.	Is there been any use of the brand in any country other than India?
23.	What are the most prominent states in India where the branded goods of the company sell significantly?
24.	Can you give product wise turnover for three financial years (04-05, 05-06, 06-07)?
25.	Can you furnish state wise turnover for three financial years (04-05, 05-06, 06-07)?
26.	Can you furnish names of the States where the products of the Company are not sold at all?
27.	Can you furnish details of those products, which though manufactured by the company are sold without applying any brand?
28.	Can you furnish details of those goods that are sold by your company as branded goods even though they are simultaneously sold without applying those brands?
29.	Is there any product that the company gets manufactured through any other party (such as a sub-contractor) who puts the brand of the company upon those goods and delivers to the company?
30.	What is the budget of the company for its advertisement and publicity for three financial years (04-05, 05-06, 06-07)? How much of the same could be related to brand promotion?
31.	Who are the major competitors of your company's goods? What are their brands? How those brands are superior or inferior to your company's brands?
32.	What is the total market in India for the goods of your company? Please give details in value terms and in quantity terms if possible.
33.	What would the approximate market share of your company?
34.	Has the market share improved after introducing branded goods?
35.	In your opinion would the price of branded goods sold is higher than the price of same goods sold without brands? (You may consider a market place where two traders are selling the same or similar goods, your

	company selling those goods as branded goods and the other trader selling his goods without any brand).
36.	Do you think because of Brands the goods of your company have been commanding higher (premium) valuation?
37.	Do you think your company has not reached out to customers adequately in respect of any territory?
38.	Could you please provide financial projections for the next three financial years (07-08, 08-09, 09-10)?
39.	Has there been any raid or criminal action against sale of spurious goods similar to your goods upon which the Brands of your company or any brand deceptively similar to the Brands of your company have been used?
40.	Has your company ever given any warning or caution notice about Brands of your company?
41.	Has your company at any time opposed the registration of any brand or trademarks of any other person?
42.	Has your company issued any legal notice to any party against misuse of any Brands of your company?
43.	Has there been any suit against any party for passing off or infringement of any of the Brands of your company?
44.	Has there been any legal notice or legal action against your company alleging copying or misuse of brands of others?
45.	Has there been any valuation of any of the Brands of your company at any time before this?

VALUATION APPROACH

Basically in an enterprise, physical resources are of the following two types:

- Machinery, that work with applied force;
- Men who work.

Both the above assets are capable of being organized provided the two vital inputs are present; viz., money and knowledge.

Brands belong to a different species. While physical resources could be created easily if augmenting financial resources is not a problem, same is not the case of brands. That is why there is always a premium price for buying branded goods rather than the business or plants and equipments. In the case of Brands, the ability of the Company to leverage the same to bring revenues in other territories and markets is of paramount importance.

As already seen, the value of an enterprise could be estimated on a going-concern basis by computing the earning capacity. Net Asset Value method may not be ideal in the cases enterprises with depreciating assets unless the enterprise in

question is asset intensive. For instance, in the case of company engaged in real estate sector, the lands in the hands of the company on ownership basis could be a stock in trade and they may be highly valuable. However, in the case of Brands, which form the lifeline of the Company, there has to be a different approach.

According to an Article that appeared in the Hindu Business Line (of Mr. G. Ramachandran, a financial analyst and Mr. R. Vijay Shankar, Director of SSN School of Management and Computer Applications) “the hands that hold a brand will determine how much value will be created. Therefore, a brand’s value is inestimable. There are no commodity-like, normative valuation methods. Brands will defy any attempts aimed at valuing them. That is what makes brands mystical. They will trample upon the egos of those that are mechanistically minded. Mr. David Haigh, Chief Executive, Brand Finance, and Mr. M. Unni Krishnan, Country Manager, Brand Finance, are of the view that traditional measures of financial performance do not reveal fully the value of brands (*Praxis*, Business Line’s Journal on Management, May 2005). Mr. Haigh and Mr. Krishnan bemoan the fact that earnings per share (EPS) and dividend yield look back rather than forward”.

Cost Approach for valuation of Brands may not help. The cost incurred in the initial years would not have been very high as all resources should have been used up for setting up manufacturing facility and sales force to give customers high quality Products for value and to ensure that customers are happy. In the case of a premium brand, a company may be incurring expenditure in order to capitalize the position and expand the territories and to ward off competition. Therefore for every rupee incurred by the Company on an established brand, returns would be manifold. This enables the Company to introduce the brand for new products and new markets. In order to retain the ability of the Brand to reach an expanded customer base, it is essential that the company have adequate physical resources and a favourable industrial outlook. Thus depending upon the facts and circumstances of each case, suitable method of valuation of the brands should be adopted. In the case of a premium brand, the price of the products that are sold under the premium brand may command a premium price as compared to any other similar product that is sold under an ordinary brand or without any brand. The price differential between the goods carrying premium brand and other similar goods would show the extent of premium the branded goods command. Taking the said premium as an indicator, it is possible to evaluate the value of the brand using the usual cash flow model of valuation. Students should refer to the section on case studies to see a case of typical brand valuation.

JUDICIAL PRONOUNCEMENTS ON VALUATION OF SHARES IN DIFFERENT SITUATIONS

Supreme Court in *CWT v. Mahadeo Jalan* (1972) 86 ITR 621 (SC) observed:

“An examination of the various aspects of valuation of shares in a limited company would lead us to the following conclusion:

- (1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.
- (2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company, then value is determined by

reference to the dividends, if any, reflecting the profit earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value.

The dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

- (3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.
- (4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set back is temporary, then it is perhaps possible to take the estimate of the value of the shares before set back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.
- (5) Where the company is ripe for winding up, then the break-up value method determines what would be realised by that process.

In setting out the above principles, we have not tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case. But, one thing is clear, the market value, unless in exceptional circumstances to which we have referred, cannot be determined on the hypothesis that because in a private limited company one holder can bring into liquidation, it should be valued as on liquidation, by the break-up method.

The yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but nonetheless is one of the methods."

Therefore, generally, in case of amalgamation, a combination of all or some of the well-accepted methods of valuation may be adopted for determining the exchange ratio of the shares of two companies.

The valuation of company shares is a highly technical matter which requires considerable knowledge, experience and expertise in the job. A ratio based on valuation of shares of both the companies done by experts, approved by majority of the shareholders of both the companies and sanctioned by court is an ideal exchange ratio.

Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*

The law on the subject has been well settled by the Supreme Court in *Miheer H.*

Mafatlal v. Mafatlal Industries Ltd. (1996) 4 Comp LJ 124 (SC) where it was held that once the exchange ratio of the shares of the transferee company to be allotted to the holders of shares in the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio of the ground that it will be detrimental to their interest.

Supreme Court in *Hindustan Lever Employees Union v. Hindustan Lever Ltd.*

In *Hindustan Lever Employees Union v. Hindustan Lever Ltd.*, (1994) 4 Comp LJ 267(SC) the Supreme Court held that the court's obligation is to satisfy that the valuation was in accordance with law and the same was carried out by an independent body.

The Supreme Court had explained that the nature of jurisdiction by the court, while considering the question of sanctioning a scheme of arrangement or compromise, is of sentinel nature and is not of appellate nature to examine the arithmetical accuracy of scheme approved by majority of shareholders. While considering the sanction of a scheme of merger, the court is not required to ascertain with mathematical accuracy the terms and targets set out in the proposed scheme. What is required to be evaluated is general fairness of the scheme.

In the matter of *Carron Tea Co. Ltd.*: Although the question of valuation of shares and fixation of exchange ratio is a matter of commercial judgment and the court should not sit in judgment over it, yet the court cannot abdicate its duty to scrutinise the scheme with vigilance. It is not expected of the court to act as a rubber stamp simply because the statutory majority has approved the scheme and there is no opposition to it. The court is not bound to treat the scheme as a *fait accompli* and to accord its sanction merely upon a casual look at it. It must still scrutinise the scheme to find out whether it is a reasonable arrangement which can, by reasonable people conversant with the subject, be regarded as beneficial to those who are likely to be affected by it. Where there is no opposition, the court is not required to go deeper. However, when there is opposition, the court not only will, but must go into the question and if it is not satisfied about the fairness of the valuation, it would be justified in refusing to accord sanction to the scheme as was held by the court in *Carron Tea Co. Ltd.* (1966) 2 Comp LJ: 278 (Cal).

Bank of Baroda Ltd. v. Mahindra Ugine Steel Co. Ltd.

In the matter of *Bank of Baroda Ltd. v. Mahindra Ugine Steel Co. Ltd.*: The jurisdiction of the court in inquiring into the fairness of the exchange ratio cannot be ousted by vote of majority shareholders on the ground that valuation of shares is a matter of commercial judgment – *Bank of Baroda Ltd. v. Mahindra Ugine Steel Co. Ltd.* (1976) 46 Comp Cas 227 (Guj).

ANNEXURE 1

VALUATION OF JYOTIKA EXPORTS – A CASE STUDY

The following is the balance sheet of M/s. Jyotika Exports, which being valued by an acquirer.

**JYOTIKA Exports
Balance Sheet As At**

<i>Liabilities</i>	<i>28/2/08</i> (₹)	<i>31/3/09</i> (₹)
CAPITAL:		
Partner 1		
Partner 2		
Partner 3		
Partner 4		
Partner 5		
Partner 6		
<i>Total Capital</i>	27,134,522	35,925,979
SECURED LOANS:		
SBI - Packing Credit/CC	29,393,313	26,533,211
SBI – FBP	6,631,796	10,012,138
UTI Bank – FBP	2,092,291	
CURRENT LIABILITIES:		
Trade Creditors –Suppliers	9,990,139	9,382,597
Trade Creditors –DGFT	5,553,363	4,394,868
<i>Creditors - Group Concerns:</i>		
JYOTIKA Industries Ltd.	7,265,386	7,493,450
JYOTIKA India	20,351	
ALS Mills	409,655	
TDS/Provision for Tax	<u>270,548</u>	<u>1,594,088</u>
Total Liabilities	<u>88,741,013</u>	<u>95,356,682</u>

Capital & Profits As At 31/12/07

	<i>Capital</i>	<i>Profits</i>	<i>Total</i>
	13.21	14.75	27.96
	19.44	(5.43)	14.01
	19.05	4.57	23.62
	0.19	142.77	142.96
	0.55	126.94	127.49
	0.55	135.00	135.55
	52.99	418.60	471.59

**JYOTIKA Exports
Balance Sheet As At**

<i>Assets</i>	<i>28/2/08</i>	<i>28/2/09</i>
	(₹)	(₹)
<i>FIXED ASSETS (WDV):</i>		
Machinery	334,338	330,420
Computer	4,486	4,486
Car	726,731	726,731
Two Wheelers	<u>24,251</u>	<u>24,251</u>
	<u>1,089,806</u>	<u>1,085,888</u>
<i>INVESTMENTS:</i>		
<i>CURRENT ASSETS:</i>		
Closing Stock	28,563,311	28,217,843
Receivables – Exports	25,923,297	26,503,609
Receivables - Exports (DEPB)	5,553,363	4,394,868
<i>Receivables - Group concerns:</i>		
JYOTIKA Foundation	13,250,000	13,250,000
JIL	1,279,180	
J Texpro	2,075,280	6,009,490
JYOTIKA Finance & Leasing	9,716,790	9,767,005
JYOTIKA Clothing	719	
Padmam Impex	2,491	2,491
ALS Mills		490,196
Cash on hand	383,364	11,207
<i>Cash at Bank:</i>		
SBI – EEFC	73,047	73,047
SBI – Commercial	47,335	1,715
SBI – Current	9,966	9,966
CSB – Current	9,418	9,335
LVB – Current	30,097	7,098
UTI- Current		61,330
<i>Deposits:</i>		
SBI – FD	141,573	187,658
EB Deposit	7,850	7,850
Sales Tax Deposit	3,000	3,000
Excise Duty Receivable		4,681,960
Drawback Receivable	543,521	543,521
Cenvat Receivable	<u>37,605</u>	<u>37,605</u>
Total Assets	<u>88,741,013</u>	<u>95,356,682</u>

The following are the cash flow estimates obtained from the profit and loss account of the firm:

**JYOTIKA Exports
Cash Flow Estimates**

(₹ lacs)

Sl No	Year	Turn- -Over	PBIDT		Dep.	After Tax C/Flow 67%	NWC 3%	Cash Flows
			% of T/O	Amount				
[1]	[2] [3]	[4]	[5]	[6]	[7]	[8]	[9]	
	2007-08	1,677						
1	2008-09	2,500	4.0%	100.00	2.00	65.66	24.69	40.97
2	2009-10	2,750	4.0%	110.00	2.00	72.36	7.50	64.86
3	2010-11	3,025	4.0%	121.00	2.00	79.73	8.25	71.48
4	2011-12	3,328	4.0%	133.10	2.00	87.84	9.08	78.76
5	2012-13	3,660	4.0%	146.41	2.00	96.75	9.98	86.77
6	2013-14	4,026	4.0%	161.05	2.00	106.56	10.98	95.58
	Onwards							

The following are the free cash flows generated from the above estimates:

Free Cash Flow Estimates

(₹ lacs)

Sl No	Year	Cash Flows	Int. on Debt	Invest in P&M	Free Cash Flows	PV @ 15%
[1]	[2]	[3]	[4]	[5]	[6]	[7]
1	2008-09	40.97	0.00	2.00	38.97	33.89
2	2009-10	64.86	0.00	2.00	62.86	47.53
3	2010-11	71.48	0.00	2.00	69.48	45.68
4	2011-12	78.76	0.00	2.00	76.76	43.89
5	2012-13	86.77	0.00	2.00	84.77	42.15
6	2013-14	95.58	0.00	2.00	93.58	357.90
	onwards					
						<u>571.04</u>

The following are the assumptions:

- 1 Turnover for 2007-08 has been estimated at ₹2,500 lacs in view of new markets available on account of quota removal;
- 2 Growth in turnover from 2008-09 onwards has been assumed at 10% per annum;
- 3 Profit before interest, depreciation and tax (PBIDT) has been estimated at 4% of turnover, in line with past trends;
- 4 Tax rate has been assumed at 33%;
- 5 The Net Working Capital (NWC) which is promoters' contribution in financing current assets, has been estimated at 3% of incremental turnover, based on past trends;
- 6 Investment in Plant & Machinery for any year has been taken as equal to the depreciation for that year;
- 7 The projections have been made for the period upto 2013-14. From 2014-15

onwards, a constant growth in cash flow (@2%) has been assumed;

- 8 The capitalization rate (rate of return that is available in the market place on investments that are expected to produce a similar income stream) has been assumed as 15%.

The following is the report submitted by a firm of independent valuers:

To

The Managing Partner,
M/s.Jyotika Exports,
Tiruchengode

We thank you for engaging our firm for valuation of your partnership firm which is proposed to be acquired by a flag ship company which is also one of the entities of your group. Our report is as under:

INTRODUCTION:

JYOTIKA Exports was set up as a partnership firm in 1992 by the promoters of the JYOTIKA group of entities, for tapping the export market for its range of cotton and synthetic textile products. The firm commenced operations during the year 1994.

Within a short period, the firm established a significant presence in various countries for its products, which are exported under the brand name "JYOTIKA".

In the initial stages, the firm had a limited product range and was exporting to a few countries. Over the last 10 years, the firm has widened its product range, entered newer territories and has increased its customer base.

The following table gives the list of the products and the countries to which they are exported:

<i>Sl No</i>	<i>Product</i>	<i>Countries</i>
1	Casuals	UAE
2	Home furnishings	Sri Lanka
3	Water repellent, fire retardant & other industrial textiles.	Europe & UK
4	Surgical towels	USA
5	Terry towels	Saudi Arabia

The turnover of the firm in the first year of operations was around Rs 1.25 crore. This has increased to Rs 16.77 crore during the financial year 2007-08, registering a compounded annual growth in excess of 25%.

The firm has been recognized as an Export House by the Govt. of India.

VALUATION OF THE FIRM:

As part of the consolidation exercise being implemented by the Promoters, the firm is to be acquired by JYOTIKA Industries Ltd. This involves determination of the acquisition price.

Determination of the price based purely on book values may not bring out the following strengths of the firm:

- Widening product range;
- Growing list of countries;
- Growing list of buyers in various countries;
- Brand name;
- Export House status.

Hence, it becomes necessary to rely on other methods of valuation that will adequately capture the above strengths. We have adopted the Free Cash Flow Method of valuation for this purpose.

Under this method, cash flows available to a firm after:

- (a) Meeting commitments towards interest and tax payments;
- (b) Investment in working capital;
- (c) Repayment of long-term debt, if any, and
- (d) Investment in plant & machinery required to maintain the cash flows,

are estimated. The cash flows are then discounted using an appropriate capitalization rate (rate of return that is available in the market place on investments that are expected to produce a similar income stream) to arrive at the value of the business.

The value of the firm based on the free cash flows method comes to Rs 571 lacs. We may round it off as Rs 600 lacs and adopt this as the acquisition price.

Place: For ABC Consultants (P) Ltd.

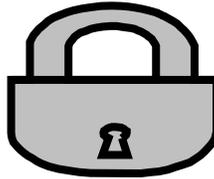
Date: Executive Director

LESSON ROUND-UP

- There are number of situations in which a business or a share or any other property may be repaired to be valued. Valuation is an exercise to assess the worth of an enterprise or a property.
- According to valuation guidelines issued by Ministry of Finance, Department of Economic Affairs, there are three methods of valuation namely net asset value, Profit Earning Capacity value and Market value.

- SEBI (Issue of Sweat Equity) Regulations, 2007 provides for price for the purpose of Sweat Equity Shares.
- SEBI takeover regulations provide for pricing of shares for the purpose of takeover of company.
- SEBI (Employee Stock Option Scheme) Guidelines, 1999 provide for the pricing method where these guidelines are attracted.
- Likewise, SEBI delisting guidelines; Unlisted Public Companies (Preferential Allotment) Rules, 2003; Sweat Equity Rules, 2003; FEMC Transfer or Issue of Security by a person Resident Outside India) Regulation, 2000 provide for pricing of shares.
- MCA has also recommended the valuation principles in its report.
- Many factors have to be assessed to determine fair valuation for an industry, a sector or a company.
- In practice, investors attach a lot of importance to the earnings per shares and the price earning ratio. The product of EPS & P/E ratio is market price per share.
- Valuation is an important aspect in merger and acquisition and it should be done by a team of experts keeping into consideration the basic objectives of acquisition.
- Supreme Court has also held some principles for valuation of shares in some judicial pronouncements.

SELF-TEST QUESTIONS

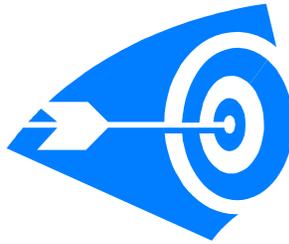


(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What do you mean by 'valuation of shares'? Briefly explain the need of valuation.
2. Narrate briefly the various methods of valuation of shares of a company.
3. What is the relevance of Price Earning Ratio in the valuation of a firm?
4. Describe two theories describing importance of dividend policy in valuation.
5. How the Brands of a Company are Valued?
6. Describe the principals laid down by Supreme Court in case of Miheer Mafat Lal v. Mafatlal Industries Ltd. LJ 124 (SC).
7. Write short notes on *any two* of following:
 - (i) Functions of Brands
 - (ii) Net Assets Value
 - (iii) Market Value for Listed Companies
 - (iv) Recommendations of Shardul Shroff Expert Committee 2002 set up by Ministry of Corporate Affairs.

STUDY VII
CORPORATE DEMERGERS AND REVERSE MERGERS

LEARNING OBJECTIVES



After going through this chapter, you will be able to understand:

- Meaning of demerger, demerged and resulting company
- Difference between demerger and reconstruction
- Legal aspects of demerger
- Spin off and split off
- Modes of demerger
- Importance of appointed date
- Procedural aspects
- Taxation aspects
- Reverse merger

INTRODUCTION

In the era of globalization, corporates all over the world are moving towards consolidation and redefining core competencies to survive and achieve their objectives. The corporate sector in India is also resorting to various mechanism of corporate restructuring to improve efficiency. Over the last few years, different modes of corporate restructuring such as stock splits, capital restructuring, mergers and acquisitions etc. have been adopted by companies in India.

Companies have to downsize or 'contract' their operations in certain circumstances such as when a division of the company is performing poorly or simply because it no longer fits into the company's plans or to give effect to rationalisation or specialisation in the manufacturing process. This may also be necessary to undo a previous merger or acquisition which proved unsuccessful. This type of restructuring can take various forms such as demerger or spin off, split off, etc.

Large entities sometimes hinder entrepreneurial initiative, sideline core activities, reduce accountability and promote investment in non-core activities. There is an increasing realisation among companies that demerger may allow them to strengthen their core competence and realise the true value of their business.

DEMERGER UNDER THE COMPANIES ACT, 1956

The expression demerger is not expressly defined in the Companies Act, 1956. However, it is covered under the expression 'arrangement' as defined in clause (b) of Section 390 of the Companies Act, 1956. According to this definition, 'arrangement' includes a re-organisation of the Share Capital of the Company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both these methods. Such divisions may take place for various reasons internal or external. Internal factors are generally split in family rather than lack of competence on the part of management.

The Companies Act does not contain the concept of 'de-merger' as such, but indirectly, it does recognize it in the following sections–

- (a) Section 391/394 – as a scheme of compromise, arrangement or reconstruction; and
- (b) Section 293(1)(a) – sale, lease or otherwise dispose of –
 - the whole of the undertaking of the company; or
 - substantially the whole of the undertaking of the company; or
 - if the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking.

DIFFERENCE BETWEEN DEMERGER AND RECONSTRUCTION

As has been discussed above “demerger” means transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by the demerged company of its one or more undertakings to a new company formed for the purpose, known as the 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 by virtue of the demerger; all the liabilities relating to the undertaking, being transferred by the demerged company become the liabilities of resulting company by virtue of the demerger; 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 demerger; the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis; the shareholders holding not less than three fourths in value of the shares in the demerged company become shareholders of the resulting company or companies by virtue of the demerger; the transfer of the undertaking is on a going concern basis; the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72 A by the Central Government in this behalf.

In the case of reconstruction, a new company (hereinafter referred to the transferee company) is formed, the existing company (hereinafter referred to the 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, instead of paying cash in lieu of their shares in the transferor company, issues and allots its shares to the shareholders of the transferor company in accordance with the pre-determined shares exchange ratio. In this

process, the old company is demolished and is reconstructed in the form of new company with substantially the same shareholders and the same undertaking and business.

Forms of Demergers

- *Divestitures* — These are sale of a segment of a company for cash or for securities to an outsider party.
- *Spin Off* — In this type of demerger the holding company distributes on a pro-rata basis all the shares it owns in a controlled subsidiary company to its shareholders. By this way both the Companies i.e. holding as well as subsidiary company exist and carry on business.
- *Equity carved out* — In spin off, distribution is made to shareholders of the parent company as a dividend in non cash form. While in Equity carved out some (minority) part of shareholding of subsidiary company is sold out to the public by an offer for sale and parent company continues to enjoy control over the subsidiary company by holding controlling interest.
- *Split off* — Shareholders of parent company get shares in the subsidiary company in exchange of their shares in parent company. It is a kind of reorganisation of controlling interest.
- *Split up* — The division of a company into two or more parts through transfer of stock is called split up. In case of split up the parent company ceases to exist after demerger.

TYPES OF DEMERGER

Partial Demerger

In a partial demerger, one of the undertakings or a part of the undertaking or a department or a division of an existing company is separated and transferred to one or more new company/companies, formed with substantially the same shareholders, who are allotted shares in the new company in the same proportion as the separated division, department etc. bears to the total undertaking of the company.

Complete Demerger

In the first case, i.e. in the case of partial demerger, the existing company also continues to maintain its separate legal identity and the new company, a separate legal identity, carries on the separated or spun off business and undertaking of the existing company.

In a complete demerger, an existing company transfers its various divisions, undertakings etc. to one or more new companies formed for this purpose. The existing company is dissolved by passing a special resolution for members' voluntary winding up and also authorising the liquidator to transfer its undertakings, divisions etc. to one or more companies as per the scheme of demerger approved by the shareholders of the company by a special resolution. The shareholders of the dissolved company are issued and allotted shares in the new company or companies, as the case may be, on the basis of the pre-determined shares exchange ratio, as per the scheme of demerger.

In the case of complete demerger, the existing company disappears from the corporate scene. It is voluntarily wound up and its entire business, undertakings etc. are transferred to one or more new companies.

WAYS OF DEMERGER

Demerger could be affected by either of the following three ways:

- (i) Demerger by agreement between promoters; or
- (ii) Demerger under the scheme of arrangement with approval by the court under section 391;
- (iii) Demerger under voluntary winding up and the power of liquidator.

(i) Demerger by agreement

English Law is quite exhaustive on 'demerger'. While 'demerger is affected by agreement' and original company is wound up after division, it was held in *Cardiff Preserved Coal and Coke Co. v Norton* (1867) 2 Ch. App 405 that the liquidator has no power to dispute the validity of the transaction. He cannot require its shareholders to transfer to him the shares which the shareholders have been allotted in the new company or companies so that he may sell them and use the proceeds for paying the original company's debts.

The only remedy available to the liquidator and to unpaid creditors of the original company is to require the new company to apply the assets in satisfying the debts and liabilities of the original company. This right appears to be derived from the equitable rules relating to tracing assets, and it seems that the right is available to the original company's creditors, even though they cannot prove that the original company's directors or shareholders had any intent to defraud them.

This right might be lost to creditors against the new company in case of novation agreement, if any, between the purchasing company and the creditors of the original company. By such an agreement, the purchasing company may agree to indemnify the original company against claims by its creditors and make an offer to the creditors to meet their claims. If a creditor then accepts the liability of the new company, there will be a novation, and the creditor's rights against the original company will cease.

Further, the English law support that in such events where the creditor accepts an undertaking from the purchasing company for honouring the original company's obligations, or if he accepts a benefit from the purchasing company to which he is not entitled under his contract with the original company, there will be a novation and the original company's liability will be discharged.

Section 395 of the Companies Act, 1956 protects the interest of the shareholders dissenting from scheme or contract approved by majority even in the cases of demergers or divisions.

(ii) Demerger under a Scheme of Arrangement

The law with respect to a scheme of demerger or division is the same as it is with respect to a scheme for a reconstruction, amalgamation or merger. In case of amalgamation, a scheme of amalgamation is required to be got approved by the

respective High Courts of the amalgamating and amalgamated company. Similarly, a company can be demerged or split into, through a scheme of demerger or division with the sanction of respective High Courts under the provisions of the Companies Act, 1956. The Memorandum of Association of the Company must contain provisions of demerger or split in order to accomplish the same.

(iii) Demerger and Voluntary Winding up

A company, which has split into several companies after division can be wound up voluntarily pursuant to Section 484 to 498 of the Companies Act, 1956.

Section 494 of the Companies Act provides that where a company (referred to as the transferor company) is proposed to be or is in the course of being wound up voluntarily; and the whole or any part of its business or property is proposed to be transferred or sold to another company (referred to as the transferee company); the liquidator of the transferor company may, with the sanction of a special resolution of that company conferring on the liquidator either a general authority or an authority in respect of any particular arrangement, receive, by way of compensation or part compensation for the transfer or sale, shares, policies, or other like interests in the transferee company, for distribution among the members of the transferor company; or enter into any other arrangement whereby the members of the transferor company, may, in lieu of receiving cash, shares, policies or other like interests or in addition thereto, participate in the profits of or receive any other benefit from the transferee company.

The sale or arrangement in pursuance of this section is binding on the members of the transferor company.

PROCEDURAL ASPECTS OF DEMERGER

Scheme must be within company's powers

The court cannot sanction a scheme of compromise or arrangement which is beyond the powers of the company as defined in its Memorandum of Association. In such an event, the company should first take steps for alteration of the relevant clauses in its Memorandum and thereafter propose a scheme of compromise or arrangement and make an application for the court's sanction.

Res judicata

Where a proposed scheme of compromise or arrangement has already been rejected by the court and the same persons propose another scheme which is substantially the same as the earlier one, the general principle of *res judicata* applies to bar the second scheme.

Rules and Forms in respect of Scheme of Demerger

The procedure for convening, holding and conducting class meetings for affecting demerger, is laid down in rules 67 to 87 of the Companies (Court) Rules, 1959. The Rules also set out the following forms for various purposes:

Form No. 33 Summons for directions to convene a class meeting under Section 391 — Rule 67.

<i>Form No. 34</i>	Affidavit in support of summons — Rule 67.
<i>Form No. 35</i>	Order on summons for directions — Rule 69.
<i>Form No. 36</i>	Notice convening meeting — Rule 73.
<i>Form No. 37</i>	Form of proxy — Rule 73.
<i>Form No. 38</i>	Advertisement of Notice convening meeting of creditors/ shareholders etc. — Rule 74.
<i>Form No. 39</i>	Report by Chairman of the meeting — Rule 78.
<i>Form No. 40</i>	Petition to sanction the scheme of compromise or arrangement — Rule 79.
<i>Form No. 41</i>	Order on petition Rule 81

Steps to be taken for Demerger

1. Preparation of scheme of demerger
 - (i) Prepare a scheme of demerger in consultation with all interested parties and have the same approved in principle by the Board of Directors of the company at a meeting.
 - (ii) Appoint an expert for valuing the shares to determine the share exchange ratio.
 - (iii) Engage an advocate for the preparation of scheme and for appearing subsequently before the High Court.
 - (iv) In case of listed companies, the stock exchanges where the shares are listed should be intimated.

2. Application to court for direction to hold meetings of members/creditors

Both the companies should make an application under Section 391(1) of the Companies Act, 1956 to respective High Courts for an order to convene and hold meeting(s) of members/creditors or any class of them, by a Judge's summons supported by an affidavit. A copy of the proposed scheme of demerger should be annexed to the affidavit as an exhibit thereto. The summons should be moved ex parte. The summons should be in Form No. 33 and the affidavit in support thereof in Form No. 34 ? [Rule 67 of the Companies (Court) Rules, 1959].

Save as provided in Rule 68, the summons shall be moved ex-parte. When the company is not the applicant, a copy of summons and of affidavit shall be served on the company or where it is being wound up, on its liquidator, not less than 14 days before the date fixed for hearing the summons. Application is to be filed to the High Court, where the Registered Office is situated, for directions to convene a meeting along with the following documents:

1. Judge's Summons [Form No. 33] under order XIV.
2. An affidavit in support of summons in Form No. 34 of Companies (Court) Rules, 1959.

3. Memorandum and Articles of Association of the company.
4. Latest Audited Balance Sheet.
5. List of Shareholders and Creditors (Optional) Scheme.
6. Extract of Board Resolution approving the scheme.
7. Draft notice of meeting, explanatory statement, proxy under Section 393 of Act.

(Above documents are to be prepared separately for both transferor and transferee companies and any Director may be authorized to sign the applications).

Normally, an application under Section 391 of the Act is made by the company, but a creditor or member may also make the application. Although a creditor or a member may move an application under Section 391(1) of the Act, yet, such an application may not be accepted by court because the scheme of arrangement submitted to the court along with the application will not have the approval of the Board of directors of the company or of the company in general meeting. However, the court has the discretion to give whatever directions that it may deem proper.

Before an application under Section 391 of the Act is made by a company, as a matter of common procedure, the Chairman of the Board of directors of the company which is proposed to be reconstructed by demerger should send a circular letter to the members of the company explaining details of the scheme of reconstruction and the reasons which have prompted the Board to propose reconstruction. The circular letter should specify how the scheme would affect the shareholdings of the members. Copies of the circular should also be sent to the stock exchanges, where the shares of the company or companies are listed.

The petition must pray for appropriate orders and directions under Section 394 of the Act for facilitating the reconstruction (by demerger) of the company.

3. Obtaining court's order for holding meetings of members/creditors

On receiving a petition the court may order meeting(s) of the members/creditors of the company, to be called, held and conducted in a prescribed manner. Once the ordered meeting(s) is/are duly convened, held and conducted and the scheme is approved by the prescribed majority in value of the creditors or number of members, as the case may be, the court is bound to sanction the scheme.

The court shall look into the fairness of the scheme before ordering meeting(s) because it would be no use putting before the meeting(s), a scheme containing proposals which are not capable of being implemented. At that stage, the court may refuse to pass an order for the convening of the meeting(s).

The court must also ensure that the circular about the details of the scheme which is sent to the members and creditors should give a fair picture of the proposed scheme.

Upon the hearing of the summons, or any adjourned hearing thereof, the judge shall, unless he thinks fit for any reason to dismiss the summons, give directions as he may think necessary in respect of the following matters:

- (i) determining the class or classes of creditors and/or members whose meeting or meetings have to be held for considering the proposed scheme of demerger;
- (ii) fixing the time and place for such meeting or meetings;
- (iii) appointing a Chairman or Chairmen for the meeting or meetings to be held, as the case may be;
- (iv) fixing the quorum and procedure to be followed at the meeting or meetings, including voting by proxy;
- (v) determining the values of the creditors and/or the members, or the creditors or members of any class, as the case may be whose meetings have to be held;
- (vi) notice to be given of the meeting or meetings and the advertisement of such notice; and
- (vii) the time within which the Chairman of the meeting or Chairmen of the meetings should report to the Court the result of the meeting or meetings, as the case may be;

and such other matters as the Court may deem necessary.

The order made on the summons should be in Form No. 35 of the Court Rules, with such variations as may be necessary. Within 3 days of orders being received by the Companies from the Court, the companies are required to get the draft explanatory statement, notice of meeting, draft resolutions, proxy forms, publication also translated in regional language in Form No. 38 vouched by Registry of High Court.

An application under Sub-section (6) of Section 391 for stay of commencement or continuation of any suit or proceeding against the company may be moved by a Judge's summons ex-parte, provided where a petition for winding up or that under Section 397 or 398 is pending, notice of application shall be given to petitioner where a stay order has been made. Any person aggrieved by such order may apply to the court by a Judge's summons to vacate or vary such order.

4. Notice of the meetings of members/creditors

After obtaining the court's order containing directions to hold the meeting(s) of the creditors/members of company, the company should make arrangement for the issue of notice of the meeting(s) to them. The notice of such meeting(s) should be sent individually in Form No. 36 of the said rules and must be sent by the person authorised by the court in this behalf, who may be the Chairman appointed by the court for the meeting, or if the court so directs, by the company or by any other person as the court may direct. The notice should be sent by post under certificate of posting to their last known address at least twenty-one clear days before the date fixed for the meeting. The notice must be accompanied by a copy of the scheme for the

proposed demerger and of the statement required to be furnished under Section 393 setting forth the terms of the proposed compromise or arrangement explaining its effects, and a form of proxy in Form No. 37 of the said rules. According to Rule 70 voting by proxies shall be permitted provided a proxy in the prescribed form duly signed by the person entitled to attend and vote at the meeting is filed with the company at its registered office not later than 48 hours before the meeting. Also Rules 227 to 229 relating to proxies apply to proxies lodged under this rule.

The notice must particularly disclose any material interest of the directors, managing director or manager whether as shareholders or creditors or otherwise and the effect on their interests of the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons. Such information must also be included in the form of a statement in the notice convening the meeting, where such notice is given by advertisement, or, if this is not practicable, such advertised notice must give notification, of the place at and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement. If debenture holders are affected, the statement referred to must give like information as far as it affects the trustees for the debenture holders. Statements which have to be supplied to creditors and members as a result of press notification must be supplied by the company to those entitled, free of charge. (Section 393)

The notice of the meeting shall be advertised in such newspapers and in such manner as the Judge may direct, not less than 21 clear days from the date fixed for the meeting. Advertisement shall be in Form No. 38.

Every creditor or member entitled to attend the meeting shall be furnished by the company, free of charge and within 24 hours of a requisition being made for the same, with a copy of the proposed compromise or arrangement together with a copy of the statement required to be furnished, unless the same had already been furnished to such member/creditor.

According to Rule 76, the Chairman appointed for the meeting or other person directed to issue the advertisement and the notices of the meeting shall file an affidavit not less than seven days before the date fixed for the holding of the meeting or first of the meetings, showing that the directions regarding the issue of notices and the advertisement have been duly complied with. Along with the affidavit, the paper publications, one in English and another in vernacular daily and proof of certificate of posting are to be filed one week before the date of meeting.

5. Holding meeting(s) of members/creditors

Pursuant to the directions, the meeting(s) should be held. The chairman of the meeting, or where there are separate meetings, the chairman of each meeting, shall report the result thereof to the court. The report shall state accurately the number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present and who voted at the meeting either in person or by proxy, their individual values and the way they voted.

6. Reporting the result of the meeting by the Chairman to the court

The result of the meeting must be decided only by taking poll and by separately counting the votes in favour and against the resolution. The chairman of the meeting should within the time fixed by the court or where no time has been fixed, within seven days after the conclusion of the meeting, report the result of the meeting in the prescribed Form 39 to the Court. (Rule 78)

7. Petition to the court for sanctioning the scheme of demerger

When the scheme of demerger has been approved by the required majority of shareholders/creditors, i.e. majority in number representing three-fourths in value of the creditors, or class of creditors, or members or class of members, as the case may be, present and voting either in person, or, where proxies are allowed, by proxy, at the meeting, a petition must be made to the court for sanctioning the scheme of demerger. The petition must be made by the company. The petition is required to be made in Form No. 40 of the said rules. The following documents are necessary for enabling the High Court to sanction the scheme: (Rule 79)

- (a) Company Petition (Form No. 40 with Court Fee).
- (b) An affidavit verifying petition in Form No. 3.
- (c) Scheme.
- (d) Memorandum and Articles of Association.
- (e) Audited Accounts.
- (f) Independent professional valuers' report.
- (g) Copy of the Chairman's Report in Form No. 35.
- (h) Six copies of Form No. 5 being the advertisement of petition and Form No. 6 being the notice of petition to be issued to Regional Director, Department of Company Affairs and Registrar of Companies.

The Court shall fix a date for the hearing of the petition, and notice of hearing shall be advertised in the same papers in which notice of the meeting was advertised, or in such other papers, as the court may direct not less than 10 days before the date fixed for hearing.

8. Obtaining order of the court sanctioning the scheme

Obtain an order of the court sanctioning the scheme of demerger. Where the Court sanctions the compromise or arrangement, the order shall include such directions in regard to any matter and such modifications as the Judge may think fit. The order shall direct that a certified copy of the same shall be filed with the Registrar of Companies within 14 days from the date of the order or such other time as may be fixed by the Court. (Rule 81)

9. Court's order on petition sanctioning the scheme of demerger

Section 394 of the Act provides that where the application is made to the court under Section 391 for the sanctioning of a scheme proposed between a company and its shareholders and it is shown to the court:

- (a) that the demerger has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company; and
- (b) that under the scheme the whole or any part of the undertaking, property or liabilities of any company (the transferor company) concerned in the scheme is to be transferred to another company (the transferee company),

the court may either by the order sanctioning the scheme of demerger or by a subsequent order, make provision for all or any of the following matters:

- (i) The transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of the transferor company.
- (ii) The allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company to be allotted or appropriated by the company to or for any person.
- (iii) The continuation by or against the transferee company of any legal proceedings pending by or against any transferor company.
- (iv) Such incidental, consequential and supplemental matters as are necessary to secure that the demerger shall be fully and effectively carried out.

However, no order sanctioning any compromise or arrangement shall be made by the court unless the court is satisfied that the company or any other person by whom an application has been made has disclosed to the court, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 to 251 and the like.

The order made by the court will have effect only after a certified copy has been filed with the Registrar of Companies in e-form 21 and will be binding on all the creditors/members, or all the creditors/members of the class, as the case may be and also on the company or, in the case of a company which is being wound up, on the liquidator and contributories of the company.

TAX ASPECTS OF DEMERGER

Meaning of Demerger

The word demerger has been defined in Section 2(19AA) of the Income-tax Act, 1961 as follows :

“demerger”, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956) by a demerged company of its one or more undertakings to any 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 the demerger;

- (ii) all the liabilities relating 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 demerger 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;
- (v) the shareholders holding not less than three-fourths in value of the 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 company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1. – For the purposes of this clause, “undertaking” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2. – For the purposes of this clause, the liabilities referred to in sub-clause (ii), shall include-

- (a) the liabilities which arise out of the activities or operations of the undertaking;
- (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3. – For the determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4. – For the purposes of this clause, the splitting up or the reconstruction of any authority of a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfills such conditions as may be notified in the Official Gazette by the Central Government.

Meaning of Demerged Company

According to section 2(19AAA) 'demerged company' means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

Meaning of Resulting Company

According to section 2(41A) '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.

Tax concession/incentives in case of demerger

If any demerger takes place within the meaning of section 2(19AA) of the Income-tax Act, the following tax concessions shall be available to:

1. Demerged company.
2. Shareholders of demerged company.
3. Resulting company

These concessions are on similar lines as are available in case of amalgamation. However some concessions available in case of amalgamation are not available in case of demerger.

1. Tax concession to demerged company

- (i) Capital gains tax not attracted [Section 47(vib)]

According to section 47(vib), where there is a transfer of any capital asset in case of a demerger by the demerged company to the resulting company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the resulting company is an Indian company.

- (ii) Tax concession to a foreign demerged company [Section 47(vic)]

Where a foreign company holds any shares in an Indian company and transfers the same, in case of a demerger, to another resulting foreign company, such transaction will not be regarded as transfer for the purpose of capital gain under section 45 if the following conditions are satisfied:

- (a) at least seventy-five per cent of the shareholders of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.
- (iii) Reserves for shipping business: Where a ship acquired out of the reserve is transferred in a scheme of demerger, even within the period of eight years of acquisition there will be no deemed profits to the demerged company.

2. Tax concessions to the shareholders of the demerged company [Section 47(vid)]

Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company shall not be regarded as a transfer if the transfer or issue is made in consideration of demerger of the undertaking.

In the case of demerger the existing shareholder of the demerged company will hold after demerger:

- (a) shares in resulting company; and
- (b) shares in demerged company.

and in case the shareholder transfers any of the above shares subsequent to the demerger, the cost of such shares shall be calculated as under:—

Cost of acquisition of shares in the resulting company [Section 49(2C)]:

It shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

Cost of acquisition of shares in the demerged company [Section 49(2 D)]:

The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under section 49(2C) above.

For the above purpose net worth shall mean the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Period of holding of shares of the resulting company [Section 2(42A)(g)]:

In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

3. Tax concession to the resulting company

The resulting company shall be eligible for tax concessions only if the following two conditions are satisfied:

- (i) The demerger satisfies all the conditions laid down in section 2(19AA); and
- (ii) The resulting company is an Indian company.

The following concessions are available to the resulting company pursuant to a scheme of demerger:

- (a) Expenditure on acquisition of patent rights or copy rights [Section 35A(7)]

Where the patent or copyrights acquired by the demerged company is

transferred to any resulting Indian company, the provisions of section 35A which were applicable to the demerged company shall become applicable in the same manner to the resulting company consequently:

- (i) The expenditure on patents copyrights not yet written off shall be allowed to the resulting company in the same number of balance instalments.
- (ii) Where such rights are later on sold by the resulting company, the treatment of the deficiency/surplus will be same as would have been in the case of demerger company.

However, if such expenditure is incurred by the demerged company after 31-3-1998, deduction under section 35A is not allowed, as such expenditure will be eligible for depreciation as intangible asset. In this case, provisions of depreciation shall apply.

(b) Expenditure on know-how [Section 35AB(3)]

W.e.f. assessment year 2000-2001, where there is a transfer of an undertaking under a scheme of demerger, the resulting company shall be entitled to claim deduction under section 35AB in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the demerger company, had such demerger not taken place.

However, if such expenditure is incurred by the demerger company after 31-3-1998, deduction under section 35AB is not allowed, as such expenditure will be eligible for depreciation as intangible asset. In this case provisions of depreciation shall apply.

(c) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB(7)]

Where in a scheme of demerger, the demerged company sells or otherwise transfer its licence to the resulting company (being an Indian company), the provisions of section 35ABB which were applicable to the demerged company shall become applicable in the same manner to the resulting company, consequently:

- (i) The expenditure on acquisition of licence, not yet written off, shall be allowed to the resulting company in the same number of balance instalments.
- (ii) Where such licence is sold by the resulting company, the treatment of the deficiency/surplus will be same as would have been in the case of demerger company.

(d) Treatment of preliminary expenses [Section 35D(5A)]

Where the undertaking of an Indian company which is entitled to deduction of preliminary expenses is transferred before the expiry of ten years/5 years, as the case may be, to another company in a scheme of demerger, the preliminary expenses of such undertaking which are not yet written off shall be allowed as deduction to the resulting company in the same manner as would have been allowed to the demerged company. The demerged company will not be entitled to the deduction thereafter.

- (e) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E(7A)]

Where the undertaking of an Indian company which is entitled to deduction on account of prospecting of minerals, is transferred before the expiry of period of 10 years to another company in a scheme of demerger, such expenditure of prospecting, etc. which is not yet written off shall be allowed as deduction to the resulting company in the same manner as would have been allowed to the demerged company.

The demerged company will not be entitled to the deduction thereafter.

- (f) Treatment of bad debts [Section 36(1)(vii)]

Where due to demerger the debts of the demerged company have been taken over by the resulting company and subsequently by such debt or part of debt becomes bad such bad debt will be allowed as a deduction to the resulting company. This is based upon the decision of the Supreme Court in the case of *CIT v. Veerabhadra Rao (T.), K. Koteswara Rao & Co.* (1985) 155 ITR 152 (SC) which was decided in the case of amalgamation of companies.

- (g) Amortisation of expenditure in case of demerger [Section 35DD]

Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the demerger takes place.

No deduction shall be allowed in respect of the expenditure mentioned in sub-section (1) under any other provision of this Act.

- (h) Carry forward and set off of business losses and unabsorbed depreciation of the demerged company [Section 72A(4) & (5)]

The accumulated loss and unabsorbed depreciation, in a demerger, should be allowed to be carried forward by the resulting company if these are directly relatable to the undertaking proposed to be transferred. Where it is not possible to relate these to the undertaking, such loss and depreciation shall be apportioned between the demerged company and the resulting company in proportion of the assets coming to the share of each as a result of demerger.

In Central Government may, for the purposes of this Act, by notification in the Official Gazette, specifying such conditions on it considers necessary to ensure that the demerger is for genuine business purpose.

- (i) Deduction available under section 80-1A(12) or 80-1B(12)

Where an undertaking which is entitled to deduction under section 80-1A (12)/80-1B (12) is transferred before the expiry of the period to another Indian company in a scheme of amalgamation or dermerger –

- (i) no deduction under section 80-1A(12)/80-1B(12) shall be available to the demerged company for the previous year in which amalgamation

takes place; and

- (ii) the provisions of section 80-1A (12)/80-1B(12) shall apply to the resulting company in such manner in which they would have applied to the demerged company.

RECENT JUDICIAL PRONOUNCEMENTS ON DEMERGER

Disclosure of Ratio of Exchange of Shares

In Mercury Containers (P.) Ltd., [2010] 98 SCL 43 (ALL.), High Court Of Allahabad, Petitioner-company/demerged-company filed a petition under section 391 for sanction of proposed scheme of its demerger - Pursuant to an order of Court, meeting of creditors of demerged company was convened and they unanimously approved proposed scheme of demerger - Advertisement of petition was published in newspapers and notices were issued to Official Liquidator and Regional Director - Official Liquidator had no objection to proposed scheme - However, Regional Director had objected to proposed scheme by stating that ratio of exchange of shares had not been disclosed - It was found that objection in respect of ratio of exchange of shares had been explained before authorities – It was held that scheme of arrangement or demerger was in interest of shareholders/creditors of companies, proposed scheme was to be approved

Application of AS-14 to Demergers

In Gallops Realty (P.) Ltd., In re [2010] 97 SCL 93 (GUJ.), High Court Of Gujarat

Petitioner-companies, i.e., demerged company and resulting company, sought for sanction of composite scheme of arrangement in nature of purchase of shares and demerger of hotel business of demerged company to resulting company and consequent reconstruction of share capital of demerged company under section 391, read with sections 394, 78 and 100 consisting of reduction of paid-up share capital as well as utilization of share premium account –

Meetings of equity shareholders of both companies and unsecured creditors of demerged company had been dispensed with in view of their written consent - Regional Director stated that as per the scheme, capital profit on demerger would be transferred to general reserve in books of resulting company which was not in consonance with generally accepted accounting principles as also Accounting Standard- 14 which provide that any profit arising out of a capital transaction, like merger or demerger, ought to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve - Whether observation of Regional Director was not in consonance with accounting principles in general and Accounting Standard-14 in particular, as Accounting Standard-14 is applicable only in case of amalgamation and not in case of demerger, as envisaged in instant scheme – It was held that since proposed scheme of arrangement was in interest of companies and their members, same was to be sanctioned.

REVERSE MERGER

It must be understood at the outset that amalgamation and merger are corporate restructuring methods. Both the terms are synonymous. The procedure to be adopted for both is the same and the consequences of both are also the same. For achieving

amalgamation as well as merger, an existing company (which is referred to as the “amalgamating or merging or transferor company”), under a scheme of amalgamation or merger, loses its own legal identity and is dissolved without being wound up and its assets, properties and liabilities are transferred to another existing company (which is referred to as the “amalgamated or merged or transferee company”).

Generally, a loss making or less profit earning company merges with a company with track record, to obtain the benefits of economies of scale of production, marketing network, etc. This situation arises when the sick company's survival becomes more important for strategic reasons and to conserve the interest of community.

In a reverse merger, a healthy company merges with a financially weak company. The main reason for this type of reverse merger is the tax savings under the Income-Tax Act, 1961. 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. In the context of the Companies Act, 1956 there is no difference between a merger and a reverse merger. It is like any amalgamation. 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.

To save the Government from social costs in terms of loss of production and employment and to relieve the Government of the uneconomical burden of taking over and running sick industrial units, Section 72A was introduced in Income Tax Act, 1961.

Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc.

Section 72A of Income Tax Act, 1961 is meant to facilitate rejuvenation of sick industrial undertaking by merging with healthier industrial companies possessing incentives of tax savings, to benefit the general public through continued productivity, increased avenues for employment and revenue generation.

The provisions of Section 72A relating to reverse merger are given hereunder.

(1) Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company referred to in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was reflected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

W.e.f. 1.4.2008 (A.Y. 2009-10):

- (1) Where there has been an amalgamation of—
 - (a) a company owning an industrial undertaking or a ship or a hotel with another company; or
 - (b) a banking company referred to in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or
 - (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,

then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

(2) Notwithstanding anything contained in Sub-section (1), the accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless—

- (a) the amalgamating company—
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
- (b) the amalgamated company—
 - (i) holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
 - (iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

(3) In a case where any of the conditions laid down in Sub-section (2) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

(4) Notwithstanding anything contained in any other provisions of this Act, in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall—

- (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

(5) The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

(6) Where there has been reorganization of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in clause (xiii) of Section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in clause (xiv) of Section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganization was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:

Provided that if any of the conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) to Section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

(7) For the purposes of this section,—

- (a) “accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of Section 72 if the reorganization of business or amalgamation or demerger had not taken place;
- (aa) “industrial undertaking” means any undertaking which is engaged in—
 - (i) the manufacture or processing of goods; or
 - (ii) the manufacture of computer software; or
 - (iii) the business of generation or distribution of electricity or any other form of power; or
 - (iiia) the business of providing telecommunication services, whether basic or

cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or

- (iv) mining; or
- (v) the construction of ships, aircrafts or rail systems;
- (b) “unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganization of business or amalgamation or demerger had not taken place;
- (c) “specified bank” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955) or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959) or a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980).

In the discussion that follows, “reverse merger” means “reverse amalgamation” and vice versa. SICA used the term “amalgamation”, which means “merger” also.

Salient features of reverse mergers under Section 72A

1. Amalgamation should be between the companies and none of them should be a firm of partners or sole-proprietor. In other words, partnership firm or sole-proprietary concerns cannot get the benefit of tax relief under Section 72A merger.

2. The companies entering into amalgamation should be engaged in either industrial activity or shipping business or hotel with another company or banking business under Section 5(c) of the Banking Regulation Act, 1949 or Public Sector Companies engaged in the business of operation of aircraft. In other words, the tax relief under Section 72A would not be made available to companies engaged in trading activities or services.

3. After amalgamation, the “sick” or “financially unviable company” shall survive and the other income generating company shall extinct. In other words, essential condition to be fulfilled is that the acquiring company will be able to revive or rehabilitate having consumed the healthy company.

4. One of the merger partner should be financially unviable and have accumulated losses to qualify for the merger and the other merger partner should be profit earning so that tax relief to the maximum extent could be had. In other words, the company which is financially unviable should be technically sound and feasible, commercially and economically viable but financially weak because of financial stringency or lack of financial resources or its liabilities have exceeded its assets and is on the brink of insolvency. The second requisite qualification associated with financial unviability is the accumulation of losses for past few years.

5. Amalgamation should be in the public interest i.e. it should not be against

public policy, should not defeat the basic tenets of law, and must safeguard the interest of employees, consumers, customers, creditors and shareholders apart from the promoters of the company through the revival of the company.

6. The merger should result into the following benefits to the amalgamated (acquired/target) company i.e. (a) carry forward of accumulated business losses of the amalgamating company; (b) carry forward of unabsorbed depreciation of the amalgamating company and (c) accumulated loss would be allowed to be carried forward and set off for eight subsequent years under Section 72A of the Income-tax Act, from the A.Y. 2009-10, the accumulated loss or the case may be, allowance for unabsorbed depreciation of amalgamating company shall be deemed to be the loss or as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Income Tax Act relating to set off and carry forward of loss and allowance for depreciation.

7. Accumulated loss should arise from "Profits and Gains from business or profession" and not be loss under the head "Capital Gains" or "Speculation".

8. For qualifying carry forward loss, the provisions of Section 72 should not have been contravened.

9. Similarly for carry forward of unabsorbed depreciation the conditions of Section 32 should not have been violated.

10. Specified Authority has to be satisfied of the eligibility of the company for the relief under Section 72 of the Income-tax Act. It is only on the recommendation of the specified authority that Central Government may allow the relief.

11. The company should make an application to the "specified authority" for requisite recommendation of the case to the Central Government for granting or allowing the relief.

12. Procedure for merger or amalgamation to be followed in such cases is the same as discussed above. Specified Authority makes recommendation after taking into consideration the court's direction on scheme of amalgamation.

Concept of reverse merger under SICA

Section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) provides for the preparation and sanction of schemes of rehabilitation of sick industrial companies, which are registered with the Board for Industrial and Financial Reconstruction (BIFR).

Sub-section (1) of Section 18 lays down that where an order is made under Section 17(3) in relation to any sick industrial company, the operating agency specified in the order shall prepare, as expeditiously as possible and ordinarily within ninety days from the date of such order, a scheme with respect to such company providing for specified measures.

One of the measures, which is mentioned in clause (c) to Sub-section (1) of Section 18 reads as:

“The amalgamation of—

- (i) the sick industrial company with any other company, or
- (ii) any other company with the sick industrial company (hereinafter in this section, in the case of sub-clause (i), the other company, and in the case of sub-clause (ii), the sick industrial company, referred to as “transferee company”).

The concept is that while ordinarily a sick and economically weak company seeks the support and strength of a healthy and fit company by amalgamating itself with such a company. In a reverse merger, a healthy, strong and economically viable company amalgamates itself with a sick and economically weak company, thereby giving up its own identity to the sick company.

Relevant extracts of certain other provisions, of the Act, which provide for amalgamation or merger or reverse merger are produced hereunder —

Section 18(2): The scheme may provide, inter alia, for the following:

- (i) Alteration of the memorandum or articles of association of the sick industrial company or the transferee company for the purpose of altering the capital structure thereof, or for such other purposes as may be necessary to give effect to the reconstruction or amalgamation.
- (ii) Any other terms and conditions for the reconstruction or amalgamation of the sick industrial company.
- (iii) Such incidental, consequential and supplemental matters as may be necessary to secure that the reconstruction or amalgamation or other measures mentioned in the scheme are fully and effectively carried out.

Section 18(3)(a):

The scheme prepared by the operating agency shall be examined by the BIFR and copies of the scheme with modifications, if any, made by BIFR, shall be sent to the sick industrial company, the operating agency and in case of amalgamation, also to any other company concerned and the BIFR shall also publish or caused to be published the draft scheme in brief in such daily newspapers as the BIFR may consider necessary for suggestions and objections if any, within the specified period.

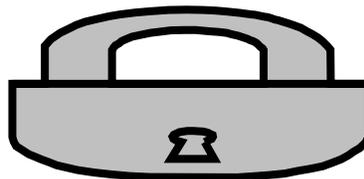
With the above amendments, for a reverse merger of a sick industrial company, the compliance under Section 72A of the Income tax Act, 1961 is not required. Similarly, once the reverse merger is approved by the BIFR, the procedures outlined in Sections 391 or 394 of the Companies Act, 1956 are not required to be followed. The BIFR can thus make distinctive provisions in a scheme of rehabilitation of a sick company through reverse merger.

LESSON ROUND UP



- Companies have to downsize or 'contract' their operation in certain circumstances such as when a division of the company is performing poorly or simply because it no longer fits into the company's plans or to give effect to rationalization.
- Demerger is defined as division or separation of different undertakings of a business functioning hitherto under a common umbrella.
- Demerger may take the shape of spin off, split off or split up.
- Demerger may be partial or complete.
- Demerger may be by agreement between promoters or under scheme of arrangement with approval by the court under section 391 or under voluntary winding up.
- Chapter covers in detail the procedure for demerger of a company.
- There are various tax incentives to demerged company, to shareholders of demerged company and to resulting company.
- In a reverse merger, a healthy company merges with a financially weak company. The chapter provides for salient features of reverse merger and the provisions of Section 72A of Income-tax Act, 1961.

SELF TEST QUESTIONS



(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

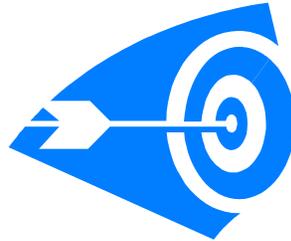
1. Define the term 'Demerger' and Reverse merger and briefly explain their relevance as a tool of restructuring.
2. What do you mean by 'demerged company' and 'resulting company'?
3. Is demerger different from reconstruction in concept? If so, how?
4. X Ltd. and Y Ltd. propose to effectuate a scheme of demerger. Assuming

any of them as a loss making company, enumerate the steps to be taken in this respect.

5. Explain in brief the tax reliefs emerging in demerger to:
 - (a) Shareholders;
 - (b) Demerged company;
 - (c) Resulting company.
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STUDY VIII
POST MERGER RE-ORGANISATION

LEARNING OBJECTIVES



This lesson explains the concept of post merger reorganization along with the post merger valuation and measuring post merger objectives. The lesson also discusses the human and cultural aspects of merger and amalgamation.

At the end of the lesson, you should be able to understand:

- Factors in Post Merger Reorganization.
- Integration of business and operation.
- Financial Accounting
- Taxation Aspects
- Post Merger Success and Valuation.
- Human and Cultural Aspects in mergers and acquisitions.
- Measuring Post-Merger Efficiency.
- Merger and Acquisition trends.

1. INTRODUCTION

Mergers, amalgamations, acquisitions, takeovers or any other kind of business combinations are undertaken for the purpose of expansion or growth of a business. 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.

However, there is more to such transactions than joining two legal entities or creating a new one. 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.

The relevance of Post-merger organisation and integration cannot be overstated. Continuous appraisal and improvement are the basic elements in the success of a merger or an acquisition. Due to the complexity of numerous activities and

occurrence of many unanticipated events, it is quite possible that the process gets off the track and results are not realized. In fact the main reason, why so many mergers either fail or fall short of expectations is a lack of adequate efforts to integrate the purchased company into the buyer's existing operations. It should be realised that once the deal is put through, the 'real' work has only begun. Often, the buying company underestimates as to how long it will take to get the two companies to act as one. Therefore, where importance is placed on whether it is a good idea to purchase a company and figure out the right price, it is equally essential to understand the target company with an eye to post-merger efforts.

'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 of every amalgamating company differently depending upon its requirements, objectives of merger and management corporate policy.

IMPACT OF POST MERGER REORGANISATION

1. Gain or Loss to Stakeholders

In mergers and acquisitions it largely depends upon the terms and conditions of the merger and the track record of the transferee or acquirer company. Based on the cardinal principle, every buyer, in other words transferee or acquirer has to pay more than the book value of the transferor or target company. However, the terms and conditions of the transaction depend upon their present operations and past historical records. Some instances of the effect of acquisitions to small shareholders worth mentioning are as under:

1. On the announcement of merger of ICICI Ltd. with ICICI Bank, share prices jumped from ₹ 47.70 and ₹ 77.00 on 25.9.2001 to ₹ 56.10 and ₹98.00 on 24.10.2001 respectively.
2. AV Birla group acquired 14.5% shares of Larsen & Toubro Ltd. (L&T) from Reliance Industries Ltd. at ₹ 309 per share. For increasing the stake up to 34.5% the Birla group's open offer at ₹ 190 per share is under protest by the Investors Grievances Forum and the Financial Institutions (FIs). The L&T script surged to close at ₹ 189 from ₹ 172 on 16.10.2002. FIs collectively hold over 36% shares in L&T. They demanded ₹ 340 per share. The open offer has been stayed and was under review by the SEBI on 18.10.2002. National Association of Small Investors (NASI) said that a section of Grasim shareholders will approach the Supreme Court asking the company to increase the offer price for acquisition of L&T to ₹ 350/- per share. As such, the small shareholders of L&T will be provided with an exit opportunity at a price higher than the ruling market price.
3. AV Birla group open offer for 25.5% shares in Indian Aluminium Ltd. (Indal) at ₹ 120/- per share opened on 14.10.2002 did not receive favourable response in view of Sterlite's offer at ₹ 221/- per share made in 1998 against which the shareholders tendered their shares. There is a good chance for upward revision in the offer price or a strategic deal between Sterlite and AV Birla group. It may also be beneficial to the small shareholders.

4. The takeover by Mr. Arun Bajoria for Bombay Dyeing provided a golden opportunity to the small shareholders to exit at ₹ 110/- per share against the market price ruling between ₹ 60-75 per share.
5. The takeover bid by Mr. Abhishek Dalmia for the Gesco Corporation resulted in upward revision in offer price to ₹ 45/- after acquiring 45% shares at ₹27/- per share. The Dalmias sold their entire 10.5% stake at ₹ 54 per share to Sheth Mahiaha combine.
6. The takeover bids for Ahmedabad Electricity Company (AEC) by Gujarat Torrent group and the Bombay Dyeing resulted in increasing the offer price from ₹ 65/- per share to ₹ 132/- per share and at this price Gujarat Torrent Group acquired AEC; undoubtedly, the small shareholders were benefited prior to acquisition of AEC.
7. Similarly, the takeover bid of Mr. Arun Bajoria for Ballarpur Industries resulted in a surge of the scrip price from around ₹ 50/- to ₹ 68/- when it was made public.

From the above it is evidently clear that such acquisition attempts cause an increase in share price, which benefits the share holders of the target company. For the post acquisition or merger achievements, reorganisational efforts of the acquirer or merged company are very important. Improving the acquisition integration process is one of the most compelling challenge facing businesses today. The results are dependent on the 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

We have so far discussed various objectives, motives, reasons and purposes which are to be achieved and accomplished by implementing them after completion of merger, amalgamation or acquisition. Much of the senior management's attention must be focused 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. These economies are known as synergistic operative economies. Synergy is also possible in the areas of Research and Development function of the combined company for optimum utilization of technological development, which could not be taken up by the separate companies for want of resources.

A key challenge in mergers and acquisitions is their effective implementation as there are chances that mergers and acquisitions may fail because of slow integration. The key is to formulate in advance integration plans that can effectively accomplish the goals of the M&A processes. Since time is money and competitors do not stand still, integration must not only be done well but also done expeditiously.

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 followed heads:

(i) Legal Requirements

Fulfilment of legal requirements in post-merger reorganisation of any amalgamating company becomes essential for an effective and successful venture. The quantum of such obligations will depend upon the size of company, debt structure and profile of its creditors, compliances under the corporate laws, controlling regulations, distribution channels and dealers network, suppliers relations, labour etc. In all or in some of these cases legal documentation would be involved. If foreign collaborators are involved, their existing agreements would need a mandatory documentation to protect their interests if their terms and conditions so require. Secured debenture holders and unsecured creditors would also seek legal protection to their rights with new or changed management of the amalgamating company. Regulatory bodies like the RBI, Stock Exchanges, the SEBI, etc. would also ensure adherence to their respective guidelines, regulations or directives. In this way, the legal counsel of the amalgamating company or its consultant would have to ensure that the company meets its legal obligations in all related and requisite areas. Issuing shares and other securities to the shareholders of the transferor company and preservation of the books and papers of that company are also the functions required to be carried out after merger.

(ii) Combination of operations

The amalgamating company has to consolidate the operations of the transferor company's operations with its own. This covers not only the production process, adoption of new technology and engineering requirements in the production process but also covers the entire technical aspects like technical know-how, project engineering, plant layout, schedule of implementation, product designs, plant and equipment, manpower requirements, work schedule, pollution control measures, etc. in the process leading to the final product.

Integrating two different technological systems for complex business entities while continuing to run the business can be a massive challenge. It requires proper planning for phased transitions, extensive preparation and intensive testing. It is necessary to define workable implementation plans as to what needs to be integrated, when it should happen and how it can be done successfully.

(iii) Top Management Changes

The takeover or merger of one company with another affects the senior managerial personnel. A cohesive team is required both at the board level as well as at senior executive level. The reorganisation would involve 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 to broad base the Board for public image as well as smooth functioning of the company. Selection of directors, finalising their term of holding the office as directors, managerial compensation and other payments or reimbursements of expenses etc. are issues to be sorted out.

At the senior executive level also, changes are required particularly in respect of compensation depending upon the terms and conditions of merger, amalgamation or takeover and to adjust in suitable positions the top executives of the amalgamated company to create a congenial environment and cohesive group leadership within the organisation. Understanding different cultures and where and how to integrate them

properly is vital to the success of an acquisition or a merger. Important factors to be taken note of would include the mechanism of corporate control particularly encompassing delegation of power and power of control, responsibility towards accounting, management information system, to and fro communication channels, interdivisional and intra-divisional harmony and achieving optimum results through changes and motivation.

(iv) Management of financial resources

Takeover, merger, amalgamation or demergers facilitate the attainment of the main objectives of achieving growth of the company's operations. Growth is dependent upon the expansion, modernization or renovation or restructuring. Generally, the 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. Better debtors' realisation is also important as it improves financial resources and reduces finance costs.

Even in those cases where merger is arranged by the BIFR for revival of a sick unit, the scheme would spell out the financing plans, terms of loans from financial institutions and banks, promoters contribution, etc. but sometimes on happening of certain uncontrollable events these financing plans have got to be verified, reviewed and changed depending upon the change in pre-planned technology adaptation, acceptance or deletion of foreign collaboration or participation, eliminating borrowings from institutions by going public for raising equity and *vice-versa* etc.

(v) Financial Restructuring

Financial restructuring becomes essential in post merger reorganisation. Financial restructuring is characterised by liquidity crisis, 'abnormal' balance sheets and negative equity. The 'clean-up' must happen fast. 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. This being an important aspect concerns most of the top management, creditors, bankers, shareholders, regulatory bodies like stock exchange, SEBI as well as the government where provisions of corporate laws are attracted and their permissions or approvals for planned changes are required. Generally, financial restructuring is done as per the scheme of arrangement, merger or amalgamation approved by the shareholders and creditors but in those cases where takeover or acquisition of an undertaking is made by one company of the other through acquiring financial stake by way of acquisition of shares, e.g. IPCL by RIL, 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. Decisions have to be made regarding raising owners funds or resorting to borrowed funds as per debt bearing capacity of the company or going in for leasing options. These steps are taken in consultation with the financial consultant and auditors of the company.

(vi) 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. With technological upgradation, reduction in labour costs through providing on the job training, motivation, and labour cut by way of voluntary retirement schemes or otherwise forms part of post merger function. This will help in better productivity and higher return on capital employed. The judgement of the Supreme Court of India announced on 30th August, 2002 on the petition of Steel Authority of India Limited (SAIL) has cleared a major hurdle to several Public Sector Undertakings (PSUs) which were not employing contract labour due to the fear of having to absorb them in regular jobs. The five judges Bench has relaxed contract labour laws for PSUs by quashing a 1976 notification and held that there will not be automatic absorption of contract labour.

(vii) 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. Decisions are taken on the basis of feasibility studies done by experts covering technoeconomic aspect, cost-benefit analysis of production process, identification of market, customers and their preferences, fixing price of product with targeted mark-up, required rate of return and competitive strength. Decisions are generally taken on the recommendations covering economic analysis based on incremental reasoning, fine-perspective, opportunity cost, etc. Another aspect closely related to production is to improve productivity and cost-reduction without affecting product quality. This demands attention to the following aspects:

1. Efficiency of management
2. Degree of technological adaptation
3. Size of plant
4. Rate of output and utilisation of existing capacity of fixed assets
5. Productivity and quality of input factors including manpower and material management.

The important economic tools which are used for cost reduction includes the following:

- (1) Short-run and long-run cost analysis techniques.
- (2) Break-even chart is also a tool which is used for adjusting fixed and variable cost to profit volume for desired cost reductions.
- (3) Inventory analysis.
- (4) Linear programming, a recent technique, used in cost reduction by taking into consideration the opportunity cost factor.
- (5) Reviewing input materials in view of substitutes made available and other options.
- (6) Technological improvements.

To tone up production, it is also necessary that available resources are properly allocated for prudent and planned programme for utilisation of scarce and limited resources available to an enterprise so as to direct the production process to result

into optimal production and operational efficiency. Resource allocation can be accomplished by a company using the following techniques:

- (a) Production function analysis with one or two or more variables;
- (b) Input output analysis;
- (c) Linear programming when there are more than two variables in the production activity;
- (d) Examining the available options, substitutes and alternative processes.

Revamping of marketing strategy becomes essential, which is accomplished on the basis of market surveys, and recommendation of marketing experts. Marketing surveys may cover both established as well as new products. Pricing policy also deserves attention for gaining competitive strength in the different market segments. Reorganisation of marketing network and rationalisation of marketing strategy is equally important.

(viii) Corporate planning and control

Corporate planning to a large extent is governed by the corporate policy. The management's attitude and promoter's inclinations are amply reflected in the expressions directed towards achievement of corporate goals. Corporate policy prescribes guidelines that govern the decision making process and regulates the implementation of the decisions. Corporate planning is to be done in consonance with the corporate policy which might prescribe the broader frame within which activity is to be restricted, minimum returns to be obtained, optimal utilisation of financial, human and material resources is to be made, delegation and de-centralisation of authority is effected, corporate plan made and implemented, and plans and policies formulated prior to the merger or acquisition reviewed.

Other factors to be considered may, *inter alia*, include the existing and prospective market segments, the product and production activity and the nature of demand. All these factors indicate the future of the concern and the commitments to be fulfilled.

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. In other words, control, as an activity of management, involves comparison of performance with predetermined standards, ascertaining causes for deviations and prescribing corrective action to reinforce the planned programme. In each area of corporate activities whether it is personnel management, material management, real estate management or financial management, planning is associated with control.

Control techniques which are used by the corporate units would require changes from traditional to modern control techniques.

The traditional control techniques include (1) Budgeting control; (2) Standard costing; (3) Financial ratios; (4) Internal audit, whereas the modern control techniques are: (1) Performance budgeting; (2) Zero Base Budgeting; (3) Programme Planning & Budgeting System (PPBS); (4) Programme Evaluation and Review Technique (PERT) and (5) Critical Path Method (CPM). All these techniques are now computer based for which softwares are easily available.

Review of the control techniques could be better done if responsibility centres are defined. In an organisation there may be four responsibility centres viz. Revenue centres, expense centres, profit centres and investment centres. In revenue centres, the output is measured in monetary terms. These centres relate to marketing activities and sales budget focuses main attention on control systems. In expenses centres, inputs are measured in monetary and quality terms. Profit centres which measure both input and output in terms of expenses and revenue respectively, are created when manufacturing and marketing is done by the same organisation.

These 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. Creeping changes, uncertainty and anxiety that last for months are debilitating and start to drain value from an acquisition.

It would be relevant to mention some of the leading common mistakes, made by the corporates, leading to pitfalls in mergers and acquisition:

1. Ego problems on both sides – buyer and seller – rear up very frequently and resulting clashes make bad situations worse. Trying to have two chiefs is a formula for disaster.
2. Attempt to hasten the integration between both the parties raises the likelihood of making serious errors. Sudden and radical changes such as relocating the company's entire production operations should be carefully considered before implementation.
3. Many buyers assert their ownership by moving quickly to convert the acquired company. This does not always work in the right direction.
4. A cautious approach should be applied to competitor end runs. While the company is focussed on integration, it furnishes an ideal time for competitors to make a run on the market.
5. Unless the acquired business is in the exact same field, different dynamics might apply.
6. One of the most common and damaging mistakes is to lay off crucial employees from the acquired company. This is a very complicated, delicate matter and even the seller might not have an accurate idea as job titles can be misleading.

3. INTEGRATION OF BUSINESSES AND OPERATIONS

Recognizing the importance of mergers in the success of a company, it is important to discuss some critical aspects that should be taken into account in the integration stage of a M&A deal:

- Focus on people and their incentives:

Innovation is not a mechanical process but depends on key employees and the incentive structure to which they are subject. These, which are perhaps the most important assets of the firm, are nonetheless not automatically part of the deal but need to be co-opted into it. Just maintaining the R&D budget will not necessarily do the trick. Subtle 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:

It may make sense to integrate the distribution operations of two employees. It hardly makes sense to integrate their creative units. Competition has to be maintained in the areas where innovation is more important and intense. The areas where the processes are more standardized and less human capital-intensive are in general more amenable to integration.

— Do not delay decisions and communicate clearly the new rules:

As any other economic activity, the efforts put into innovation critically depend on the expected rewards. 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.

Suppressing competition with coordination and control may not be a win-win proposition after all. Constant innovation and adaptation is critical for the long-term survival of an organization. Without competition- the fear to fall behind — there is not much rationale for constant re-invention. This fact must be taken into account in the way that the various parts of the new organization are integrated.

4. FINANCIAL ACCOUNTING

This aspect has been discussed in detailed in Chapter 3 of this study.

5. TAXATION ASPECTS OF MERGERS AND AMALGAMATIONS

This aspect has been discussed in detailed in Chapter 3 of this study.

6. POST MERGER SUCCESS AND VALUATION

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. It has been found that the probability of success or failure in economic benefits was very high among concentric mergers. Simple vertical and horizontal mergers were found successful whereas the performance of concentric mergers was in between these two extremes i.e. failure and success.
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 determines its success or failure. Similarly, dividend rate and payouts also 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.

In general, growth in profit, dividend payouts, company's history, increase in size provides base for future growth and are also the factors which help in determining the success or failure of a merged company.

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. Such valuation is generally made in pre merger cases.
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 data is analyzed to estimate reasonable future earnings for the subject company.

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) A 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. However, share prices are influenced by many factors other than the performance results of a company. Hence, this cannot be taken in isolation as a single factor to measure the success or failure of a 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. In addition to the above factors, a more specific consideration is required to be given to factors like 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.

7. HUMAN AND CULTURAL ASPECTS

The merger is a period of great uncertainty for the employees of the merging organizations. The uncertainty relates to job security and status within the company leading to fear and hence low morale among the employees. It is natural for employees to fear the loss of their revenue or change in their status within the company after a merger since many of these employees literally invest their whole lives in their jobs. Hence the possibility of a change in their position is likely to be viewed with fear and resentment. The possibility of a change in compensation and benefits also creates a feeling of insecurity and unease. The influx of new employees into the organisation can create a sense of invasion at times and ultimately leads to resentment. Further, the general chaos which follows any merger results in disorientation amongst employees due to ill defined role and responsibilities. This further leads to frustrations resulting into poor performance and low productivity since strategic and financial advantage is generally a motive for any merger. Top executives very often fail to give attention to the human aspects of mergers by neglecting to manage the partnership in human terms. By failing to give attention to the problems faced by their employees, they fail to fully develop their companies' collaborative advantage.

In such cases what is normally forgotten is the centrality of cultural integration. The issues of cultural integration and the issues of human behaviour need to be addressed simultaneously if not well before the issues of financial and legal integration are considered. Implementation of structural nature may be financially and legally successful. But if cultural issues are ignored, the success may only be transient. Culture of an organisation means the sum total of things the people do and the things the people do not do. Behavioral patterns get set because of the culture. These patterns create mental blocks for the people in the organization. Pre-merger survey and summarization of varying cultures of different companies merging, needs to be carried out. People belonging to the each defined culture need to be acquainted with other cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of cultures and ethos easy and effective.

The successful merger demands that strategic planners are sensitive to the human issues of the organizations. For the purpose, following checks have to be made constantly to ensure that:

- sensitive areas of the company are pinpointed and personnel in these sections carefully monitored;
- serious efforts are made to retain key people;
- a replacement policy is ready to cope with inevitable personnel loss;
- records are kept of everyone who leaves, when, why and to where;
- employees are informed of what is going on, even bad news is systematically delivered. Uncertainty is more dangerous than the clear, logical presentation of unpleasant facts;
- training department is fully geared to provide short, medium and long term training strategy for both production and managerial staff;

- likely union reaction be assessed in advance;
- estimate cost of redundancy payments, early pensions and the like assets;
- comprehensive policies and procedures be maintained up for employee related issues such as office procedures, new reporting, compensation, recruitment and selection, performance, termination, disciplinary action etc.;
- new policies to be clearly communicated to the employees specially employees at the level of managers, supervisors and line manager to be briefed about the new responsibilities of those reporting to them;
- family gatherings and picnics be organized for the employees and their families of merging companies during the transition period to allow them to get off their inhibitions and breed familiarity.

The classic examples of effective human resource management is the acquisition of Wellcome group by Glaxo.

Wellcome and Glaxo were profoundly different companies, both structurally as well as culturally. Wellcome was more of an academic culture and Glaxo more of a commercial, business driven culture. Everything was different between the companies, from finance to information technology, the structure of sales representatives to legal side. Less diplomatic Glaxo staff saw Wellcome as an over-centralised organisation with employees who were unrealistic in their expectations for the business's financial success. Academia-like penny-pinching officials had saddled Wellcome with out-of-date information technology.

Wellcome staff, in contrast, saw Glaxo as overly commercial mercenaries assaulting their worthy enterprise and driven by cash. They argued, in its enthusiasm for the latest high-tech research gadgetry the Glaxo officials refused to study tropical diseases where sufferers could not afford western prices.

To try to combat such sentiments, management declared that both old companies were history and decreed that a new company was to be built in its place. But, the most difficult aspect of merger was to lay off staff both on account of closing down of certain manufacturing units as well as to cut down on excess costs. To overcome the difficulties, management offered a very lucrative package. The solution was expensive but unavoidable, given that Glaxo management was trying not to give the impression that it was steamrolling Wellcome.

In France, the company established an organisation called Competence Plus, comprising employees who had been made redundant. They were guaranteed up to 15 months on full salary and given training courses on everything from "networking" to new skills. They were also the first to be interviewed for any vacancies that arose within the new group during that period. Employees hired by other companies for trial periods had their salaries paid by Glaxo-Wellcome. For those who remained, there were improvements too. Glaxo staff worked a 39-hour week, whereas Wellcome did 37 hours. Now Glaxo-Wellcome people work 37 hours. "We were concerned not to make mistakes in the social sphere," said Mangeot, the Chairman of Glaxo-Wellcome, France.

In Hindustan Lever Ltd. (HLL) and Tomco merger case, HLL had been known for its result oriented, systems driven work environment, where a strong emphasis is

placed on performance. Accordingly, it always has/had and strives for a team of high performing and high profile executives, carefully selected from the best management institutes. Discussing product profitability and target achievement is the only language that its managers understand. The work culture is very demanding and only the best survive. In fact, about 100 managers at that time for Unilever group companies had quit their jobs, as they were unable to cope with the demanding work culture.

It was felt that the more difficult part would be the management of the two very different work cultures and ethos, after the merger. In TOMCO the employee productivity was only 60% of HLL. It was opined that HLL would have to rationalize TOMCO's work force. HLL itself had launched a voluntary retirement package, in order to get rid of about 500 workers, however only a few resigned. However TOMCO employees had been assured that their employment conditions were to be protected and service conditions would be honoured. All the employees of TOMCO were to be absorbed as HLL employees.

It is probably not an exaggeration to assert that most cross-border deals run into difficulties because of failures in the integration process. What is acquisition integration? First and foremost, it is the process of realizing the strategic benefits of a merger. In other words, it is everything merging companies must do to achieve synergies and position the new firm for growth. It requires effective interaction and coordination between merging firms to realize the strategic potential of the deal at the same time that it necessitates special attention to human resource concerns. Stated in this way, it is a tall order, and indeed seems absolutely critical to M&A success.

Differences among management and workers can sometimes spiral into broader community and political problems. Such was the case in the 1988 acquisition of Rowntree, headquartered in York, England by Nestle, the Swiss foods giant. Concerns about the future of Rowntree workers, facilities, and even the town of York itself created an uproar in the UK, involving Members of Parliament, political parties, and the Archbishop of York. In the end, Nestle was forced to make several concessions to public opinion in its integration of Rowntree, including retaining York facilities and making certain guarantees with respect to the job security of Rowntree workers.

8. MEASURING POST-MERGER EFFICIENCY

The criterion to judge a successful merger differs in different conditions. Different factors may be considered for making value judgements such as growth in profit, dividend, company's history, increase in size, base for growth etc. Several studies suggest different parameters to assess the success of mergers:

- (i) Successful merger creates a larger industrial organization than before, and provides a basis for growth [Edith Perirose].
- (ii) In Arthur Dewing's study, three criteria were considered viz. (a) merger should give a larger net profit than before (b) merger should provide a higher return on total funds (c) there should be a sustained increase in earnings.
- (iii) Earnings on capitalization and dividend records determine the success of merger [Shaw L.].

During the studies in late 1960s, two types of efficiency improvements were expected to result from mergers: (1) improvements due to economies of large scale production (2) application of superior management skills to a larger organisation. Some other researches in the seventies and eighties, measure efficiency based on stock market measures, labour productivity or total factor productivity etc. These improvements pointed towards market dominance, but for gauging efficiency, resultant profitability was accepted as a benchmark. In order to ensure progress, a conscious and concerted effort to keep track of several key elements is required, alongwith answers to the following questions:

1. What impact is the integration (merger/acquisition) having on key indicators of business performance? Whether synergies which were hypothesized during the valuation are being realized?
2. Are the activities and milestones developed with the integration process on target?
3. What are the major issues emerging during the integration, requiring considerable attention?
4. What important facts have emerged during the merger or acquisition that can be used to improve subsequent mergers or acquisition?

Measuring Key Indicators

The main purpose of a merger or acquisition is to deliver the expected financial results namely earnings and cash flow. However, there are certain other measures that serve as key indicators and they also need to be measured. The indicators may be grouped as:

- (i) Financial outcomes.
- (ii) Component measures of these outcomes namely revenues, costs, net working capital and capital investments.
- (iii) Organisational indicators such as customers, employees and operations.

All the areas being integrated and both the acquirer and target, or in a merger, both partners, should be brought within the ambit of continuous appraisal. Also, the appraisal should be based on benchmarks to ensure that merger or acquisition are yielding the financial and strategic objective so intended and are not resulting in value leakage.

There are broadly four possible reasons for business growth and expansion which is to be achieved by the merged company. These are (1) Operating economies, (2) Financial economies, (3) Growth and diversification, and (4) Managerial effectiveness. These are explained in detail below:

1. Operating Economies

Whenever two or more firms combine, certain economies are likely to be realised as a result of larger volume of operations resulting in economies of scale. These economies may arise due to better utilisation of production capacities, distribution network, engineering services, research and development facilities and so on. The operating economies (economies of scale) would be the maximum in the case of

horizontal mergers where intensive utilisation of production capacities will result in benefits for the merged firm.

On the other hand, in the case of vertical mergers, the benefits would accrue from better co-ordination of facilities, both backward and forward, reduction in inventory levels and higher market power of the combined firms. Operating economies in the form of reduction or elimination of certain overhead expenses may also arise even in the case of conglomerate mergers. The net result of realising economies of scale would be a decrease in the cost of production. But if the scale of operations or size of the merged firm becomes too large and unwieldy, then 'dis-economies' of scale may also arise and the unit cost of production would show a rising trend.

2. Financial Economies

Merger of two or more firms brings about the following financial advantages for the merged firm:

(a) Relief under the Income Tax Act

Under Section 72A of the Income Tax Act, 1961 carry forward and setting off of accumulated losses and unabsorbed depreciation of the amalgamating company is allowed against the future profits of the amalgamated company in order to encourage revival of sick units.

(b) Higher Debt Capacity

The merged firm would enjoy higher debt capacity because the combination of two or more firms provide greater stability to the earnings level. This is an important consideration for the lenders since the possibility of default in repayment of loan and interest is reduced to a great extent. A higher debt capacity if utilised, would mean greater tax advantage for the merged firm leading to higher value of the firm.

(c) Reduction in Floatation Costs

Whenever the merged firm raises funds from the market through public issue of shares or debentures, it can reduce the floatation costs as compared to the similar amount being raised independently by the merging firms. Such reduction in the floatation costs represents a real benefit to the merged firm.

Apart from the above, earnings and cash flows are primary financial outcomes that need to be tracked since valuation are built on them. Particular attention should be given to the components of these measures, namely, revenue, costs, investments and net working capital. The extent to which these components show progress will determine whether value is being created or not.

3. Growth and Diversification

As stated earlier, merger/amalgamation of two or more firms has been used as a dominant business strategy to seek rapid growth and diversification. The merger improves the competitive position of the merged firm as it can command an increased market share. It also offers a special advantage because it enables the merged firm to leap several stages in the process of expansion. In a saturated market, simultaneous expansion and replacement through merger/takeover is more desirable than creating additional capacities through expansion. A merger proposal has a very high growth

appeal, and its desirability should always be judged in the ultimate analysis in terms of its contribution to the market price of the shares of the merged firm.

The merged firm can also seek reduction in the risk levels through diversification of the business operations. The extent to which risk is reduced, however, depends on the correlation between the earning of the merging (combining) firms. A negative correlation between the combining firms is less risky whereas a positive correlation is more risky.

The business firm may pursue the objective of diversification with maximum advantage under the following circumstances:

- (1) If a firm is saddled with problems which can lead to bankruptcy or jeopardise its very existence, then its merger with another firm can save it from such undesirable consequences. Indian industrial sector is faced with the problems of the creation of splintered capacities. As a result, many firms with minimum economic size, such as manufacturers of light commercial vehicles, mini steel plants, mini paper plants, mini dry cell battery plants, mini sponge iron plants, mini cement plants, etc. were created. Many of these units have either closed down or are incurring substantial losses. A few of them, though earning profits today, may fall sick in future due to the increasing competition. In such a situation mergers and takeovers can bring about consolidation of capacities, lead to the revival of sick units and also prevent the occurrence of sickness.
- (2) If the shares of one of the combining firms are not traded at the stock exchange then creative diversification would be the only feasible route to reduce the level of risk for the investment in these firms.

4. Managerial Effectiveness

It has been pointed out by various studies that incompetency of management has been the most important reason for firms becoming sick. If a sick firm is merged with another well managed company, it will lead to better co-ordination of human resources of both the companies. Managerial effectiveness can also bring substantial gains to the merging firms if two well managed firms combine together to take advantage of valuable human resources.

Customer Reactions

It is necessary to ensure that customers are not adversely affected during a merger or acquisition as losing either profitable customers or a percentage of their business may have a negative impact on earnings and cash flows, especially if the customer represents a large percentage of company's revenues and profits. Several indicators may be deployed such as customer satisfaction, retention, acquisition, market share etc. Keeping track of market value and sales volume of each segment is also useful. Often during mergers and acquisitions competitors attempt to disrupt the relationship between an acquirer and its customers. This implies that a company needs to do more than just maintain customer relationships. It has to make an extra effort to ensure that its business does not erode.

Employee Reactions

Employees are capable of having an impact on productivity and customer

satisfaction, especially in service business. Employee assessments made at multiple times and with relevant measures may allow better changes to take place. It should be analysed whether employees understand the expected contribution to be made to new organization; the view of employees towards various aspects of organisation and leadership; commitment to the newly formed organization; performance and productivity expected etc.

Motives as per survey of US firms

According to a survey of US manufacturing firms, the following motives for mergers and amalgamations were identified:

- A desire to utilize competition or to achieve monopoly profits;
- A desire to harness unutilized market power;
- A response to shrinking opportunities for growth and/or profit in one's own industry due to shrinking demand or excessive competition;
- A desire to diversify to reduce risk of business;
- A desire to achieve a large enough size to realise economies of scale of production and/or distribution;
- A desire to overcome critical drawbacks in one's own company by acquiring the necessary complementary resources, patents or factors of production;
- A desire to achieve sufficient size to have efficient access to capital markets or inexpensive advertising;
- A desire to utilize more resources or personnel controlled by the firm, with particular applicability to managerial skill;
- A desire to displace an existing management;
- A desire to utilize tax advantages otherwise not available;
- A desire to reap the promotional or speculative gains contingent upon new security issues, or changed price earning ratios;
- A desire of managers to create an image of themselves as aggressive managers;
- A desire of managers to manage an ever-growing set of subordinates.

Apart from the above, in the present complex business environment, two more factors have assumed importance viz. Customer reactions and employee reactions.

Successfully integrating two or more organizations after a merger requires many things, but above all, it requires strong effective leadership, a plan, and a commitment to ongoing evaluation and adaptation. It must be ensured that both the integration process and the programmatic work of the organization continue to move forward in tandem.

An integration plan is also essential. Leaders with experience in integrating two or more organizations emphasise the need for a plan than almost any other factor for success in integration. It was concluded in a series of interviews conducted with leaders who had been through a merger that a integration plan was a key factor for success.

Lastly, an organization and its leadership must be proactive in evaluating progress throughout the integration process. Its desired outcomes and outcome targets must be regularly revisited and progress against them must be measured. A thoughtful leader will be responsive to such ongoing evaluation, and adapt both the integration plan and the organization's course of action accordingly.

A successful integration 'moulds' not only the various technical aspects of the businesses but also the different cultures. The best way to do so is to get people working together quickly to solve business problems and accomplish results that could not have been achieved before.

Thus, the aspect of post-merger reorganisation is not exhaustive and the parameters of the same would have to be established by the management of the companies, depending upon the organisational requirements, corporate policies and plans and the objectives of the merger etc. sought to be met.

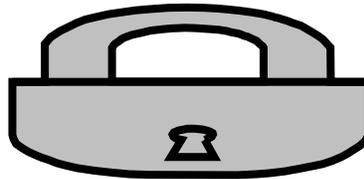
LESSON ROUND UP



- 'Post-merger reorganization' is a wide term which encompasses the reorganization of each and every aspect of the company's functional areas to achieve the objectives planned and aimed at.
- There are certain parameters to measure post merger efficiency. Some of them are - successful merger creates a larger organization than before, net profit is more, there is sustained increase in earnings, continuous dividend distribution etc.
- There are broadly four possible reasons for business growth and expansion which is to be achieved by the merged company. These are (1) Operating economies, (2) Financial economies, (3) Growth and diversification, and (4) Managerial effectiveness.
- There is a spurt of mergers and acquisitions in the last two to three years as is evident from the recent acquisition of Anglo Dutch steel company Corus by India based Tata Steel. Other recent examples are suitably discussed under the chapter.
- To implement the objectives of mergers or acquisitions, some factors are required to be considered for post merger integration – legal requirements, combination of operations, top management changes, management of financial resources, rationalization of labour cost, production and marketing management and corporate planning and control.
- Human and cultural integration is central to the success of any merger.
- Fair market value is one of the valuation criteria for measuring the success of post merger company. 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's position.

- The earning performance of the merged company can be measured by return on total assets and return on net worth.
- In general, growth in profit, dividend payouts, company's history and increase in size provides the base for future growth and are also the factors which help in determining the success or failure of a merged company.

SELF TEST QUESTIONS

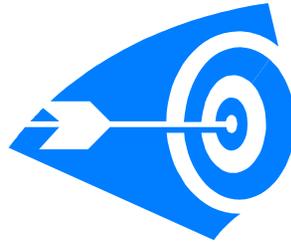


(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Enumerate the main objectives which companies seek to attain, from mergers.
 2. What are the factors to be kept in mind for a post merger reorganisation?
 3. How can post merger efficiency be measured? Enumerate the main parameters involved.
 4. Briefly explain the factors relevant for post-merger evaluation and analyse its success.
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STUDY IX
FINANCIAL RESTRUCTURING

LEARNING OBJECTIVES



After going through this chapter, you will be able to understand:

- Need for financial restructuring
- Reorganisation of capital
- Reduction of share capital
- Buyback of shares – concept and objects
- Provisions of buy back under Companies Act, 1956
- SEBI (Buy back of Securities) Regulations, 1998
- Private Limited Company and Unlisted Public Limited Company (Buy back of Securities) Rules, 1999.

INTRODUCTION

Companies have access to a range of sources from which they finance business. These funds are called 'capital'. The sources of capital can be divided into two categories; internally generated funds and funds provided by third parties. Whichever form of capital is used, it will fall into one of the two categories – debt or equity.

Determination of the proportion of own funds and borrowed funds

Internally generated funds are an important component of a company's capital structure but it would be unusual for a company to grow at a fast pace only through internal generation of funds. The deficit between the funds which a company requires to fund its growth and the funds which are generated internally, is funded by provision of capital from third parties.

Cost of various types of capital

Equity capital is the permanent capital of the company, which does not require any servicing in the form of interest. However, the return to the equity capital is in the form of dividend paid to the equity shareholders out of the profits earned by the company. The ideal capital structure would be to raise money through the issue of equity capital.

Debt is essentially an obligation, the terms of which are, *inter alia*, the repayment of the principal sum within a specific time together with periodic interest payments. Perhaps the easiest form of capital for a company to raise is, a loan from a bank. This form of loan capital may be comparatively expensive than equity.

However, as regards servicing of capital there are advantages of issuing debt instruments. Dividend is not a deductible expense when calculating a company's taxable profit; it is on the contrary an appropriation of profits. On the other hand, interest paid by a company on debt finance is an allowable expense when calculating a company's tax, thereby reducing its taxable profit.

Broadly speaking, the financial structure of a company comprises its—

- (i) paid up equity and preference share capital;
- (ii) various reserves;
- (iii) all borrowings in the form of –
 - (a) long-term loans from financial institutions;
 - (b) working capital from banks including loans through commercial papers;
 - (c) debentures;
 - (d) bonds;
 - (e) credits from suppliers;
 - (f) trade deposits;
 - (g) public deposits;
 - (h) deposits/loans from directors, their relatives and business associates;
 - (i) deposits from shareholders;
 - (j) Global Depository Receipts, American Depository Receipts and Foreign Currency Convertible Bonds;
 - (k) funds raised through any other loan instrument.

A company may require any one or more of the above keeping in view its financial requirements at a particular point of time. A dynamic Board should constantly review the financial structure of the company and effect financial restructuring and reorganisation whenever the need arises.

NEED FOR FINANCIAL RESTRUCTURING

A company is required to balance between its debt and equity in its capital structure and the funding of the resulting deficit. The targets a company sets in striking this balance are influenced by business conditions, which seldom remain constant.

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.

Financial restructuring of a company involves rearrangement of its financial structure so as to make the company's finances more balanced.

Restructuring of under-capitalized Company

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.

Restructuring of over-capitalized company

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.

REORGANISATION OF CAPITAL

In accordance with Section 390(b), the expression "arrangement" includes a re-organisation of the share capital of the Company by the consolidation of shares of different classes or by division of shares of one class into shares of different classes or by both these methods.

Accordingly, as per Section 390(b), the reorganization of share capital of a company may take place—

- (1) by the consolidation of shares of different classes, or
- (2) by the division of shares of one class into shares of different classes, or
- (3) by both these methods [Section 390(b)].

Besides, a company may reorganize its capital in different ways, such as – (a) reduction of paid-up share capital; (b) conversion of one type of shares into another; (c) conversion of shares into debentures or other securities. But these are only illustrations, there may be other ways. Besides, a company may modify all or any of the rights attached to the shares of any class.

The reorganization of share capital of a company may be proposed—

- (a) between a company and its creditors or any class of them; or
- (b) between a company and its members or any class of them.

In such a case, the Company Law Board¹ may, on the application of the company or of any creditor or member of the company, order a meeting of the creditors, or of the members, as the case may be. The meeting is to be called, held and conducted in such manner as the Company Law Board directs. A majority of 3/4th in value of the creditors or members present and voting either in person or by proxy at the meeting should agree to the reorganization of share capital. The reorganization should also be sanctioned by the Company Law Board. If these conditions are satisfied, the reorganization is binding on all the creditors or all the members, and also on the company or, in the case of a company which is being wound up, on the liquidator and contributories of the company.

The order of the Company Law Board has no effect until a certified copy of the order in e-form 21 has been filed with the Registrar (Section 391).

REDUCTION OF SHARE CAPITAL

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company. Section 100 provides for the reduction of share capital, if the articles of the company so authorise. If there is no such clause in the articles, these must be altered by a special resolution giving the company the power to reduce its capital.

The need for reduction of capital may arise in various circumstances for example trading losses, heavy capital expenses and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a company may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets [*Indian National Press (Indore) Ltd., In re.* (1989) 66 Com Cases 387, 392 (MP)].

The mode of reduction, as laid down in Section 100 of the Companies Act, is as follows:

A company limited by shares or a company limited by guarantee and having a share capital may, if authorised by its articles, by special resolution, and subject to its confirmation by the Court on petition, reduce its share capital in any way and in particular:

- (a) by reducing or extinguishing the liability of members in respect of uncalled or unpaid capital e.g., where the shares are of ₹ 100 each with ₹ 75 paid-up, reduce them to ₹ 75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of ₹ 25 per share;

¹ Substituted by NCLT by the Companies (Second Amendment) Act, 2002, but not yet brought into force.

- (b) by paying off or returning paid-up capital not wanted for the purposes of the company, e.g., where the shares are fully paid-up, reduce them to ₹ 75 each and pay back, ₹ 25 per share;
- (c) by paying off the paid-up capital on the conditions that it may be called up again so that the liability is not extinguished;
- (d) by following a combination of any of the preceding methods;
- (e) by writing off or canceling the capital which has been lost or is under represented by the available assets e.g. a share of ₹ 100 fully paid-up is represented by ₹ 75 worth of assets. In such a situation reality can be re-introduced by writing off ₹ 25 per share. This is the most common method of reduction of capital. The assets side of the balance sheet may include useless assets which are cancelled. On the other side i.e. on the liability side share capital is reduced.

There is no limitation on the power of the Court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured [*British and American Trustee and Finance Corpn. v. Couper*, (1894) AC 399, 403: (1991-4) All ER Rep 667].

When exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short, the Court shall consider the following, while sanctioning the reduction:

- (i) The interests of creditors are safeguarded;
- (ii) The interests of shareholders are considered; and
- (iii) Lastly, the public interest is taken care of.

Reduction of share capital without sanction of the Court

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. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad v. Equity Insurance Co. Ltd.*, (1948) 18 Com Cases 309: AIR 1948 Oudh 197]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted for further liability on shares.

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.

Reduction of capital when company is defunct

The Registrar of Companies has been empowered under Section 560 to strike off the name of a company from its register on the ground of non-working company. Therefore, where the company has ceased to trade, and Registrar exercises his power under Section 560 a reduction of capital cannot be prevented. [*Great Universal Stores Ltd., Re.* (1960) 1 All ER 252: (1960)].

Reduction of capital of unlimited company

An unlimited company to which Section 100 does not apply, can reduce its capital in any manner that its Memorandum and Articles of Association allow. It is not governed by Sections 94 and 100 of the Act.

Equal Reduction of Shares of One Class

Where there is only one class of shares, *prima facie*, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalizing the amount so paid-up. [*Marwari Stores Ltd. v. Gouri Shanker Goenka* (1936) 6 Com Cases 285]. The same principle is to be followed where there are different classes of shares.

It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly, where reduction is not involved, Section 100 would not be attracted. [*Asian Investment Ltd. Re.* (1992) 73 Com Cases 517, 523 (Mad)].

Qualification shares of directors [Section 270]

Where the directors are required to hold qualification shares, care must be taken to ensure that the effect of a reduction does not disqualify any director.

Creditors' Right to Object to Reduction

After passing the special resolution for the reduction of capital, the company is required to apply to the Court by way of petition for the confirmation of the resolution under Section 101. Where the proposed reduction of share capital involves either (i) diminution of liability in respect of unpaid share capital, or (ii) the payment to any shareholder of any paid-up share capital, or (iii) in any other case, if the Court so directs, the following provisions shall have effect:

The creditors having a debt or claim admissible in winding up are entitled to object. To enable them to do so, the Court will settle a list of creditors entitled to object. If any creditor objects, then either his consent to the proposed reduction should be obtained or he should be paid off or his payment be secured. The Court, in deciding whether or not to confirm the reduction will take into consideration the minority shareholders and creditors.

A Company might decide to return a part of its capital when its paid-up share capital is in excess of its needs. It is not simply handed over to shareholders in proportion to their holdings. Their class rights will be considered with the Court treating the reduction as though it was analogous to liquidation. Therefore, the preference shareholders who have priority to return of capital in liquidation will be the first to have their share capital returned to them in a share capital reduction, even if they prefer to remain members of the company.

Confirmation and Registration

Section 102 of the Act states that if the Court is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been determined, discharged, paid or secured, it may confirm the reduction. The Court may also direct that the words "and reduced" be added to the company's name for a specified period, and that the company must publish the reasons for the reduction and the causes which led to it, with a view to giving proper information to the public.

Section 103 states that the Court's order confirming the reduction together with the minutes giving the details of the company's share capital, as altered, should be delivered to the Registrar who will register them. The reduction takes effect only on registration of the order and minutes, and not before. The Registrar will then issue a certificate of registration which will be a conclusive evidence that the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be altered accordingly.

Conclusiveness of certificate for reduction of capital

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd.*, (1903) 88 LT 792 (Ch D)]. Similarly, in a case where the special resolution for reduction was an invalid one, but the company had gone through with the reduction, the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook*, (1900) 2 QB 376].

Diminution of share capital is not a reduction of capital

In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

- (i) Where the company cancels shares which have not been taken or agreed to

be taken by any person [Section 94(1)(e)];

- (ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 80;
- (iii) Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital;
- (iv) Where the company buys-back its own shares under Section 77A of the Act.

In all these cases, the procedure for reduction of capital as laid down in Section 100 is not attracted.

Liability of Members in respect of Reduced Share Capital

On the reduction of share capital, the extent of the liability of any past or present member or any call or contribution shall not exceed the difference between the amount already paid on the share, or the reduced amount, if any, which is deemed to have been paid thereon by the member, and the amount of the shares fixed by the scheme of the reduction.

If, however any creditor entitled to object to the reduction of share capital is not entered in the list of creditors by reason of his ignorance of the proceedings for reduction and, after the reduction the company is unable to pay his debt or claim, then:

- (a) every member at the time of registration of the Court's order for reduction is liable to contribute for the payment of the debt or claim, an amount not exceeding the amount which he would have contributed on the day before registration of the order and minutes; and
- (b) if the company is wound up, the Court on the application by the creditor and on proof of his ignorance, may settle a list of contributories and make and enforce calls and orders on the contributories, settled on the list, as if they were ordinary contributories in a winding up.

It is further provided that, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction; or knowingly misrepresents the name or amount of the debt or claim of any creditor; or abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable to be punishable with imprisonment upto one year, or with fine or with both (Section 105).

REDUCTION OF SHARE CAPITAL AND SCHEME OF COMPROMISE OR ARRANGEMENT

Arrangement includes 'a reorganisation of share capital of the company' and reorganisation can involve reduction of share capital. However, as part of the scheme of compromise or arrangement, distinct formalities as prescribed under section 100 do not have to be observed [Maneckchowk and Ahmedabad Mfg. Co.Ltd., Re (1970) 2 Comp LJ 300 (Guj); also *Vasant Investment Corporation Ltd. v. Official Liquidator* (1981) 51 Comp Cas 20 (Bom); *Mcleod & Co.Ltd. v. S.K. Ganguly* (1975) 45 Comp Cas 563 (Cal)]. In such cases, the scheme of amalgamation as approved unanimously by the shareholders of the transferor and transferee companies and also the arrangement between the transferee company and its members, including capital restructuring by way of reduction and consolidation of share capital of the transferee company may be sanctioned and confirmed so as to be binding on all the

members, secured and unsecured creditors and the employees of both the amalgamating companies [Novopan India Ltd., Re (1996) 5 Comp LJ 96 (AP)]. In this connection, it may be noticed that the requirement of setting out intention to move a resolution as a special resolution for reduction of the share capital cannot be said to be mandatory requirement, though passing special resolution is mandatory [Sumitra Pharmaceuticals & Chemicals Ltd., Re (1996) 5 Comp LJ 202 (AP)].

Not only is section 391 a complete code, as held by the courts, but, it is also intended to be in the nature of a 'single window clearance' system to ensure that the parties are not put to avoidable, unnecessary and cumbersome procedure of making repeated applications to the court for various other alterations or changes which might be needed effectively to implement the sanctioned scheme whose overall fairness and feasibility has been judged by the court under section 394 of the Act [Maneckchowk and Ahmedabad Mfg. Co.Ltd., Re (1970) 2 Comp LJ 300 (Guj); and *Vasant Investment Corporation Ltd. v. Official Liquidator, Colaba Land and Mill Co.Ltd.* (1981) 51 Comp Cas 20 (Bom); J. A. Nordberg Ltd., Re (1915) 2 Ch 439. Schweppes Ltd., Re (1914) 1 Ch 322. The limitation spelt out by the observation in *Katni Cement and Industrial Co.Ltd.*, Re (1937) 7 Comp Cas 348 (Bom) that 'this rule is subject to the limitation that if the Companies Act contains express provisions enabling the doing of any act in a particular way, the provisions of that enabling section, and not those in section 153 (of the 1913 Act), must be followed' does not state the law correctly : PMP Auto Industries Ltd., Re (1995) 5 Comp LJ 598 (Bom).

It may however be noted that, in all such cases involving reduction of share capital in the scheme of compromise or arrangement, the petition seeking confirmation of the court with respect to the scheme must also expressly mention that the company is also seeking, at the same time, the confirmation of the court with respect to the reduction of share capital, and that, while seeking the consent of the members to the scheme, the consent of the members with respect to the reduction of share capital had also been obtained.

The power of court to give to creditors an opportunity of raising objections to the reduction of capital is discretionary. In an appropriate case, for example, where the interests of creditors are duly and fully protected, the court may exercise its discretion against calling upon the creditors to raise objections.

In *PMP Auto Industries Ltd.*, In Re [1994] 80Comp. Cases 289 (Bom.), it was held that once a scheme of arrangement falls squarely within the ambit of section 391 to 394, the same could be sanctioned even if it involves doing acts for which procedure is specified in other sections of the Companies Act.

In a recent judgement of High Court of Delhi in *HCL Infosystems Ltd.*, In re [2003] 46 SCL 365 (Delhi) that Section 391 to 394 of The Companies Act, 1956 is a complete code in itself and therefore there is no requirement to comply with the provisions of section 293(1)(a).

5. BUY-BACK OF SHARES

Not only statute, but also common law, has upheld the 'sanctity' of a company's capital. In 1887, in *Trevor v. Whitworth* (1887) 12 App Cas 409, it was held that a company limited by shares may not purchase its own shares as this would amount to an unauthorized reduction of capital. The rationale for this decision is plain, namely,

that the creditors of the company make decisions on its credit-worthiness on several grounds, but an important ground is the amount of its share capital. If the courts had not established at an early stage that capital was 'sacrosanct' and could not be returned to shareholders at their whim, then share capital would not have been protected. Without this protection, creditors could find shareholders depleting share capital, with creditors left to carry all the business risks.

In India, the rule in *Trevor v. Whitworth* was enshrined in Section 77 of the Companies Act, 1956 which prohibited a company from buying or cancelling its own shares, unless it complied with the provisions and followed the procedure for reduction of share capital under Sections 100 to 104 of the Companies Act, 1956 which involved confirmation by the Court.

However, Section 77A of the Companies Act, 1956 which was inserted in the Companies Act, 1956 by the Companies (Amendment) Act, 1999 with retrospective effect from 31.10.1998 is an exception to the prohibition under Section 77 and Section 100. Section 77A allows companies to buy-back their own shares as well as 'other specified securities'.

Concept of Buy-Back of Shares

The concept of buy-back is a recent one so far as India is concerned. The Companies Amendment Act, 1999 introduced the concept of buy-back of shares.

Buy-back of shares means the purchase by the company of its own shares. Buy-back of equity shares is an important mode of capital restructuring. It is a corporate financial strategy which involves capital restructuring and is prevalent globally with the underlying objectives of increasing earnings per share, averting hostile takeovers, improving returns to the stakeholders and realigning the capital structure.

In India, while buy-back of securities is not permitted as a treasury option under which the securities may be reissued later, a company can resort to buy-back to reduce the number of shares issued and return surplus cash to the shareholders.

Objectives of Buy-Back

Good corporate governance calls for maximizing the shareholder value. When a company has surplus funds for which it does not have good avenues for deployment assuring an average return on capital employed and earnings per share, the company's financial structure requires balancing.

The reasons for buy-back may be one or more of the following:

- (i) to improve earnings per share;
- (ii) to improve return on capital, return on net worth and to enhance the long-term shareholder value;
- (iii) to provide an additional exit route to shareholders when shares are under valued or are thinly traded;
- (iv) to enhance consolidation of stake in the company;
- (v) to prevent unwelcome takeover bids;
- (vi) to return surplus cash to shareholders;
- (vii) to achieve optimum capital structure;

- (viii) to support share price during periods of sluggish market conditions;
- (ix) to service the equity more efficiently.

The decision to buy-back is also influenced by various other factors relating to the company, such as growth opportunities, capital structure, sourcing of funds, cost of capital and optimum allocation of funds generated.

Non-applicability

Prior to the enactment of the Companies (Amendment) Act, 1999, no company limited by shares and no company limited by guarantee and having a share capital could buy its own securities unless the consequent reduction of capital was effected and sanctioned pursuant to the provisions of Sections 100 to 104 or of Section 402 of the Act.

The Company Law Board (CLB), pursuant to the provisions of Section 402 of the Act, may order a company to purchase the shares or any interest of its members in the company on an application made by members under Section 397 or 398 of the Act to remedy oppression and mismanagement. The reduction of share capital as a consequence of such an order is not affected by nor will it be governed by the provisions of the Act relating to buy-back of securities.

The provisions of the Act relating to buy-back of securities are also not applicable to the extent of the sanction of a High Court to any scheme of compromise or arrangement pursuant to Sections 391 to 394 of the Act.

In the case of *Union of India v. Sterlite Industries (India) Ltd.* (2003)-(113)-Comp Cas 0273, (Bom), the Court observed that the non obstante clause in Section 77A, namely "Notwithstanding anything contained in this Act....." means that notwithstanding the provisions of Section 77 and Sections 100 to 104, the company can buy-back its shares subject to compliance with the conditions mentioned in Section 77A without approaching the Court under Sections 100 to 104 or Section 391. Therefore, Section 77A is an enabling provision and the Court's powers under Sections 100 to 104 and Sections 391 are not in any way curtailed or affected. The provisions of Section 77A are applicable only to buy-back of securities under Section 77A and the conditions applicable to Sections 100 to 104 and Section 391 cannot be imported into or made applicable to buy-back of securities under Section 77A. Similarly, the conditions for buy-back of securities under Section 77A cannot be applied to a scheme under Sections 100 to 104 and Section 391, as the two operate in independent fields.

In the case of *Himachal Telematics Ltd. v. Himachal Futuristic Communications Ltd.* (1996) 86 Comp Cas 325 (Del) a scheme of amalgamation was to be undertaken. However, the transferee company had a subsidiary which was holding shares of the transferor company. An objection was raised that the sanction of the scheme of amalgamation would result in the buying back by the transferee company of shares of its subsidiary and would thereby violate the provisions of Sections 42 and 77 of the Act. Dealing with the argument regarding violation of Section 77, it was held that no violation would result as a consequence of sanctioning the scheme of amalgamation as the transferee company was not buying any of its own shares.

In *Gurmit Singh v. Polymer Papers Ltd.* (2003) 45 SCL 251 (CLB – N. Delhi),

petitions were filed under Sections 397 and 398 which empower the CLB to make such order as it deems fit with a view to put an end to the matters against which complaints were raised. Section 402 specifically empowers the CLB to order purchase of the shares or interest of any member of the company by other members or by the company and consequent reduction in the share capital. The issue considered in this case was whether this power of CLB is subject to compliance with the provisions of Section 77A in view of its *non obstante* clause. It was observed that the object of Section 77A is to put some checks and balances when a company, on its own, desires to buy-back its own shares and as such Section 77A has no application in a case where the CLB exercises its powers under Section 402. The contention that no court can bypass the provisions of Section 77A would only mean that the provisions of those sections empowering the Court to pass an order on a company to purchase its own shares would be nugatory. When the Legislature had intended that the CLB should have the power to order purchase of its own shares by a company with the purpose of putting an end to the matters complained of, it would never have intended that such a power was subject to the provisions of other sections. Thus, the powers of the CLB to pass an order directing a company to purchase its own shares in terms of Section 402 are not curtailed by the provisions of Section 77A. Moreover, Section 402 empowers the CLB to direct purchase of shares of a member not only by the company but even by other members.

It was also held that even assuming that Section 77A is a bar to give a direction to a company to purchase its shares, directions can be given to other members to purchase the shares of any member as long as the direction is with a view to put an end to the matters against which complaints were raised. The ultimate aim in such a direction is to safeguard the interest of the company and its members.

6. RULES AND REGULATIONS FOR BUY-BACK OF SECURITIES

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**.

The procedure to be followed for buy-back of securities by listed companies is contained in **Sections 77A, 77AA and 77B of the Companies Act, 1956 and the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998**, (referred to as 'the Regulations' hereinafter).

7. AUTHORITY AND QUANTUM OF BUY-BACK OF SECURITIES

Authority in the Articles

Buy-back of securities should be authorised by the Articles of Association of the company. [Section 77A(2)(a)]. In case the Articles do not contain such a provision, they should be amended appropriately authorizing the buy-back of securities. Such an amendment should be made either at a meeting preceding the meeting wherein

the resolution for buy-back is to be passed or at the same meeting wherein the resolution for buy-back is to be passed but the resolution for amendment of Articles should precede the resolution for buy-back of securities.

Board resolution and quantum of buy-back

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. [Proviso to Section 77A(2)]. The aforesaid limit is to be applied not to the number of securities to be bought back but to the amount required for buy-back of such securities.

The resolution authorizing buy-back should be passed at a meeting of the Board [Section 292(1)(aa)]. Such a resolution should not be passed by circulation or at a meeting of a committee of the Board. However, the methodology, mode of buy-back and other procedural requirements for buy-back may be delegated by the Board.

Shareholders' resolution and quantum of buy-back

By passing a special resolution, 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)].

Paid-up capital includes both equity and preference share capital.

Whereas unlisted companies should obtain shareholders' approval by passing the special resolution only at a duly convened general meeting, listed companies should obtain such approval by postal ballot.

The notice containing the special resolution proposed to be passed should be accompanied by an explanatory statement stating:

- (a) all material facts, fully and completely disclosed;
- (b) the necessity for buy-back;
- (c) the class of security intended to be purchased under the buy-back;
- (d) the amount to be invested under buy-back; and
- (e) the time limit for completion of buy-back [Section 77A(3)].

The detailed requirements in this regard, as laid down in the Regulations and Rules respectively for listed and unlisted companies, are explained later.

Maximum quantum of buy-back

A company cannot buy-back more than 25% of its total paid-up capital and free reserves. [Section 77A(2)(c)]. The aforesaid limit is to be applied not to the number of securities to be bought back but to the amount required for buy-back of such securities.

Buy-back of equity shares in any financial year should not exceed 25% of the total paid-up equity capital of the company. [Proviso to Section 77A(2)(c)].

A company may buy-back its entire (i.e. 100%) securities other than equity shares, viz. preference shares and any other securities as may be notified by the

Central Government from time to time, in a financial year, subject to the overall limit of 25% of the total paid-up capital and free reserves of the company.

Given below are illustrations of the quantum that the Board/shareholders can buy-back in certain situations:

Illustration A:

The capital structure of a company consists of:

- (a) 10,00,000 equity shares of ₹ 10 each fully paid-up.
- (b) Free reserves ₹ 7,50,00,000.

The Board can authorise buy-back upto 10% of the total paid-up equity share capital and free reserves, i.e. 10% of ₹ [1,00,00,000 + 7,50,00,000] = ₹ 85,00,000

However, buy-back of equity shares in a financial year cannot exceed 25% of the paid-up equity capital in that year and hence the Board cannot authorize buy-back of equity shares in excess of 25% of ₹ 1, 00,00,000 = ₹ 25,00,000.

Shareholders can approve buy-back upto 25% of paid-up capital and free reserves, i.e. 25% of ₹ [1,00,00,000 + 7,50,00,000] = ₹ 2,12,50,000, but this is subject to the overall limit of 25% of ₹ 1,00,00,000 = ₹ 25,00,000.

Illustration B:

The capital structure of a company consists of:

- (a) 10,00,000 equity shares of ₹ 10 each fully paid-up.
- (b) 10,00,000 equity shares of ₹ 10 each on which ₹ 5 is paid-up.
- (c) Free reserves ₹ 7,50,00,000.

The total paid-up equity share capital of the company is ₹ [1,00,00,000 + 50,00,000] = ₹ 1,50,00,000.

The Board can, within the overall limits, buy-back upto 10% of the total paid-up equity share capital and free reserves, i.e. 10% of ₹ [1,50,00,000 + 7,50,00,000] = ₹ 90,00,000.

The shareholders can approve buy-back upto 25% of paid-up capital and free reserves, i.e. 25% of ₹ [1,50,00,000 + 7,50,00,000] = ₹ 2,25,00,000.

However, the buy-back in the present case cannot exceed 25% of paid-up equity capital i.e. 25% of ₹ [1,00,00,000 + 50,00,000] = ₹ 37,50,000.

Illustration C:

The capital structure of a company consists of:

- (a) 10,00,000 equity shares of ₹ 10 each fully paid-up.
- (b) 10,00,000 equity shares of ₹ 10 each on which ₹ 5 is paid-up.
- (c) 10,00,000 equity shares of ₹ 10 each fully paid-up with differential rights as to voting.

(d) 1,00,000 preference shares of ₹ 100 each fully paid-up.

(e) Free reserves ₹ 7,50,00,000.

The total paid-up equity share capital of the company is ₹ [1,00,00,000 + 50,00,000 + 1,00,00,000] = ₹ 2,50,00,000.

The Board can draw upto 10% of the total paid-up equity share capital and free reserves, i.e. 10% of ₹ [2,50,00,000 + 7,50,00,000] = ₹ 1,00,00,000.

The shareholders can approve buy-back upto 25% of paid-up capital and free reserves, i.e. 25% of ₹ [2,50,00,000 + 1,00,00,000 + 7,50,00,000] = ₹ 2,75,00,000.

However, the buy-back of equity shares should be limited to 25% of the total paid-up equity capital of ₹ 2,50,00,000 = ₹ 62,50,000.

In both the cases of approval by the Board or the shareholders, the buy-back of preference shares can be done upto 100% i.e. 1,00,000 preference shares of ₹ 100 each as it is within the overall limit of ₹ 1,00,00,000 or ₹ 2,75,00,000 respectively.

Further offer of buy-back

Once the buy-back has been made with the authorization of the Board and not that of the shareholders, no further offer for buy-back of any securities can be made without the consent of shareholders accorded by a special resolution within 365 days reckoned from the date of the offer. [Second Proviso to Section 77A(2)].

However, the shareholders can make further offer within a period of 365 days, provided the aggregate of authorisation does not exceed the quantum specified in 1.3 and 1.4 above.

Illustration D:

Where an earlier offer up to 8% of the total paid-up equity capital and free reserves was made with the approval of the Board, no further offer can be made without the approval of shareholders within a period of 365 days reckoned from the date of offer, inspite of the fact that the Board is entitled to buy-back upto 10% of paid-up equity capital and free reserves but had drawn upon only 8% thereof.

8. AVAILABLE SOURCES FOR BUY-BACK OF SECURITIES

Sources of buy-back

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.

Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

Free reserves and securities premium account

While the surplus in the profit and loss account can be used for buy-back of securities, in case the profit and loss account shows a debit balance, such debit balance should first be deducted from free reserves.

Capital redemption reserve, revaluation reserve, investment allowance reserve, profit on re-issue of forfeited shares, profits earned prior to incorporation of the company and any other specific reserve are not available for distribution as dividend and hence do not form part of free reserves for the purpose of buy-back.

Even though Section 77A(1) provides that a company may buy-back its securities out of securities premium account, Sub-section (2) of Section 78 does not mention buy-back of securities as one of the purposes for which the balance in the securities premium account may be utilised. However, by virtue of the non obstante clause in Section 77A, namely 'Notwithstanding anything contained in this Act....', Section 77A prevails over Section 78. Therefore, the securities premium account can be utilized for buy-back of securities.

Illustration E:

The following reserves appear in the balance sheet of XYZ Limited.

- (a) Capital Redemption Reserve.
- (b) Debenture Redemption Reserve.
- (c) Dividend Equalization Reserve.
- (d) Foreign Currency Fluctuation Reserve.
- (e) General Reserve.
- (f) Securities Premium Account.
- (g) Statutory Reserve.
- (h) Investment Fluctuation Reserve.

Of the above, for the purpose of buy-back of securities, only the following are considered as free reserves:

- (i) Dividend Equalization Reserve.
- (ii) Foreign Currency Fluctuation Reserve (if not in the nature of provision).
- (iii) General Reserve.
- (iv) Securities Premium Account.
- (v) Investment Fluctuation Reserve.

Proceeds of issue

Buy-back may be made out of the proceeds of an issue of securities other than the same kind of securities as are proposed to be bought back.

The proceeds of an earlier issue of one kind of securities may be used for the purpose of buy-back of any other kind of securities. The proceeds of an issue of preference shares may be used to buy-back equity shares and the proceeds of an issue of equity shares may be used to buy-back preference shares.

However, the proceeds of issue of preference shares carrying differential rights as to dividend, voting etc. cannot be utilized *inter se* for the purpose of buy-back. For instance, the proceeds of issue of 10% preference shares cannot be utilized for buy-back of 8% preference shares, as these are of the same kind, though of different classes of shares.

There should be no direct nexus between the proceeds of an issue and buy-back of securities of a company. For instance, if equity shares had been issued by a company in 1994 and the funds raised therefrom were deposited in a bank account, buy-back of equity shares by the company in 2003 will be permissible from the funds in that account, if there is evidence to prove that, over the years, the aforesaid bank account has functioned as common pool for deposit of all the funds raised and no direct nexus can be established between the proceeds of the issue in 1994 and the buy-back in 2003.

Borrowings from banks/financial institutions

Where a company has borrowed any money from banks/ financial institutions for any purpose, it should not utilize such money for buy-back of securities. [Rule 8(e)]. Further, if any approval is required to be obtained from banks/financial institutions, such approval should be obtained before passing the Board resolution for buy-back of securities.

9. CONDITIONS TO BE FULFILLED AND OBLIGATIONS FOR BUY-BACK OF SECURITIES

- Only fully paid-up securities qualify for buy-back. [Section 77A (2)(e)].

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.

Fully paid-up securities, even if quoted below par on the stock exchanges, qualify for buy-back.

If a security has been issued at a discount, the payment of the total amount due thereon should be considered as a sufficient qualification for its buy-back.

- After buy-back, 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. However, the Central Government has the power to prescribe a higher debt-equity ratio for a class or classes of companies. [Section 77A(2)(d)].

For the purpose of computing debt-equity ratio, 'debt' includes:

- (i) long-term loans/deposits (repayable after 12 months) including interest bearing unsecured loans from government;
- (ii) debentures including convertible debentures (except the part of debentures which are compulsorily convertible into equity), until they are converted, irrespective of the maturity period;
- (iii) deferred payments;

redeemable preference shares due for redemption between 1 to 3 years.

'Equity' includes:

- (i) paid-up equity share capital;
- (ii) redeemable preference shares due for redemption after 3 years;
- (iii) share premium;
- (iv) free reserves less accumulated losses, arrears of unabsorbed depreciation, all items of assets which are of intangible nature or expenditure not written off;
- (v) Government subsidies.

- 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. [Section 77AA].

In any other case, the company is not required to transfer to the capital redemption reserve account a sum equal to the nominal value of the shares so bought back.

Such transfer to capital redemption reserve account will also not be required when buy-back is of securities other than shares.

- 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 77A(8)]. The date of further issue of securities, for this purpose, means the date of the resolution passed by the Board or shareholders, as the case may be.

Hence, an issue of preference shares may be made by a company within a period of 6 months from the date of completion of buy-back of equity shares and vice versa. 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. [Section 77A(8)].

An issue of shares in pursuance of a scheme of amalgamation, being by virtue of a court order, is permissible. However, no buy-back of securities should be undertaken while a petition for amalgamation is pending.

- No issue of any security including bonus shares should be made till the closure of offer of buy-back. [Regulation 19(1)(b) & Rule 8(1)(b)].
- 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. [Regulation 19(2)].
- 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. [Clause 40A (iii) of Listing Agreement of Mumbai Stock Exchange].
- 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.

- Promoters or persons acting in concert should not deal in the securities of the company while the buy-back offer is open. [Regulation 19(1)(e)].

10. DISPUTED SECURITIES KEPT IN ABEYANCE

Securities which are under dispute and have been kept in abeyance under Section 206A, or in respect of which transfer or transmission has not been effected, are not available for buy-back.

Before undertaking any buy-back, the company should ensure that no transfer deed is pending for registration.

11. RESTRICTIONS ON BUY-BACK OF SECURITIES IN CERTAIN CIRCUMSTANCES

- A company should not buy-back its securities if default subsists in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan or interest payable thereon to any financial institution or bank. [Section 77B(1)(c)].

Deposits for this purpose include deposits under Section 58A read with Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975.

- Buy-back should not be made if a company has defaulted in relation to preparation and filing of its annual return. [Section 77B(2)].

However, such a company may buy-back its securities after the default has been rectified.

- Buy-back should not be made in the event of any default in relation to payment of dividend to any equity or preference shareholder. [Section 77B(2)].

Where a dividend has been declared by a company but has not been paid in accordance with the provisions of the Act, the company may buy-back its securities only after payment of dividend and interest thereon as per the provisions of the Act.

- Buy-back should not be made in the event of default in preparation of the annual accounts. [Section 77B(2)].

Where the report of the statutory auditors of the company contains a qualification that annual accounts are not prepared as per the accounting standards or otherwise are not in accordance with the provisions of Section 211, the company cannot proceed to buy-back its securities.

- However, compounding of the aforementioned defaults or subsequent curing of the default may qualify as an enabling provision for buy-back.

- Buy-back should not be made by a company:

- (i) through any subsidiary company including its own subsidiary companies;
- (ii) through any investment company or group of investment companies. [Section 77B(1)(a) and (b)].

12. DECLARATION OF SOLVENCY

As per section 77A(6) where the Board or the shareholders of a listed company pass a resolution to buy-back shares, the company should, before making such buy-back, file with the Registrar and SEBI a declaration of solvency in the prescribed form.

A private company and a public company whose shares are not listed on a stock exchange should file the declaration of solvency with the Registrar in the prescribed form.

13. STAMP DUTY ON BUY-BACK

Transfer of shares attracts stamp duty vide Schedule I, entry 62 to the Indian Stamp Act, 1899. For completion of transfer of shares, a company is required to register the shares in the name of the transferee. In the case of buy-back, the shares bought back have to be statutorily extinguished within 7 days from the last date of completion of buy-back. Hence, no registration of such shares takes place in the name of the company. The names of the members/holders of the shares have to be struck off from the register of members if the entire holding is bought back. Therefore, buy-back cannot be considered as transfer and stamp duty would not be payable in a case where buy-back of shares takes place in physical form even if the shares are accompanied by an application form for transfer of shares in favour of the company. Further, buy-back of shares will not be construed as "release" falling under Article 55 of the Indian Stamp Act attracting stamp duty.

Shares received by the company for buy-back in electronic mode do not attract stamp duty in terms of the provisions contained in the Depositories Act, 1996.

14. INCOME TAX ASPECTS

Section 46A has been inserted in the Income Tax Act, 1961 with effect from the assessment year 2000-01. The said section provides that any consideration received by a securityholder from any company on buy back shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the securityholder as capital gains.

The computation of capital gains shall be in accordance with the provisions of Section 48 of the Income Tax Act, 1961.

In respect of Foreign Institutional Investors (FIIs), as per the provisions of Section 196D(2) of the Income Tax Act, 1961 no deduction of tax at source shall be made before remitting the consideration for equity shares tendered under the offer by FIIs as defined under Section 115AD of the Income Tax Act, 1961. NRIs, OCBs and other non-resident shareholders (excluding FIIs) will be required to submit a No Objection Certificate (NOC) or tax clearance certificate obtained from the Income Tax authorities under the Income Tax Act. In case the aforesaid NOC or tax clearance certificate is not submitted, the company should deduct tax at the maximum marginal rate as may be applicable to the category of shareholders on the entire consideration amount payable to such shareholders.

15. PROCEDURE AND PRACTICE FOR BUY-BACK OF SECURITIES

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.

15.1 BUY-BACK PROCEDURE FOR LISTED SECURITIES

The procedure to be followed for buy-back of securities by listed companies is contained in Sections 77A, 77AA and 77B of the Companies Act, 1956 and the **Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998**, (referred to as 'the Regulations' hereinafter) and is detailed below:

(i) Amendment of Articles

As per Section 77A(2) of the Companies Act, 1956, a buy-back must be authorised by the articles of association of the company. It is, therefore, necessary for a company proposing to resort to a buy-back to make sure that such an authority exists in its articles. If the articles do not contain such a provision, the company must follow the procedure laid down in Section 31 of the Companies Act, 1956 for altering its articles to incorporate such a provision by passing a special resolution and filing a certified true copy of the same alongwith Form No. 23, with the concerned Registrar of Companies, for registration as required by Section 192 of the Act. (See Annexure 2)

(ii) Approval of Shareholders

In terms of Sub-section (2)(b) of Section 77A, a buy-back must be approved by a special resolution. However, a special resolution at a general meeting is not necessary where buy-back is or less than ten per cent of the total paid-up equity capital and free reserves of the company and such buy-back has been authorised by the Board of Directors of the company by means of a resolution passed at its meeting and not by way of a resolution of board of directors passed by circulation. (See Annexure 3)

In case of a listed company, the approval of shareholders should be taken only by way of postal ballot [Section 192A].

Sub-regulation (1) of Regulation 5 of the Regulations, lays down that for the purposes of passing a special resolution under Sub-section (2) of Section 77A of the Companies Act, 1956 the explanatory statement to be annexed to the notice for the general meeting pursuant to Section 173 of the Companies Act shall contain disclosures as specified in Schedule I to the Regulations.

Sub-regulation (2) provides that a copy of the resolution passed at the general meeting under Sub-section (2) of Section 77A of the Companies Act, 1956 shall be filed with Securities and Exchange Board of India ("SEBI") and the stock exchanges where the shares or other specified securities of the company are listed, within seven days from the date of passing of the resolution. Regulation 5A of the Regulations, provides the following conditions subject to which a company may buy back its shares or other specified securities when authorised by a Board resolution pursuant to proviso to Section 77(A)(2)(b) of Companies Act:

- (a) before making a public announcement under Regulation 8(1), a public notice shall be given in atleast one English national daily, one Hindi national daily

and a regional language daily, all with wide circulation at the place where the registered office of the company is situated.

- (b) the public notice shall be given within 2 days of the passing of the resolution by the Board of Directors.
- (c) the public notice shall contain the disclosures as specified in Schedule I of the Regulations.

Also, a copy of the resolution, passed by the Board of Directors at its meeting, authorising buy back of its shares or other specified securities, shall be filed with the SEBI and the stock exchanges where the shares or other specified securities of the company are listed, within two days of the date of passing a special resolution.

All the shares or other specified securities for buy-back must be fully paid-up [Section 77A(2)(e)].

(iii) Special Resolution and Explanatory statement to be annexed

Where buy-back of securities needs the approval of the company at a general meeting by special resolution, Sub-section (3) of Section 77A provides that the notice of the meeting at which the special resolution authorising the buy-back is proposed to be passed should be accompanied by an explanatory statement stating:

- (a) a full and complete disclosure of all material facts;
- (b) necessity for the buy-back;
- (c) class of security intended to be purchased under the buy-back;
- (d) amount to be invested under the buy-back; and
- (e) time limit for completion of the buy-back.

Exceptional importance has been given to the explanatory statement in the SEBI Buy-back Regulations because maximum disclosures can be made through it.

According to Regulation 7 of the Regulations, the explanatory statement annexed to the notice under Section 173 of the Companies Act, should contain the following additional disclosures:

(iv) Explanatory statement

An explanatory statement containing full and complete disclosure of all the material facts and the disclosures prescribed in Schedule I of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders' approval.

The explanatory statement should include the following [Regulation 5(1)]:

- (i) the date of the Board meeting at which the proposal for buy-back was approved by the Board;
- (ii) an indication that the shareholders at the general meeting may authorise the Board to adopt at the appropriate time one of the methods referred to in sub-regulation (1) of Regulation 4;
- (iii) the maximum amount required under the buy-back and the sources of funds from which the buy-back would be financed;

- (iv) the basis of arriving at the buy-back price;
- (v) the number of securities that the company proposes to buy-back;
- (vi)
 - (a) the aggregate shareholding of the promoter and of the directors of the promoter company, where the promoter is a company, and of persons who are in control of the company as on the date of the notice convening the general meeting or the meeting of the Board;
 - (b) the aggregate number of equity shares purchased or sold by persons including persons mentioned in (a) above during a period of 6 months preceding the date of the Board meeting at which the buy-back was approved till the date of notice convening the general meeting;
 - (c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;
- (vii) intention of the promoters and persons in control of the company to tender their specified securities for buy-back indicating the number of specified securities, details of acquisition, with dates and price;
If the promoters and persons in control of the company do not intend to tender their securities for buy-back, it is desirable that the reasons thereof are given in the explanatory statement.
- (viii) a confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institution or bank;
- (ix) a confirmation that the Board has made a full enquiry into the affairs and prospects of the company and that it has formed the opinion:
 - (a) that immediately following the date on which the general meeting or the meeting of the Board is convened there will be no grounds on which the company could be found unable to pay its debts;
 - (b) as regards its prospects for the year immediately following that date that, having regard to the intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in the view of the Board be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
 - (c) in forming their opinion for the above purposes, the directors have taken into account the liabilities as if the company were being wound up under the provisions of the Act (including prospective and contingent liabilities).
- (x) a report addressed to the Board by the company's auditors stating that:
 - (i) they have inquired into the company's state of affairs;
 - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined; and
 - (iii) the Board has formed the opinion as specified in clause (x) on

reasonable grounds and that the company will not, having regard to its state of affairs, be rendered insolvent within a period of one year from that date.

(v) Nomination of compliance officer

The company should nominate a compliance officer for ensuring compliance of the provisions of the Act, the Regulations, listing agreement and any other applicable laws relating to buy-back of securities and to redress the grievances of the investors. [Regulation 19(3)].

For this purpose, a Board resolution should be passed and Form 1AA and Form 1AB of the Companies (Central Government's) General Rules and Forms, 1956 should be filed with the Registrar by the person designated as compliance officer.

Specimens of Form 1AA and Form 1AB are given at Annexures VII and VIII.

The name, telephone no., fax no. and e-mail ID of the compliance officer should be given in the public announcement and letter of offer.

(vi) Investor service centre

The company should have at least one investor service center. It is desirable that such centers are opened in all such cities where the securityholders holding 10% or more of voting rights reside. [Regulation 19(3)].

(vii) Appointment of merchant banker

The company should appoint a merchant banker registered with SEBI, for buy-back of securities through any of the modes specified. Such appointment should be made before the public announcement for buy-back of securities.

(viii) Time limit for completion of buy-back

Every buy-back must be completed within twelve months from the date of passing of the special resolution or the resolution of the Board of Directors (i.e. in case of buy-back is or less than ten per cent of the total paid-up equity capital and free reserves of the company), as the case may be. [Section 77A(4)].

(ix) Methods of buy-back

According to Sub-section (5) of Section 77A, a buy-back may be made:

- (a) from the existing security-holders on a proportionate basis; or
- (b) from the open market; or
- (c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such market lot, as may be specified by the stock exchange; or
- (d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

According to Regulation 4 of the Regulations, a company may buy back its own shares or other specified securities by any one of the following methods:

- (a) from the existing security-holders on a proportionate basis through the tender offer;
- (b) from the open market through:
 - (i) book-building process,
 - (ii) stock exchange
- (c) from odd-lot holders.

(ix)(a) Buy-back from existing security-holders through tender offer

According to Regulation 6 of the Regulations, a company may buy back its securities from its existing security-holders on a proportionate basis in accordance with the provisions of the Regulations.

Public announcement—Filing of offer documents specified

Sub-regulation (1) of Regulation 8 of the regulations, provides that the company which has been authorised by a special resolution or a resolution passed by board at their meeting, should before the buy-back of securities make a public announcement in at least one English national daily, one Hindi national daily and a regional language daily all with wide circulation at the place where the registered office of the company is situated, containing all the material information as specified in Schedule II to the Regulations. (See Schedule II of Annexure 1)

Sub-regulation (2) of Regulation 8 provides that the public announcement should specify a date, which would be the 'specified date' for the purpose of determining the names of the security-holders to whom the letter of offer is required to be sent. The specified date should not later than 30 days from the date of public announcement [Sub-regulation (3) of Regulation 8].

Filing of offer documents with SEBI

Sub-regulation (4) of Regulation 8 provides that the company shall, within seven working days of the public announcement, file with SEBI, a draft letter of offer containing disclosures as specified in Schedule-III to the regulations, through a merchant banker who is not associated with the company.

The draft letter of offer should be accompanied by the fees specified in Schedule IV to the regulations [Sub-regulation (5) of Regulation 8].

Despatch of letter of offer to shareholders

The letter of offer should be despatched to the shareholders not earlier than twenty-one days from its submission to SEBI under Sub-regulation (4) [Sub-regulation (6) of Regulation 8];

If within twenty-one days from the date of submission of the draft letter of offer, SEBI specifies any modification in the draft letter of offer, the merchant banker and the company are required to carry out such modifications before the letter of offer is despatched to the shareholders.

Offer procedure

Regulation 9 of the SEBI Regulations lays down the following procedure for

making of the offer for buy-back of shares:

1. The offer for buy-back must remain open to the members for a period of not less than fifteen days and not exceeding thirty days.
2. The date of the opening of the offer must not be earlier than seven days or later than thirty days after the specified date.
3. The letter of offer must be sent to the security-holders so as to reach there before the opening of the offer.
4. If the number of securities offered by the security-holders is more than the total number of securities to be bought back by the company, the acceptances per security-holder should be equal to the acceptances tendered by the security-holders divided by the total acceptances received and multiplied by the total number of securities to be bought back. The acceptance per security holder can be decided by applying the following formula:

$$AS = \frac{ATS}{TA} \times NSB$$

Where AS = Acceptance per security holder
 ATS = Acceptance tendered by the security-holders
 TA = Total acceptances received
 NSB = Number of securities to be bought back

5. The company is required to complete the verification of the offers received, within fifteen days of the closure of the offer and the securities lodged will be deemed to be accepted unless a communication of rejection is made within fifteen days from the closure of the offer.

Escrow account

Regulation 10 of the SEBI Regulations provides that-

1. the company should as and by way of security for performance of its obligations under the Regulations, on or before the opening of the offer, deposit in an escrow account the sum as specified in Sub-regulation (2).
2. the escrow amount is payable in the following manner:
 - (i) if the consideration payable does not exceed ₹100 crores—25 per cent of the consideration payable;
 - (ii) if the consideration payable exceeds ₹100 crores—25 per cent upto ₹100 crores and 10 per cent thereafter;
3. the escrow account referred to above shall consist of:
 - (a) cash deposited with a scheduled commercial bank, or
 - (b) bank guarantee in favour of the merchant banker, or
 - (c) deposit of acceptable securities with appropriate margin, with the merchant banker, or
 - (d) a combination of (a), (b) and (c) above;

4. where the escrow account consists of deposit with a scheduled commercial bank, the company while opening the account, should empower the merchant banker to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the Regulations;
5. where the escrow account consists of bank guarantee, such bank guarantee shall be in favour of the merchant banker and valid until thirty days after the closure of the offer;
6. where the escrow account consists of securities, the company should empower the merchant banker to realise the value of such escrow account by sale or otherwise. If there is any deficit on realisation of the value of the securities, the merchant banker shall be liable to make good any such deficit;
7. in case the escrow account consists of bank guarantee or approved securities, these shall not be returned by the merchant banker till the completion of all obligations under the Regulations;
8. where the escrow account consists of bank guarantee or deposit of approved securities, the company is also required to deposit with the bank in cash, a sum of at least one per cent of the total consideration payable, as and by way of security for fulfilment of the obligations under the Regulations by the company;
9. on payment of consideration to all the security-holders who have accepted the offer and after completion of all the formalities of buy-back, the amount, guarantee and securities in the escrow, if any, should be released to the company;
10. SEBI, in the interest of the security-holders, may, in case of non-fulfilment of obligations under the Regulations by the company forfeit the escrow account either in full or in part;
11. the amount so forfeited may be distributed pro rata amongst the security-holders who accepted the offer and the balance, if any, shall be utilised for investor protection.

Payment to the Security holders

Regulation 11 of the Regulations lays down that—

1. The company should immediately after the date of closure of the offer, open a special account with a SEBI registered banker to an issue and deposit therein, such sum as would, together with the amount lying in the escrow account make up the entire sum due and payable as consideration for the buy-back and for this purpose, may transfer the funds from the escrow account.
2. Within seven days of the time specified in regulation 9(5), the company should either make the payment of consideration in cash to those security-holders whose offer has been accepted or return the security certificates to the security-holders. Payment by installments is thus not permissible.

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 Regulations 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 (1), 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.

Register of bought-back securities

The company is required to maintain a record of security certificates which have been cancelled and destroyed, as prescribed in Sub-section (9) of Section 77A of the Companies Act. According to the said section, where a company buys-back its securities, it shall maintain a register of securities so bought, the consideration paid for the securities bought back, the date of cancellation of securities, the date of extinguishment and physically destroying of securities and such other particulars, as may be prescribed under Rule 5C and Form No. 4B of General Rules and Forms.

Odd lot buy-back

The above provisions pertaining to buy-back from existing security-holders are also applicable to odd lot securities.

Buy-back from Open Market

Regulation 14 of the Regulations lays down that a buy-back of shares from the open market may be in any one of the following methods:

- (i) Through stock exchange.
- (ii) Book-building process.

Buy-back through the stock exchange

Regulation 15 of the Regulations provides that a company should 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.

Extinguishment of Certificates

Regulation 16 lays down that the provisions of Regulation 12 pertaining to extinguishment of certificates will be applicable *mutatis mutandis* and the company shall complete the verification of acceptances within fifteen days of the pay-out.

Buy-back through book-building

A company can buy-back its securities through the book-building process as provided hereunder:

1. (a) The special regulation as in Regulation 5 or 5A, should specify the maximum price at which the buy-back will be made.
- (b) The company should appoint a merchant banker.
- (c) A public announcement as referred to in Regulation 8 shall be made at least seven days prior to the commencement of the buy-back.
- (d) Subject to the provisions of Sub-clauses (i) and (ii), the provisions of Regulation 10 regarding escrow account are applicable:
 - (i) The deposit in the escrow account should be made before the date of the public announcement.
 - (ii) The amount to be deposited in the escrow account should be determined with reference to the maximum price as specified in the public announcement containing detailed methodology of the book-building process, manner of acceptance, format of acceptance to be sent by the security-holders pursuant to public announcement and details of bidding centres.
- (e) A copy of the public announcement must be filed with SEBI within two days of the announcement along with the fees as specified in Schedule

IV to the Regulations. The Public announcement shall also contain the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the security holders pursuant to the public announcement and the details of bidding centres.

- (f) The book-building process should be made through an electronically linked transparent facility.
 - (g) The number of bidding centres should not be less than thirty and there should be at least one electronically linked computer terminal at all the bidding centres.
 - (h) The offer for buy-back should be kept open to the security-holders for a period of not less than fifteen days and not exceeding thirty days.
 - (i) The merchant banker and the company should determine the buy-back price based on the acceptances received and the final buy-back price, which should be the highest price accepted should be paid to all holders whose securities have been accepted for the buy-back.
2. The provisions of Regulation 9(5) pertaining to verification of acceptances and the provisions of Regulation 11 pertaining to opening of special account and payment of consideration are applicable *mutatis mutandis*.

Extinguishment of certificates

The provisions of Regulation 12 pertaining to extinguishment of certificates are applicable *mutatis mutandis*.

Declaration of solvency to be filed with SEBI

In the case of buy-back of listed securities, before making a buy-back, the company must file with the Registrar of Companies and SEBI, a declaration of solvency in the prescribed form and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company and as a result has formed an opinion that the company is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom should be the managing director, if any.

Regulation 8(7) lays down that the company shall file along with the draft letter of offer, the declaration of solvency in the prescribed form and in a manner prescribed in Section 77A(6) of the Companies Act, 1956.

Section 77A(8) of the Companies Act, 1956 provides that where a company completes a buy-back, it shall not make a further issue of same kind of shares or other specified securities including allotment of further shares under Section 81(1)(a) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Filing of return of boughtback securities with Registrar

After completion of buy-back, the company should, within thirty days of its completion, file with the Registrar and SEBI, a return containing the prescribed particulars relating to the buy-back [Section 77A(10)].

Punishment for default

Section 77A(11) of the Act provides that if a company default in complying with the provisions of this section or any rules or regulations made thereunder, the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both.

Transfer of certain sums to capital redemption reserve account

Where a company purchases its shares out of free reserves, a sum equal to the nominal value of the shares so purchased should be transferred to the capital redemption reserve account of the company and details of such transfer shall be disclosed in the balance sheet (Section 77AA).

Obligations of the company

According to Regulation 19 of the Regulations,

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.

Communication with Authorities

A ready referencer in respect of communication with various authorities in a buy-back is given below:

1. *Registrar of Companies (ROC)*
 - (a) File Form No. 23 within 30 days from the date of passing of the special resolution;
 - (b) File declaration of solvency before the buy-back;
 - (c) File return of securities bought back within 30 days of the completion of buy-back.
2. *Securities & Exchange Board of India (SEBI)*
 - (a) File a copy of the special resolution within 7 days from the date of passing of the resolution;
 - (b) File a copy of the public announcement within two days of the announcement;
 - (c) File the draft letter of offer, within seven working days of the public announcement, where the securities are to be bought back from the existing security-holders;
 - (d) File declaration of solvency before the buy-back;
 - (e) File certificate of compliance regarding extinguishment and physical destruction of securities bought back within seven days;
 - (f) File return of securities bought back within 30 days of the completion of buy-back.
3. *Stock Exchange (where securities of the company are listed)*
 - (a) Intimate about the Board meeting of the company convened to decide the scheme of buy-back;

- (b) Inform the decision taken at the Board meeting in regard to the buy-back;
- (c) File a copy of the special resolution within seven days from the date of passing of the resolution;
- (d) Furnish particulars of the security certificates extinguished and destroyed within seven days of the extinguishment and destruction of the certificates.

Obligations of the merchant banker

Regulation 20 provides that the merchant banker should ensure that:

- (a) the company is able to implement the offer;
- (b) the provision relating to escrow account has been made;
- (c) firm arrangements for monies for payment to fulfil the obligations under the offer are in place;
- (d) the public announcement of buy-back is made and the letter of offer has been filed in terms of the Regulations;
- (e) the merchant banker should furnish to SEBI, a due diligence certificate which should accompany the draft letter of offer;
- (f) the merchant banker should ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary.
- (g) the merchant banker should ensure compliance of Section 77A and Section 77B of the Companies Act, and any other applicable laws or rules in this regard;
- (h) upon fulfilment of all obligations by the company under the Regulations, the merchant banker should inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company and send a final report to SEBI in the specified form, within 15 days from the date of closure of the buy-back offer.

Action against market intermediaries

Regulation 21 of the Regulations provides that SEBI may, on failure of the merchant banker to comply with the obligations or failing to observe due diligence, initiate action against the merchant banker in terms of the SEBI (Merchant Bankers) Regulations, 1992.

SEBI may, on the failure of a Registrar or a broker to comply with the provisions of these Regulations or failing to observe due diligence, initiate action against the Registrar or the broker in terms of the Regulations applicable to such intermediaries.

SEBI's power to order investigation

Regulation 22 empowers SEBI to suo-moto or upon information received by it, cause an investigation to be made in respect of the conduct and affairs of any person associated with the process of buy-back, by appointing an officer of SEBI;

The investigations may be made for the following purposes, namely:

- (a) to ascertain whether there are any circumstances which would render any person guilty of having contravened any of these Regulations or any directions issued thereunder;
- (b) to investigate into any complaint of any contravention of the Regulation, received from any investor, intermediary or any other person.

An order passed under Sub-regulation (1) is sufficient authority for the Investigating Officer to undertake the investigation and on production of an authenticated copy of the order, the person concerned is bound to carry out the duty imposed on him under these Regulations.

Duty to produce records, etc.

Regulation 23 lays down that

1. It is the duty of every person in respect of whom an investigation has been ordered to produce before the Investigating Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as he may require for the purposes of the investigation.
2. Such person shall—
 - (a) extend to the Investigating Officer reasonable facilities for examining any books, accounts and other documents in his custody or control, kept in any form, reasonably required for the purposes of the investigation;
 - (b) to provide such Investigating Officer copies of such books, accounts and records which, in the opinion of the Investigating Officer, are relevant to the investigation or, as the case may be, allow him to take out computer printouts thereof;
 - (c) to provide the required assistance and co-operation in connection with the investigation and to furnish information relevant to such investigation as may be sought by such officer.
3. The Investigating Officer for the purpose of investigation, has the full powers:
 - (a) of summoning and enforcing the attendance of persons;
 - (b) to examine orally and to record on oath the statement of the persons concerned, any director, partner, member or employee of such person.

Submission of Report

The Investigating Officer shall, on completion of his investigation, after taking into account all relevant facts and circumstances, submit a report to the Board and on receipt of the report, the Board may initiate such action as it may be empowered to do in the interests of investors and the securities market. (Regulation 24)

SEBI's power to issue directions

Regulation 25 lays down that—

1. SEBI may in the interest of the securities market and without prejudice to its

right to initiate action including criminal prosecution under Section 24 of the SEBI Act give such directions as it deems fit including:

- (a) directing the person concerned not to further deal in securities in any particular manner;
 - (b) prohibiting the person concerned from cancelling any of the securities bought back in violation of the Companies Act;
 - (c) directing the person concerned to sell or divest the securities acquired in violation of the provisions of these regulations or any other law or regulations;
 - (d) taking action against intermediaries registered with SEBI in accordance with the regulations applicable to them;
 - (e) prohibiting the persons concerned, its directors, partners, members, employees and associates of such persons from accessing the securities market;
 - (f) disgorgement of any ill-gotten gains or profit or avoidance of loss;
 - (g) restraining the company from making a further offer for buy-back.
2. In case any person is guilty of insider trading or market manipulation, the person concerned shall be dealt with in accordance with the provisions of SEBI (Prohibition of Insider Trading) Regulations 1992 and SEBI (Provision of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995.

SEBI's power to remove difficulties

Regulation 26 provides that in order to remove any difficulties in the interpretation or application of the provisions of these Regulations, SEBI has the power to issue directions through guidance notes or circulars. However, any direction issued by SEBI in a specific case relating to interpretation or application of any provision of these Regulations can be done only after affording a reasonable opportunity to the concerned parties and after recording reasons for the direction.

BUY-BACK PROCEDURE FOR PRIVATE LIMITED & UNLISTED PUBLIC LIMITED COMPANIES

The procedure to be adopted for buy-back of securities by private limited companies and by unlisted public limited companies is laid down in Sections 77A, 77AA and 77B of the Companies Act, 1956 and the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999 [hereinafter referred to as 'the Rules'] issued by the Central Government.

The procedure is detailed below:

(i) Buying-back

According to Rule 3, an unlisted company can buy-back its shares from the existing shareholders on a proportionate basis through private offers or by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. The process of buy-back of shares begins with the approval of the Board of Directors of the Company. The Board will pass the necessary resolutions approving the proposal for buy-back.

(ii) Contents of explanatory statement

When buy-back is subsequently to be approved by a special resolution passed in a general meeting of the company, the notice of the general meeting at which the special resolution is proposed to be passed should be accompanied by an explanatory statement.

In terms of Rule 4, for passing the required special resolution under Section 77A(2), the explanatory statement to be annexed to the notice for the general meeting pursuant to Section 173 of the Companies Act should, *inter alia*, contain the following disclosures: (See Schedule I of Annexure 4)

- (i) the date of the Board meeting at which the proposal for buy-back was approved by the Board;
- (ii) the necessity for the buy-back;
- (iii) the class of security intended to be bought-back;
- (iv) the method to be adopted for the buy-back;
- (v) the maximum amount required for the buy-back and the sources of funds to finance it;
- (vi) the basis of arriving at the buy-back price;
- (vii) the number of securities proposed to be bought-back;
- (viii) time limit for completion of buy-back;
- (ix) (a) the aggregate shareholding of the promoter and the directors of promoters, where the promoter is a company and of persons who are in control of the company as on the date of the notice convening the general meeting;
- (b) aggregate number of equity shares purchased or sold by persons including persons mentioned in (a) above during the period of six months preceding the date of the Board meeting at which the buy-back was approved till the date of notice convening the general meeting;
- (c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;
- (x) intention of the promoters and persons in control of the company to tender shares for buy-back indicating the number of shares, details of acquisition with dates and price;
- (xi) a confirmation that there are no defaults subsisting in the repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institution or bank;
- (xii) a confirmation that the Board of Directors has made a full enquiry into the affairs and prospects of the company and that they have formed the opinion:
 - (a) that immediately following the date on which the general meeting is convened there will be no grounds on which the company could be found unable to pay its debts;
 - (b) as regards its prospects for the year immediately following that date that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and

character of the financial resources which in their view will be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and

- (c) in forming their opinion for the above purposes, the directors should take into account the liabilities as if the company were being wound up under the provisions of the Companies Act, 1956 (including prospective and contingent liabilities).
- (xiii) a report addressed to the Board of Directors by the company's auditors stating that:
 - (a) they have inquired into the company's state of affairs;
 - (b) the amount of the permissible capital payment for the securities in question is in their view properly determined; and
 - (c) the Board of Directors have formed the opinion as specified in clause (xii) on reasonable grounds and that the company will not, having regard to its state of affairs, be rendered insolvent within a period of one year from that date.
- (xiv) the price at which the buy-back of shares will be made;
- (xv) if the promoters intend to offer their shares-
 - (a) the quantum of shares proposed to be tendered; and
 - (b) the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back including information of number of shares acquired, the price and the date of the acquisition.

(iii) Filing of letter of offer with Registrar

Rule 5 lays down that before buy-back, the company should file with the concerned Registrar of Companies a draft letter of offer containing the prescribed particulars as specified in Schedule II of the Rules (please see Annexure 4). The company should also file alongwith the letter of offer, a declaration of solvency in Form No. 4A prescribed under the Companies (Central Government's) General Rules and Forms, 1956 and in accordance with the provisions of Section 77A(6) of the Companies Act, 1956. (See Schedule II of Annexure 4)

(iv) Offer Procedure

According to the Rule 6, the letter of offer should be despatched immediately after filing with the Registrar of Companies but not later than 21 days from such filing.

The offer should remain open to the members for a period of not less than fifteen days and not exceeding thirty days from the date of despatch of the letter of offer.

In case the number of shares offered by the shareholders is more than the total number of shares to be bought back by the company, the acceptance per shareholder should be on proportionate basis.

The company should complete the verification of the offers received within 15 days of the closure of the offer and the shares lodged will be deemed to be accepted

unless a communication of rejection is made within 21 days from the closure of the offer.

(v) Payment to shareholders

Rule 7 provides that the company should immediately after the date of closure of the offer open a special bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the buy-back in terms of the Rules.

The company should within 7 days of the specified period make the payment of consideration in cash or bank draft/pay order to those shareholders whose offer has been accepted or return the share certificates to the shareholders forthwith.

(vi) General obligations of the company

According to Rule 8, following are the general obligations of the company:

- (a) The letter of offer should contain true, factual and material information and 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 should not issue any shares including by way of bonus till the date of closure of the offer under these rules.
- (c) The company should confirm in its offer the opening of a separate bank account testifying the availability of funds earmarked for this purpose and pay the consideration only by way of cash or Bank draft/pay order.
- (d) The company should not withdraw the offer to buy-back after the draft letter of offer is filed with the Registrar of Companies.
- (e) The company should not utilise any money borrowed from Banks/Financial institutions for the purpose of buying back its shares.

(vii) Return to be filed with Registrar

After completion of the buy-back, the company should file with the Registrar of Companies, a return in the prescribed Form specified in Annexure 'A' of the Rules [Rule 9].

(viii) Extinguishment of certificates

Rule 10 lays down that the company should extinguish and physically destroy the share certificates so bought back in the presence of a company secretary in whole-time practice within seven days from the date of acceptance of the shares.

The company should furnish a certificate to the Registrar of Companies duly verified by (a) two whole-time directors including the managing director and (b) company secretary in whole-time practice, certifying compliance of these rules including those specified in sub-rule (1) above within seven days of the extinguishment and destruction of the certificates.

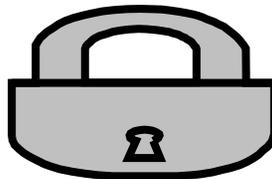
The company should maintain a record of share certificates which have been cancelled and destroyed within seven days of the buy-back of the shares.

(ix) Register of shares

The company should maintain a register of shares bought back by it, which should be in the prescribed format specified.

LESSON ROUND UP

- Financial restructuring of a company involves a rearrangement of its financial structure to make the company's finances more balanced.
- A company may reorganize its capital in different ways, such as reduction of paid up share capital; conversion of one type of shares into another; conversion of shares into debentures or other securities.
- Section 100 of the Companies Act deals with reduction of capital which means reduction of issued, subscribed and paid up capital of the company.
- Section 77A of the Companies Act is an exception to the prohibition under Section 77 as it allows companies to buy-back their own shares as well as 'other specified securities', subject to the conditions specified therein.
- Under Section 77A, any company limited by shares or company Ltd. 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 of securities of listed companies are guided by SEBI (Buy-back of Securities) Regulations, 1998.
- The buy-back in respect of securities which are not listed on any recognized stock exchange must be in accordance with Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

SELF TEST QUESTIONS

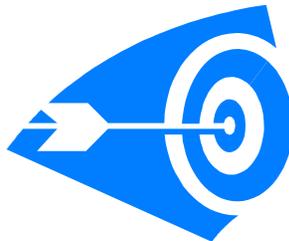
(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Briefly explain the need of financial restructuring and highlight reasons in the context of over capitalised and under capitalised companies.

2. What do you mean by 'buy-back' of shares or specified securities as under the Companies Act, 1956. Explain the relevant provisions.
 3. What are the different alternatives available to a public company for 'buy-back'?
 4. Enumerate the provisions relating to Escrow account and offer procedure as under SEBI (Buy-back of Securities) Regulations, 1998.
 5. Can private and unlisted public companies, buy-back their securities, if so, how?
-

STUDY X
LEGAL DOCUMENTATION

LEARNING OBJECTIVES



The importance of legal documentation in the corporate world cannot be overstated. One wrong provision may defeat the very purpose of the document. Mergers and takeovers in a company involve a number of legal documents. This chapter covers specimen of various documents involved in the process of mergers and takeovers.

A. INTRODUCTION

In this study an outline of procedural aspects of mergers and takeovers has been given along with specimen of various documents required for the purpose. The procedure for convening and holding of general meetings for approval of scheme of compromise or arrangement under Sections 391 to 394 of the Companies Act is laid down in Rules 67 to 87 of the Companies (Court) Rules, 1959. With regard to mergers, draft schemes and notices could be read from Study 3 and with regard to demergers, students may find a detailed write up in Study 7. However, the scope of this study is to give:

Mergers/Amalgamation

1. A brief reference to the procedural aspects of applicable provisions of the Companies Act, 1956 the Companies (Court) Rules, 1959 and the Income Tax Act, 1961 in the regard to mergers.
2. A list of the major and minor activities of mergers.
3. Specimen application to dispense with general meeting.
4. A specimen scheme of merger.
5. A specimen of the advertisement to be published in newspapers with regard to convening of a general meeting.
6. A specimen of the notice and explanatory statement.

7. A specimen of admission slip.
8. A specimen of proxy form.
9. A specimen of the advertisement of the petition to be published in newspapers.
10. A specimen of the resolutions of the Board of Directors.
11. Irrevocable letter of undertaking from shareholders in target company to accept offer made by offeror company.
12. Specimen format for offer document.
13. Specimen agreement entered into between the acquirer and the management of the offeree company.
14. Specimen form of acceptance of offer.
15. Notice to dissenting shareholder.
16. Resolution in respect of takeover by offeror company.
17. Specimen of board minutes of offeror company approving press announcement.
18. Draft board minutes.
19. Draft letter of authority from offeror company to its receiving bankers.
20. Draft power of attorney.
21. Disclosure in terms of Regulation 8(3).
22. Format of Disclosure.
23. Format of letter of offer.

B. MERGERS & AMALGAMATION

APPLICABLE PROVISIONS

As most of the provisions have already been explained only an outline of the procedural aspects has been given.

Under the Companies Act

- Section 391/394 – Presenting an application/petition to the appropriate High Court.

- Section 393 – Providing an explanatory statement about the various aspects of mergers.
- The Court Rules – Mainly to understand the formalities and formats.

Under the Listing Agreement

Under Clause 24(f) of the Listing Agreement, where the scheme of merger or demerger involves a listed company, it is necessary to send a copy of the scheme to the stock exchanges where the shares of the said company are listed to obtain their No Objection Certificate (NOC). Generally stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the takeover code or the Disclosure and Investor Protection Guidelines, Stock Exchanges accord their approval. Where the shares are listed on BSE or NSE, other Stock Exchanges wait for the approval by BSE or NSE before granting their approval.

Under the Income Tax Act, 1961

A scheme of amalgamation is not a transfer at all for the purpose of the Income Tax Act, 1961. However, when a scheme of merger or demerger involves the merger of a loss making company or a hiving off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, *inter alia*, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferor Company. Important aspects of Income Tax Act have already been dealt with in Study 3 and Study 7. Students are instructed to refer them.

Under the Indian Stamp Act

It is necessary to refer to the Stamp Act to check the stamp duty payable on transfer of undertaking through a merger or demerger.

MAJOR AND MINOR ACTIVITIES

MAJOR ACTIVITIES

Sl. No.	Description of Activity
1.	Board meeting to decide about the need for merger and for fixing the transfer date.
2.	Appointment of experts for valuation of shares and fixation of share exchange ratio; Appointment of experts/consultants for drafting the scheme.

3.	Board meeting to approve the valuation and share exchange ratio fixed by the experts and the scheme of merger.
4.	Filing a copy of the scheme with stock exchanges and obtaining their NOC.
5.	Filing an application to High Court for obtaining order of the court for convening a general meeting.
6.	Obtaining order of High Court
7.	Advertisement of general meeting and despatch of notice of general meeting
8.	General Meeting
9.	Filing of Chairman's report and affidavit with High Court
10.	Filing of a petition for sanction of scheme of amalgamation with the High Court
11.	Advertisement of the petition
12.	Obtaining the Sanction of the High Court
13.	Registration of the order of the High Court
14.	Application for appointment of auditor for scrutiny of books of post merger defunct transferor company
15.	Report of auditor
16.	Order of High Court for dissolution without winding up
17.	Registration of the order

MINOR ACTIVITIES

1. Scrutiny of Memorandum of both the companies with regard to power to amalgamate and the power of Transferee Company to carry on the activities of Transferor Company.
2. Preparation of a notice of Board Meeting to approve the merger proposal and to determine related issues.

3. Preparation of detailed notes on agenda with relevant statutory and other general references.
4. Despatch of notice of Board meeting and agenda papers.
5. Preparation of Press release, if thought fit.
6. Preparation of minutes of Board Meeting.
7. Preparation of application and affidavit to High Court.
8. Fixing up date, time and venue for the general meeting.
9. Preparation of text of advertisement.
10. Selection of newspapers.
11. Preparation of Notice of General Meeting and Explanatory Statement under Section 393 of the Act.
12. Despatch of Notice and explanatory statement to Members.
13. Appointment of scrutineers, if necessary.
14. Preparation of minutes of general meeting.
15. Preparation of chairman's report and affidavit.
16. Preparation of Petition.
17. Preparation of draft advertisement.
18. Selection of News Papers.
19. Filing of Book of documents with the Registrar of Companies for his report to Regional Director.
20. Filing of Affidavit of Regional Director with his NOC for the sanction of the scheme.
21. Follow up with OL for appointment of auditor, dissolution without winding up.

Notes:

- No meeting of creditors will be normally ordered.
- It is better to secure the approval or NOC of secured creditors.

SPECIMEN SCHEME OF ARRANGEMENT**SCHEME OF ARRANGEMENT****OF ABC LIMITED****WITH****XYZ LIMITED****1. Definitions**

In this Scheme, unless inconsistent with the subject or context

- 1.1 "Transferor Company" means ABC LIMITED, a Company incorporated under the Companies Act, 1956 having its Registered Office at _____.
- 1.2 "Transferee Company" means XYZ LIMITED a Company incorporated on under the Companies Act, 1956 having its Registered Office at _____.
- 1.3 "The Act" means the Companies Act, 1956.
- 1.4 "The Appointed Date" means _____ (in words).
- 1.5 "The Effective Date" means the last of the dates on which certified copies of the order(s) of the _____ High Court sanctioning the Scheme are filed with the Registrar of Companies, Tamilnadu.
- 1.6 "Undertaking" shall mean
 - (a) the entire business, all the assets, rights, licenses, and properties of the Transferor Company as on the Appointed Date.
 - (b) all the debts, liabilities, duties and obligations of whatsoever kind of the Transferor Company as on the Appointed Date including liabilities for payment of gratuity, superannuation benefits, provident fund and compensation in the event of retrenchment and the liabilities as appearing in its Provisional Balance Sheet as on 31st March _____.

Provided that to the extent that there are any loans, outstandings or balances due from the Transferor Company to the Transferee Company or vice versa, the obligations in respect thereof shall come to an end and corresponding effect shall be given in the books of accounts and records of the Transferee Company.

- (c) without prejudice to the generality of the sub-clause (a) above, the undertaking of the Transferor Company shall include all the movable and

immovable properties, assets, both tangible and intangible including, land, buildings, furniture and fixtures, computers, vehicles, gensets, inventories, reserves, lease-hold rights, tenancy rights, industrial and other licenses, permits, authorizations, quotas, trademarks, goodwill, patents, letters of intent, investment in shares and other investments, raw materials, stock in trade, work-in-progress, finished goods, plant, machinery and equipment, tools and implements, goods in transit, advances of all kinds, deposits, book debts, outstanding monies, recoverable claims, agreements, arrangements and other industrial and intellectual property rights, easements, advantages, benefits and approvals, rights and benefits of all agreements, and other interests, including without any limitation, privileges, liberties, rights and powers of all kinds, nature and description whatsoever in any manner owned by, in relation to or connected with the Transferor Company.

- 1.7 "The Scheme" means this Scheme of Amalgamation in its present form or with any modifications approved or imposed or directed by the High Court at _____ or by the shareholders in general meeting.

2. Share capital

- 2.1 The Authorized Share Capital of the Transferor Company as per Balance Sheet is ₹ _____/- divided into _____ Equity Shares of ₹10/- each and _____ % cumulative convertible preference shares of ₹____/- each. The Issued, Subscribed and Paid-up Capital of the Transferor Company is ₹ _____/- divided into _____ Equity Shares of ₹____/- each which includes _____ equity shares of ₹____/- each amounting to ₹____/- allotted against consideration otherwise than cash.
- 2.2 The Authorized Share Capital of the Transferee Company as per Balance Sheet is ₹ _____/- divided into _____ Equity Shares of ₹10/- each and _____ % cumulative convertible preference shares of ₹____/- each. The Issued, Subscribed and Paid-up Capital of the Transferee Company is ₹ _____/- divided into _____ Equity Shares of ₹____/- each which includes _____ equity shares of ₹____/- each amounting to ₹____/- allotted against consideration otherwise than cash.

[In case the particulars mentioned as per latest audited balance sheet have undergone changes, due to allotment/transfer of shares/mere increase in capital/consolidation/split, make a mention of such developments and enclose proof of documents.]

3. Transfer of undertaking

With effect from the Appointed Date, the entire Undertaking of the Transferor

Company shall, without any further act, deed or order be transferred to and vested in or deemed to have been transferred to or vested in the Transferee Company in accordance with and pursuant to Section 394 of the Act.

4. Contracts, deeds, bonds and other instruments

Subject to other provisions contained in this Scheme, all contracts, deeds, bonds, agreements, instruments and writings and benefits of whatsoever nature to which the Transferor Company is a party subsisting or having effect immediately before the Effective Date and subject to such changes and variations in the terms, conditions and provisions thereof as may be mutually agreed to between the Transferee Company and other parties thereto shall remain in full force and effect against or in favour of the Transferee Company, as the case may be, and may be enforced by and/or against the Transferee Company as fully and effectively as if the Transferee Company was party thereto instead of Transferor Company.

Provided contracts if any between the Transferor and the Transferee Companies shall stand cancelled and amounts if any due by the Transferor Company to the Transferee Company or vice versa shall stand cancelled.

5. Position as to charges

The transfer/vesting of the Undertaking as provided above shall be subject to existing charges/hypothecation/mortgage (if any as may be subsisting) over or in respect of the said assets or any part thereof, including the encumbrances.

Provided however, that any reference to the assets of the Transferor Company which it has offered or agreed to be offered as security for any financial assistance or obligations, to any of the creditors of the Transferor Company, shall be construed as reference only to the assets pertaining to the Undertaking of the Transferor Company, as is vested in the Transferee Company by virtue of the aforesaid clause, to the end and intent that such security, mortgage and charge shall not extend or be deemed to extend, to any of the assets or to any of the other units or divisions of the Transferee Company.

6. Accounting policy

6.1 With effect from the Appointed Date, and subject to any adjustments, modifications as may, in the opinion of the Board of Directors of the Transferee Company be required, the reserves of the Transferor Company will be merged with those of the Transferee Company in the same form as they appeared in the financial statements of the Transferor Company with the identity of the reserves of the Transferor Company preserved at the hands of the Transferee Company.

6.2 The difference between the face value for which shares have been issued by

the Transferee Company to the members of Transferor Company in accordance with this scheme and the amount of share capital of the Transferor Company shall be accounted as Capital Reserves of the Transferee Company.

- 6.3 In case of any differences in the accounting policy between the Companies, the impact of the same will be quantified and adjusted in the revenue reserves to ensure that the financial statements of the Transferee Company reflect the financial position on the basis of consistent accounting policy.

7. Legal proceedings

If any suit, writ petition, appeal, revision or other proceedings of whatever nature (hereinafter called "the Proceedings") by or against the Transferor Company be pending as on the Effective Date, the same shall not abate, be discontinued or be in any way prejudicially affected by reason of the transfer of the undertaking of the Transferor Company or of anything contained in the Scheme, but the Proceedings may be continued, prosecuted and enforced by or against the Transferee Company in the same manner and to the same extent as it would or might have been continued, prosecuted and enforced by or against the Transferor Company as if the Scheme had not been made.

8. Operative date of the scheme

The Scheme, shall be operative from the Appointed Date.

9. Transferor company's staff, workmen and employees

All the staff, workmen and other employees in the service of the Transferor Company immediately before the transfer of the Undertaking under the Scheme shall become the staff, workmen and employees of the Transferee Company as on the Effective Date upon their respective existing conditions of service on the basis that:

- 9.1 Their service shall have been continuous and shall not have been interrupted by reason of the transfer of the Undertaking;
- 9.2 The terms and conditions of service applicable to the said staff, workmen or employees after such transfer shall not in any way be less favourable to them than those applicable to them immediately before the transfer; and
- 9.3 It is expressly provided that as far as Provident Fund, Gratuity Fund, Superannuation Fund or any other Special Fund created or existing for the benefit of the staff, workmen and other employees of the Transferor Company are concerned, upon the Scheme becoming effective, the Transferee Company shall stand substituted for the Transferor Company for all purposes whatsoever related to the administration or operation of such

Funds or in relation to the obligation to make contributions to the said Funds in accordance with the applicable provisions subject to which such Funds are in force. It is the aim and intent that all the rights, duties, powers and obligations of the Transferor Company in relation to such Funds shall become those of the Transferee Company and all the rights, duties and benefits of the employees employed in different units of the Transferor Company under such Funds shall be protected. It is clarified that the services of the employees of the Transferor Company will also be treated as having been continuous for the purpose of the aforesaid Funds or provisions.

10. Conduct of business by transferor company till effective date

With effect from the Appointed Date and upto the Effective Date:

- 10.1 The Transferor Company shall carry on and shall be deemed to carry on all its activities for and on account of and in trust for the Transferee Company.
- 10.2 All income or profit accruing to the Transferor Company and all expenses or losses incurred by it shall for all purposes be treated as income, profits, expenses and losses as the case may be of the Transferee Company.
- 10.3 The Transferor Company shall not, without the concurrence of the Board of Directors of the Transferee Company, alienate, charge, encumber or otherwise deal with the said undertaking or any part thereof except in the ordinary course of business.
- 10.4 The Transferor Company shall not without the written prior consent of the Transferee Company:
 - (i) undertake any new business;
 - (ii) declare any dividend;
 - (iii) issue any new shares by way of rights, bonus or otherwise.

11. Issue of shares by the transferee company

- 11.1 Upon the Scheme becoming finally effective, in consideration of the transfer and vesting of the Undertaking of the Transferor Company in the Transferee Company in terms of this Scheme, the Transferee Company shall subject to the provisions of this Scheme and without any further application or action or deed, issue at par and allot ___ Equity Share of ₹___/- (Rupees ___ Only) credited as fully paid in the Capital of Transferee Company to the shareholders of the Transferor Company whose names are found in the Registrar of Members of Transferor Company on the effective date for every ___ Equity Shares of the Face Value of ₹___/- each fully paid up.

- 11.2 If necessary, the Transferee Company shall before allotment of Equity shares in terms of the Scheme, increase its Authorised Share Capital by the creation of at least such number of Equity Shares of ₹____/- each as may be necessary to satisfy its obligations under the provisions of the Scheme.
- 11.3 The Equity Shares to be allotted as aforesaid, shall rank for dividend, voting and all other rights pari passu with the existing equity shares of the Transferee Company provided they shall not qualify for dividend declared in respect of the period prior to their allotment.
- 11.4 The Shareholders shall surrender to the Transferee Company their share certificates in the Transferor Company for cancellation thereof and for fresh issue by Transferee Company as per the said exchange ratio. In case of default by the shareholders of the Transferor Company to surrender their shares as aforesaid, upon issue and allotment of new shares by the Transferee Company to the Shareholders of Transferor Company, the share certificates in relation to the shares held by them in the Transferor Company shall be deemed to have been cancelled.
- 11.5 For the purposes as aforesaid, the Transferee Company shall, if and to the extent required, apply in and obtain the requisite consent or approval of the Reserve Bank of India and other Appropriate Authorities concerned, for the issue and allotment by the Transferee Company to the respective members of the Transferor Company of the Equity Shares of the Transferee Company in the ratio aforesaid.

12. Applications to High Court

On this Scheme being approved by the respective Boards of the Transferor Company and the Transferee Company, the two companies will, with reasonable despatch, apply to the High Court of_____ for sanctioning the Scheme, with modification, if any, and for dissolution of the Transferor Company without winding up.

13. Modifications/amendments to the scheme

- 13.1 The Transferor Company (by its Directors) and the Transferee Company (by its Directors) may agree to any modification or amendment to the Scheme or agree to any terms and/or conditions which the Court and/or any other authorities under law may deem fit to direct or impose or which may otherwise be considered necessary or desirable for settling any question or doubt or difficulty that may arise for implementing and/or carrying out the Scheme and do all acts, deeds and things as may be necessary, desirable or expedient for putting the Scheme into effect.
- 13.2 The Board of Directors of Transferor Company and Transferee Company are hereby authorised to do all acts, deeds and things to give such directions

and/or to take such steps as may be necessary or desirable for the purpose of giving effect to this Scheme or to any modification thereof, including any directions for settling any question or doubt or difficulty whatsoever that may arise in relation to the Scheme.

14. Dissolution of transferor company without winding-up

Upon this Scheme being sanctioned by the High Court under Section 394 of the Act and on its becoming effective, the Transferor Company shall be dissolved without winding up with effect from the Appointed Date, or such other date as may be fixed by the High Court.

15. Scheme conditional on approvals / sanctions

This Scheme is conditional upon and subject to:

- 15.1 the approval of the shareholders of both the Transferor and Transferee Company by requisite majority and the sanction of the Court being accorded to the Scheme.
- 15.2 the requisite resolution(s) under the applicable provisions of the said Act being passed by the shareholders of the Transferee Company for any of the matters provided for or relating to the Scheme including approval to the issue and allotment of Equity Shares in the Transferee Company to the members of the Transferor Company, as may be necessary or desirable.
- 15.3 the sanction of the High Court of Judicature at _____ under Section 391 and 394 of the said Act, in favour of the Transferor Company and the Transferee Company and to the necessary Order or Orders under Section 394 of the said Act, being obtained.

16. Effect of non-receipt of approvals / sanctions

In the event of any of the said sanctions and approvals not being obtained and/or the Scheme not being sanctioned by the High Court and/or the Order or Orders not being passed as aforesaid on or before the _____ or within such further period or periods as may be agreed upon between the Transferor Company and the Transferee Company through their respective Boards of Directors, the Scheme shall become null and void and each party shall bear and pay its respective costs, charges and expenses for and/or in connection with the Scheme of Amalgamation.

17. Expenses connected with the scheme

All costs, charges and expenses of the Transferor Company and the Transferee Company respectively in relation to or in connection with this Scheme and of carrying out and completing the terms and provisions of this Scheme and/or incidental to the completion of amalgamation of the said Undertaking of the Transferor Company in

pursuance of this Scheme shall be borne and paid solely by the Transferee Company.

For _____ Limited

Director

C. DOCUMENTATION FOR MERGER-DEMERGER

The following are the documents that are required in the process of merger/amalgamation as per the prescribed formats:

- Summons in Form No. 33 prescribed in the Companies (Court) Rules, 1959, for High Court's directions to convene general meetings of shareholders/class of shareholders/creditors/debenture holders, under Section 391 [Rule 67 of the Companies (Court) Rules].
- Affidavit in Form No. 34 in support of the summons [Rule 67].
- Notice in Form No. 36 prescribed in the Companies (Court) Rules, for convening general meetings of share-holders/class of shareholders/debenture holders/creditors, etc. on a direction of the High Court under Section 391 of the companies Act [Rule 73];
- Form of proxy in Form No. 37 prescribed in the Companies (Court) Rules, to be issued to the shareholders etc. for voting through proxy at the general meeting, if allowed by the Articles of Association of the company [Rule 73];
- Advertisement of notice of meeting in Form No. 38 [Rule 74];
- Report of the result of the meeting in Form No. 39 prescribed in the Companies (Court) Rules, to the High Court, by chairman of the general meeting called on the direction of the High Court [Rule 78].
- Form No. 23, along with which the certified true copies of the resolutions passed at the general meeting of shareholders are filed with the concerned Registrar of Companies for registration under Section 192 of the Companies Act.
- Petition to High Court in Form No. 40 prescribed in the Companies (Court) Rules, under Section 394 of the Companies Act, to confirm the scheme of merger/demerger. [Rule 79]

- Form No. 21 prescribed in the Companies (Central Government's) General Rules & Forms, 1956, for giving notice to the concerned Registrar of Companies, of the order of the High Court directing the holding of general meeting of the shareholders of the company, on the company's application under section 391 of the Companies Act, 1956.

SPECIMEN APPLICATION TO DISPENSE WITH GENERAL MEETING

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

C.A. NO. _____ of 201__ __

In the matter of Companies Act (1 of 1956)

And

In the matter of Scheme of Amalgamation of
_____ Limited with _____ Limited.

Applicant / Transferee Company

Affidavit filed on behalf of the Applicant

I, _____, son of Mr. _____, Hindu, aged about __ years, residing at _____, do hereby solemnly affirm and sincerely state as follows:

1. I am the Managing Director of _____ - Limited (hereinafter referred to as "the Applicant / Transferee Company"). I am duly authorised by a resolution of the Board of Directors of the Applicant Company passed on _____ to file this Affidavit on behalf of the Applicant Company. I am well aware of the facts of the case.
2. I state that _____ Limited (the Transferee Company) was incorporated under the provisions of the Companies Act, 1956 on the _____ as a private limited company under the name and style of _____ Private Limited. Subsequently the Transferee Company became a public limited company on _____. The Registered office of the Transferee Company is situated at _____.
3. The Authorized Share Capital of the Transferee Company as per the Balance Sheet as at _____ is ₹ _____/- divided into _____ Equity Shares of ₹ _____/- each. The Issued, Subscribed and Paid-up Capital of the Transferee Company is ₹ _____/- divided into _____ Equity Shares of ₹ _____/- each. The Transferee company is engaged in the business of _____. The Applicant Company has _____ shareholders as on date.

4. The main objects of the Transferee Company are set out in the Memorandum of Association annexed hereto. They are briefly:
 - (i)
 - (ii)
5. The financial year of the Transferee Company ends on the 31st day of March every year. A true copy of the audited accounts of the Transferee Company for the year ending 31st March 2001 is filed herewith.
6. I state that the _____ Private Limited (Transferor Company) was incorporated on the _____ as a private limited company under the name and style of “_____ Private Limited”. The Transferor Company became a public company on _____ and its name was changed to _____ Limited on _____. The Registered office of the Transferor Company is situated at _____.
7. The Authorized Share Capital of the Transferor Company as per the Balance Sheet as at _____ is ₹_____/ - divided into _____ Equity Shares of ₹_____/ - each and _____ % cumulative convertible preference shares of ₹_____/ - each. The issued, subscribed and paid-up capital of the Transferor Company is ₹_____/ - divided into _____ Equity Shares of ₹_____/ - each and _____ Redeemable Preference Shares of ₹_____/ - each. The Transferor Company is presently engaged in the business of _____.
8. I state that the Board of Directors of the Transferor Company and the Transferee Company have at their respective meeting held on the _____ considered and approved a Scheme of Amalgamation of _____ Limited, the Transferor Company with _____ Limited (the Transferee Company). A copy of the said scheme of Amalgamation is attached.
9. I state that the Transferor and Transferee are primarily engaged in the similar type of business viz. the business of _____. The members of the Transferee Company and their relatives hold more than ___% of the capital of the Transferor Company. The proposed scheme of amalgamation is expected to synergise the operations of Transferor and Transferee Companies, which would result in increased efficiency, better utilisation of the pooled administrative, managerial and financial position by one large company as compared with two companies. The merger of both the companies would improve the performance of the combined entity and the further integration of activities of both the companies, would also result in _____ which could be leveraged for raising additional capital

for securing trade on more favourable terms. Further the proposed scheme of Amalgamation will result in reduction of overheads, administrative and operational costs and avoid duplication of expenditure by both Companies. **The proposed amalgamation will enable a pooling of the financial, production, manufacture and distribution of resources of both the Companies to their best advantages.** The integration of production, management and staff of both the Companies will produce a strong and versatile organisation and lead to increased efficiency.

10. The Salient features of the Scheme are as under:

[Only broad heading have been given here. These may be explained in brief, by the company concerned.]

1. "The Appointed Date"
 2. Transfer of Undertaking
 3. Legal Proceedings
 4. Operative Date Of The Scheme
 5. Transferor Company's Staff, Workmen and Employees
 6. Issue of Shares by the Transferee Company
 7. Applications to High Court
 8. Dissolution of Transferor Company Without Winding-Up
11. I state that the transferor and transferee companies are doing well. The Transferor Company had made pre-tax profits of ₹___ Crores during 201_-201_. The Transferee Company had made pretax profits of ₹___ Crores during 201_-201_. Its reserves and surplus as on 31st March 201__ were ₹___ Crores. I state that the assets of the Transferor Company as well as the Transferee Company are more than adequate to meet their respective liabilities.
12. I further state that the Transferee Company will be in a position to discharge all the binding obligations of the Transferor Company and no prejudice will be caused to any creditor to the Transferor Company and Transferee Company. A list of sundry creditors (other than secured creditors) as at 31/03/201__ of the Transferee Company is annexed herewith. A list of its secured creditors as at 31/03/201__ of the Transferee Company is annexed. The Transferee Company has sent letters to the secured creditors informing them about the proposed merger. A copy of the said letter is also enclosed.

13. I state that no investigation proceedings are pending against the Transferor Company and the Transferee Company under sections 235 to 251 or any other provisions of the Companies Act, 1956. The Transferee Company and Transferor Company are not registered under the provisions of MRTP Act, 1969.
14. I state that the Applicant Company has ___ equity shareholders only. There are no outside shareholders involved in the Transferee Company. All the ___ equity shareholders of the Company have approved the Scheme of Amalgamation and have filed affidavits to this effect. The affidavits are filed herewith.
15. I respectfully submit that under these circumstances it may not be necessary to convene a meeting of the shareholders since the conclusion of such meeting is already foregone. The convening of the meeting of the shareholders, advertisement and issue of notices thereof will involve disproportionate expenditure of money and time. I respectfully submit that it is in the interests of the Applicant Company concerned and in the interests of its shareholders as well that the needless expenditure could be avoided, especially since one of the purposes of the amalgamation itself is to avoid duplication of expenditure by the Company.
16. It is therefore just and necessary that this Hon'ble Court may be pleased to dispense with the convening and holding of the meeting of the equity shareholders of the Transferee Company and pass such further orders as this Hon'ble Court may deem fit and proper in the circumstances of the case and thus render justice.

Solemnly affirmed at _____ this the _____ day of _____ and signed his name in my presence.

Form No. 38

SPECIMEN ADVERTISEMENT OF CONVENING OF GENERAL MEETING

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

Company Application No. ___ of 201__

In the matter of Section 391 of the Companies Act, 1956

And

In the matter of Scheme of Amalgamation of _____ Ltd. with _____ Ltd.

_____ Ltd., a company incorporated under the Companies Act, 1956
having its registered office at _____

_____ Applicant

Notice convening Meeting of Equity Shareholders (Specimen-I)

Notice is hereby given that by an order dated the _____ day of _____ 200--, the Court has directed a meeting to be held of the equity shareholders of the Applicant Company for the purpose of considering, and if thought fit, approving, with or without modification, the Scheme of Amalgamation proposed to be made between the Applicant Company and _____ Limited.

[Only broad headings have been given here. These may be given here in brief, by the company concerned.]

In pursuance of the said order and as directed therein, further notice is hereby given that a meeting of the equity shareholders of the said company will be held at _____ on ____ (enter the day) the _____ day (enter the date) of ____ 201_ (enter the year) at _____ (enter the time) at which time and place the said equity shareholders are requested to attend.

Copies of the Scheme of Amalgamation and of the Statement under Section 393 of the Companies Act, 1956 can be had free of charge at the Registered Office of the Company at _____ (enter the address), or at the office of its advocates M/s. _____ (enter the name(s) of the advocate) at _____ (enter the address of the advocates).

Persons entitled to attend and vote at the meeting may vote in person or by proxy, provided that all proxies in the prescribed form are deposited at the Registered Office of the company at _____ (enter the address) not later than 48 hours before the meeting. The quorum for the meeting shall be ____ (check the Articles and write accordingly) members present in person or by proxy. Forms of proxy can be held at the Registered Office of the company.

The Court has appointed Mr. _____, Managing Director of the company as the Chairman of the meeting. The above mentioned Scheme of Amalgamation, if approved by the meeting, will be subject to the subsequent approval of the Court.

Dated at _____ this ____ day of _____, 201--

Sd/-

_____ (enter the name),

Chairman appointed for the meeting.

SPECIMEN NOTICE OF MEETING OF EQUITY SHAREHOLDERS AND EXPLANATORY STATEMENT (SPECIMEN-II)

Form No. 36

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

Company Application No.____ of 201__

In the matter of Companies Act, 1956

And

In the matter of Scheme of Amalgamation of _____ Ltd. with _____ Ltd.

_____ Co. Ltd., an existing company under the Companies Act, 1956 and having its registered office at _____

_____ Applicant

Notice Convening Meeting

To

Equity shareholders,

TAKE NOTICE that by an order made on ___ day of _____ 201_, the Court has directed that a meeting of the equity shareholders of the company be held at _____” on ___day the ___ day of _____ 201_ at ___ AM/PM for the purpose of considering and, if thought fit, approving, with or without modification, the Scheme of Amalgamation proposed to be made between the Applicant Company and _____ Limited.

TAKE FURTHER NOTICE that in pursuance of the said order, a meeting of the equity shareholders of the Applicant Company will be held at “_____” on ___day the ___ day of _____ 201_ at ___ AM when you are requested to attend.

TAKE FURTHER NOTICE that you may attend and vote at the said meeting in person or by proxy, provided that a proxy in the prescribed form, duly signed by you, is deposited at the registered office of the company at _____ not later than 48 hours before the meeting. The quorum for the meeting shall be 5 members present in person or by proxy.

The Court has appointed Mr._____, Managing Director of the Applicant Company to be the Chairman of the said meeting.

A copy each of the Scheme of Amalgamation, the statement under Section 393 of the Companies Act, 1956 and a form of proxy and attendance slip are enclosed.

Dated at _____ this ____ 201__.

Sd/-

Chairman appointed for the meeting.

Note: All alterations made in the form of Proxy should be initialed.

EXPLANATORY STATEMENT UNDER SECTION 393 OF THE COMPANIES ACT, 1956

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

Company Application No. ____ of 201__

In the matter of Sections 391 to 394 of the Companies Act, 1956

And

In the matter of Scheme of Amalgamation of _____ Ltd. with _____ Ltd.

_____ Ltd.

Applicant Company

1. The Scheme

The Scheme of Amalgamation (hereinafter called "the Scheme" or "this Scheme" as the context may admit) provides for the amalgamation of your company the "_____ Limited", incorporated under the provisions of the Companies Act, 1956, on _____, with its registered office at _____ (herein referred as "your company" and in the Scheme as the Transferor Company) with _____ Limited, a company incorporated under the provisions of Companies Act, 1956 having its registered office at _____ (hereinafter called "the Transferee Company") pursuant to the relevant provisions of the Companies Act, 1956 (hereinafter called "the said Act").

2. Approval of Board of Directors

The Board of Directors of your company approved the said scheme of amalgamation on _____ and the Board of Directors of the Transferee Company had approved the scheme on _____.

3. Salient Features of the Scheme

- (a) As per the said scheme, the scheme shall operate from the _____, known as the Appointed Date. However the Scheme will be effective only after the dates on which certified copies of the order(s) of the High Court of Judicature at Madras sanctioning the Scheme are registered by the Registrar of Companies, Tamilnadu and the last of the said dates is known as "The Effective Date".
- (b) When the Scheme becomes effective, the scheme provides for transfer and vesting of the entire undertaking of your company with the Transferee Company (Clause 3) and for continuation of contracts, etc, executed by your company (Clause 4) and also continuation of legal proceedings by or against your company (Clause 6). The employees of your company will become the employees of the Transferee Company (Clause 8). Until the effective date, your company will be carrying on its business in trust for the Transferee Company (Clause 9).
- (c) The Transferee Company will issue equity shares of ₹10/- each credited as fully paid up to all the members of your company who remain as members on a record date which will be fixed by the Transferee Company after the effective date. The ratio for such issue of shares is 1:3 (Clause 10) as per details furnished in the paragraph given hereunder with the title "Exchange Ratio".
- (d) Clause 13 of the Scheme provides for dissolution of your company without winding up.

4. Objectives and Benefits of the Scheme

- (a) Both companies are primarily engaged in the business of manufacture_____. The Transferor Company _____ to the Transferee Company. The Transferee Company transfers electric power generated from its windmill to your company.
- (b) The Scheme permits the companies to take advantage of the natural synergy in their operations. This would result in increased efficiency, better utilization of the pooled administrative, managerial and financial position by one large company as compared with two companies.

- (c) The merger of both the companies would improve the performance of the combined entity and there is further scope for integration of activities of both the companies. Such integration would also result in creation of a big firm in the _____ industry, which could be leveraged for raising additional capital for securing trade on more favourable terms.
- (d) Further the scheme will result in reduction of overheads, administrative and operational costs and avoid duplication of expenditure by both companies. The scheme will enable pooling of the financial, production, manufacture and distribution of resources of both the companies to their best advantages. The integration of production, management and staff of both the companies will produce a strong and versatile organisation and leading to increased efficiency.

5. Valuation of Shares of both the Companies and Exchange Ratio

The valuation of shares of both the companies have been carried out by _____ Private Limited, who are experts in the relevant field and as per their recommendation, the Board of Directors of both the companies have approved an exchange ratio 1:3 meaning issue of 1 (one) equity share of ₹10/- each of the Transferee Company, credited as fully paid up in the capital of the Transferee Company for every 3 (three) fully paid up equity shares of ₹10/- each of your company held by those members of your company who hold such shares as per the Register of Members of your company on a record date to be fixed by the Transferee Company after the Effective Date. The Transferee Company will issue one redeemable preference share of ₹10/- each of the Transferee Company credited as fully paid up in the capital of the Transferee Company for 1 (one) redeemable preference share of ₹100/- each of your company held by preference shareholders of your company on such record date.

6. Memorandum of Disclosure of Interest

In the opinion of the Board of Directors of the Applicant company, the scheme of amalgamation is in the interest of the Applicant company and neither the rights and interests of the Applicant company nor the rights and interests of its members and creditors are likely to be prejudicially affected in any manner whatsoever by the proposed scheme of amalgamation.

7. No Objection of Secured Creditors

Separate letters have been sent to secured creditors of both the companies for their approval of the scheme and most of them have given their "in-principle" oral sanction to the scheme as the scheme offers benefits of consolidation.

8. Further Statutory Formalities

The scheme is subject to consent to be accorded by members of both the companies. The members of the Transferee Company being only _____ (_____ in words _____) in number have given their consent in the form of affidavits. The Hon'ble High Court of Judicature at _____ has directed the holding this Meeting of your company as per agenda and information given in the notice of the meeting for securing your consent. Further the scheme is subject to sanction by the Hon'ble _____ High Court and registration with Registrar of Companies.

Dated at _____ this _____ 201_.

Enclosed a copy of the scheme of amalgamation.

Sd/-

Chairman appointed for the meeting.

SPECIMEN NOTICE TO CREDITORS REGARDING PETITION UNDER SECTION 391

IN THE HIGH COURT OF JUDICATURE AT MUMBAI

Ordinary Civil Jurisdiction

Company Petition No. _____ of _____

Company Application No. _____ of _____

In the matter of Sections 391 and 394 of the Companies Act, 1956

And

In the matter of Scheme of Amalgamation between A Limited and B Limited

A Limited a company incorporated under the Companies Act, 1956, having its registered office at _____

_____ Petitioner

Notice to Creditors

PLEASE TAKE NOTICE that a Petition under Sections 391 and 394 of the Companies Act, 1956, for sanction of the Scheme of Amalgamation of the Petitioner Company with B Limited presented by the Petitioner Company on the _____, was admitted on the _____ day of _____, _____, and that the said

Petition is fixed for hearing before the Learned Judge taking company matters on _____ day the _____ day of _____, _____ at _____ A.M./P.M.

By the said Order dated _____, the Hon'ble Court has directed notice of hearing of the Petition to be given to you as a Creditor of the Petitioner Company having a Claim against us for ₹ _____

If you desire to support or oppose the said Petition at the hearing, you should give notice thereof in writing to us or to our Advocates, _____, having their office at _____, not later than four days before the date fixed for hearing of the Petition and appear on the aforesaid date either in person or by an Advocate entitled to practice in this Hon'ble Court. If you are desirous of opposing the said Petition, a copy of your affidavit should be presented with your notice.

A copy of the Petition will be furnished by our Advocates to you on payment of the prescribed charges for the same.

Dated this _____

Yours faithfully,

For _____ Limited

Director

SPECIMEN NOTICE CONVENING MEETING OF UNSECURED CREDITORS IN THE CASE OF A SCHEME OF COMPROMISE OR ARRANGEMENT (NOT BEING AMALGAMATION)

In the High Court of Judicature

At Bombay

Ordinary Original Civil Jurisdiction

Company Application No. _____ of _____

In the matter of Section 391 of the Companies Act, 1956 (Act 1 of 1956)

And

In the matter of _____ Private Limited

And

In the matter of Scheme of Compromise/Arrangement between
_____ Private Limited and its Unsecured Creditors.

_____Private Limited, a company incorporated under the Companies Act, 1956 and having its Registered Office at_____.

_____Applicant

Notice Convening Meeting of Unsecured Creditors

To,

Unsecured Creditors of the

Applicant Company

Take notice that by an order made on the _____ day of _____ 201__ the Hon'ble High Court of Judicature at _____ has directed that a meeting of the Unsecured Creditors of the Applicant Company be held at _____ 201__ on _____, the _____ day of _____ 201__ at _____ p.m. for the purpose of considering and, if thought fit approving, with or without modifications, the compromise/arrangement proposed to be made between the said Applicant Company and its Unsecured Creditors.

Take further notice that in pursuance of the said order a meeting of the Shareholders of the Company will be held at _____ on _____, the _____ day of _____ 201__ at _____ a.m. when you are requested to attend.

Take further notice that you may attend and vote at the said meeting in person or by proxy, provided that a proxy in the prescribed form, duly signed by you, is deposited at the Registered Office of the Company at _____, not later than 48 hours before the meeting.

This Court has appointed _____ and failing him, Mr. _____ to be the Chairman of the said meeting.

A copy each of the Scheme of compromise/Arrangement, the statement under Section 393 and a form of proxy is enclosed.

Dated this _____ day of _____ 201__.

Sd/-

Chairman appointed for the meeting

Note: All alterations made in the form of proxy should be initiated.

SPECIMEN ADMISSION SLIP

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

C.A. No. ____ of 2003

In the matter of Companies Act (Act 1 of 1956)

And

In the matter of Scheme of Amalgamation of X Limited with Y Limited.

_____ Applicant

Please complete the Admission Slip and hand it over at the entrance of the Meeting Hall.

Full name of member attending _____

Name of Proxy _____

(To be filled in if Proxy Form has been duly deposited with the Company)

I hereby record my presence at the Meeting of the Company held on _____
201__ pursuant to the Order dated _____ of the Hon'ble High Court of
Judicature at _____.

REG. FOLIO NO.	
NO. OF SHARES	
NAME OF THE SHAREHOLDER (IN BLOCK LETTERS)	
SIGNATURE OF THE SHAREHOLDER OR PROXY	

----- Cut here -----

Form No. 37**FORM OF PROXY**

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

C.A. No. _____ of 2003

In the matter of Sections 391(1) & 393 of the Companies Act (Act 1 of 1956)

And

In the matter of Scheme of Amalgamation of X Limited with Y Limited.

Applicant / Transferor Company

I _____ the undersigned as equity shareholder of the above company hereby appoint _____ of _____ and failing him _____ of _____, as my proxy, to act for me at the meeting of the equity shareholders to be held at " _____ " on _____ the ____ day of ____ 201__ at ____ AM/PM for the purpose of considering and, if thought fit, approving, with or without modification, the Scheme of Amalgamation proposed to be made between the Applicant Company and _____ Limited and at such meeting and any adjournment thereof, to vote, for me and in my name _____ [Here, 'if for' insert 'for', 'if against' insert 'against' and in the later case, strike out the words below the word "Amalgamation"] the said Scheme of Amalgamation either with or without modification as my proxy may approve.

Dated at _____ this _____ day of _____ 201__.



_____ Signature

Name: _____

Address: _____

Notes:

- (1) Please affix appropriate stamp before putting signature.
- (2) The proxy must be deposited at the Registered Office of _____ Ltd. not less than 48 hrs. before the time for holding the meeting.

SPECIMEN BALLOT PAPER FOR VOTING AT A MEETING CONVENED UNDER SECTION 391

A Limited

Registered Office: _____

Meeting of the Shareholders

on _____ day, _____, at _____ a.m.

Ballot Paper

Item: Amalgamation of A Limited and B Limited

Notes:

1. A member present in person or by proxy, is entitled to vote.
2. Please fill in all correct details before casting vote/s.
3. One share carries one vote only.

Full name of shareholder : _____

(Beginning with first name)

Ledger Folio Number : _____

Name of Proxy/Corporate : _____

Representative

VOTES CAST: No. of Votes	
FOR	AGAINST

Date: _____

Signature of shareholder/proxy

SPECIMEN ADVERTISEMENT OF PETITION

Form No. 5

IN THE HIGH COURT OF JUDICATURE OF _____

(ORIGINAL JURISDICTION)

C.P.No. ___ of 201__

(Connected with C.A. No. ___ of 201_)

In the matter of Companies Act (Act 1 of 1956)

And

In the matter of Scheme of Amalgamation of _____ Limited with _____ Limited

Petitioner/Transferor Company.

_____ Limited

Rep. By its Managing Director,

Mr. _____

FORM No.5

NOTICE OF PETITION

A petition under Sections 391 and 394 of the Companies Act, 1956 for sanctioning the Scheme of Amalgamation of the Petitioner Company with _____ Limited was presented by the Petitioner Company on the _____ and the said petition is fixed for hearing before the Company Judge on _____. Any person desirous of supporting or opposing the said petition should send to the Petitioner's advocates, notice of his intention, signed by him or his advocate with his name and address, so as to reach the Petitioner's advocates not later than 2 days before the date fixed for the hearing of the petition. Where he seeks to oppose the petition, the grounds of opposition or a copy of the affidavit shall be furnished with such notice. A copy of the petition will be furnished by the undersigned to any person requiring the same on payment of the prescribed charges for the same.

Dated at _____ this the ____ day of ____ 201__.

(Advocates for Petitioner)
_____ (Address)
_____.

Specimens of some of the above forms are given hereunder specimen important resolutions and outlines for agreement are given hereunder.

Mergers and Acquisitions – Specimen Resolutions and Agreements for Miscellaneous Purposes

BOARD RESOLUTIONS

I. Approval of merger of ABC Limited with XYZ Limited:

The Chairman informed the Board that ABC Ltd. company (enter the name of the

company) and XYZ Ltd. company is in the business of manufacturing _____, which is similar to the objects of our company and are group companies. He further added that in order to integrate and synergise the operations of the company it is necessary to merge the said company with our company.

The Chairman also brought to the notice of the directors the following important observations:

- The inter company transactions between ABC Ltd. and XYZ Ltd. companies for _____ (enter the advantages) and other provisions for transport, IT and allied services would get obviated.
- The combined turnover of the merged entity would be of the order of ₹ _____ crores.
- The merged entity's workforce would stand at around _____ (no. of employees) on direct employment.
- The merged entity's paid up capital would be above ₹ _____ crores.
- The fixed assets of the merged entity would be around ₹ _____ crores.
- The merged entity would own the trademarks _____ (enter the trademark's name), which are at present owned by the company.
- The merged entity will get better ranking in national level in terms of size and profits.
- The strength of the combined entity will give better opportunities for leverage.

The Chairman also brought to the notice of the Board the fact that major shareholdings of both the companies are more or less in the same group.

As regards statutory and other formalities, the Chairman said that the merger would require compliance of the provisions of the Companies Act, 1956 and the Income Tax Act, 1961. Merger would also require the sanction of _____ High Court.

The Board resolved as follows:

WHEREAS ABC Ltd. (enter this co.'s name) was incorporated on _____ and registered as a company under the Companies Act, 1956

WHEREAS XYZ Ltd. (enter the other co.'s name) was incorporated on _____ and registered as a company under the Companies Act, 1956

WHEREAS the main objects of ABC Ltd. is among others to carry on all activities related to _____ (enter the description of the main business), which are consistent with the main objects of XYZ Ltd

WHEREAS the major shareholdings of ABC Ltd. and XYZ Ltd. are more or less with the same group

WHEREAS the merger of ABC Ltd. and XYZ Ltd. would improve the performance of the combined entity and reduce administrative and operational costs in view of the further scope for integration of activities of both ABC Ltd. and XYZ Ltd. and would also result in creation of a big firm in the _____ industry.

BOARD RESOLVED THAT

- Approval of the Board of Directors of the Company be and is hereby granted for the merger of ABC Ltd. with XYZ Ltd. in accordance with the provisions of Section 391 read with Section 394 of the Companies Act, 1956.
- The merger shall take effect from _____.
- M/s. _____, Company Secretaries, be and are hereby appointed the consultants for handling the proposed merger and all the related matters arising there from and they are further authorised to prepare the draft scheme of merger, appoint advocates, representatives and other persons as they may deem fit and to do all acts, deeds and things for giving effect to merger of ABC Ltd. with XYZ Ltd.
- Approval of the Board of Directors be and is hereby accorded for the appointment of M/s. _____ to act as experts to carry out valuation of shares of ABC Ltd. and XYZ Ltd. and fix the exchange ratio.
- Approval of the Board of Directors be and is hereby accorded for the appointment of Mr. _____, Advocates, _____ for representing the company before the Hon'ble _____ High Court, *inter alia*, for obtaining the sanction of the said High Court and for connected matters until dissolution of the transferor company".
- Mr. _____, Managing Director and Mr. _____, Director & Company Secretary be and are hereby severally authorised to carry out the requirements for the merger, including but not limited to the following activities:
 - Signing of the scheme of merger.
 - Making application and affidavit to the High Court for convening meetings of members.
 - Issue of notices of meetings of directors and general meeting of members of the company.
 - Filing reports.

- Publication of statutory advertisements.
- Fixing professional fees and charges.
- Appointing advocates, consultants and other professionals; and
- Such other acts, deeds and things as may from time to time be required for the purpose of giving effect to the merger of ABC Ltd. with XYZ Ltd.

Appointment of Share Valuers for the said merger:

“RESOLVED THAT the approval of the Board of Directors accorded for the appointment of M/s. _____, _____ to act as the Share Valuers of the Company to calculate the exchange ratio for shares to be issued by the transferee company to the shareholders of the transferor company which forms the consideration for the shareholders of the transferor company, and that they shall furnish the report to the Board on the same”.

Appointment of consultants, advocates and advisers for handling merger matters:

The Chairman informed the Board that it also necessary to appoint an expert for consultancy matters in the proposed merger. He further stated that a scheme of arrangement and other related documents should be presented before the High Court for the proposed merger. The Chairman added that M/s. _____ & Co., Company Secretaries, being a reputed firm, having experience in company law, legal and restructuring matters could be appointed the consultants of the company for the assisting the company in handling the proposed merger. The Board had a detailed discussion and passed the following resolution:

“RESOLVED THAT M/s. _____, Company Secretaries, be and are hereby appointed as the consultants for handling the proposed merger and all the related matters arising therefrom and they are further authorised to appoint advocates, representatives and other persons as they may deem fit and to do all acts, deeds and things in the proposed merger of the company”.

Resolution of Board of acquiring company for increase of capital

RESOLVED THAT with a view to the acquisition of [part of] the undertaking of (target company) [being the part known as the (specify) manufacturing division] the capital of the company be increased to Rs. by the creation of (number) [preference] shares of (amount) each [and (number) ordinary shares of (amount) each].

II. Specimen outlines of the agreement for the purchase of shares in exchange for an issue of shares and/or loan

THIS AGREEMENT is made the day of

Between:

- (1) *(name of company)* whose registered office is at *(address)* ('the Purchaser') and
- (2) the persons whose respective names and addresses are set out in the Schedule column 1 ('the Target Shareholders').

NOW IT IS AGREED as follows:

1. Definitions

In this agreement:

- 1.1 'the Target Company' means *(name of company)* whose registered office is at *(address)*.
- 1.2 'the Target Shares' means all the issued *(specify class)* shares of *(amount)* each in the Target Company.
- 1.3 'the Consideration Shares' means the *(specify class)* shares of *(amount)* each in the Purchaser set out in the Schedule column 3.

2. Recital

The Target Shareholders are the registered holders of the Target Shares in the proportions set out in the Schedule column 2.

3. Sale and purchase

The Target Shareholders and the Purchaser agree for the sale by the Target Shareholders and the purchase by the Purchaser of the Target Shares in consideration of the issue and allotment by the Purchaser of the Consideration Shares to the Target Shareholders.

4. Completion

- 4.1 The sale and purchase shall be completed at the office of *(specify)* on *(date)*.
- 4.2 On completion:
 - 4.2.1 the Target Shareholders will deliver to the Purchaser duly executed transfers of the Target Shares together with the share certificates for the Target Shares.
 - 4.2.2 the Purchaser will issue and allot the Consideration Shares to the Target Shareholders.

5. General

5.1 The Target Shareholders and the Purchaser shall procure that such resolutions of the Target Company and of the Purchaser and of their respective boards of directors shall be passed and shall make or do or procure to be made or done such other deeds, acts or things as may be necessary or appropriate to implement the terms of this agreement.

5.2 The Target Shareholders waive any rights of pre-emption in respect of the target shares contained in the articles of association of the Target Company.

Schedule

<i>Column 1</i>	<i>Column 2</i>	<i>Column 3</i>
Names and addresses of shareholders	Number of Target Shares	Number of Consideration Shares
<i>(specify)</i>	<i>(specify)</i>	<i>(specify)</i>

[signature of (or on behalf of) the parties]

III. Resolution of the Board of Directors of the acquiring company allotting the consideration shares

RESOLVED THAT pursuant to an agreement ('the Agreement') for the acquisition of the undertaking of *(target company)* dated *(date)* and made between (1) the Company and (2) the persons whose names and addresses appear in the Schedule to the Agreement ('the Target Shareholders') *(number)* fully paid up ordinary shares of *(amount)* each and *(number)* fully paid up preference shares of *(amount)* each in the capital of the Company be allotted to each of the Target Shareholders as specified below as consideration for the acquisition and that the company secretary be directed to register the Target Shareholders as the respective holders of such shares, to prepare and issue to the Target Shareholders duly executed share certificates in the respective names of the Target Shareholders in respect of such shares and to file a copy of the Agreement together with a notice of such allotment in the prescribed form with ROC:

<i>Names and addresses of Target Shareholders</i>	<i>Number of Equity Shareholders</i>	<i>Number of Preference Shareholders</i>

D. TAKEOVERS

A takeover may be defined as a corporate strategy whereby an individual or a group of individuals or a company acquires control over the management of a company by acquiring majority of its shares. Simply stated, a takeover is acquisition of shares in a company carrying voting rights with a view to gaining control over the management of the company.

Transferor company*Documents involved*

- Offer of a scheme or contract from the transferee company.
- Irrevocable letter of underwriting from shareholders in transferor company to accept the offer made by the transferee company.
- Form of acceptance of offer.
Agreement between the acquiring company and shareholders holding majority of the shares. (Specimen agreement)
Notice of Board meeting
Minutes of Board meeting.
Notice for general meeting.
- e-Form No. 35A (to be circulated to members).
- Minutes of the general meeting.
- Court order, if any.
- Register of Share Transfers.
- Register of Members
- Notice sent by the transferee company to dissenting shareholders, of acquiring their shares, in Form No. 35.
- Duly filled in and executed instrument(s) of transfer for shares held by the dissenting shareholders.
- 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.
- Annual Return.

The other documents that are involved are:

- (a) Balance Sheet as at the date of the take-over supported by an affidavit from all the directors.
- (b) Indemnity bond from outgoing directors.
- (c) Resolutions passed by the Company for
 - (i) transfer of shares
 - (ii) appointment of new directors
 - (iii) acceptance of resignation of directors (outgoing) and
 - (iv) change in signatories
- (d) Execution of special power of attorney to be granted by the transferor of shares, if the shares are to be transferred after the expiry of a certain period.

Transferee company

Documents involved

- Offer of a scheme or contract to the transferor company.
- Notice of Board meeting.
- Agreement between the acquiring company and shareholders holding majority of the shares of the transferor company.
- Minutes of Board meeting.
- Notice for general meeting.
- Minutes of the general meeting.
- Court order, if any.
- Notice to dissenting shareholders of the transferor company for acquiring their shares, in Form No. 35.
- Duly filled in and executed instrument(s) of transfer for shares held by the dissenting shareholders.
- Register of Investments.
- Letter of Authority to its receiving bankers.
- Letter of responsibility from a director of the company.
- Power of attorney from director in favour of other directors.

E. TAKEOVER DOCUMENTS FOR LISTED COMPANIES

Takeover of companies whose securities are listed on one or more recognised stock exchanges in India is regulated by the provisions of the Companies Act, 1956, Listing Agreements signed with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2012.

Legal documents required for takeover under SEBI Regulations

- (1) Disclosure to all the stock exchanges of the aggregate number of shares held by any person, which would entitle him to more than specified thresholds.
- (2) Yearly disclosures to all the stock exchanges 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 on 31st March.
- (3) Register to record the specified information received by the company.
- (4) Public announcement
 - (a) to acquire shares or voting rights entitling an acquirer to exercise fifteen per cent or more of the voting rights in a company.
 - (b) for consolidation of holdings.
 - (c) for acquiring control over a company.
- (5) Contract with the SEBI-registered merchant banker for the purpose of takeover.
- (6) Share Purchase Agreement in the case of disinvestment of a Public Sector Undertaking, with the Central government or the State government.
- (7) Shareholders Agreement in the case of disinvestment of a Public Sector Undertaking.
- (8) Public announcement communications, for submission of copy thereof to SEBI through merchant banker, to stock exchanges and target company directly.
- (9)
 - (a) Letter of offer to SEBI and to shareholders.
 - (b) Form of Acceptance-cum-Acknowledgement
- (10) Post offer Public announcement (for specimen, please see Annexure XXIII at the end of this study material)

- (11) Offer to buy out in the case of a bail out takeover.
- (12) Disinvestment through an offer for sale in the case of a bail out takeover.

Documents for Inspection

Some of the material documents in connection with the takeover available for inspection by the public include:

1. Certificate of incorporation, Memorandum and Articles of Association of the Acquirer, in case Acquirer is a company;
2. A Chartered Accountant's certificate certifying the net worth of Acquirer(s) in case Acquirer in an individual;
3. A Chartered Accountant's certificate certifying the adequacy of financial resources with acquirers to fulfil the open offer obligations;
4. Audited annual reports of the Acquirer and Target company for the last three years;
5. A letter from the Bank confirming the amount kept in the escrow account and a lien in favour of MB;
6. A copy of the agreement, if any, which triggered the open offer;
7. A published copy of Public announcement;
8. A copy of the letter from SEBI;
9. When Escrow Account consists of approved securities, details of securities such as name, quantity, face value, paid up value, market price on the date of creation of escrow etc.;
10. A copy of the agreement entered into with Depository participant for opening a special depository account for the purpose of the offer;
11. A copy of the non-compete agreement, if any;
12. Any other relevant document(s).

I. SPECIMEN IRREVOCABLE LETTER OF UNDERTAKING FROM SHAREHOLDERS IN TARGET COMPANY TO ACCEPT THE OFFER MADE BY THE OFFEROR COMPANY

(date)

Dated:

From: *(name of shareholder)*

To: *(name of offeror)* ('the Offeror') or offeror's Bank

[*(name of bank)* ('the Bank')]

Dear Sirs

Sub: Proposed offer for all the issued share capital of
(name of company) ('the Company')

I refer to the proposal under which it is intended that the Bank will make an offer ('the Offer') on behalf of the Offeror to acquire the entire or ...% of the issued equity/preference (*class of shares for which the offer is made*) of the above Company on the terms and subject to the conditions set out in the attached draft press announcement ('the Press Announcement'), together with such additional terms and conditions as may be required to comply with the requirements of the *(name)* Stock Exchange and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations [SEBI Regulations]:

1. In connection with the Offer I irrevocably and unconditionally covenant and undertake with the Offeror [and as a separate covenant and undertaking with the Bank] as follows:

- (1) to accept (or procure acceptance of) the Offer in respect of:

- (i) the shares in the capital of the Company details of which are more particularly set out in the schedule below;
- (ii) any other shares in the Company of which I may after the date of this undertaking become beneficial owner; and
- (iii) any other shares in the Company attributable to or deriving from the shares referred to in paragraph (i) and (ii) above

(together called 'the Shares') by delivering (or procuring delivery) to the Bank, so as to be received not later than the first business day [7] days after despatch of the formal document containing the Offer ('the Offer Document') (or in respect of any of the Shares allotted or of which I became the beneficial owner after such date the date of allotment or the date on which I became the beneficial owner of the same) forms of acceptance of the Offer duly completed in accordance with their terms together with the share certificate(s) or other document(s) of title in

respect of the Shares which would at that time enable the acceptance to be counted towards fulfilling an acceptance condition in accordance with SEBI Regulations.

- (2) unless and until the Offer lapses or is withdrawn:
- (i) notwithstanding the provisions of the SEBI Regulations or of any terms of the Offer regarding withdrawal, not to withdraw the acceptance(s) referred to in paragraph 1(1) above;
 - (ii) except pursuant to my acceptance of the Offer, not to sell, transfer or otherwise dispose of, charge, incumber or grant any option or other right over the Shares or any of them or any interest in the Shares;
 - (iii) not to accept (conditionally or unconditionally) any other offer in respect of the Shares (by whatever means such offer is implemented);
 - (iv) not to purchase any shares in the Company;
 - (v) so far as not inconsistent with my duties or obligations as a director under general law, the SEBI Regulations or otherwise not to initiate any approach for the purpose of securing a competitive offer for any or all of the issued share capital of the Company;
 - (vi) not to exercise the voting rights attached to the Shares in any manner which is likely to be prejudicial to the Offer or its outcome and, in particular but without limitation, to exercise (or procure the exercise of) the voting rights attaching to the Shares in favour of the *(insert details of resolutions to be passed at forthcoming general meeting)*;
 - (vii) so far as not inconsistent with any duties or obligations as a director under general law, the SEBI Insider Trading Regulations and SEBI Takeover Regulations or otherwise not to procure or enter into any agreement or arrangement with any person(s), whether conditionally or unconditionally, to do all or any of the acts referred to hereinabove.
- (3) to procure that any announcement made by or on behalf of me prior to the release by the Bank of the Press Announcement shall not, without the Bank's consent, contain any express or implied reference to the Company or the Offeror unless required by law, the SEBI Regulations or the Stock Exchange.
- (4) to supply or procure the supply of, to the extent and I am able, to the

Bank for inclusion in the offer document ('the Offer Document') all information required to be included in it by the SEBI Regulations or Securities Contracts (Regulations) Act, 1956, SCRA Rules, 1956, the Rules and Regulations of Stock Exchange, the Companies Act, 1956 (as amended) or the SEBI Act, 1992 (as amended).

- (5) being a director of the Company, so far as not inconsistent with my duties or obligations as a director under general law, the Code or otherwise:
- (i) to use my best endeavours to procure that the directors of the Company recommend acceptance of the offer to the shareholders of the Company;
 - (ii) not to take any step to impede, prevent or delay the Offer becoming unconditional;
 - (iii) from the date of this Undertaking to the date the Offer closes, lapses or is withdrawn, not to take any action or deliberately fail to take any action which to my knowledge might reasonably amount to or be reasonably expected to cause a breach of any condition set out in [the Appendix to] the Press Announcement;
 - (iv) to use my reasonable endeavours to procure that the directors of the Company and the Company provides all necessary information and facilities to the Offeror and its professional advisers to enable the Offer to be made in accordance with the requirements of the Stock Exchange and the SEBI Regulations;
 - (v) to use my reasonable endeavours to procure that, save to the extent the Offeror otherwise agrees in writing, pending the Offer becoming unconditional in all respects or lapsing or being withdrawn:
 - (a) (so far as I am able to ensure by the exercise of my voting and other powers in relation to the Company) the business of the Company will be carried on in the ordinary and normal course and no amendment will be made to the Company's memorandum and articles of association;
 - (b) (so far as I am able to ensure by the exercise of my voting and other powers in relation to the Company) no alteration will be made to the authorised or issued share capital of the Company or any member of the Company's Group and no options or rights shall be granted in respect of such capital (for the purposes of this sub-paragraph 'the Company's Group' shall mean the Company and all and any subsidiaries of the Company,

'subsidiary' having the meaning given to it under Section 4 of the Companies Act, 1956);

- (c) no amendments to their existing service agreements or arrangements of any nature whatever will be made by the Company with its directors or employees;
 - (d) no dividend will be distributed or bonus will be declared, paid or made in respect of the profits or capital of the Company; and
 - (e) no disposal of the business or any property or assets of a material amount of the Company to any person or third party will be made and no interest in the nature of a mortgage or charge on such business, property or assets will be made or effected.
2. I further covenant and undertake with the Offeror and as a separate covenant and undertaking with the Bank:
- (i) that the Shares will be transferred pursuant to the Offer free from all liens, charged and incumbrances and with all rights attached to the Shares, including rights to all dividends declared, made or paid after the date of this Undertaking (other than as provided by the terms of the Offer);
 - (ii) that I have full power and authority to give this covenant and undertaking in respect of all the Shares and am entitled to accept the Offer and execute any document recording acceptance of the Offer in respect of all the Shares;
 - (iii) that I am not acting in concert with any person for the purposes of SEBI Takeover Regulations (disregarding for this purpose any person giving an irrevocable undertaking to accept the Offer or any director of the Company);
 - (iv) that the obligations and provisions set out in this undertaking apply equally to the persons from whom I am to procure acceptance of the Offer pursuant to paragraph 1(1)(i) above and I shall procure the observance by such persons of the terms of this undertaking as if they were each specifically a party to it.
3. I acknowledge and agree that particulars of this undertaking will be contained in the Press Announcement and the Offer Document and that this undertaking will be available for inspection during the period for which the Offer remains open for acceptance.

4. I warrant and represent to the Offeror and as a separate warranty and representation to the Bank that:
 - (i) as far as I am aware all statements of fact contained in the Press Announcement relating to the Company and the directors of the Company are true and accurate in all material respects and are not misleading and that all expressions of opinion, expectation and intention contained in the Press Announcement on the part of the directors of the Company are made on reasonable grounds and are honestly held and fairly based;
 - (ii) I am the beneficial owner of the Shares and the Shares comprise of all the shares in the Company beneficially owned by me or members of my immediate family whose interests would be notifiable to the Company under the Companies Act, 1956.
5. I recognise and acknowledge that if I should fail to accept or procure the acceptance of the Offer in accordance with my obligations in this undertaking or should otherwise be in breach of any of those obligations, damages in the form of a liquidated sum would not be adequate remedy and that an order for specific performance would be the only adequate remedy for such failure or breach.
6. I irrevocably appoint (any director of the Bank) to be my attorney in my name or otherwise and on my behalf [subject to my being in breach of my obligations under paragraph 1(1) above] to accept the Offer and execute any form or forms of acceptance and/or transfer relating to the Offer in respect of the Shares.
7. The provisions of this undertaking shall (save where the context otherwise requires) not be extinguished or affected by completion of the sale and purchase of the Shares.
8. This undertaking shall be binding upon and enure for the benefit of my respective executors, administrators, heirs and successors.
9. My obligations under this undertaking will lapse if the Press Announcement is not issued within (4) days from the date of this undertaking
10. In this undertaking reference to the Offer shall include any revised offer which is at least as favourable as the Offer.
11. In relation to any of the Shares which are not in my beneficial ownership or registered in my name my obligations under this undertaking shall be read as being to procure that the obligations contained in this undertaking are complied with by the person(s) in whose name the Shares are registered.

12. Time is to be of the essence as regards any time, date or period mentioned in this undertaking or as extended by mutual agreement.
13. The covenants and undertakings contained in this undertaking and each part of them shall each be deemed to be, in respect of each of the same, entire, separate, severable and separately enforceable in the widest sense so that each covenant and undertaking and each part of them shall be deemed to be a separate covenant and undertaking notwithstanding the fact that it appears in the same paragraph, sub-paragraph or sentence as any other covenant and undertaking or is imposed by the introduction of a word or phrase conjunctively with or disjunctively from or alternatively to other words or phrases.
14. This undertaking shall be governed by and construed in accordance with the laws of India and I irrevocably agree to submit to the exclusive jurisdiction of Indian courts.

In Witness, etc.

SCHEDULE

The Shares

Beneficial owner	Registered holder	Class and number (of Shares)
(insert details)	(insert details)	(insert details)

[signatures (or common seals) of shareholder]

(signatures of witnesses)

Guidance Notes

1. The offer may be a partial offer for some only of the issued share capital.
2. The shareholder may insist on the inclusion of circumstances under which the undertaking will not be binding, e.g. if a higher offer is made.
3. The words in square brackets will be appropriate if the shareholder is also a director but not otherwise.
4. e.g. resolutions to appoint the offeror's nominees to the target board of directors.
5. The words in square brackets will be appropriate if the shareholder is also a director but not otherwise.

6. The whole of clause 1(5) may be appropriate if the shareholder is also a director but will generally not be appropriate otherwise.
7. If Bank is authorised for that purpose.
8. Ibid
9. The words in square brackets will be appropriate if the shareholder is also a director but not otherwise.
10. If inappropriate, the words in square brackets should be omitted.

II. FORMAT OF OFFER DOCUMENT

Broadly the offer document should contain the following information:

1. Warning Statement i.e. 'If you are in doubt about this offer, you should consult a SEBI Registered Merchant Banker (or similar wording).
2. Definitions.
3. Index.
4. Letter from offeror's merchant bank or other authorised person setting out the terms of the offer, the financial effects of acceptance and the procedure for acceptance.
5. Letter from chairman of target company.
6. Details of conditions and further terms of the offer as required by the SEBI Takeover Regulations.
7. Financial details and other information of the offeror required under the SEBI Regulations and the Stock Exchange Listing Requirements for example directors' names, summary of accounts and accounting policies.
8. Financial and other information on the target required by the SEBI Regulations and the Stock Exchange Listing Requirements.
9. Information on any non-cash consideration.
10. General information, for example, directors' responsibility statement, disclosure of directors' interests and dealings, material contracts and other information required by the SEBI Regulations.

Format of standard letter of offer is given elsewhere in this study lesson.

III. SPECIMEN AGREEMENT ENTERED INTO BETWEEN THE ACQUIRER AND THE MANAGEMENT OF THE OFFEREE COMPANY

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 takeover 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 ₹ per equity share aggregating to ₹
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.
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,
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 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 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 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

.....
.....
.....

IV. SPECIMEN OUTLINE FORM OF ACCEPTANCE OF OFFER

This document is important and requires your immediate attention. It should be read in conjunction with the accompanying offer document dated (*date*) ('the Offer Document'). If you are in any doubt as to the action you should take, you are advised to consult an adviser authorised pursuant to the SEBI Act, 1992 and Regulations made thereunder. The definitions set out in the Offer Document have the same meanings in this document.

If you have sold all your shares in (*name of target company*), please send this Form of Acceptance and the accompanying documents and reply-paid envelope to the purchaser or to the stock-broker, bank or other agent through whom the sale was effected, for transmission to the purchaser.

Form of Acceptance

Offer

By

(name of bank)

on behalf of

(name of offeror company)

for

(name of target company)

ACTION TO BE TAKEN TO ACCEPT THE OFFER

Please read pages..... and..... of this Form of Acceptance and complete and sign page.....

AND THEN

Send the completed Form of Acceptance [accompanied by your (target company) share certificate(s) and/or other document(s) of title] by post or by hand to (name and address of receiving bank) in either case so as to arrive as soon as possible and in any event not later than ___p.m. on *(first closing date)*.

[A reply-paid envelope is enclosed for your convenience.]

If your share certificate(s) and/or other document(s) of title is/are not readily available or is/are lost, the completed Form of Acceptance should nevertheless be delivered as stated above and the document(s) of title forwarded as soon as possible after that delivery.

If having decided on what action you wish to take, you have questions as to how to complete this Form of Acceptance, please contact *(Insert name and address and telephone number of receiving bankers)*.

V. FORM NO. 35

Notice to dissenting shareholders

Registration No. of Transferee Company.....

No. if any, of Transferor Company.....

THE COMPANIES ACT, 1956

[Pursuant to Section 395]

.....Limited/Private Limited (hereinafter called "the transferor company")

Notice by.....Limited/Private Limited (hereinafter called "the transferee company")

To.....

Whereas on the..... day of..... 200..... the transferee company made an offer to all the holders of..... shares in the transferor company (state shortly the nature of the offer).....; and

Whereas up to the..... day of..... 200..... being a date within four months of the date of the making thereof such offer as approved by the holders of not less than nine-tenths in value of the said shares,⁴ other than shares already held at the date of the offer by or by a nominee for the transferee company or its subsidiary.

Now, therefore, the transferee company in pursuance of the provisions of Section 395(1) of the Companies Act, 1956 hereby gives you notice that it desires to acquire the..... shares⁴ held by you in the transferor company.

And further take notice that unless, upon application made to the Court by you the said..... on or before the..... day of..... 200..... being one month from the date of this notice, the court thinks fit to order otherwise, the transferor company will be entitled and bound to acquire the..... shares held by you in the transferor company on the terms of the above-mentioned offer, approved by the approving..... shareholders in the said company.

Signature for

Designation

Dated this..... Day of..... 200.....

Note:

1. Name of transferor company.
2. Name of transferee company.
3. Name(s) and address(es) of dissenting shareholder(s).
4. If the offer is limited to a certain class or classes of shareholders, state description of that class or those classes.
5. State whether Director, Managing Director, Manager or Secretary.

VI. RESOLUTIONS IN RESPECT OF TAKEOVER BY OFFEROR COMPANY

Offer by Offeror Company

RESOLVED THAT an offer be made, to the persons who are the members of..... Ltd. as on....., for acquisition of..... equity shares of ₹ 10/- each representing a.....% of the total issued capital of the.....Ltd.

RESOLVED FURTHER THAT above said offer shall remain open till..... at a price of ₹ each payable by cheque/DD.

RESOLVED FURTHER THAT shares be accepted even if such shares in aggregate are less than the limit mentioned above and in case shares offered exceed the limit, the company shall have an option to accept or reject the same in consultation with the concerned authorities and offer will be accepted according to the order in which they are received and full shareholding of the members accepting the offer be acquired subject to abovementioned limit.”

Appointment of Merchant Banker

“RESOLVED THAT M/s being Category-I Merchant Banker be and is hereby appointed as Merchant Banker for aforesaid public offer, on the terms and conditions as contained in the draft letter of appointment placed before the meeting duly initialed by the Chairman for the purpose of identification, for making the public announcement of the takeover offer in the newspapers, forward the same to the Securities and Exchange Board of India, Stock Exchange(s) and to the target company and to draft the Letter of Offer to be sent to the shareholders of, target company in accordance with the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997”.

Opening of Escrow Account

“RESOLVED THAT an Escrow Account be opened with Bank and Rs.....be deposited in the said account.

RESOLVED FURTHER THAT M/s....., Merchant Banker, be and is hereby authorised to operate the above said account and the Bank be and is hereby authorised to act on the instructions given by M/s Merchant Banker, in relation to operation of bank account.”

RESOLVED FURTHER THAT Mr., Director of the company, be and is hereby authorised to collect and communicate the same to.....Bank, the names and specimen signatures of the person authorised by M/s., Merchant Banker, to operate the above said bank account.”

General Meeting Resolution u/s 372A of the Companies Act, 1956

“RESOLVED THAT pursuant to Section 372A and other applicable provisions, if any, of the Companies Act, 1956, Board of Directors of the company be and is hereby authorised to invest, by purchase of..... equity shares of ₹ 10/- each of.....Ltd. at a premium of Rs..... each notwithstanding the fact that proposed purchase of..... equity shares together with the equity shares already bought by the company exceeds 60% of the paid-up share capital and free reserves of the company.

RESOLVED FURTHER THAT Board of Directors of the company be and is hereby authorised to do all the needful in this regard.”

Board Meeting Resolution u/s 372A of the Companies Act, 1956

“RESOLVED THAT pursuant to Section 372A, other applicable provisions, if any, of the Companies Act, 1956, and authorization given by the members of the company at their meeting held on, unanimous consent of the Board of Directors be and is hereby given to invest upto % equity shares of Ltd. at a price of ₹ each.

RESOLVED FURTHER THAT Mr..... and Mr. Directors of the company, be and are hereby severally authorised to do all the needful in this regard.”

Further Issue of Capital u/s 81(1A) of the Companies Act, 1956 — Board Resolution for issue of Securities to the Offeree Company

“RESOLVED THAT subject to approval of shareholders, pursuant to the provisions of Sections 80, 81 and other applicable provisions, if any, of the Companies Act, 1956, the Articles of Association of the company and subject to the regulations/rules/guidelines issued by the Securities and Exchange Board of India (hereinafter referred to as “the SEBI”), Listing Agreements entered into by the company with the recognized Stock Exchanges in India where the equity shares/securities of the company are listed, Foreign Investment Promotion Board (hereinafter also referred to as “FIPB”), Secretariat of Industrial Assistance (hereinafter referred to as “SIA”), Government of India, Reserve Bank of India (hereinafter referred to as the “RBI”) and such approvals, permissions, sanctions and consents as may be necessary and required under applicable laws, rules, regulations, agreements and contracts on such terms, conditions, alterations, modifications, corrections, changes and variations, if any, that may be stipulated or imposed or prescribed under such approvals, permissions, sanctions and consents, which may be agreed to and accepted by the Board of Directors (which terms shall include any duly constituted and authorised committee thereof) of the company, consent and authority of the company be and is hereby accorded to the Board to create, offer, issue and allot, in one or more parts or in full or in one or more

trenches, such number of equity shares and/or convertible debentures and/or non-convertible debentures and/or bonds and/or optionally convertible debenture and/or preference share and/or any other securities with or without detachable, freely tradable warrants or warrants with restrictions, with a right to acquire and be allotted equity shares on a future date and/or naked warrants and/or through Global Depository Receipts with underlying equity shares (hereinafter also referred to as "GDRs") and/or American Depository Receipts with underlying equity shares (hereinafter also referred to as "ADRs") (hereinafter collectively referred to as "the securities" of aggregate value not exceeding Rs..... and/or equivalent US dollars and /or any other equivalent currency, for cash on such terms and conditions and to such persons as the Board may deem fit, proper and appropriate including the existing members on rights entitlement basis, with a right of renunciation to the directors, promoters, their friends, relatives, associates, employees, Indian resident public, Non-resident Indians (hereinafter also referred to as "NRI"), Overseas Corporate Body/Bodies (hereinafter also referred to as "OCB"), development financial institutions (including state level multilateral, unilateral, development financial institutions), scheduled commercial banks, foreign/private banks, mutual funds, Foreign Institutional Investors, foreign nationals/corporate, venture capital funds whether registered in India or not or to the exclusion of any one or more of such persons by way of a public issue, including by means of book building method or otherwise and/or private placement basis/firm allotment basis/preferential allotment basis and/or any other method."

VII. SPECIMEN OF BOARD MINUTES OF OFFEROR COMPANY APPROVING PRESS ANNOUNCEMENT

PROCEEDINGS OF THE MEETING OF THE BOARD OF DIRECTORS OF THELIMITED HELD AT A.M. ON..... DATE..... AT.....(ADDRESS).

Directors Present:

In attendance:

Chairman

Mr. was unanimously elected the chairman of the meeting.

Leave of Absence

Leave of absence was granted to Mr. and Mr. due to their preoccupation elsewhere.

Minutes

Minutes of the last Board Meeting held on..... were approved and they were signed by the chairman of this meeting.

Noting of proposed terms for offer

The Chairman informed the Board that elaborate discussions had taken place with Limited (name of target company) in connection with offer to be made by(name of Bank) on the behalf of the company for entire issued share capital of Limited (name of target company). Thereafter, a draft offer document containing the terms and conditions for the offer was placed before the Board and the following resolution was passed:

“RESOLVED THAT terms of the offer as contained in draft offer document, a copy of which is placed before the Board and initialed by the Chairman for the purpose of identification, be and is hereby approved.”

Noting of other documents

The Board took the note of the following documents, the copies of which were placed before the Board and initialed by the Chairman for the purpose of identification:

- (a) a draft press announcement setting out the major terms and conditions of the offer.
- (b) irrevocable undertakings executed by (specify the names).
- (c) letter from..... (name of lawyers) dated.....giving confidential guidance.
- (d) letter confirming availability of financing for the offer.

Information by the Chairman regarding offer

The Chairman informed the Board that a letter had been received by the company from the (name of the Bank) stating that the bank had considered the terms and conditions of the offer and in its view, offer was fair and reasonable. The Board took note of the same.

The Chairman further informed that as per the requirements of the SEBI Regulations/listing agreement, the directors are required to be satisfied that company has sufficient resources available to satisfy full acceptance of offer and the financial position of the company should be carefully considered by the directors. After due discussion, the directors were of the opinion that the company had sufficient financial resources to meet fully, the funds' requirement of offer.

Approval to announcement

The Chairman further informed that as per SEBI (Substantial Acquisition of

Shares and Takeover), the announcement was required to be treated with same standard of care as if it were a prospectus. He further informed that it had been reported by all the directors that they had received a copy of the announcement and found all the terms and conditions in order. After due discussion it was:

RESOLVED THAT confirmation of Board be and is hereby given that

- (i) all the statement of facts contained in the Announcement in relation to the company and its business and its directors are true and accurate in all material respects.
- (ii) All expressions, opinions, intentions or expectations in relation to the company were bona fide held and made out of a proper consideration of all material facts.
- (iii) There were no other facts which should have been known to the company and its directors, and were not disclosed, and which would make any statements in the announcements, misleading.
- (iv) Having taken all appropriate professional advice, the board of directors considered that they had complied with the requirements of the Stock Exchange and SEBI Regulations.
- (v) All necessary enquire, confirmations and verifications in relation to all facts stated, information given, statement made by all opinions expressed in the Announcement had been made, accordingly it was resolved [subject to receiving written confirmation from the directors of (name of target company) that they would recommend the offer to their shareholders] that the announcement be approved and that the bank be authorized to issue the announcement on(specify the date)

RESOLVED FURTHER THAT Mr.be and is hereby authorised to dispatch a copy of announcement as approved by the board.

Vote of thanks

There being no other business, meeting was concluded with a vote of thanks to the chair.

Chairman

Place:

Date:

**VIII. SPECIMEN OF BOARD MINUTES OF OFFEROR COMPANY
CONSTITUTING A COMMITTEE**

**PROCEEDINGS OF THE MEETING OF THE BOARD OF DIRECTORS OF THE
.....LIMITED HELD AT..... A.M. ON..... (DATE)..... AT.....(ADDRESS).**

Directors Present:

- 1.
- 2.
- 3.
- 4.

In attendance:

Chairman

Mr.was unanimously elected the Chairman of the meeting.

Leave of Absence

Leave of absence was granted to Mr. and Mr. due to their pre-occupation elsewhere.

Minutes

Minutes of the last Board Meeting held on..... were approved and they were signed by the chairman of this meeting.

Constitution of Committee

The Chairman informed the Board that elaborate discussion had taken place withLimited (name of the target company) in connection with offer to be made by(name of Bank) on the behalf of the company for entire issued share capital of Limited (name of the target company). He further appraised the need for constituting a committee of the Board to deal with the matters arising in relation to the offer. The board discussed the matter and thereafter, it was;

RESOLVED THAT a committee of the Board of the Directors consisting (i) Mr..... (ii) Mr. and (iii) Mr. be and is hereby constituted to do or cause to be done all acts and things as such committee may deem necessary or desirable in order to carry out and effect fully the offer.

RESOLVED FURTHER THAT aforesaid committee shall, *inter alia*, have the powers:

- to provide all necessary information required by (name of financial advisers) in relation to the contents of the offer document and all other relevant documents relating to the offer and to consider any revision or extension of the terms of the offer in consultation with (name of financial advisers);
- to approve alterations to documents relating to the offer;
- to consider and approve the formal offer document to shareholders and all further documents, advertisements or announcements which it might consider desirable to send to shareholders of the company or otherwise or to release publicly in connection with the offer or any revision of it;
- to authorize it to be stated in any document, advertisement or announcement that might be issued, released or published in connection with the offer or any revision of it, that all directors of the company accept responsibility of the statements made in it;
- to do all necessary acts, deeds and things in relation to above said matters.

Vote of Thanks

There being no other business, the meeting concluded with a vote of thanks.

Date:

Place:

CHAIRMAN

IX. SPECIMEN BOARD MINUTES OF OFFEROR APPROVING ISSUE OF OFFER DOCUMENT

(Name of offeror Company)

MINUTES of meeting of the Board of Directors of the above company held at *(address)* on *(date)* at *(time)*

PRESENT: *(names)*

LEAVE Of ABSENCE: *(names)*

IN ATTENDANCE: *(names)*

1. Quorum

The chairman declared that a quorum was present.

2. Leave for absence

The chairman reported that apologies had been received from [name(s) of absent directors] for [his or their] absence. However it was reported to the meeting

that [he or they] [was or were] aware of the subject-matter of the meeting and had discussed this matter with the directors present on (date of previous meeting) and had signed a responsibility letter and a power of attorney in the form set out in paragraph 4 below.

3. Business of the meeting

It was noted that the principal purpose of the meeting was to approve the documents proposed to be entered into and/or despatched in connection with the offer ('the Offer') proposed to be made by (name of bank) ('the Bank') on behalf of the Company for the entire issued share capital of (name of target company) on the basis of (insert details of offer).

4. Documents

There were produced and tabled to the meeting the following documents:

- 4.1 a final draft of the offer document to be despatched to shareholders of (*name of target company*) by the Bank on behalf of the Company on (*date*) incorporating manuscript amendments and setting out the terms of the Offer and incorporating, *inter alia*, a letter from (name of chairman of target company) and a letter from the Bank including the terms of the Offer ('the Offer Document');
- 4.2 the final proof of form of acceptance referred to in the Offer Document ('the Form of Acceptance');
- 4.3 individual responsibility letters each signed by one of the directors of the Company confirming, *inter alia*, that they accept responsibility for the information contained in the Offer Document ('the Responsibility Letters');
- 4.4 powers of attorney executed by each of the directors authorising any other director to approve and execute all documents and to do all acts and things necessary or desirable to implement the offer as attorney for the appointor ('the Powers of Attorney');
- 4.5 letters from the Bank, from (*name of target's financial adviser*) and from (*names of target's solicitors and accountants*) consenting to the publication of the Offer Document and the inclusion in the Offer Document of their names ('the Consent Letter');
- 4.6 letter from the auditors of the Company in relation to the indebtedness of the Company;
- 4.7 a schedule of estimated expenses to be incurred by the Company and (*name of target company*) in connection with the Offer as stated in the Offer Document;

- 4.8 a letter from (*name of auditors*) relating to the Company's working capital requirements;
- 4.9 a letter from (*name of stock-brokers to the Company*) confirming the middle market quotations of the (*class of shares in the Company*) referred to in the Offer Document;
- 4.10 verification notes produced by (*name of solicitors*) verifying the factual information set out in the Offer Document (*the Verification Notes*);
- 4.11 in respect of each Director not present at the meeting a copy of the latest proof of the Offer Document initialled by him;
- 4.12 draft press announcement to be issued by the Company (*the Press Announcement*).

5. Consideration of documents

- 5.1 It was noted that each of the documents referred to in paragraph 4 had already been discussed informally by the board.
- 5.2 It was further noted that the Press Announcement and the Offer Document were required by the SEBI Regulations, to be treated with the same standard of care as if it were a prospectus within the meaning of the Companies Act, 1956 and the information given must be adequately and fairly presented. In addition, it was noted that the Directors were required to accept personal responsibility for the contents of the Press Announcement and the Offer Document and in this regard the terms of the Responsibility Letters were carefully noted. The terms of the Powers of Attorney were also noted.

6. The Offer Document

- 6.1 It was reported that all the directors of the Company had received a copy of each of the Offer Document, the Form of Acceptance and the Press Announcement and had not raised any objection to their terms or contents.
- 6.2 The directors carefully considered:
 - 6.2.1 the terms of the Announcement;
 - 6.2.2 the contents of the Offer Document as a whole and in particular the Responsibility Statement set out in Appendix (*number*) which stated:

‘the directors of (*name of offeror company*) accept responsibility for information contained in this document [apart from that relating to

(*name of target company*), the directors of (*name of target company*) and their immediate families]. To the best of the knowledge and belief of the directors of (*name of offeror company*) (who have taken all reasonable care to ensure that such is the case) such information is in accordance with the facts and does not omit anything likely to affect the import of such information'; and

- 6.2.3 the remaining documents referred to in paragraph 4 above. The directors confirmed that in relation to the Press Announcement and the Offer Document on behalf of each of the directors of the Company:
 - 6.2.3.1 all statements of facts contained in those documents in relation to the Company and its business and its directors are true and accurate in all material respects;
 - 6.2.3.2 all expressions, opinions, intentions or expectations in relation to the Company are *bona fide* held and made out of proper consideration of all material facts;
 - 6.2.3.3 there are no other facts known or which on reasonable enquiry should be known to the Company and its directors which are not disclosed, the existence of which would make any statements in such documents misleading;
 - 6.2.3.4 each director's interests and those of his family in the share capital of the Company were correct and further details of dealing of such persons during the preceding 12 months were fully disclosed;
 - 6.2.3.5 having taken all appropriate professional advice, the board considered that the said documents complied with the requirements of the Stock Exchange and with the Code.
- 6.3 Detailed verification of the Offer Document was undertaken and the Verification Notes were carefully considered and replies were given to the questions set out there.
- 6.4 All necessary enquiries, confirmations and verifications of all facts stated or information given, statements made by and opinions expressed in the Offer Document and the Press Announcement having been made, it was resolved that:
 - 6.4.1 having considered all opinions relating to the Company contained in the Offer Document the directors of the Company accept responsibility in the manner set out in such document;

6.4.2 the Offer Document, the Acceptance Form and the Press Announcement be approved;

6.4.3 the Bank be authorised to make the Offer and the Offer Document be despatched on *(date of despatch)* to the persons referred to in it together with the Form of Acceptance referred to as enclosed with it.

7. Display Documents

It was noted that certain documents would be put on display and these were to be retained in the office of (name of solicitors)

8. Close

There being no further business, the meeting was concluded.

(Signature)

Chairman

Guidance Notes

1. *All the directors of the company should attend this meeting, if at all possible.*
2. *These are usually financial or legal advisors.*

X. SPECIMEN LETTER OF AUTHORITY FROM OFFEROR COMPANY TO ITS RECEIVING BANKERS

[On company's letterhead]

(name and address of receiving banker)

Dated: *(date)*

Dear Sirs,

Sub: Offer to acquire [the whole or part] of the issued share capital of
(name of target company)

We refer to the offer by *(name of bank)* ('the Offering Bank') on behalf of *(offeror company)* ('the Offer') for [the whole or part] of the issued share capital of *(name of target company)*, details of which are set out in the press release and offer document attached to this letter. We confirm that you are appointed on the terms and conditions set out below to act as receiving bankers to the Offer:

1. In your capacity as receiving bankers to the Offer, you are authorised, save as provided in this letter, and you agree:
 - (1) to receive the forms of acceptance from acceptors of the Offer ('the Acceptors') together with the documents of title required by the terms of the Offer to be provided under the Offer and to notify us and the Offering Bank at our or their request as the case may be of the number of shares in (*name of target company*) at any time in respect of which valid acceptances of the Offer are received;
 - (2) to issue at our request, or the request of the Offering Bank, any certificate which might be required to be issued by SEBI/Stock Exchanges or any other regulatory body;
 - (3) If the offer becomes unconditional in all respects:
 - (i) to issue to the Acceptors the cash consideration due to them under and subject to the terms of the Offer and in accordance with the authority contained in the relevant form(s) of acceptance. No consideration will be sent to Acceptors until the relevant share certificates and/or documents of title have been received; and
 - (ii) to calculate the amount of stamp duty payable on the transfer to us of the (insert class of shares) shares acquired pursuant to the Offer; to complete as soon as possible all or any forms of transfer and/or document(s) necessary in order to register transfers of such shares to us and to deliver such documents as soon as possible together with valid form(s) of acceptance to the Registrars of (*name of target company*), together with the relevant share certificates and/or documents of title and receive from them the resultant share certificates for onward transmission to (*name and address of company secretary*);
 - (4) if the Offer does not become unconditional to return share certificates and/or documents of title together with the appropriate form(s) of acceptance to the persons entitled to them; and
 - (5) to comply in all respects with any requirements under the SEBI Takeover Regulations or any other relevant Act in force.
2. For your services we shall pay you a fee equal to ₹..... (*amount*) plus out-of-pocket expenses reasonably incurred.
3. Please confirm the acceptance of your appointment as receiving bankers to

the Offer on the terms and conditions set out above by signing and returning the attached duplicate copy of this letter.

Yours faithfully,

(signature on behalf of the offeror company)

To: *(offeror company)*

We accept our appointment as receiving bankers to the Offer on the terms and conditions set out above and agree with you to perform the obligations set out above.

Signed:

Name: *(insert details)*

Title: *(insert details)*

For and on behalf of *(name of receiving bankers)*

XI. SPECIMEN LETTER OF RESPONSIBILITY

To: *(name and address of financial adviser to issue)*

(name of offeror company)

I, the undersigned, as a director of *(offeror company)* ('the Company') authorise the issue or publication or release by or on behalf of the company of any approved document relating to or in connection with the transaction described in the schedule below ('the Transaction') with the inclusion in such document of a declaration in the terms or to the effect that the Directors of the Company accept responsibility for the information contained in such document and that, to the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that such is the case), such information contained in the document is in accordance with the facts and does not omit anything likely to affect the import of such information. I accept responsibility accordingly.

I also confirm that I shall take all reasonable care to ensure that any statement in any approved document relating to my own interests is fair and accurate.

I acknowledge and accept that it may be necessary for meetings of the Board of Directors of the company or any committee of the Board to be convened in

connection with the transaction on shorter notice than is normally the case and that the business of such meetings may include consideration and approval of approved documents. I appreciate that I will be responsible for each such approved document whether or not I attend the meeting of the Board or the committee of the Board or otherwise participate in the decision which settles its final form.

Without in any way limiting or qualifying my responsibility for approved documents once issued or published, this authority may be revoked, either generally or in relation to any specified documents, at any time by notice in writing and shall, so far as is not previously revoked, cease to have effect [6] months after the date of this letter.

For the purposes of this letter 'approved document' means any offer document, circular, application, form or any other document (including without limitation an advertisement or announcement) relating to, or connected with the Transaction which shall have been approved by resolution of the Board or by resolution of duly authorised committee of the Board or by any duly authorised Director or Directors on behalf of the Board and of which I shall not have expressed disapproval by notice in writing (including a telex or fax message) addressed to the secretary of the Company and handed to him or delivered to the registered office of the Company.

SCHEDULE

Description of the Transaction

The making by *(name of bank)* on behalf of *(name of offeror company)* of an offer for [the whole] of the issued share capital of *(name of target company)* for a consideration of *(amount)* in cash for every *(number and class of shares)* in *(name of target company)* [with an alternative consideration of *(details of alternative consideration)*] ('the Offer'). [Further details of the Offer will be set out in an Offer Document to be despatched to shareholders of *(target company)* on or about *(date of proposed despatch)* together with all or any matters incidental to the Offer.]

(Signature)

Director

(date)

XII. SPECIMEN POWER OF ATTORNEY

BY THIS POWER OF ATTORNEY made the..... day of..... I, the undersigned, a director of *(name of offeror company)* ('the Company') appoint any

other director of the Company as my true and lawful attorney to act for me and in my name, place and stead in approving, signing or initialling (*as necessary*) all deeds and documents and in doing all acts and things necessary or desirable to implement the offer to be made by (*name of bank*) on behalf of the Company for [the whole] of the issued share capital of (*name of target company*) ('the Offer') referred to in the draft press announcement (*a copy of which is attached to this deed*) to include (but without prejudice to the generality of the foregoing) approving, signing, or initialling on my behalf any offer document, circular, application form, responsibility statement, proxy or announcement in connection with the Offer and all other matters incidental to the Offer, all in such form as may have been approved by resolution of the board of directors of the Company or by a duly authorised committee of the Company.

And I ratify and confirm and agree to ratify and confirm all that my attorney may lawfully do or cause to be done by virtue of this Power of Attorney.

This Power of Attorney shall become effective immediately and shall be irrevocable for a period of ____ months from the date of this Power of Attorney.

In witness, etc.

(Signature of director)

(Signature of witness)

XIII. DISCLOSURE IN TERMS OF REGULATION 29

Format for Disclosures under Regulation 29(1) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

1.	Name of the Target Company (TC)	
2.	Name(s) of the acquirer and Persons Acting in Concert (PAC) with the acquirer	
3.	Whether the acquirer belongs to Promoter/Promoter group	
4.	Name(s) of the Stock Exchange(s) where the shares of TC are Listed	

5.	Details of the acquisition of shares/voting rights/holding of the Acquirer and PAC	Number	% w.r.t. total share/voting capital wherever applicable	% w.r.t. total diluted share/voting capital of the TC (*)
	<i>Before the acquisition under consideration, holding of :</i>			
	(a) Shares carrying voting rights			
	(b) Voting rights (VR) otherwise than by equity shares			
	(c) Warrants/convertible securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the TC (specify holding in each category)			
	Total (a+b+c)			
	<i>Details of acquisition</i>			
	(a) Shares carrying voting rights acquired			
	(b) VRs acquired otherwise than by equity shares			
	(c) Warrants/convertible securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the TC (specify holding in each category) acquired			
	Total (a+b+c)			

	<i>After the acquisition, holding of:</i>			
	(a) Shares carrying voting rights			
	(b) VRs otherwise than by equity shares			
	(c) Warrants/convertible securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the TC (specify holding in each category) after acquisition			
	Total (a+b+c)			
6.	Mode of acquisition (e.g. open market / public issue / rights issue / preferential allotment / inter-se transfer, etc.)			
7.	Date of acquisition of/ date of receipt of intimation of allotment of shares / VR / warrants/convertible securities/any other instrument that entitles the acquirer to receive shares in the TC.			
8.	Equity share capital / total voting capital of the TC before the said acquisition			
9.	Equity share capital/ total voting capital of the TC after the said acquisition			

10.	Total diluted share/voting capital of the TC after the said acquisition	
-----	-------------------------------------------------------------------------	--

Note: (*) Diluted share/voting capital means the total number of shares in the TC assuming full conversion of the outstanding convertible securities/warrants into equity shares of the TC.

Signature of the acquirer / Authorised Signatory

Place:

Date:

Annexure-B
Format for disclosures under Regulation 29(2) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

1.	Name of the Target Company (TC)			
2.	Name(s) of the acquirer and Persons Acting in Concert (PAC) with the acquirer			
3.	Whether the acquirer belongs to Promoter/Promoter group			
4.	Name(s) of the Stock Exchange(s) where the shares of TC are Listed			
5.	Details of the acquisition / disposal/holding of shares/voting rights/holding of the Acquirer and PAC	Number	% w.r.t. total share/voting capital wherever applicable	% w.r.t. total diluted share/voting capital of the TC (*)
	Before the acquisition/disposal under consideration, holding of :			

	(a) Shares carrying voting rights			
	(b) Voting rights (VR) otherwise than by shares			
	(c) Warrants/convertible securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the T C (specify holding in each category)			
	Total (a+b+c)			
	Details of acquisition/sale			
	(a) Shares carrying voting rights acquired/sold			
	(b) VRs acquired /sold otherwise than by shares			
	(c) Warrants/convertible securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the TC (specify holding in each category) acquired/sold			
	Total (a+b+c)			
	After the acquisition/sale, holding of:			
	(a) Shares carrying voting rights			
	(b) VRs otherwise than by shares			
	(c) Warrants/convertible			

	securities/any other instrument that entitles the acquirer to receive shares carrying voting rights in the TC (specify holding in each category) after acquisition.			
	Total (a+b+c)			
6.	Mode of acquisition / sale (e.g. open market / off-market / public issue / rights issue / preferential allotment / inter-se transfer etc).			
7.	Date of acquisition / sale of shares / VR or date of receipt of intimation of allotment of shares, whichever is applicable			
8.	Equity share capital / total voting capital of the TC before the said acquisition / sale			
9.	Equity share capital/ total voting capital of the TC after the said acquisition / sale			
10.	Total diluted share/voting capital of the TC after the said acquisition/sale.			

() Diluted share/voting capital means the total number of shares in the TC assuming full conversion of the outstanding convertible securities/warrants into equity shares of the TC.*

Signature of the acquirer/seller/Authorised Signatory

Place:

Date:

FORMAT FOR LETTER OF OFFER**General Instructions:**

1. The Merchant bankers are advised to submit two hard copies each of Public Announcement, Detailed Public Statement and draft and final Letter of Offer to SEBI. Further, the softcopies of the above stated documents shall also be provided to SEBI for furnishing the same on SEBI website. Softcopies of the above documents shall be accompanied by a duly filled in checklist.
2. The purpose of this standard Letter of Offer (LoF) for an open offer made in accordance with Chapter II of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 is to provide the requisite information about the acquirer(s)/offer so as to enable the shareholders to make an informed decision of either continuing with the Target Company (TC) or to exit from the TC. Care shall be taken by the Manager to the Offer (Manager) to ensure that the LoF may not be technical in legal or financial jargons, but it shall be presented in simple, clear, concise and easily understandable language.
3. This standard LoF enumerates the minimum disclosure requirements to be contained in the LoF of an open offer. The Manager / acquirer is free to add any other disclosure(s) which in his opinion is material for the shareholders, provided such disclosure(s) is not presented in an incomplete, inaccurate or misleading manner and is made in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred as "the Regulations") and subsequent amendments thereof.
4. The standard LoF prescribes only the nature of the disclosures that should be contained under various heads in the LoF and is not intended to describe the language to be contained therein.
5. All the financial data shall be in terms of Rupees Lacs/Millions/Crores unless required otherwise (e.g. EPS). When financial data pertains to an overseas entity, the rupee equivalent shall be disclosed in terms of Rs. Lacs/ Millions/Crores and the basis of conversion shall also be disclosed. (If so desired, such data may also be disclosed in terms of the monetary unit applicable for that overseas entity).
6. Unless otherwise specified
 - 6.1. Reference to shares (as defined in Regulations 2(1)(v)) shall mean reference to fully paid up shares.
 - 6.2. Information contained in LoF shall be updated as on the date of the LOF.

- 6.3. The "Regulations" shall mean SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and subsequent amendments thereof.
- 6.4. The Manager to the Offer (Manager) would mean the Merchant Banker appointed by the acquirer in terms of regulation 12. 1 Inserted on 22nd November, 2011. 2 Inserted on 22nd November, 2011.
- 6.5. The Registrar to the Offer would mean an entity registered with SEBI under SEBI (Registrar to Issue and Share Transfer Agents) Rules and Regulations, 1993.
7. All the requisite disclosures/statements in respect of the acquirer(s), persons who are acting in concert with the acquirer for the purpose of the offer (PAC) and persons who are deemed to be acting in concert with the acquirers for the purpose of the offer (PAC) shall be made in the Letter Of Offer.
8. The Form of acceptance cum acknowledgement may be with a perforation.
9. The source from which data / information is obtained should be mentioned in the relevant pages of LoF.
10. Manager shall ensure that the timelines specified for identified date, for opening of the tendering period, for tendering period, for payment of consideration to shareholders, etc. are as per the timelines specified in the Regulations.
11. Manager shall submit the Due Diligence Certificate and other documents in terms of Regulations to SEBI along with the draft LoF as per the standardized format.
12. Further, the Manager, while filing the draft Letter of Offer, shall also be required to separately file with SEBI, the following additional information about the acquirer, TC, its promoters, etc -
 - (a) Due Diligence Certificate in terms of Regulations.
 - (b) Details of Chapter II (1997 Regulations) / Chapter V (2011 Regulations) compliance by the TC as well as sellers, promoters, other major shareholders, Acquirer and PAC within the time specified in the Regulations. Delay or non-compliance with these provisions if any, may be disclosed. In case of delay or non compliance, disclose the complete address of the said person along with phone/fax numbers together with individual holding. The format for submission for the above mentioned document is placed here.³
 - (c) Names and residential addresses of Board of Directors of acquirer(s).

- (d) Status of compliance with the applicable provisions of the SEBI (SAST) Regulations/other applicable Regulations under the SEBI Act, 1992 and other statutory requirements with respect to details of the earlier acquisitions, if any made in the TC by the Acquirer and PAC including acquisition made through open offers. Change in shareholding pursuant to the said acquisition/offers and thereafter, if any, as applicable. The format for submission for the above mentioned document is placed here.⁴
- (e) The build-up of current capital structure of the company since inception shall be provided as per the specified format. Further, disclose changes in the holding of promoters/promoter group as per the format specified. In this regard, disclose status of compliance with the applicable provisions of the SEBI (SAST) Regulations/other applicable Regulations under the SEBI Act, 1992 and other statutory requirements, as applicable.
- (f) Detailed reasons of suspension of trading of the shares in any Stock Exchange(s), as applicable. What steps have been taken by the TC to resume/ regularize the trading?
- (g) Detailed reasons of non-listing of some and/or all shares of the company at any Stock Exchange(s), as applicable. What steps has been taken by the company to regularize the listing.
- (h) Compliance status with the listing requirements and the penal actions, if any, taken by the Stock Exchanges. In the absence of any punitive action, make a specific statement to such effect.
- (i) Details of the change in shareholding of the promoters as and when it happened in the TC. In this regard, disclose status of compliance with the applicable provisions of the SEBI (SAST) Regulations/other applicable Regulations under the SEBI Act, 1992 and other statutory requirements, as applicable.

Format of the Standard Letter of Offer:

The sequence of presentation in LoF shall be as under:

1. Cover page
2. Disclaimer clause
3. Details of the offer
4. Background of the Acquirer(s) (including PACs, if any).

5. Background of the TC
6. Offer price and financial arrangements
7. Terms & Conditions of the offer
8. Procedure for acceptance and settlement of the offer.
9. Documents for inspection
10. Declaration by the Acquirer(s) (including PACs, if any).

(1) COVER PAGE

Cover pages shall be white with no patterns or pictures printed on it except emblems/ logo, if any, of the acquirer company / Manager / Registrar.

(A) Front outer cover page shall contain the following details :

(i) On Top

“This Document is important and requires your immediate attention.”

This LoF is sent to you as a shareholder(s) of (name of the TC). If you require any clarifications about the action to be taken, you may consult your stock broker or investment consultant or Manager/Registrar to the offer (the latter only if appointed). In case you have recently sold your shares in the Company, please hand over this LoF and the accompanying Form of Acceptance cum acknowledgement and Transfer Deed to the Member of Stock Exchange through whom the said sale was effected.”

(ii) In middle in a box

1. Name and address of the Acquirer(s) (including names of PACs, if any with him.) along with their telephone and fax numbers.
2. Name and address of the registered office of the TC along with its telephone and fax numbers.
3. Number and percentage of equity shares of TC proposed to be acquired by acquirer(s) through the open offer. Ensure that the percentage is calculated and disclosed w.r.t. total share/voting capital of the TC on a fully diluted basis.
4. Offer price per share in terms of rupees. Indicate separately the offer price for fully paid up equity shares as well as partly paid up equity

shares, if any, of the TC. Disclose the mode of payment (i.e. cash, exchange of securities etc.). Where the offer price is by way of exchange of securities etc., the disclosures should be made accordingly.

5. A statement that the offer is pursuant to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and subsequent amendments thereof.
6. If the offer is conditional, specify conditions viz minimum level of acceptance, differential pricing, if any.
7. If the offer is a competing offer, mention that the competing offer is made pursuant to an open offer made by the original bidder (name) and that the competing offer has been made as the regulations..
8. Mention the statutory approval(s), if any, required to implement the offer and its current status.
9. A statement that upward revision/withdrawal, if any, of the offer would be informed by way of the Issue Opening P.A. in the same newspapers where the original Detailed Public Statement has appeared. Indicate the last date for such revision. Also mention that the same price would be payable by the acquirer(s) for all the shares tendered anytime during the offer.
10. Disclose the following in bold
 - A. “ If there is competing offer :**
 - 1. The public offers under all the subsisting bids shall open and close on the same date.**
 - B. If there is no competing offer:**

A statement confirming that there was no competing offer.
11. A statement that a copy of public announcement, detailed public statement and LoF (including form of acceptance cum acknowledgment) is also available on SEBI's website (www.sebi.gov.in)

(iii) At the bottom

1. The name of Manager and address of the dealing office of Manager along with its telephone, fax number and email address, contact person.
2. The name and address of the Registrar to the offer, along with its telephone, fax number and email address, contact person.

3. Disclose the schedule of the activities as per the following table. Further also disclose the day along with the dates in the activity schedule e.g. January 3, 2011 (Monday).

Activity	Day and date
Public Announcement (PA) Date	
Detailed Public Statement (DPS) Date	
Last date for a competing offer	
Identified Date	
Date by which LoF will be despatched to the shareholders	
Issue Opening PA Date	
Last date by which Board of TC shall give its recommendation	
Date of commencement of tendering period (Offer opening Date)	
Date of expiry of tendering period (Offer closing Date) Date by which all requirements including payment of consideration would be completed.	

(B) Front inside cover page shall contain the following

- (i) Risk factors relating to the transaction, the proposed offer and the probable risk involved in associating with the acquirer(s).
- (ii) On top

An index as follows:

Sr. No.	Subject	Page No.
1	Disclaimer clauses	
2	Details of the offer	
3	Background of the Acquirer(s) (including PACs , if any).	
4	Background of the TC	
5	Offer Price and Financial arrangements	

6	Terms & Conditions of the offer	
7	Procedure for acceptance and settlement of the offer.	
8	Documents for inspection	
9	Declaration by the Acquirer(s) (including PACs, if any)	

(iii) At the Bottom

Definitions of the specialized terms used in the LoF for easy understanding by the shareholders viz TC, Acquirers, PACs, Regulations, etc. No other terms should be used in the LoF for entities defined as such in the Regulations. (eg. the word offeror(s) should not be used to refer the term acquirer(s)).

2. DISCLAIMER CLAUSE

The following on the first page of Letter of Offer:

“IT IS TO BE DISTINCTLY UNDERSTOOD THAT FILING OF DRAFT LOF WITH SEBI SHOULD NOT IN ANY WAY BE DEEMED OR CONSTRUED THAT THE SAME HAS BEEN CLEARED, VETTED OR APPROVED BY SEBI. THE DRAFT LOF HAS BEEN SUBMITTED TO SEBI FOR A LIMITED PURPOSE OF OVERSEEING WHETHER THE DISCLOSURES CONTAINED THEREIN ARE GENERALLY ADEQUATE AND ARE IN CONFORMITY WITH THE REGULATIONS. THIS REQUIREMENT IS TO FACILITATE THE SHAREHOLDERS OF (NAME OF THE TARGET CO.) TO TAKE AN INFORMED DECISION WITH REGARD TO THE OFFER. SEBI DOES NOT TAKE ANY RESPONSIBILITY EITHER FOR FINANCIAL SOUNDNESS OF THE ACQUIRER(S), PACs OR THE COMPANY WHOSE SHARES/CONTROL IS PROPOSED TO BE ACQUIRED OR FOR THE CORRECTNESS OF THE STATEMENTS MADE OR OPINIONS EXPRESSED IN THE LETTER OF OFFER. IT SHOULD ALSO BE CLEARLY UNDERSTOOD THAT WHILE ACQUIRER(S) IS PRIMARILY RESPONSIBLE FOR THE CORRECTNESS, ADEQUACY AND DISCLOSURE OF ALL RELEVANT INFORMATION IN THIS LETTER OF OFFER, THE MERCHANT BANKER IS EXPECTED TO EXERCISE DUE DILIGENCE TO ENSURE THAT ACQUIRER(S) DULY DISCHARGES ITS RESPONSIBILITY ADEQUATELY. IN THIS BEHALF, AND TOWARDS THIS PURPOSE, THE MERCHANT BANKER (INDICATE NAME) HAS SUBMITTED A DUE DILIGENCE CERTIFICATE DATED _____ TO SEBI IN ACCORDANCE WITH THE SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVER) REGULATIONS 2011 AND SUBSEQUENT AMENDMENT(S) THEREOF . THE FILING OF THE LOF DOES NOT, HOWEVER, ABSOLVE THE ACQUIRER(S) FROM THE REQUIREMENT OF OBTAINING SUCH A STATUTORY CLEARANCES AS MAYBE REQUIRED FOR THE PURPOSE OF THE OFFER..”

3. DETAILS OF THE OFFER

3.1 Background of the offer

- 3.1.1 Mention the Regulation in accordance with which the offer is made i.e. mention whether the offer is a voluntary offer, is made for substantial acquisition of shares or Consolidation of holdings and/or Change in Control or a Competing Offer.
- 3.1.2 Details of the proposed acquisition (substantial acquisition of shares/voting rights or change in control or both) which triggered the open offer such as name(s) of acquirer(s) and of PACs, their existing share holding in the TC, whether it was a negotiated deal or open market purchase(s) or whether offer is as a result of global acquisition resulting in indirect acquisition of the TC, acquisition price per share (highest and average), number and percentage of shares acquired, etc.
- 3.1.3 In case there is any agreement, mention important features of the agreement(s), acquisition price per share (highest and average as well as separately for fully paid and partly paid up), number and percentage of shares to be acquired under the agreement, name of the seller(s), names of parties to the agreement, date of agreement, manner of payment of consideration, proposed change in control, if any,
- 3.1.4 Salient features of the agreement, if any, entered between the acquirer and PAC with regard to the offer/ acquisition of shares
- 3.1.5 Whether the proposed change in control is through an arrangement. Give salient features of the arrangement.
- 3.1.6 Whether any of acquirer(s) / PAC has been prohibited by SEBI from dealing in securities, in terms of direction issued u/s 11B of SEBI Act or under any of the regulations made under the SEBI Act.
- 3.1.7 Proposed change, if any, in Board of Directors after the offer, mentioning names of the Directors representing acquirers.
- 3.1.8 A statement stating that the Board of the TC will come out with a recommendation for the Offer before the date of commencement of Offer.

3.2 Details of the proposed offer

- 3.2.1 Mention names, dates and editions of the newspapers where the detailed public statement appeared. Disclose the detailed public statement is also available on the SEBI website at www.sebi.gov.in.
- 3.2.2 Indicate the number and percentage of shares proposed to be acquired by

the acquirers from the existing shareholders and the mode of payment of consideration, if it is in cash, then the offer price per share shall be mentioned, if by way of exchange of shares/ secured instruments, then, inter-alia, the exchange ratio to be disclosed.

- 3.2.3 In case, there are fully paid up and partly paid up shares, offer price for both shall be mentioned separately.
- 3.2.4 Differential price, if any, to be disclosed.
- 3.2.5 In case of competing offers, the competing bidder shall also disclose the following details:
- (a) The fact that his offer is competing offer made pursuant to the open offer made by the original bidder.
 - (b) Details of the original offer such as name of the original acquirer(s), name of the Manager, number and % of shares bid for, offer price, mode of payment, opening date.
 - (c) Any other relevant information
- 3.2.6 In case of the conditional offer, specify the following :
- (a) Minimum level of acceptance (no. and % of shares)
 - (b) Differential price, if any.
- 3.2.7 Disclose details of further acquisition(s), if any, by acquirer(s)/ PACs after the date of P.A and upto the date of LoFviz., no. and % of shares acquired, mode and acquisition price etc.
- 3.2.8 Details of the competing offer, if any.

3.3 Object of the acquisition/ offer

- 3.3.1 Disclose in details the reasons of acquiring shares or control over the TC and/or consolidation of share holding in the TC alongwith the long term commercial justification for the proposed offer.
- 3.3.2 Provide details of the acquirer's intentions regarding the future business of the TC together with his strategic plans for the TC and their likely repercussions on employment and the locations of the TC's places of business.

4. BACKGROUND OF THE ACQUIRER (INCLUDING PACs, IF ANY)

- 4.1 If acquirer(s) (including PACs) is a company

- 4.1.1 The relationship, if any, existing between them
- 4.1.2 Brief History & Major areas of operations.
- 4.1.3 Identity of the promoters and /or persons having control over such companies and the group, if any, to which such companies belong to.
- 4.1.4 Confirm and disclose as to whether the applicable provisions of chapter V of SEBI Takeover Regulations, 2011 (or Chapter II of the SEBI Takeover Regulations, 1997, as the case may be) has been complied with by acquirer/ PACs within the time specified in the Regulations. Delay or non-compliance with these provisions if any, may be disclosed in the LoF.
- 4.1.5 Share holding pattern as under. [Key categories as per the relevant jurisdiction]

<i>Sl. No</i>	<i>Shareholder's Category</i>	<i>No. and Percentage of Shares held</i>
1	Promoters	
2	FII/ Mutual-Funds/FIs/Banks	
3	Public	
	Total Paid Up Capital	

- 4.1.6 Names and D.I.N (if applicable) of Board of Directors of acquirer(s). Confirm whether any of such director(s) is already on the Board of Directors of TC. If so, disclosures thereof.
- 4.1.7 Details of the experience, qualifications, date of appointment of the Board of Directors.
- 4.1.8 Brief audited financial details for a period of last three years. The subsequent certified financial data should also be disclosed so that the financials are not older than six months from the Detailed Public Statement's date.

(Amount Rs. In lacs)

Profit & Loss Statement	Year I	Year II	Year III
Income from operations			
Other Income			

Total Income			
Total Expenditure			
Profit Before Depreciation Interest and Tax			
Depreciation			
Interest			
Profit Before Tax			
Provision for Tax			
Profit After Tax			
Balance Sheet Statement	Year I	Year II	Year III
Sources of funds			
Paid up share capital			
Reserves and Surplus (excluding revaluation reserves)			
Networth			
Secured loans			
Unsecured loans			
Total			
Uses of funds			
Net fixed assets			
Investments			
Net current assets			
Total miscellaneous expenditure not written off			
Total			
Other Financial Data	Year I	Year II	Year III
Dividend (%)			
Earning Per Share			

4.1.9 Ensure that the un-audited financial results, if any disclosed, should be certified / limited review by statutory auditors.

4.1.10 Disclose the major contingent liabilities

4.1.11 In case of acquirer being a listed company, disclose:

4.1.11.1 Name of the stock exchanges where the shares of acquirer are listed/traded in the permitted category, if acquirer is a listed company.

4.1.11.2 Market Price of shares.

4.1.11.3 The status of Corporate Governance

4.1.11.4 The name and other details of the Compliance Officer.

4.1.11.5 In case the offer price is payable in terms of securities as provided in Regulation 9(1)(b) and 9(1)(c) and (d) of the Regulations, the following may be given :

(a) Following details about the acquirer or PAC whose securities are being offered.–

Give relevant details of any merger/demerger, spin off during last 3 years involving the acquirer or PAC, as the case may be Change in name since incorporation/listing and dates thereof.

The following information in respect of all listed Indian companies promoted by the acquirer or PACs as the case may be for the last three years based on the audited statements

Name of Company,

Nature of Business,

Equity capital, Reserves (excluding revaluation reserves),

Total Income,

Profit After Tax (PAT),

Mention if any of the companies stated above is a sick industrial company.

(b) All disclosures including that of litigations pertaining to the acquirer or PAC (depending upon whose securities are being offered) which in opinion of Manager to the offer, are material for the shareholder to make an informed decision to invest in the acquirer or PAC, as the case may be, while making a decision to exit the TC.

4.2 If Acquirer(s) (including PACs, if any) is an individual

4.2.1 The relationship, if any, existing between the PAC

4.2.2 Principal areas of business and relevant experience

4.2.3 Net Worth duly certified by a Chartered Accountant

4.2.4 Confirm and disclose as to whether the applicable provisions of chapter V of SEBI Takeover Regulations, 2011 (or Chapter II of the SEBI Takeover Regulations, 1997, as the case may be) has been complied with by acquirer/ PACs within the time specified in the Regulations. Delay or non-compliance with these provisions if any, may be disclosed in the letter of offer.

4.2.5 Positions held on the Board of directors of any listed company (ies)

4.2.6 Name (s) of the company where individual is a whole time director.

4.2.7 Disclose the details of the earlier acquisitions, if any made in the TC including acquisition made through open offers. Change in shareholding pursuant to the said acquisition/offers and thereafter, if any.

5. BACKGROUND OF THE TC [to be restricted only to relevant information from public domain]

5.1 Share capital structure of the TC

Paid up Equity Shares of TC	No. of Shares/ voting rights	% of shares/ voting rights
Fully paid up equity shares		
Partly paid up equity shares		
Total paid up equity shares		
Total voting rights in TC		

5.2 If shares are currently suspended, disclose the reasons of suspension of trading of the shares in any Stock Exchange(s), as applicable. What steps has been taken by the TC to resume/ regularize the trading.

Profit & Loss Statement	Year I	Year II	Year III
Income from operations			
Other Income			
Total Income			
Total Expenditure			

Profit Before Depreciation			
Interest and Tax			
Depreciation			
Interest			
Profit Before Tax			
Provision for Tax			
Profit After Tax			
Balance Sheet Statement	Year I	Year II	Year III
Sources of funds			
Paid up share capital			
Reserves and Surplus (excluding revaluation reserves)			
Networth			
Secured loans			
Unsecured loans			
Total			
Uses of funds			
Net fixed assets			
Investments			
Net current assets			
Total miscellaneous expenditure not written off			
Total			
Other Financial Data	Year I	Year II	Year III
Dividend (%)			
Earning Per Share			
Return on Networth			
Book Value Per Share			

5.3 In case some shares are currently not listed, disclose the detailed reasons of non-listing of some and/or all shares of the company at any Stock Exchange(s), as applicable. What steps has been taken by the company to regularize the listing.

(2) Acquirers								
a. Main Acquirer**	@							
b. PACs **								
Total 2(a+b)								
(3) Parties to agreement other than(1) (a) & (2)								
(4) Public (other than parties to agreement, acquirers & PACs)								
a. FIs/MFs/ FIs/Banks, SFIs (Indicate names)								
b. Others								
(Indicate the total number of shareholders in "Public category)								
Total (4)(a+b)								
GRAND TOTAL (1+2+3+4)								

** If more than one acquirer / PACs, details shall be given for each separately.

@ Also include shares of TC, purchased by acquirers and PACs, if any, after the Public announcement till the date of letter of offer.

Note: The percentage holding shall be taken on the basis of diluted share capital as defined in the SAST 2011 Regulations.

If acquirer is coming in joint control with the existing promoters, their total holding shall be shown as "shareholding of promoters"

6. OFFER PRICE AND FINANCIAL ARRANGEMENTS

6.1 Justification of Offer price

6.1.1 Direct Acquisition

6.1.2 Indirect Acquisition

6.2 Financial arrangements :

6.2.1 Disclose the total amount of funds required to make the payment of consideration for the shares tendered during the open offer (assuming full acceptances) and at the highest price, if the offer is subject to differential pricing.

6.2.2 Disclosures about the amount deposited in escrow account.

6.2.3 In case, the escrow account consists of cash deposit, disclose the name and address of the bank, where cash amount has been deposited. Also ensure and disclose that the MB has been empowered to operate the escrow account in accordance with the Regulations.

6.2.4 In case the escrow account consists of a Bank guarantee, disclose the name and address of the bank. Also disclose that bank guarantee is valid at least for a period commencing from the date of PA until 30 days after the closure of the offer. Also ensure that bank guarantee is sought from a bank who is not associate of or group of the acquirer or TC. Disclose that the Bank Guarantee is in favour of Merchant Banker.

6.2.5 In case, the escrow account consists of a deposit of securities, give the following details:

6.2.5.1 Disclose the Name, quantity, face value, paid up value, market price on the date of creation of escrow account, the margin etc.

6.2.5.2 Disclose whether they are free of lien/encumbrances.

6.2.5.3 Disclose whether they are carrying voting rights and if so, details about the suspension or freeze of voting rights, if any.

6.2.5.4 Disclose who is holding the securities and whether NOC has been obtained from the holder for depositing the same in the escrow account.

6.2.5.5 Disclose that the Manager has been empowered by acquirer to realise the value of such escrow account by sale or otherwise.

6.2.5.6 Disclose that if there is any deficit on realisation of value of the securities, the Manager shall make good any such deficit.

6.2.6 In case the escrow account consists of a Bank guarantee or deposit of approved securities, disclose the name and address of bank where cash

deposit of at least 1% of the total consideration payable, is made.

- 6.2.7 Ensure and disclose that the acquirer has adequate and firm financial resources to fulfil the obligations under the open offer. Disclosures regarding sources of funds should be made.
- 6.2.8 Disclose the date of certificate, name, complete address (including telephone, Fax number) and membership number of the Chartered Accountant certifying the adequacy of financial resources of acquirer for fulfilling all the obligations under the offer.
- 6.2.9 Ensure and disclose that Manager has satisfied himself about the ability of the acquirer to implement the offer in accordance with the Regulations.
- 6.2.10 In case the acquirer is a foreign body, disclose the details of the escrow account opened abroad, pending RBI permission for opening the same in India. Ensure and disclose that on receipt of RBI permission, the escrow account would be transferred in India. If amount kept therein is in foreign currency, disclose the equivalent amount in INR with rate of conversion as on the date of letter of offer. Also ensure and disclose that the minimum amount as stipulated in the Regulations would be maintained at all times irrespective of the fluctuations in the conversion rate.

7. TERMS AND CONDITIONS OF THE OFFER

- 7.1 All the operational terms and conditions subject to which acquirer(s) would accept the offer should be disclosed. The conditions mentioned in the LoF should not be in violation of the provisions contained in the Regulations.
- 7.2 Locked in shares: Regarding acceptance of locked-in shares, whether acquired pursuant to the agreement or the offer, the same can be transferred to the acquirer subject to the continuation of the residual lock -in period in the hands of the acquirer. Manager shall ensure that there shall be no discrimination in the acceptance of locked-in and non locked-in shares
- 7.3 Eligibility for accepting the offer: Disclose as to who are eligible to tender shares in the offer.
- 7.4 Statutory and other approvals: Mention the nature of statutory approvals required for the offer. Disclose the current status of such approval. A statement that no approval other than those mentioned is required for the purpose of this offer shall be incorporated. Also disclose the conditions stipulated in the underlying agreement, meeting of which are outside the reasonable control of acquirer, and in view of which the offer might be withdrawn under regulation 23 of the SEBI (SAST) Regulations, 2011.

8. PROCEDURE FOR ACCEPTANCE AND SETTLEMENT

8.1 Procedure for accepting the offer by eligible persons shall be mentioned indicating

Name and Address of the entities (merchant banker/ registrar) to whom the shares should be sent including name of the contact person, telephone no., fax no. and email address etc.	Working days and timings	Mode of delivery

Mention all the relevant documents viz. Form of Acceptance cum acknowledgement, Original share Certificate, valid transfer deed required to be tendered. Disclose that shares and other relevant documents should not be sent to the acquirer/PACs/ TC.

8.2 Procedure for acceptance of the offer by unregistered shareholders, owners of shares who have sent them for transfer or those who did not receive the Letter of Offer

8.2.1 Procedure for said persons shall be specified. The option of applying on plain paper giving all relevant details and forwarding relevant documents along with it, shall necessarily be given to such shareholders. Alternatively, such shareholders, if they so desire, may apply on the form of acceptance cum acknowledgement obtained from the website (www.sebi.gov.in) . It shall be noted that no indemnity is needed from the unregistered shareholders.

8.3 Disclose the relevant provisions pertaining to acceptance of shares when shares offered under the offer by the shareholders are more than the shares agreed to be acquired by the acquirer(s).

8.4 Disclosure about extension of time for payment of consideration and payment of interest should be made.

8.5 Ensure and disclose that the unaccepted shares / documents shall be returned by Registered Post to the shareholders.

8.6 Ensure and disclose that the share certificates would be held in trust by the Manager to the offer/registrar to the offer, as the case may be, till the acquirer completes the offer obligations in terms of Regulations.

8.7 In case, the shares of TC are dematerialized, Manager should ensure to specify all the requisite procedural requirements in the LoF.

9. DOCUMENTS FOR INSPECTION

- 9.1 For inspection of material documents by public disclose the addresses of the places and timings. Such documents shall include:
 - 9.1.1 Certificate of incorporation, Memorandum and Articles of Association of the Acquirer, in case Acquirer is a company;
 - 9.1.2 C.A. certificate, certifying the net worth of Acquirer(s) in case Acquirer is a individual.
 - 9.1.3 C.A. certificate, certifying the adequacy of financial resources with acquirers to fulfil the open offer obligations.
 - 9.1.4 Audited annual reports of the Acquirer and TC for the last three years.
 - 9.1.5 A letter from the Bank confirming the amount kept in the escrow account and a lien in favour of Manager.
 - 9.1.6 A Copy of the agreement, if any, which triggered the open offer.
 - 9.1.7 A copy of Public Announcement, published copy of the detailed public statement statement, issue opening PA and any corrigendum to these.
 - 9.1.8 A copy of the recommendation made by the TC's Board.
 - 9.1.9 A copy of the comments letter from SEBI.
 - 9.1.10 When Escrow Account consists of approved securities, details of securities such as name, quantity, face value, paid up value, market price on the date of creation of escrow. etc.
 - 9.1.11 A copy of the agreement into with Depository Participant for opening a special depository account for the purpose of the offer.
 - 9.1.12 Any other relevant document(s).

10. DECLARATION BY THE ACQUIRERS (INCLUDING PACs, IF ANY)

- 10.1 Statements regarding the Acquirer's responsibility for the information contained in the LoF.
- 10.2 A statement to the effect that each of the acquirers (including PACs, if any) would be severally and jointly responsible for ensuring compliance with the Regulations shall be incorporated in the LoF.
- 10.3 LoF shall be signed by the acquirer(s)/owner of Attorney holders on their behalf giving date and place. Manager to ensure and disclose that person(s) signing the LoF is duly and legally authorised by Acquirers (including PACs, if any).

XX. BUY-BACK OF SECURITIES

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

In the case of listed companies, the buy-back of the shares or other specified securities should be in accordance with the regulations made by the Securities and Exchange Board of India (SEBI) in this behalf. SEBI has framed the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998 which are applicable to the buy-back of listed securities.

The buy-back of securities by unlisted companies must be in accordance with the guidelines prescribed by the Government of India (Department of Company Affairs). The Central government has notified the Private Limited Company and Unlisted Public Company (Buy-back of Securities) Rules, 1999 in this regard. In both cases, the Articles of Association of the company must expressly authorise the buy-back of securities. The documents involved in a buy-back of securities are

- (a) Memorandum and Articles of Association of the Company.
- (b) Resolution of the Board of Directors of the company approving the buy-back.
- (c) Special resolution by the shareholders of the company approving the buy-back.
- (d) Declaration of solvency by the Board of Directors of the Company.

[For a specimen of the declaration of solvency, which may be in Form No. 4A, prescribed under the Companies (Central government's) General Rules and Forms, 1956 please see Annexure XXV at the end of this study material].

- (e) In the case of a buy-back of securities from the existing shareholders of the company, a public announcement.
- (f) Letter of offer to the security holders.
- (g) Register of securities bought back
- (h) Return on buy-back of securities.

XXI.

FORM NO. 4A

Declaration of solvency

(See Rule 5C)

Name of Company : _____

Address (Regd. Office) : _____

Presented by : _____ (Name)

_____ (Designation)

We, _____ of _____
and of _____ being all the directors of M/s. _____
do solemnly affirm and declare that we have formed the opinion that the company is
capable of meeting its total liabilities and that the company will not be rendered
insolvent within a period of one year from the date of making this declaration.

We append a statement of company's assets and liabilities as at _____
being the latest date before making of this declaration (Annexure-I).

We further declare that the company's audited annual accounts including the
Balance Sheet have been filed upto date with the Registrar of Companies _____

Signature _____

Name _____

Managing Director

Signature _____

Name _____

Directors

Signature _____

Name _____

Directors

Verification

And we make this solemn declaration believing the same to be true.

We solemnly declare that we have made a full enquiry into the affairs of the
company including assets and liabilities of this company and that having done so and
having noted that the shareholders by a special resolution have approved the buy-
back of..... (.....) (in words)
number of shares/securities as per the provisions of section 77A of the Companies
Act, 1956, as inserted by the Companies (Amendment) Ordinance, 1999.

Verified this day the.....day of....., 20.....

Signature_____

Name_____

Managing Director

Signature_____

Name_____

Directors

Signature_____

Name_____

Directors

Solemnly affirmed and declared at_____ the_____ day of _____ 201__
before me.

Commissioner for Oaths and Notary Public or Justice of the Peace

Annexure A: Statement of Assets and Liabilities

Statement as at_____ 201__, showing assets
at estimated realisable values and liabilities expected to rank.

Name of the Company:_____

Assets

	<i>Book Value</i>	<i>Estimated to realise</i>
1. Balance at Bank		
2. Cash in hand		
3. Marketable Securities		
4. Bills Receivables		
5. Trade Debtors		
6. Loans and Advances		
7. Unpaid Calls		
8. Stock-in-trade		
9. Work in Progress viz.		

10. Freehold Property
11. Leasehold Property
12. Plant and Machinery
13. Furniture, Fittings, utensils, etc.
14. Patents, Trade Marks, etc.
15. Investments other than Marketable Securities
16. Other property viz.

Total

Liabilities

*Estimated to rank for payment
 (to the nearest rupee)*

1. Secured on specific assets viz;
2. Secured by floating charge(s), viz;
3. Estimated cost of liquidation and other expenses including interest accruing until payment of debts in full.
4. Unsecured creditors
 (amounts estimated to rank for payment)
 - (a) Trade accounts
 - (b) Bills payable
 - (c) Accrued expenses
 - (d) Other liabilities

(e) Contingent liabilities

Total

Total estimated value of assets

₹ _____

Total Liabilities

₹ _____

Estimated surplus after paying
debts in full

₹ _____

Remarks

Signature_____

Name_____

Managing Director

Signature_____

Name_____

Directors

Signature_____

Name_____

Directors

Place : _____

Date : _____

* The period to be filed in should not exceed 3 years.

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

NOTICE is hereby given that an Extraordinary General Meeting of the members of ABC Limited will be held at..... on Thursday, 10th January, 2002, 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 ₹ 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 ₹ 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, 13th December, 2001

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

The Company is proposing to acquire upto 38,40,000 fully paid-up equity shares of ₹ 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, 13th December, 2001

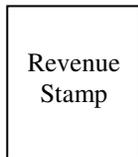
ABC Limited

Registered Office:

.....

Proxy Form

I/We.....
of.....
being a member/members of the abovenamed Company hereby appoint
.....
of..... or
failing him.....
of.....
..... as my/our
proxy to vote for me/us on my/our behalf at the EXTRAORDINARY GENERAL
MEETING of the Company to be held at 10.00 a.m. on Friday, 11th January, 2002
and at any adjournment thereof.



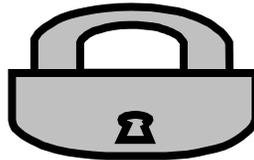
Signed:

Date:

Note: Proxies must reach the Company's Registered Office not less than 48 hours before the meeting.

LESSON ROUND-UP

- Description of major and minor activities involved in mergers is outlined in the study.
- Chapter covers amongst others, the specimen of following documents involved in merger in a company
 - Specimen scheme of arrangement
 - Application to dispense with General Meeting
 - Specimen Advertisement of convening of General Meeting
 - Specimen notice to creditors regarding petition under Section 391
 - Specimen advertisement of petition
 - Resolutions
- Further the lesson covers the documents involved in takeover by transferor company and transferee company.
- The legal documents required for takeover under SEBI Regulations, are also specified.

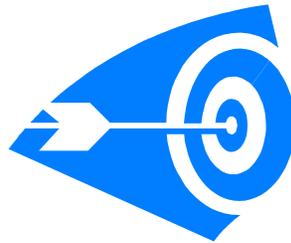
SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. List the major and minor activities involved in the process of merger of a company.
2. Draft suitable resolutions for the following:
 - (a) Appointment of a Merchant Banker during takeover process of a company.
 - (b) Opening an escrow account.
3. Write down the checklist for the submission of softcopy of information to be published on SEBI website.
4. List out the documents that are required in the process of mergers/ amalgamations.

STUDY XI
CASE STUDIES

LEARNING OBJECTIVES



The purpose of this study lesson is to illustrate and analyse the historical factors, situations and strategies in mergers, takeovers, amalgamations, and to assess the restructuring benefits to the companies and reverse mergers, so as to enable the students to understand, the practical aspects of corporate restructuring. Names and ancillary information in some case studies have been changed.

1. DEMERGER - LARSEN & TOUBRO LIMITED

Introduction

L&T was established in 1942. Within a span of fifty years L&T became a leading manufacturer and engineer in turnkey projects having diversified activities in electrical and electronics; construction projects; cement manufacturing; medical equipment; shipping; earthmoving equipment; heavy engineering and information technology. From the year 2000, the company was planning to restructure some of its business divisions through demerger and consolidation in order to concentrate more on infrastructure and turnkey businesses.

Why demerger?

Grasim Industries Ltd. (GIL) a flagship company of Aditya Birla Group was trying to take over control in L&T management by purchasing shares of L&T from the open market. The company first acquired 15 percent stake in L&T and also made an open offer to L&T shareholders to increase its stake which does not succeed. In the year 2004, shareholders approved the demerger of L&T's cement division with a resulting entity named UltraTech CemCo Ltd. (UCL).

Demerger: The Three phases

First Phase

It was decided that in the first phase L&T would spin off the cement business into a new company, UltraTech CemCo Ltd. (UCL), where L&T would hold 20 percent and the balance of 80 percent would be held by existing shareholders of L&T.

Second Phase

In the second phase, GIL would buy 8.5 percent of UCL from L&T @ ₹ 342.60

per share and make an open offer to other shareholders of another 30 percent at the same price. It would take GIL's stake to 51 percent in UCL, if this offer was fully subscribed, and on the sale of its stake in UCL, L&T would realize ₹ 3.62 billion.

Third Phase

In the third phase, L&T Employee Welfare Foundation would acquire the GILs 15.3 percent stake in the residual engineering company.

Hence, after the demerger, GIL gave an open offer to UCL shareholders and purchased the shares to cover a 51 percent hold in UCL. Immediately after the acquisition, GIL finally changed the name from UltraTech CemCo Ltd. to UltraTech Cement Ltd.

The demerger ratio

As per the demerger ratio, for every 2 shares (of face value ₹ 10) held in L&T, the shareholder was given 1 share (face value ₹ 2) in the New L&T.

At the same time for every 5 shares held in L&T, the shareholder was given 2 shares in the demerged cement company – Ultra Tech CemCo.

Benefits of Demerger to L&T

- Lead to immediate realization of value from cement business;
- Create two distinct listed entities for (a) engineering and (b) cement;
- Enable L&T to become focussed Engineering, Construction and Technology Company

Benefits of Demerger to Grasim

- Economies of scale and overall competitiveness
- Multi-functional synergies in the areas of procurement, marketing, logistics and cost reductions
- Combined resource pool
- Cross leverage financial strengths to access domestic and international markets
- Increased Capacity.

2. OVERSEAS ACQUISITION – TATA - CORUS DEAL

This acquisition of Corus Group Plc by Tata Steel Limited (TSL), was the biggest overseas acquisition by an Indian company. TSL emerged as the fifth largest steel producer in the world after the acquisition. The acquisition gave Tata Steel access to Corus' strong distribution network in Europe.

Tata Steel had first offered to pay 455 pence per share of Corus, to close the deal at US\$ 7.6 billion on October 17, 2006. CSN then counter offered 475 pence per share of Corus on November 17, 2006. Within hours of Tata Steel increasing its original bid for Corus to 500 pence per share, Brazil's CSN made its formal counter bid for Corus at 515 pence per share in cash, 3% more than Tata Steel's Offer.

Finally, an auction was initiated on January 31, 2007, and after nine rounds of

bidding, TSL could finally clinch the deal with its final bid 608 pence per share, almost 34% higher than the first bid of 455 pence per share of Corus. The deal (between Tata & Corus) was officially announced on April 2nd, 2007 at a price of 608 pence per ordinary share in cash.

Indian Steel Giant Tata Steel Limited (TSL) finally acquired the Corus Group Plc (Corus), European steel giant for US\$ 13.70 billion. The merged entity, Tata-Corus, employed 84,000 people across 45 countries in the world. It had the capacity to produce 27 million tons of steel per annum, making it the fifth largest steel producer in the world as of early 2007.

Tata Corus Deal Synergy

1. Tata was one of the lowest cost steel producers in the world and had self sufficiency in raw material. Corus was fighting to keep its productions costs under control and was on the look out for sources of iron ore.
2. Tata had a strong retail and distribution network in India and South East Asia and was a major supplier to the Indian auto industry and hence there would be a powerful combination of high quality developed and low cost high growth markets.
3. Technology transfer and enhanced R&D capabilities between the two companies that specializes in different areas of the value chain.
4. There was a strong culture fit between the two organizations both of which highly emphasized on continuous improvement and ethics, i.e. 'The Corus Way' with the core values and code of ethics, integrity, creating value in steel, customer focus, selective growth and respect for people etc. were strong synergies.

BANKING SECTOR MERGER

3. MERGER OF ICICI WITH ICICI BANK

ICICI Limited

ICICI Limited was basically a Development Financial Institution providing medium-term or long-term project finance to industries in India. It was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian industry. Initially it focused on project finance, and providing long-term funds to a variety of industrial projects. Subsequently, it diversified into venture capital financing, commercial banking asset management and management of mutual funds brokering and marketing, internet stock trading, housing finance etc.

ICICI Bank

ICICI Bank was originally promoted in 1994 by ICICI Limited, an Indian financial institution, and was its wholly-owned subsidiary. ICICI's shareholding in ICICI Bank was reduced to 46% through a public offering of shares in India in fiscal 1998, and an equity offering in the form of ADRs listed on the NYSE in fiscal 2000,

RBI Announcement

The RBI announced in April, 2001 that it would consider proposals from Development Financial Institutions wishing to transform themselves into banks.

The Merger

After consideration of various corporate structuring alternatives in the context of the emerging competitive scenario in the Indian banking industry, and the move towards universal banking, the managements of ICICI and ICICI Bank formed the view that the merger of ICICI with ICICI Bank would be the optimal strategic alternative for both entities, and would create the optimal legal structure for the ICICI group's universal banking strategy. The merger would enhance value for ICICI shareholders through the merged entity's access to low-cost deposits, greater opportunities for earning fee-based income and the ability to participate in the payments system and provide transaction-banking services. The merger would enhance value for ICICI Bank shareholders through a large capital base and scale of operations, seamless access to ICICI's strong corporate relationships built up over five decades, entry into new business segments, higher market share in various business segments, particularly fee-based services, and access to the vast talent pool of ICICI and its subsidiaries

In October 2001, the Board of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly-owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank.

The merger was approved by shareholders of ICICI and ICICI Bank in January 2002, by the High Court of Gujarat at Ahmedabad in March 2002, and by the High Court of Judicature at Mumbai and the Reserve Bank of India in April 2002.

Consequent to the merger, the ICICI group's financing and banking operations, both wholesale and retail, have been integrated in a single entity.

4. SLUMP SALE (BUSINESS TRANSFER) – BY PIRAMAL TO ABBOTT

Slump sale means the transfer of one or more undertakings as a result of the sale, for a lump sum consideration, without values being assigned to the individual assets and liabilities.

The acquisition of the domestic formulations business by Abbott Healthcare Private Limited (“**AHPL**”), an Indian subsidiary of Abbott Laboratories, USA (“**Abbott Lab**”), from Piramal Healthcare Limited (“**PHL**”). During May 2010 PHL declared the execution of definitive agreements with Abbott Lab for the sale of its Formulation Business to AHPL by way of a business transfer as a going concern. The acquisition of the Formulation Business was done for a total consideration of USD 3.72 billion. The assets transferred include PHL's manufacturing facilities at Baddi, Himachal Pradesh and rights to approximately 350 brands and trademarks.

The transaction for sale of the Formulation Business was structured as a slump sale/Business Transfer under Section 293(1)(a) of the Companies Act pursuant to a Business Transfer Agreement dated May 21, 2010 entered into between PHL and AHPL. The said Business Transfer involves the transfer of all the assets and liabilities of the Formulation Business excluding cash and cash equivalents and any liability relating to indebtedness of the Company, taxes, employee and other claims, environmental matters and any actual or potential litigation.

The Business Transfer has been undertaken for an all cash consideration of USD 3.72 billion. Out of the said amount USD 2.12 billion would be payable by AHPL to

Piramal Healthcare on closing of the sale and a further USD 400 million payable upon each of the subsequent four anniversaries of the closing commencing in 2011.

Business Transfer requires approval of the shareholders only and not the high court

Section 293(1)(a) of the Companies Act mandates every company to obtain prior approval of its shareholders to undertake a sale of whole or substantial part of its undertaking. Such an approval has to be obtained by way of an ordinary resolution (simple majority). Besides, the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001, makes it mandatory for all listed companies to obtain such approval of shareholders by way of a postal ballot and not in any ordinary meeting of shareholders. Further Transfer of business undertaking need not be approved by the High Courts. Accordingly, pursuant to the approval of the board of directors of the Company on May 21, 2010, necessary steps were taken to seek the approval of equity shareholders of Piramal Healthcare vide postal ballot. The results of the said postal ballot were announced on June 25, 2010 and both the resolutions mentioned above were approved by the shareholders of Piramal Healthcare by an overwhelming majority.

Non-Compete clause

The business transfer agreement has a Non-Compete clause which prohibits Piramal Enterprises, Piramal Healthcare and their respective associates from engaging in any business that competes with the Formulation Business either in India or in the emerging markets for a period of eight years from the date of closing of the Business Transfer.

Slump sale – Tax liability is more

In comparison to demerger, slump sale is not generally tax efficient as the transfer of assets could be subject to capital gains tax in the hands of the transferor. Where the undertaking being transferred was held for more than 3 years prior to the date of the slump sale, the gains from such a sale would qualify as long-term capital gains, and the effective rate of tax would be 20%. If the undertaking had been held for 3 years or any period lesser than that, prior to the date of slump sale, then the income would be taxable as short-term capital gains, the effective rate of which is currently 30%. Also, any distribution by the company to its shareholders could attract dividend distribution tax.

5. MULTIPLE CORPORATE RESTRUCTURING – REDDY LABORATORIES LIMITED

Introduction

Established in 1984, Dr. Reddy's Laboratories (NYSE: RDY) is an emerging global pharmaceutical company.

As a fully integrated pharmaceutical company, the purpose is to provide affordable and innovative medicines through three core businesses:

- Pharmaceutical Services and Active Ingredients, comprising Active Pharmaceuticals and Custom Pharmaceuticals businesses;

- Global Generics, which includes branded and unbranded generics; and
- Proprietary Products, which includes New Chemical Entities (NCEs), Differentiated Formulations, and Generic Biopharmaceuticals.

The products are marketed globally, with a focus on India, US, Europe and Russia.

Its strong portfolio of businesses, geographies and products gives it an edge in an increasingly competitive global market and allows to provide affordable medication to people across the world, regardless of geographic and socio-economic barriers. Its Restructuring process over a period of decade has resulted in financial and geographic expansion, market leadership etc.

The following table provides the chronology of growth through various restructuring Strategies.

	<i>Event</i>	<i>Year</i>
1	Incorporation	1984
2	Became Public Limited Company	1985
3	IPO	1986
4	Acquires Benzex Laboratories Pvt. Limited to expand its Bulk Actives business	1988
5	Makes a GDR issue of USD 48 million	1994
6	Acquisition of Controlling Stakes at American Remedies Limited	1999
7	Listing on NewYork Stock Exchange	2001
8	First overseas acquisition-Meridian Healthcare	2002
9	Acquires Trigenesis gives access to drug delivery technology platforms	2004
10	Key acquisition: Falcon (Mexico)	2005
11	Key acquisition: betapharm (Germany)	2006
12	Acquisition of Dowpharma's Small Molecules business associated at Mirfield and Cambridge sites in UK	2008
13	Acquisition of BASF's facility at Shreveport, US	2008
14	Announces strategic alliance with GlaxoSmithKline plc to develop and market select products across emerging markets outside India.	2009
15	Reorganizes Drug Discovery Operations to merge into Aurigene, a wholly owned independent subsidiary of Dr. Reddy's	2009

The analysis of above chronology of restructuring events reveals that the

restructuring has taken in the following forms.

- Domestic Acquisitions
- Overseas acquisitions
- Domestic and overseas Listing
- Internal reorganization etc.

6. LEVERAGED BUY-OUT – BHARTI - ZAIN DEAL

A leveraged buyout, is an acquisition of a company or its division majorly financed with borrowed funds. The acquirer resorts to a combination of a small investment and a large loan to fund the acquisition. The loan capital is availed through a combination of repayable bank facilities and/or public or privately placed bonds. Alternatively, the acquiring company could float a Special Purpose Vehicle (“SPV”) as a 100% subsidiary with a minimum equity capital. The SPV can leverage this equity to gear up significantly higher debt to buyout the target company. The target company's assets can be used as collaterals for availing the loan and once the debt is redeemed, the acquiring company has the option to merge with the SPV. The debt will be paid off by the SPV using the cash flows of the target company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

Bharti started its telecom services business by launching mobile services in Delhi (India) in 1995. Since then there has been no looking back and Bharti Airtel, the group's flagship company, has emerged as one of top telecom companies in the world and is amongst the top five wireless operators in the world. Through its global telecom operations Bharti group has presence in 21 countries across Asia, Africa and Europe. Over the past few years, the group has diversified into emerging business areas in the fast expanding Indian economy.

Zain was established in 1983 in Kuwait as the region's first mobile operator. It is a public company engaged, together with its subsidiaries, in the provision of mobile telecommunication and data services, including operation, purchase, delivery, installation, management and maintenance of mobile telephones and paging systems in Kuwait and 21 other countries in the Middle East and North Africa. Its wholly owned subsidiaries include; Mobile Telecommunications Company Lebanon (MTC) SARL, Lebanon, and Sudanese Mobile Telephone (Zain) Company Limited, Sudan. Wholly owned subsidiary of Zain, incorporated in Netherlands and held the African operations of Zain. The company was originally named Celtel which was acquired by Zain in 2005 and renamed as Zain International BV. The same has been acquired by Bharti Airtel now through Bharti Airtel Netherlands BV

During the first quarter of 2010, Bharti Airtel announced that it had entered into exclusive agreement with Mobile Telecommunications Company KSC (“**Zain**”) for the acquisition of Zain Africa International BV (“**Zain Africa**”) and thereby the entire African operations of Zain, excluding the operations in Sudan and Morocco. The deal makes Bharti Airtel the seventh largest mobile group in the world by subscriber connections and the second-largest African operator, behind MTN for an offer of USD 10.7 billion. In the Indian telecom space, the deal is the second largest after the USD 11.2 billion (approximately) Vodafone Hutchison transaction in 2007.

Funding through Special Purpose Vehicles

The acquisition deal was structured as a leveraged buyout and the loan for financing the transaction has been availed by the two Special Purpose Vehicles created in Netherlands and Singapore for this purposes. These SPVs, whose dealings will be guaranteed by Bharti, will own the African assets of Kuwait's Zain. SPVs, which mostly feature in large acquisitions, are often used to convey the impression to investors that companies are not taking huge dollops of debt. In this instance, the SPV has to repay the debt from the cashflows of the African business. But Bharti will have to step in case of a default. Thus, Bharti Airtel has structured the acquisition strategically and routed it through the SPVs keeping Bharti Airtel's standalone financials intact. However, that does not absolve Bharti Airtel from overall responsibility of a borrower since it has provided a guarantee to bankers for the loan that will be in the SPV's books.

7. OVERSEAS ACQUISITION – DAIICHI - RANBAXY

Ranbaxy Laboratories Limited., India's largest pharmaceutical company, is an integrated, research based, international pharmaceutical company producing a wide range of quality, affordable generic medicines, trusted by healthcare professionals and patients across geographies. Ranbaxy's continued focus on R&D has resulted in several approvals in developed markets and significant progress in New Drug Discovery Research. The Company's foray into Novel Drug Delivery Systems has led to proprietary 'Platform technologies' resulting in a number of products under development. The Company is serving its customers in over 125 countries and has an expanding international portfolio of affiliates, joint ventures and alliances, ground operations in 49 countries and manufacturing operations in 11 countries.

Daiichi Sankyo Company was established in 2005 through the merger of two leading Japanese pharma companies. This integration created a more robust organization that allows for continuous development of novel drugs that enrich the quality of life for patients around the world. A central focus of Daiichi Sankyo 's research and development are thrombotic disorders, diabetes, hypertension etc.

Ranbaxy and the Singh family, the largest and controlling shareholders of Ranbaxy (the "Sellers"), entered into a binding Share Purchase and Share Subscription Agreement (the "SPSSA") with Daiichi Sankyo, pursuant to which, Daiichi Sankyo to acquire the entire shareholding of the Sellers in Ranbaxy and further seek to acquire the majority of the voting capital of Ranbaxy at a price of Rs 737 per share with the total transaction value expected to be between US\$3.4 bn to US\$4.6 bn. On the post closing basis, the transaction would value Ranbaxy at US\$8.5 bn.

Highlights of the Acquisition

- To take the Company to a new orbit and a higher growth trajectory
- To catapult the combined entity as the World's 15th biggest drug maker
- To become the largest generic Company in Japan, the world's second largest pharma market
- Complementary business model • Global reach covering mature and emerging markets
- Strong growth potential
- Cost competitiveness

Acquisition stages

<i>Date</i>	<i>Particulars</i>
June 11, 2008	Signing of Agreement by Daiichi with Ranbaxy and its Promoters
June 14, 2008	Public announcement by Daiichi to the shareholders of Ranbaxy to acquire additional 20% equity shares at ₹737 per share under the Takeover Code.
June 27, 2008	Submission of draft letter of offer by Daiichi to SEBI for its observations.
July 15, 2008	Approval of preferential allotment of equity shares and warrants to Daiichi by the shareholders of Ranbaxy.
August 16, 2008	Opening of open offer
September 4, 2008	Closing of open offer
October 15, 2008	Acquisition of 20% equity stake by Daiichi pursuant to open offer
October 20, 2008	Ranbaxy becomes subsidiary of Daiichi upon increase in Daiichi's stake to 52.5% (including preferential allotment and transfer of 1st tranche shares from Promoters)
November 7, 2008	Daiichi acquires balance 11.42% shares from the Promoters off the stock market and the deal is concluded. Daiichi's equity stake in Ranbaxy reached up to 63.92%

Approvals Obtained

Ministry of Finance mandates prior approval of FIPB, if the foreign investor is already having an existing joint venture or technology transfer / trademark agreement in the 'same' field, as on January 12, 2005. Since Daiichi was already holding equity stake in Uni-Sankyo Limited, a company engaged in 'same' business as Ranbaxy, prior approval of FIPB was obtained. As this foreign investment required prior approval of Cabinet Committee on Economic Affairs (CCEA), the clearance was received from CCEA by Daiichi in the month of October, 2008.

Synergies

The Synergies are

1. Their respective presence in the developed and emerging markets. Ranbaxy's strengths in the 21 emerging generic drug markets can allow Daiichi Sankyo to tap the potential of the generics business,
2. Both Daiichi Sankyo and Ranbaxy possess significant competitive advantages, and have profound strength in striking lucrative alliances with other pharmaceutical companies.
3. R&D perhaps playing the most important role in the success of these two players.

4. The patent perspective of the merger clearly indicates the intentions of both companies in filling the respective void spaces of the other and emerge as a global leader in the pharmaceutical industry.

According to Ranbaxy newsletter it will provide a new and stronger platform to harness Ranbaxy's capabilities in drug discovery/development, manufacturing and global reach, helping it establish a significant milestone in the Company's mission of becoming a '*Research based International Pharmaceutical Company*'.

This transaction will create significant long-term value for all stakeholders through:

- A complementary business combination that provides sustainable growth by diversification, that spans the full spectrum of the pharmaceutical business;
- An expanded global reach that enables leading market positions in both mature and emerging markets with proprietary and nonproprietary products;
- Strong growth potential by effectively managing opportunities across the full pharmaceutical life cycle, cost competitiveness by optimizing usage of R&D and manufacturing facilities of both companies, especially in India.
- Ranbaxy will be able to leverage its extensive front-end presence through a larger product flow and ascend the pharma value chain by enhancing drug discovery capabilities. It will also widen the scale and scope of the biosimilars opportunity.

Ranbaxy has also established the 'Synergy Office' in July 2009 which has the task of promoting synergies and thereby helping maximize the opportunities for Ranbaxy and Daiichi Sankyo to expand their global operations.

Pharmaceutical companies are working together on a number of areas including drug discovery and development, marketing and manufacturing. Surely a healthy trend, it will go a long way in addressing the growing imperative of the global pharmaceutical industry to lower the cost of medicines while addressing availability challenges around the world.

8. INTERNAL BUSINESS REORGANISATION

Objective:

Consolidation of all operations of the Shil Group of Companies presently carried on by different entities within the group. Shil Group of companies is engaged in the manufacture of speciality textile garments. They export garments to different countries. They have a strong presence in the domestic market also.

Shil Group is promoted by the leading industrialist 'Mr.Chandran' and it is run by him and two of his daughters. Over a period of thirty years, Shil Group has interest in textiles, granites, medical, health care and also in basic and management education. They post a combined turnover of about 250 Cr. of which ₹100 Cr comes from textiles. They are interested in consolidating their business and going for an initial public offer. They are attempting to augment necessary human resources, identify wastes, install management information systems, carry out proper tax planning, understand their inherent strengths and draw a road map for the consolidating and expanding group's textile activity in the context of the opening up of the economy and removal of the quota regime. They have a very strong brand and they plan to come

out with a brand promotion campaign in some of the countries where they see huge potential. In short, they want to consolidate, corporatize all their activities, professionalise and take off in a big way.

They have asked a company secretary in practice to look at their companies, firms and concerns engaged in textile business so as to give them a suitable option and provide all related services as a package.

The following are the companies, firms and concerns of the group engaged in textile activity:

1. Shil Industries Limited, a closely held public company.
2. M/s.Shil Processors, a partnership firm.
3. M/s.Shil Exports, a proprietorship concern where one of the daughters is the proprietor.
4. M/s.Shil Sizing Mills, a proprietorship concern of which the founder promoter is the proprietor.

Their latest balance sheet and profit and loss account are as follows:

Shil Industries Limited

Balance Sheet As At

Liabilities	31/3/08 (Prov.) (₹ lacs)
<hr/>	
SHARE CAPITAL:	
Paid up share capital	102.02
Share application money	4.08
RESERVES & SURPLUS:	104.82
SECURED LOANS:	
SBI – CC	302.22
UNSECURED LOANS:	
From Directors	149.11
CURRENT LIABILITIES:	
Trade Creditors	36.97
Creditors for expenses/Others	6.71
Advances - Group Concerns	0.11
PROVISIONS:	
Tax Payable	
Total Liabilities	<hr/> 706.04

Shil Industries Limited

Balance Sheet As At

Assets	31/3/08 (Prov) (₹ lacs)
FIXED ASSETS:	
Gross Block	150.28
Less: Depreciation	106.45
Closing WDV	43.83
INVESTMENTS:	
CURRENT ASSETS:	
Closing Stock	144.88
Receivables - Domestic	206.05
Cash on hand & at Bank	7.18
Deposits with Bank	0.00
Deposits	4.70
Advances to staff/Others	4.88
Sister concern dues	281.77
Claims Receivable	12.75
Advance IT	0.00
MISC. EXPENDITURE:	
Preliminary Exp.	
Total Assets	706.04
Shil Processors	
Balance Sheet As At	
Liabilities	31/3/08 (Prov) (₹lacs)
CAPITAL:	
RESERVES & SURPLUS:	
SECURED LOANS:	
SBI/ UTI Bank - CC	99.65
SBI/ UTI Bank - TL (Windmill)	224.02
UTI Bank - TL (P&MI)	749.42
UTI Bank - FLC (CG)	164.72

ICICI Bank	1.75
LVB	

UNSECURED LOANS:

From Promoters

CURRENT LIABILITIES:

Loan Creditors (Current A/c)	302.14
Trade Creditors	358.35
Creditors for expenses/Others	29.98
Creditors - Group Concerns	217.00

PROVISIONS:

Tax Payable	
Total Liabilities	<u>2,172.99</u>

Shil Processors

Balance Sheet As At

Assets	31/3/08 (Prov) (₹lacs)
--------	------------------------------

FIXED ASSETS:

Gross Block	1,942.18
Less: Depreciation	<u>378.38</u>
Closing WDV	1,563.80

INVESTMENTS:

CURRENT ASSETS:

Closing Stock	107.62
Receivables - Domestic	119.13
Receivables - Group Concerns	2.77
Cash on hand & at Bank	11.15
Deposits (with Bank/Others)	105.29
Cenvat/Other receivables	139.28
Advance for Machinery	<u>123.95</u>
Total Assets	<u>2,172.99</u>

Shil Exports

Balance Sheet As At	
Liabilities	31/3/08
	(₹)
Capital	35,925,979
SECURED LOANS:	
SBI - Packing Credit / CC	26,533,211
SBI – FBP	10,012,138
UTI Bank – FBP	
CURRENT LIABILITIES:	
Trade Creditors –Suppliers	9,382,597
Trade Creditors –DGFT	4,394,868
Creditors – Group Concerns:	
Shil Industries Ltd	7,493,450
Shil Distributors	20,351
Shil Sizing Mills	
TDS/Provision for Tax	1,594,088
Total Liabilities	95,356,682
Shil Exports	
Balance Sheet As At	
Assets	28/2/08
	(₹)
FIXED ASSETS (WDV):	
Machinery	330,420
Computer	4,486
Car	726,731
Two Wheelers	24,251
	1,085,888
INVESTMENTS:	
CURRENT ASSETS:	
Closing Stock	28,217,843
Receivables – Exports	26,503,609
Receivables - Exports (DEPB)	4,394,868

Receivables – Group concerns:	
Meere Foundation	13,250,000
Shil Industries Limited	
Shil Processors	6,009,490
Meera Finance & Leasing	9,767,005
Meera Trading	
Meera Impex	2,491
Shil Sizing Mills	490,196
Cash on hand	11,207
Cash at Bank:	
SBI – EEFC	73,047
SBI – Commercial	1,715
SBI	9,966
CSB	9,335
LVB	7,098
UTI	61,330
Deposits:	
SBI – FD	187,658
EB Deposit	7,850
Sales Tax Deposit	3,000
Excise Duty Receivable	4,681,960
Drawback Receivable	543,521
Cenvat Receivable	37,605
Total Assets	<u>95,356,682</u>

Shil Sizing Mills

Balance Sheet As At

Liabilities	31/3/08
	(₹)
CAPITAL:	237,779
SECURED LOANS:	
UTI Bank - CC	1,500,000
UTI Bank - Term Loan	1,545,000
CURRENT LIABILITIES:	
Trade Creditors	1,744,458
Sales Tax payable	30,299

Creditors - Group Concerns	
Meera Trading	4,374
Meera Finance & Leasing	1,516,656
Shil Industries Ltd	869,639
Shil Processors	88,398
Total Liabilities	<u>7,536,603</u>

Shil Sizing Mills

Balance Sheet As At

Assets	28/2/08
	(₹)
FIXED ASSETS (WDV):	
Machinery	2,276,694
Computer	27,322
Car	69,926
Two Wheelers	10,897
	<u>2,384,839</u>
INVESTMENTS:	
CURRENT ASSETS:	
Closing Stock	726,698
Receivables – Domestic	3,143,592
Receivables - GR. Concerns:	
Shil Exports	409,655
Meera India	79,215
Loans with Ass.concerns:	
Meera Foundation	250,000
Cash on hand	48,989
Cash at Bank	
UTI BANK LTD- C/A	96,854
LVB	7,895
CSB	10,262
Deposits	
EB	292,781
G-Tex – EMD	5,000
Advances to staff/Others	
Total Assets	<u>7,536,603</u>

They have given the following information:

- Shil Industries Limited (SIL) seems to be their flagship company.
- Shil Exports does a lot of exports and enjoys export house status.
- Shil Sizing Mills was the very first business unit started by them.
- Shil Processors is a very valuable unit. It has highly valued immovable properties in its name.
- The company also has immovable properties.
- Other concerns own lands in the personal names of the proprietors and for business purpose such concerns have taken the lands on lease basis only.

How to go about it?

A perusal of the above clearly brings out the need for organizing all their related activities under one roof. If the Partnership firm is registered under Part IX of the Companies Act, by virtue of Section 575 of the Companies Act, the assets will get automatically vested in the company so formed.

Therefore we may do as follows:

- SIL the public company could remain as the ultimate company.
- The partnership firm M/s. Shil Processors could be registered under Part IX of the Companies Act.
- SIL could take over other proprietorship concerns.
- After registering the firm as a Part IX company, it could be merged with SIL.

Nature and Scope of the Initial Work

General Consultancy until a programme / plan of action is finalized.
SIL to takeover of business of Shil Exports and Shil Sizing Mills in accordance with Section 47(xiv) of the Income Tax Act or otherwise.
Registration/conversion of Shil Processors into a company under Part IX of the Companies Act, 1956 and in accordance with Section 47(xiii) of the Income Tax Act or otherwise.
Merger of companies within the group for creating the ultimate single entity.
Valuation of Shares
Appearance before High Court
Appearance before the Registrar of Companies
Appearance before the Regional Director
Appearance before the Company Law Board
Appearance before the Registrar of Firms
Other related miscellaneous, ancillary and incidental jobs

1. Detailed Analysis of the jobs involved – Shil Processors

Registration of the firm under Part IX involves the following jobs:

Job involved at the Registrar of Firms (RoF):

Obtaining 'Form A' from the RoF to check the latest entries made in the Register of Firms.

Scrutinizing all the partnership deed, supplemental partnership deeds entered into between the partners of the firm till date.

To file and record at the RoF necessary changes as per the said deeds, if any, with respect to change in address of the firm, admission / retirement of partners, change in address of partners, change of name, yearly renewals etc.

Determining the share capital of the Firm and accordingly dividing the contribution of each partner so that it shall form the basis for the number of shares to be subscribed by the partners as members of the company to be registered.

Drafting a Supplementary Deed of Partnership to make the firm an existing joint stock company to enable registration as a company and filing the particulars thereof with RoF.

Change the name of the Firm, if necessary, to suit the name with which the company should be incorporated and File Form V with the RoF for the said change.

Obtaining 'Form A' from RoF duly incorporating all the above changes.

Jobs involved at the Registrar of Companies (RoC):

Making an application to RoC for checking whether the name with which the company should be incorporated is available or not and collect the name availability letter.

Preparing the Memorandum and Articles of Association of the proposed company.

Preparing the necessary Forms (Form Nos. 37, 39, 41, 1, 18, 32) and all connected papers, for filing at RoC.

Filing all the papers with RoC.

Carrying out corrections if any as may be directed by RoC.

Obtaining the certificate of registration of the company.

2. Detailed analysis of Jobs involved in conversion of proprietorship concerns into company or takeover of those concerns by a company.

Takeover of other concerns involves fixing up their business value. SIL could be the acquirer. Acquiring them would be subject to provisions of the Income Tax law, particularly Section 47(xiv) of the Income Tax Act. One of the most important benefits of such an acquisition from the tax point of view will be, that the transfer will not suffer from any capital gains tax and it will not be a transfer for that purpose. However, the conditions contained in the said clause should be complied with. One of the important condition is that the proprietor should hold at least 50% of the post conversion capital

of the company. Acquisition agreements should be executed and the purchase consideration could be settled by issue of shares of the acquirer. As such, the shares of SIL have to be valued.

The following are the important items to be covered by the acquisition agreement:

I. GENERAL COVENANTS

Refer the relevant Clause of the Memorandum of Association (MoA) of SIL (i.e. Shil Industries Limited) to check whether it empowers SIL to acquire any business, activity, of the nature carried on by SE and to carry on the entire activity at present handled by SE (Shil Exports).

Refer the resolution passed by the shareholders of SIL and the resolution passed by the Board of Directors of SIL.

Refer the resolution of the Partners of SE.

SE declarations to include – that with effect from the date of acquisition, all that constitutes the entire business and undertaking of SE with all its assets, properties, status, rights, contracts, liabilities, obligations, benefits, concessions, incentives, whether already granted or to be granted, whether already availed or otherwise, whether already SE has become entitled or will become entitled, all its human and other resources, losses, if any and all other things constituting the present business of the SE, including all residuary and other rights in totality shall become those of SIL.

Determine the cost of acquisition and settlement of the same.

Provide suitable clause relating to all those who have been employed by SE.

The partners of SE stipulate that the cost of acquisition shall be the present value of the business of SE and that the acquisition cost should be settled by SIL by issue of SIL's shares to the partners of SE.

Declare that the partners of SE agree that the shares could be issued to them in the proportion in which they are holding their capital in SE subject to valuation by experts in business valuation.

II. STATUTORY CONDITIONS GOVERNING THE ACQUISITION

Both the parties to agree that the acquisition has been organized to convert the firm into company for corporatisation and shall therefore be in accordance with and subject to the conditions laid down by Section 47(xiii) of the Income Tax Act.

III. CONSIDERATION AND SETTLEMENT OF CONSIDERATION

The only consideration for the acquisition is issue of shares of SIL. Describe the same and determine the date of allotment.

IV. ASSETS AND LIABILITIES OF SHIL EXPORTS HEREBY ACQUIRED BY SIL

Give a detailed schedule of all assets and liabilities of SE acquired by SIL under this agreement.

V. HANDING OVER BY SE AND ACKNOWLEDGMENT BY SIL

SE shall handovers to SIL, all that constitutes its business, all its assets and liabilities, all its books and papers, bank account statements, pass books, incentive schemes and records relating thereto, workers and staff details and books, vouchers, bills, invoices, orders, receipts, records and documents and accounts of every description and SIL shall acknowledge the receipt for the same.

VI. REPRESENTATIONS AND WARRANTIES BY PARTNERS OF SE

SE partners may represent and warranty to SIL that they have disclosed all information and particulars and handed over all books, records, papers and accounts to SIL AND whatever they have represented are true to the best of their knowledge and they declare that all that the books of SE show are true, valid and enforceable.

VII. INDEMNITY BY PARTNERS OF SE

SE partners may agree and indemnify, SIL jointly and severally, should SIL suffer any losses or liabilities due to any matter or thing or account arising out of the business hitherto carried on by SE until immediately before this acquisition.

VIII. DISPUTE AND RESOLUTION

Both the parties agree that disputes if any between them shall be settled only through an arbitrator appointed as per the provisions of the Arbitration and Conciliation Act, 1996.

3. Detailed analysis of Valuation of Business

The next step is to value the two companies. SIL is one company and SHIL Processors will be the other, after it is registered. These are the two companies that will eventually merge. Moreover Shil Exports and Shil Sizing Mills have to be valued as SIL should acquire those two concerns and based on the valuation of those two concerns and the valuation of shares of SIL, the proprietors of Shil Exports and Shil Sizing Mills will get shares of SIL. Let us see the valuation process.

VALUATION METHODS IN VOGUE:

Basically, the methods of valuation adopted for valuing a business (or shares) can be categorized under 3 broad heads:

(a) Earnings based method:

Under this method, a reasonable estimate of the average future maintainable operating profits is made by taking (a) past earnings and (b) the trend and the future plans of the company as a base. This, after deducting preferred rights, if any, is capitalized at an appropriate rate to arrive at the value of the equity shares of the company.

(b) Asset based method:

Under this method, a business is valued on the basis of its net assets i.e. total assets less liabilities and preferred claims and by dividing the remainder by the number of equity shares outstanding on a particular date.

The valuation of assets can be done based on (a) Book values, (b) Net replacement values or (c) Net realizable values.

This method is rarely used for valuing a going concern, as it does not consider the future earning capacity of the business.

(c) Market value method:

Under this method, the average market prices of quoted shares for a certain length of time is taken as the value.

A. VALUATION OF EQUITY SHARES OF SHIL INDUSTRIES LTD

INTRODUCTION:

Shil Industries Ltd ("SIL") was formed in the year 1990 for manufacture of textile products for the consumer market.

The products of the company - made from cotton, synthetics and blends - include the following:

- Dhoties;
- Blouse materials;
- Shirting;
- Suiting;
- Terry towels;
- Lungies and
- School Uniforms.

Shil brand is very popular. SIL is managed by its Managing Director, under the guidance of the Board of Directors consisting of family members of the Promoter Group. The company has a team of qualified and experienced executives in charge of various functions. The Shil group has a significant presence in various textile related activities such as sizing, weaving, processing and speciality finishing. The group is also exporting its products to various countries.

SHIL plans to bring all related activities under a single fold so as to achieve:

- Economies of scale and
- Reasonable size of operations that will improve the stature of the company.

While a direct acquisition involves the determination of the purchase consideration, an acquisition through merger of one company with another involves determination of:

- Share-price of the companies involved and
- Share exchange ratio.

METHOD ADOPTED:

Adopt the (a) earnings based method and (b) to a limited extent the asset-based method as we have gone by the book values. Market value method is not applicable to this case, as the shares are not listed.

VALUATION BASED ON NET ASSETS & PAST EARNINGS:

The valuation has been done based on the guidelines on share valuation prescribed by the Ministry of Finance, Dept. of Economic Affairs. The guidelines talk about valuation of shares based on (a) Net Assets of an enterprise and (b) its profit earning capacity.

We have arrived at the value of the shares of SIL based on the above two methods. These are presented below. (The figures have been based on the audited accounts for the years 2005-06 and 2006-07 and provisional accounts for the year 2007-08 with adjustments where required).

<i>Method</i>	<i>Share Value (₹)</i>
Net Asset Value	20.27
Profit Earning Capacity Value	5.02
Average of above	12.65
Discounted value to take care of limited mobility of shares. (Discounted by a factor of 1.15)	11.00

JUSTIFICATION FOR CONSIDERING FUTURE EARNINGS:

The basis adopted by us for the calculation of Profit Earning Capacity Value (one of the methods discussed above) is the average of the past earnings. However, as mentioned by us earlier, intrinsic value of an equity share is a function of the future maintainable operating earnings of the firm.

Our decision to consider the future earnings of SIL is based on the following reasoning:

SIL had a marketing division of its own till the financial year 2005-06 when, for strategic reasons, it was hived off as a separate entity. The true profitability of SIL can be determined only after considering the profitability of the marketing division also. As this division is to be merged with the company with effect from 1st April 2008, we have adopted the projected earnings of SIL for 2008-09 (including the marketing division) as the basis for arriving at the share value.

Computation

Shil Industries Ltd

Net Asset Value (NAV) Method

Particulars		As at	As at
		31/3/08 (Provi.)	31/3/09 (Estimate)
Share Capital	₹ lacs	102.02	102.02
Free Reserves	₹ lacs	104.82	138.32
		206.84	240.34

Less:

Miscellaneous Expenditure	₹ lacs	0.00	0.00
Contingent Liabilities	₹ lacs		
Net Asset Value	₹ lacs	206.84	240.34
No. of Shares	Nos	1,020,200	1,020,200
Value per share	₹	20.27	23.56

Profit Earning Capacity Valuation (PECV) Method

Particulars		2005-06 to 2007-08	2008-09 (Estimate)
Average PBT (last 3 yrs)	₹ lacs	12.96	50.00
Provision for tax	₹ lacs	5.28	16.50
Average PAT	₹ lacs	7.68	33.50
Less: Pref. Dividend	₹ lacs	0.00	0.00
Net Profits After Tax	₹ lacs	7.68	33.50
No. of equity shares	Nos.	1,020,200	1,020,200
EPS	₹	0.75	3.28
PECV (@15% capitalization)	₹	5.02	21.89

Summary of Valuation

Particulars		31/3/08	31/3/09
Value under NAV Method		20.27	23.56
Value under PECV Method		5.02	21.89
Average of the above values		12.65	22.72
Discounted value	1.15	11.00	19.76
(to account for limited mobility)			

VALUATION BASED ON FUTURE EARNINGS:

Based on discussions with the company's Top Management, we have arrived at the anticipated turnover, the profit after tax and the EPS of SIL for the financial year

2008-09. This is presented below:

<i>Details</i>	<i>UoM</i>	<i>2008-09 (Estimate)</i>
Turnover (Net)	₹ lacs	2,500.00
PBT (2% of T/O)	₹ lacs	50.00
Tax (33% of PBT)	₹ lacs	16.50
PAT	₹ lacs	33.50
No. of Shares	Nos.	10,20,200
EPS	₹	3.28

The revised valuation based on the NAV and PECV Methods, after taking into account the estimates for the financial year 2008-09, is given below:

<i>Method</i>	<i>Share Value (₹)</i>
Net Asset Value	23.56
Profit Earning Capacity Value	21.89
Average of above	22.72
Discounted value to take care of limited mobility of shares. (Discounted by a factor of 1.15)	19.76

CONCLUSION & RECOMMENDATION:

The share value comes to ₹ 19.76 per share. Rounding it off, we arrive at a share value of ₹ 20/- per share. However, as valuation is inherently uncertain and not precise, it would be naïve to put great faith in a single point value estimate. Practical wisdom calls for defining an intrinsic value range around the single point value estimate.

Where an intrinsic value of ₹ 20/- has been arrived at, it may be more sensible to talk of an intrinsic value range of say ₹ 18/- to ₹ 23/-. What we are trying to convey is that while our single point value estimate is ₹ 20/-, we are aware that there may be bias in our estimate. In view of this, we feel that the value range is between ₹ 18/- to ₹ 23/-.

B. VALUATION OF EQUITY SHARES OF SHIL PROCESSORS

Similarly as has been done for Shil Industries, the valuation has to be done for Shil Processors. However determination of the price, based purely on book values, may not bring out the following strengths of the firm:

- Entire gamut of textile processing operations under one roof;

- Special fabric finishes like stain guard dhotis, water repellent fabric etc mentioned above;
- State-of-the-art Quality Control Laboratory to ensure consistency in quality;
- Sophisticated Effluent Treatment Plant together with RO Plant, to ensure a recovery of almost 75% of the water used for processing;
- Major expansion to process wider width fabric;
- 2-year old Windmill of 1.25 MW capacity with an assured generation of 38,00,000 units per annum, meeting close to 85% of the requirement of the Unit.

Hence, it becomes necessary to rely on other methods of valuation that will adequately capture the above strengths. We have adopted the Free Cash Flow Method of valuation for this purpose.

Under this method, cash flows available to a firm after meeting commitments towards interest and tax payments; Investment in working capital; Repayment of long-term debt and Investment in plant & machinery required to maintain the cash flows, are estimated. The cash flows are then discounted using an appropriate capitalization rate (rate of return that is available in the market place on investments that are expected to produce a similar income stream) to arrive at the value of the business.

The computation of free cash flows together with the assumptions is as follows:

M/s Shil Processors

Cash Flow Estimates

(₹ lacs)									
Sl No	Year	T/Over	PBIDT % of T/O	Amount	Dep.	After Tax C/Flow 67%	Dep. X Tax 33%	NWC 5%	CF
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
1	2004-05	1,742			117.26				
2	2005-06	3,000	20.0%	600.00	204.17	265.21	67.38	62.90	269.69
3	2006-07	3,225	20.0%	645.00	191.15	304.08	63.08	11.25	355.91
4	2007-08	3,467	20.0%	693.38	179.75	344.13	59.32	12.09	391.35
5	2008-09	3,727	20.0%	745.38	169.79	385.65	56.03	13.00	428.68
6	2009-10	4,006	20.0%	801.28	161.06	428.95	53.15	13.98	468.12
7	2010-11	4,307	20.0%	861.38	153.43	474.33	50.63	15.02	509.93
8	2011-12	4,630	20.0%	925.98	134.25	530.46	44.30	16.15	558.61
9	2012-13 onwards	4,977	20.0%	995.43	117.47	588.23	38.76	17.36	609.64

Free Cash Flow Estimates

(₹ lacs)

Sl No	Year	CF	Interest on Debt		Debt Repay	Invest in P&M	FCF	PV @15%
			Amount	Tax Saving $I*(1-T)$				
1	2005-06	269.69	53.43	35.80	204.00	75.00	(45.11)	(39.23)
2	2006-07	355.91	42.21	28.28	204.00	100.00	23.63	17.87
3	2007-08	391.35	30.99	20.76	204.00	100.00	66.59	43.78
4	2008-09	428.68	21.53	14.42	140.02	100.00	174.23	99.62
5	2009-10	468.12	14.05	9.41	132.00	100.00	226.71	112.71
6	2010-11	509.93	6.79	4.55	132.00	100.00	273.38	118.19
7	2011-12	558.61	1.58	1.06	57.42	100.00	400.13	150.42
8	2012-13 onwards	609.64	0.00	0.00	0.00	100.00	509.64	1,532.73
							2,036.10	

Assumptions:

- Turnover for 2008-09 has been estimated at ₹ 3,000 lacs, taking into account the additional turnover on account of expansion;
- Growth in turnover from 2009-10 onwards has been assumed at 7.5% per annum;
- Profit before interest, depreciation and tax (PBIDT) has been estimated at 20% of turnover on the following basis:

PBIDT on existing turnover of ₹ 1,750 lacs	12%
PBIDT on additional turnover of ₹ 1,250 lacs	30%
PBIDT on total turnover of ₹ 3,000 lacs	20%
- Tax rate has been assumed at 33%;
- The Net Working Capital (NWC) which is promoters' contribution in financing current assets, has been estimated at 5% of incremental turnover, based on past trends.
- Investment in Plant & Machinery for any year has been assumed at ₹ 100 lacs p/a.
- The projections have been made for the period upto 2014-15 (last year of repayment of the T/L).
From 2015-16 onwards, a constant growth in cash flow (@2.5%) has been assumed;
- The capitalization rate (rate of return that is available in the market place on investments that are expected to produce a similar income stream) has been assumed as 15%.

CONCLUSION AND RECOMMENDATION

The value of the firm based on the free cash flows method comes to ₹ 2,036 lacs. We may round it off as ₹ 2,000 lacs (Rupees twenty crore) and adopt this as the value of equity shares for determination of the exchange ratio.

C. VALUATION OF SHIL EXPORTS

Similar method has to be adopted for valuation of Shil Exports. In this case also determination of the price based purely on book values may not bring out the following strengths of the firm:

- Widening product range;
- Growing list of countries;
- Growing list of buyers in various countries;
- Brand name;
- Export House status.

Hence, it becomes necessary to rely on other methods of valuation that will adequately capture the above strengths. We have adopted the Free Cash Flow Method of valuation for this purpose. This should be computed in a similar manner as has been done for Shil Processors.

CONCLUSION AND RECOMMENDATION

The value of M/s. Shil Exports based on the free cash flows method comes to ₹ 571 lacs. We may round it off as ₹ 600 lacs and adopt this as the acquisition price.

VALUATION OF SHIL SIZING MILLS

As this unit is very small, it may be taken at book values. It will not make much difference.

4. Prepare the scheme of merger and carry it out. Merger process will involve the usual court sanction.

5. Install the MIS.

Note: The above case study presents the entire picture with a combination of companies, firms and concerns, typically and ubiquitously seen across our country. Students should also understand how firms are actually valued though valuation would change from person to person and from occasion to occasion. Moreover valuation can never be exactly determined. At the end of the day, it is the price at which market is prepared to buy. Where there is internal reorganization such as the one in the above case, valuation will be mostly based on the industrial outlook as the promoters are looking at the option of a public issue soon after the reorganization. Even before a full-fledged public issue, they may consider a private placement to strategic investors. As a whole, the above case brings out (i) takeover of proprietorship concerns and the tax and valuation issues in such acquisition; (ii) registration of firms into companies under Part IX and at the same time compliance of tax laws and doing such registration without the incidence of stamp duty and capital gains tax and (iii) merger of the companies and (iv) valuation of shares and business.

9. HLL - TOMCO MERGER

(30th June 1993 – Rationale for Arrangement)

Industry Scenario (1989 – 1992)

The soap and detergents industry in India today has matured into an amalgam of market niches with fast changing consumer loyalties. It has always been a business requiring massive advertising expenditure. The per capita consumption of soaps and detergents in India was very low and with increase in population, spread of education and rising levels of income and consumption, the soaps and detergents industry was poised for a major breakthrough. The major raw material for detergents, linear alkyl benzene, had to be imported on a large scale due to inadequate availability within the country.

HINDUSTAN LEVER LIMITED — The Company

Hindustan Lever, (HLL) the largest player, was poised to transform itself into an almost invincible colossus, with the acquisition of one-time arch rival, TOMCO. The TOMCO acquisition was a strategic move for Lever, as it came close on the heels of the much-publicised strategic alliance between Lever's global adversary, Procter & Gamble with Godrej.

Organization Culture

HLL had been known for its result oriented, systems driven work environment, where a strong emphasis is placed on performance. Accordingly, it always has/had and strives for a team of high performing and high profile executives, carefully selected from the best management institutes. Discussing product profitability and target achievement is the only language that its managers understand. The work culture is very demanding and only the best survive. In fact, about 100 managers at that time from Unilever group companies had quit their jobs, as they were unable to cope with the demanding work culture.

HLL's size had earlier proved to be its weakness, and accordingly, changes in the organisation structure were necessary to enable it to respond to a rapidly changing market place. One of the recommendations of the management committees had been the reduction in the levels of HLL's managerial hierarchy from 9 to 5. In two years time the levels were reduced to 7 and a new infotech system was introduced which would facilitate exchange of information and help to increase the speed of response. In order to stem the tide of the managerial exodus, HLL hiked the entry level remuneration for management trainees by nearly 40%, still the remuneration was lower than that of the competitors.

On the industrial relations front, 1988 was an eye opener as the HLL management declared a lock-out at Sewri, its largest production unit, and the factory was opened a year later, only when the workers signed on the dotted line giving an assurance for an increase in productivity in return for salary increases. In spite of closure for one year, the challenges of market-place were met.

Table 1 gives detailed financial information and equity share data for four years from 1989-1992 for HLL.

TABLE 1
HINDUSTAN LEVER LIMITED
Balance Sheet

	(₹ in crore)			
For the year ended 31st December	1989	1990	1991	1992
I. Sources of Funds				
1. Shareholders' Funds:				
(a) Equity Share Capital	93.32	93.32	139.99	139.99
(b) Reserves and Surplus	<u>135.20</u>	<u>162.06</u>	<u>151.11</u>	<u>193.31</u>
	<u>228.52</u>	<u>255.38</u>	<u>291.10</u>	<u>333.30</u>
2. Loan Funds:				
(a) Secured Loans	60.61	80.00	77.31	93.32
(b) Unsecured Loans	<u>67.58</u>	<u>79.07</u>	<u>87.43</u>	<u>106.95</u>
	<u>128.19</u>	<u>159.07</u>	<u>164.74</u>	<u>200.27</u>
	<u>356.71</u>	<u>414.45</u>	<u>455.84</u>	<u>533.57</u>
II. Application of Funds				
1. Fixed Assets				
(a) Net Block	114.81	144.04	160.77	176.14
(b) Capital WIP	48.54	35.15	32.76	46.60
2. Investments	7.91	8.52	7.60	12.24
3. Current Assets				
(b) Inventories	301.45	356.11	419.62	486.23
(c) Sundry Debtors	42.39	49.94	82.27	84.29
(d) Cash and Bank Balances	10.29	5.29	31.58	27.18
(e) Other Current Assets	0.01	0.00	0.02	0.04
(d) Loans and Advances	<u>71.93</u>	<u>75.48</u>	<u>76.05</u>	<u>96.82</u>
	<u>426.07</u>	<u>486.82</u>	<u>609.54</u>	<u>694.56</u>
Less: Current Liabilities and Provisions				
(a) Current Liabilities	213.42	231.52	309.45	357.08
(b) Provisions	27.20	28.56	45.38	38.89
	<u>240.62</u>	<u>260.08</u>	<u>354.83</u>	<u>395.97</u>
Net Current Assets	<u>185.45</u>	<u>226.74</u>	<u>254.71</u>	<u>298.59</u>
	<u>356.71</u>	<u>414.45</u>	<u>455.84</u>	<u>533.57</u>

HINDUSTAN LEVER LIMITED
Profit and Loss Account

	(₹ in crore)			
For the year ended 31st December	1989	1990	1991	1992
Income				
Sales 1193.21	1427.39	1775.29	2073.91	
Other Income	<u>2.97</u>	<u>5.99</u>	<u>7.19</u>	<u>24.96</u>
	<u>1196.18</u>	<u>1433.38</u>	<u>1782.48</u>	<u>2098.87</u>
Expenditure				
Raw Material Cost	698.14	816.54	902.05	1076.33

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Staff Expenditure	50.50	70.98	62.79	64.47
Other Expenses	324.95	399.56	640.12	740.30
Depreciation	15.47	17.25	19.19	19.60
Interest	17.51	18.31	20.63	32.19
	<u>1106.57</u>	<u>1322.64</u>	<u>1644.78</u>	<u>1932.89</u>
Profit Before Tax	89.61	110.74	137.70	165.98
Taxation 34.64	44.89	57.50	67.50	
Profit After Tax	54.97	65.85	80.20	98.48
Dividend Rate %	35.00	42.00	38.50	42.00
Earnings per Share (EPS)	5.89	7.06	5.73	7.03
Return on Capital Employed	25.85	28.31	29.67	0.57
Market Price –				
High	113.50	172.50	195.00	500.00
Low	69.00	101.00	131.25	161.25
Average	91.25	136.75	163.13	330.63

TOMCO - The Company

TOMCO, a one time major jewel in the Tata crown, was on the brink of becoming a BIFR case. The 74 year old manufacturer of oil based soaps and synthetic detergents had a token presence in edible oils, vanaspati and animal feeds. Over the years it had never emerged as a market leader and always trailed behind HLL, despite certain intrinsic strengths and a strong infrastructure. The company had 7 lakh urban and rural outlets and 2,500 stock lists spread all over the country. It had a market presence in almost every segment of the soaps and detergents market. In the premium segment of toilet soaps, it had Moti, which was competing with Liril of HLL and Cinthol of Godrej. In the popular segment, it had Hamam and Jai, which were pitted against Lux and Rexona of HLL. In the economy segment, its OK bar soap had proved to be no competition for the formidable Lifebuoy of HLL. In laundry soaps TOMCO was the largest producer with its 501 bar, which was in direct competition with Sunlight of HLL and Ghavi of Godrej. In the detergents bar market TOMCO's Dubble trailed behind HLL's Rin and in the lower end of this segment, TOMCO had positioned Super 501, in competition with Wheel of HLL and Nirma. In the detergents powder segment, TOMCO's Tej had proved to be no competition for HLL's Surf. In the low priced segment of the detergent powders market TOMCO's OK detergent powder was far behind Nirma and Wheel of HLL. It was only in the detergent powders for washing machines, that TOMCO had a leading presence with its Revel and Revel plus. TOMCO had indigenously developed a detergent concentrate, to compete with Procter and Gamble's Ariel and HLL's Surf Ultra. TOMCO had also launched a shampoo Raindrop, and a tooth paste - Effermint.

TOMCO's financial performance over the period March 1986 to March 1990 had been impressive, with an increase in turnover from ₹ 237 crores to ₹ 335 crores, an increase of 41%. The spectacular performance in 1990 could be attributed to a growth in rural markets as well as a ₹ 28 crores export order for detergents to USSR. A tighter control on input costs had also contributed towards better financial performance. However, after 1990, the profit margins were eroded due to increase in prices of soap making oils and fats. In fact in 1991 alone, the prices of oil rose by

₹3500 per tonne, accounting for 63 per cent of the raw material cost. With the break up of USSR the company's exports suffered a serious setback, and forex earnings* dropped from ₹ 29 crores in 1989-90 to ₹ 8 crores in 1990-91. Although the company achieved a turnover of ₹ 387.22 crores for 1990-91, a rise of 14% over the previous year, its pretax profit dipped by 11% to ₹ 6.55 crores. The high cost of raw materials and an increasing wage bill, coupled with stiff competition further eroded profit margins, in 1992. Currently the company was losing heavily and facing a severe cash crunch resulting in further deterioration of profits.

Table 2 gives financial information and shareholding pattern for TOMCO.

TABLE 2
TATA OIL MILLS COMPANY LIMITED
Balance Sheet

	(₹ in crore)			
<i>For the year ended 31st December</i>	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>
<i>I. Sources of Funds</i>				
1. Shareholders' Funds:				
(a) Equity Share Capital	8.11	8.11	9.73	21.50
(b) Preference Share Capital	1.15	1.15	1.15	1.15
(c) Reserves and Surplus	<u>20.60</u>	<u>24.21</u>	<u>26.16</u>	<u>43.35</u>
	<u>29.86</u>	<u>33.47</u>	<u>37.04</u>	<u>66.00</u>
2. Loan Funds:				
(a) Secured Loans	55.17	68.78	105.49	95.28
(b) Unsecured Loans	<u>9.87</u>	<u>13.57</u>	<u>11.84</u>	<u>37.86</u>
	<u>65.04</u>	<u>82.35</u>	<u>117.33</u>	<u>133.14</u>
Total	<u>94.90</u>	<u>115.82</u>	<u>154.37</u>	<u>199.14</u>
<i>II. Application of Funds</i>				
1. Fixed Assets				
(a) Net Block	14.50	23.93	30.87	30.00
(b) Capital WIP	13.23	6.07	3.83	2.57
2. Investments	3.00	3.23	16.01	13.43
3. Current Assets				
(a) Inventories	45.65	63.70	60.53	69.81
(b) Sundry Debtors	44.49	40.61	59.71	101.81
(c) Cash and Bank Balances	2.10	1.78	4.76	6.72
(d) Loans and Advances	<u>14.63</u>	<u>21.19</u>	<u>40.54</u>	<u>72.13</u>
	<u>106.87</u>	<u>127.28</u>	<u>165.54</u>	<u>250.47</u>
<i>Less: Current Liabilities and Provisions:</i>				
(a) Sundry Creditors	24.06	41.47	57.57	94.41
(b) Other Current Liabilities	18.64	3.22	4.93	4.38
	<u>42.70</u>	<u>44.69</u>	<u>62.50</u>	<u>98.79</u>

* FERA has been repealed and FEMA has come into existence with effect from 1.6.2000.

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Net Current Assets	<u>64.17</u>	<u>82.59</u>	<u>103.04</u>	<u>151.68</u>
Misc. Assets Not Written Off	<u>0.00</u>	<u>0.00</u>	<u>0.62</u>	<u>1.46</u>
Total	94.90	115.82	154.37	199.14

TATA OIL MILLS COMPANY LIMITED

Profit and Loss Account

(₹ in crore)

<i>For the year ended 31st December</i>	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>
Income				
Sales	282.15	335.26	382.80	428.40
Other Income	<u>3.58</u>	<u>3.60</u>	<u>4.41</u>	<u>6.43</u>
	<u>285.73</u>	<u>338.86</u>	<u>387.21</u>	<u>434.83</u>
Expenditure				
Material Cost	171.21	223.08	220.34	256.03
Staff Expenses	25.50	26.91	31.82	37.78
Other Expenses	77.43	67.12	112.41	129.11
Depreciation	2.20	3.19	3.18	3.64
Interest	<u>9.45</u>	<u>10.97</u>	<u>12.91</u>	<u>20.64</u>
	<u>285.79</u>	<u>331.27</u>	<u>380.66</u>	<u>447.20</u>
Profit Before Tax	□0.06	7.59	6.55	□12.37
Taxation 0.58	2.07	1.86	0.00	
Profit After Tax	□0.64	5.52	4.69	□12.37
Dividend Rate %	15.00	20.00	20.00	12.50
Earnings per Share (EPS)	□0.79	6.81	4.82	□5.75
Return on Capital Employed	9.90	17.06	14.91	□2.01
Market Price—				
High	85.00	340.00	100.00	260.00
Low	52.50	70.00	60.00	46.00
Average	68.75	205.00	80.00	153.00
Shareholding Pattern as on 26.8.93	%			
Directors	0.05			
Public	35.75			
Corporate Bodies	23.17			
Financial Institutions/Banks	40.83			
Foreign Holding	<u>0.20</u>			
	<u>100.00</u>			

Tapping the synergies

TOMCO was a good buy for HLL on two very important considerations — complementary brands and manufacturing locations. Although HLL had a presence in practically every segment of the soap market, it did not have an ethnic brand. TOMCO had 7 manufacturing facilities, and it was comparatively stronger in the

South with two facilities at Tatapuram, Kerala. It was proposed that the spread of manufacturing facilities would enable the combined entity to substantially reduce the transportation cost and more importantly would facilitate the rapid introduction of new products. The distribution network of over 3000 stockists would be practically doubled with the merger. Also, it was felt that HLL's technological edge could help reduce TOMCO's costs by about 30%.

HLL, with the acquisition of TOMCO, planned to have 75% share of the toilet soaps market in volume terms. This could make entry of any competing unit into the industry very costly - even a company like Procter & Gamble had already made a loss of ₹ 7 crores in entering the premium segment of the detergents markets with its Ariel. Thus, although HLL stood to benefit tremendously from the ethnic brands and access to supplementary manufacturing capacities, the real advantage was seen to be in the future stream of profits that were beneath the gross mismanagement of TOMCO. At the time in question, TOMCO was an extremely viable company with an operating profit of ₹ 22 crores in 1991-92. The high interest cost had eroded the profits, as large amounts of funds were blocked in outstanding debtors, inventories, and loans and advances. The 5500 strong workforce managed to produce only 1 lakh tonnes of soaps and detergents, while HLL produced 7 lakh tonnes with 7000 employees. It was envisaged that HLL would use its cash profits of about ₹ 120 crores for the year 1992, to pay off TOMCO's huge loans. As on 31.3.1992 the TOMCO had a total loan of ₹ 180 crores and contingent liabilities of ₹ 30 crores, which had resulted in tremendous interest costs. TOMCO's interest cost were about 4.5% of sales, while HLL stood at 1.5%. It was also expected that the HLL-like efficiency would be put into practice and TOMCO's working capital of ₹151 crores would be trimmed. On an average, TOMCO's receivables were approximately 3 months, compared to HLL's 5-10 days.

Incompatibilities and Problems

It was felt that the most difficult part would be the management of the two different work cultures and ethos, after the merger. In TOMCO the employee productivity was only 60% of HLL. It was opined that HLL would have to rationalise TOMCO's work force. HLL itself had launched a voluntary retirement package, in order to get rid of about 500 workers, however only a few resigned. Mr. S.M. Datta had however assured TOMCO employees that their employment conditions were to be protected and service conditions would be honoured. All the employees of TOMCO were to be absorbed as HLL employees. The difference in the productivity levels of TOMCO and HLL employees had been conceded as a point of imbalance. However, even within HLL, there were differences in productivity, with the Bombay factory productivity levels being lower than that in other locations. Further, Mr. S.M. Dutta felt that the productivity level in TOMCO could be raised to that of HLL only in 3 years.

Scheme of amalgamation

Considering the advantages and incompatibilities as stated above, on 30th June 1993, 99.97% of the share holders in value terms, of TOMCO and HLL approved the scheme of amalgamation, at an EGM, wherein two shares of HLL were to be allotted for every 15 shares of TOMCO. The approval of the Bombay High Court was proposed to be sought. In addition, it was decided that Unilever will get a preferential

allotment of 347,84,29 shares at a premium of ₹ 95 to increase its share holding to 51%.

10. NICHOLAS PIRAMAL TAKE OVER OF ROCHE PRODUCTS LTD.

ROCHE PRODUCTS LTD.

Roche Products Ltd. was one of the major manufacturers of Vitamin A products and had strengths in the manufacture of bulk drugs, fine chemicals, diagnostics and non-prescription drugs. Its product range also covered various anti-depressant drugs for psycholeptics and psychoanaleptics. Its well-known brand names are Bactrim, Valium and Becozyme.

The company was jointly promoted by F. Hoffmann La Roche and Voltas Ltd. in 1958, with the parent company holding 89% of the share capital and Voltas 11%. In August 1984, in compliance with FERA Regulations* the parent company diluted its equity stake to 74%, by making a public issue of shares.

In its 35 years of operations, the company's lacklustre financial performance could be attributed to the rising cost of raw materials, high labour and rigid price controls on the company's products.

The company had 1100 employees on its rolls, of which only 200 were in the field. Its large staff coupled with a high salary structure had increased the overheads, resulting in extremely low margins compared to industry norms.

The immediate steps that were required to improve profitability were expansion and improvement of distribution facilities, increasing the capacity of bulk drug plant and enhancing the productivity levels of its work force. The introduction of new products, which were outside the control of DPCO, was an area of prime importance.

NICHOLAS PIRAMAL LIMITED

In 1987, Ajay Piramal bought out Aspro - Nicholas plc of U.K. and since then the company created pharmaceutical history by achieving substantial improvements in growth and profitability, despite the constraints of price control. In 1991, it was independently rated as the fourth fastest growing company in the industry.

The Nicholas Group's performance was a success story, as evidenced by an impressive increase in the turnover from ₹18 crores in 1988 to ₹103 crores in 1993. The growth of Nicholas Labs prior to Piramal's takeover was extremely slow (please see Annexure I given at the end of this case study).

The company had strengths in the manufacture of formulations like antacids, cardio-vascular drugs and anti-ulcerants. It had also set up a sophisticated formulation plant, at a cost of ₹12 crore. It had a combined field force of 650 employees, one of the largest in the pharmaceutical industry, which acts as crucial factor for success in any industry.

Although, Nicholas Piramal had emerged as a fast growing, profitable company its growth plans were stymied as it no longer had access to new products from its foreign ex-parent. It is worth mentioning in this regard that Nicholas Piramal had been

* FERA has been repealed and FEMA has come into existence with effect from 1.6.2000.

allowed to use the brand names Aspro and Cleartone which were held by Roche's parent company, in an earlier arrangement. Therefore, the company was on the look out for a possible acquisition in the same industry. It was felt that, there should be realisable synergies in the operations of the target company, and the products should be complementary. Accordingly, since the company had strengths in formulations, its management wanted to increase its presence in bulk drugs. The company was also planning to enter the over-the-counter drugs and skincare market.

Roche Products Ltd. – Rationale for disinvestment

The parent company F. Hoffmann La Roche had decided to disinvest its equity stake of 74% in Roche Products Ltd. Although the company was the major manufacturer of Vitamin A, the parent company had lost interest in this company due to low profit margins. In the last 17 years not a single new product was introduced and no formal growth plans were made, having an adverse impact on the company's financial performance. The other motivation for the foreign company divesting its equity stake had been the termination of the distribution agreement with Voltas Ltd. making it necessary for the company to set up its own distribution facilities, involving substantial expenditure.

F. Hoffman La Roche constituted a negotiating team consisting of two representatives from the parent company and 3-4 from Roche Products Ltd. Nicholas Piramal Ltd. had expressed keen interest in buying over the controlling shares in RPL.

Nicholas Piramal Ltd. – Rationale for takeover

Some of the competitors entered into strategic alliances and tie-ups with multinational companies to gain access to new products. After considerable analysis, Roche Products was identified as one of the possible targets, as the parent company had decided to disinvest. Roche filled in well in the strategy for growth as there were realisable synergies in the operations of both the companies and the products were complementary. The company had strengths in distribution which complemented Roche's strength in R&D, as it was a multinational company.

ANNEXURE 1 NICHOLAS PIRAMAL LIMITED Balance Sheet

	(₹ in crore)				
<i>For the year ended 31st March</i>	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>
<i>I. Sources of Funds</i>					
1. Shareholders' Funds:					
(a) Equity Share Capital	1.46	1.46	3.11	6.23	8.11
(b) Reserves and Surplus	<u>6.05</u>	<u>7.77</u>	<u>20.22</u>	<u>23.50</u>	<u>39.28</u>
	<u>7.51</u>	<u>9.23</u>	<u>23.33</u>	<u>29.73</u>	<u>47.39</u>
2. Loan Funds:					
(a) Secured Loans	0.57	4.98	26.25	37.21	50.62
(b) Unsecured Loans	<u>1.19</u>	<u>1.05</u>	<u>1.42</u>	<u>8.36</u>	<u>5.38</u>
	<u>1.76</u>	<u>6.03</u>	<u>27.67</u>	<u>45.57</u>	<u>56.00</u>
Total	<u>9.27</u>	<u>15.26</u>	<u>51.00</u>	<u>75.30</u>	<u>103.39</u>

II. Application of Funds

1. Fixed Assets					
(a) Net Block	5.54	6.88	28.46	48.59	54.69
(b) Capital WIP	0.01	0.03	1.01	1.03	7.15
2. Investments	1.42	0.74	4.93	0.98	0.97
3. Current Assets					
(a) Inventories	3.05	6.20	12.12	15.65	20.86
(b) Sundry Debtors	1.99	2.67	7.59	10.18	14.88
(c) Cash and Bank Balances	0.53	0.79	1.39	23.46	1.94
(d) Other Current Assets	0.00	0.00	0.00	0.00	0.00
(e) Loans and Advances	2.25	3.53	7.87	10.96	16.87
	<u>7.82</u>	<u>13.19</u>	<u>28.97</u>	<u>60.25</u>	<u>54.55</u>
<i>Less: Current Liabilities and Provisions:</i>					
(a) Sundry Creditors	5.23	5.08	7.53	7.24	5.76
(b) Other Current Liabilities	0.34	0.50	5.00	28.49	8.37
	<u>5.57</u>	<u>5.58</u>	<u>12.53</u>	<u>35.73</u>	<u>14.13</u>
Net Current Assets	<u>2.25</u>	<u>7.61</u>	<u>16.44</u>	<u>24.52</u>	<u>40.42</u>
Misc. Assets Not Written Off	0.05	0.00	0.16	0.18	0.16
Total	9.27	15.26	51.00	75.30	103.39

NICHOLAS PIRAMAL LIMITED
Profit and Loss Account

(₹ in crore)

<i>For the year ended 31st March</i>	1989	1990	1991	1992	1993
Income					
Sales	19.06	28.88	58.04	77.94	103.46
Other Income	0.65	0.79	1.81	4.37	4.50
	<u>19.71</u>	<u>29.67</u>	<u>59.85</u>	<u>82.31</u>	<u>107.96</u>
Expenditure					
Material Consumed	8.87	13.81	12.72	20.78	26.93
Staff Expenditure	2.93	4.37	6.44	7.67	9.90
Other Expenses	5.48	6.76	29.89	39.10	49.61
Depreciation	0.27	0.84	2.02	2.74	4.32
Interest	0.23	0.34	1.99	3.56	5.45
	<u>17.78</u>	<u>26.12</u>	<u>53.06</u>	<u>73.85</u>	<u>96.21</u>
Profit Before Tax	1.93	3.55	6.79	8.46	11.75
Taxation 0.49	1.29	0.34	0.90	1.65	
Profit After Tax	1.44	2.26	6.45	7.56	10.10
Dividend Rate %	24.00	30.00	35.00	20.00	25.00
Earnings per Share (EPS)	13.15	15.48	20.74	12.13	12.45
Return on Capital Employed	31.07	25.49	17.22	15.96	16.64
Market Price—					
High	132.50	210.00	350.00	500.00	310.00
Low	70.00	130.00	100.00	210.00	155.00
Average	101.25	170.00	225.00	355.00	232.50

Financial Highlights

(₹ in crore)

<i>Year ended 30th June</i>	<i>1984</i>	<i>1985</i>	<i>1986</i>	<i>1987</i>	<i>1988</i>
Sales and Other Income	1157.00	1440.00	1880.00	1607.00	1755.00
Profit before tax	67.00	70.00	105.00	38.00	58.00
Profit after tax	27.00	31.00	52.00	20.00	26.00
Fixed Assets	129.00	148.00	182.00	178.00	445.00
Share Capital	146.00	146.00	146.00	146.00	146.00
Reserves	131.00	139.00	192.00	191.00	459.00
Earnings per Share (EPS)	18.93	19.47	23.13	23.02	41.33
Book Value per Share ₹	1.86	2.13	3.58	1.40	1.75
Dividend Rate	15.00	16.00	18.00	15.00	18.00

For revaluation reserves in 1987 of 268.69 lakhs.

ANNEXURE 2
ROCHE PRODUCTS LIMITED
Balance Sheet

(₹ in crore)

For the year ended	31/12/88	13/3/90	31/3/91	31/3/92	31/3/93
I. Sources of Funds					
1. Shareholders' Funds:					
(a) Equity Share Capital	4.81	4.81	4.81	4.81	4.81
(b) Reserves and Surplus	6.23	6.13	6.22	6.17	7.25
	<u>11.04</u>	<u>10.94</u>	<u>11.03</u>	<u>10.98</u>	<u>12.06</u>
2. Loan Funds:					
(a) Secured Loans	5.46	8.05	12.41	11.65	13.80
(b) Unsecured Loans	0.78	0.03	0.02	0.72	1.02
	<u>6.24</u>	<u>8.08</u>	<u>12.43</u>	<u>12.37</u>	<u>14.82</u>
Total	<u>17.28</u>	<u>19.02</u>	<u>23.46</u>	<u>23.35</u>	<u>26.88</u>
II. Application of Funds					
1. Fixed Assets					
(a) Net Block	7.80	8.43	9.24	8.22	7.88
(b) Capital WIP	0.14	0.61	0.07	0.16	0.35
2. Investments	1.40	0.06	0.06	0.06	0.06
3. Current Assets					
(a) Inventories	8.06	10.50	10.55	10.97	15.93
(b) Sundry Debtors	5.48	4.71	6.06	9.12	11.23
(c) Cash and Bank Balances	0.24	0.06	0.44	0.24	0.21
(d) Loans and Advances	1.33	2.14	3.10	4.14	3.64
	<u>15.11</u>	<u>17.41</u>	<u>20.15</u>	<u>24.47</u>	<u>31.01</u>

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Less: Current Liabilities and Provisions:

(a) Sundry Creditors	5.59	6.43	5.38	8.20	10.26
(b) Other Current Liabilities	<u>1.58</u>	<u>1.06</u>	<u>0.68</u>	<u>1.36</u>	<u>2.36</u>
	<u>7.17</u>	<u>7.49</u>	<u>6.06</u>	<u>9.56</u>	<u>12.62</u>
Net Current Assets	<u>7.94</u>	<u>9.92</u>	<u>14.09</u>	<u>14.91</u>	<u>18.39</u>
Total	17.28	19.02	23.46	23.35	26.88

ROCHE PRODUCTS LIMITED
Profit and Loss Account

(₹ in crore)

For the year ended

	31/12/88	13/3/90	31/3/91	31/3/92	31/3/93
Income					
Sales	43.11	56.93	49.37	58.08	71.1
Other Income	<u>0.58</u>	<u>0.76</u>	<u>0.43</u>	<u>0.45</u>	<u>0.6</u>
	<u>43.69</u>	<u>57.69</u>	<u>49.80</u>	<u>58.53</u>	<u>71.7</u>
Expenditure					
Material Consumed	24.68	34.28	28.16	35.41	43.1
Staff Expenditure	8.46	12.25	10.86	11.57	13.3
Other Expenses	6.07	6.65	7.91	8.11	8.0
Depreciation	0.87	1.11	1.03	1.08	1.0
Interest	<u>1.11</u>	<u>1.40</u>	<u>1.32</u>	<u>1.81</u>	<u>2.4</u>
(Rounded off)	<u>41.19</u>	<u>55.69</u>	<u>49.28</u>	<u>57.98</u>	<u>68.0</u>
Profit Before Tax	2.50	2.00	0.52	0.55	3.7
Taxation 0.93	0.63	0.22	0.36	2.1	
Profit After Tax	1.57	1.37	0.30	0.19	1.5
Dividend Rate %	15.00	15.00	5.00	5.00	10.0
Earnings per Share (EPS)	3.26	2.28	0.62	0.40	3.2
Return on Capital Employed	20.89	14.30	7.84	10.11	22.9
Market Price—					
High	0.00	90.00	110.00	180.00	200.0
Low	0.00	55.00	55.00	60.00	64.0
Average	0.00	72.50	82.50	120.00	132.0

Shareholding Pattern as on 05.8.93

%	
Foreign Holding (Roche)	74.00
Public	10.63
Financial Institutions/Banks	5.93
Others	<u>9.44</u>
	<u>100.00</u>

NOTE: Students are advised to refer to the balance sheets of the merged entities to see if the financial performance considerably improved after the merger. Students may also undertake a project where they study the merger / takeover thoroughly and discuss with the officers concerned to understand how the merger scheme had actually brought the results that were originally expected from such merger.

11. TAKEOVER OF PROFIT EARNING COMPANY

Hindustan Lever Limited (HLL) had in the last ten years used the takeover route to expand the base of the Company. Average sales growth in the last ten years had been 29.5 per cent, driven partly by successful acquisitions like Kwality, Dollops, TOMCO, Brooke Bond and Lakme. Sans the mergers, HLL would have maintained an average of 18 per cent year-to-year growth per annum. Net profit had grown at a compounded rate of 37 per cent during the same period. HLL acquired TOMCO in early nineties and at the same time acquired 20 per cent shareholding of Indian Perfumes Limited (IPL), a Company closely associated with operations of TOMCO and engaged in the aroma chemical business. TOMCO was merged with HLL in 1994 and IPL became HLL's subsidiary as TOMCO was holding approx. 32.5 per cent in IPL. Subsequently HLL acquired shares of IPL from other Tata companies to take its holding in IPL to 73 per cent. Also as a result of amalgamation with TOMCO, HLL acquired the 21.8 per cent stake in Vashisti Detergents Ltd. (VDL) and subsequently acquired 11 per cent stake of other promoter in VDL. In 1993, HLL acquired shares of Brooke Bond India Limited and with amalgamation of Brooke Bond with Lipton India Limited in 1994, got its holding in Lipton converted to Brooke Bond Shares. Subsequently, Pond's and Brooke Bond Lipton India, both subsidiaries of Unilever, got merged with HLL.

Facts

Takeover of Lakme brands, sales and distribution network was through a complex deal for environmental and fiscal reasons. The sale was done in two stages:

Stage I - In January 1995, the Lakme trademark, technology and related intellectual property was transferred to a 100 per cent subsidiary of Lakme Ltd. — Lakme Brands Ltd. The transfer consideration was determined at ₹ 78 crore. Lakme Brand Ltd.'s capitalization was represented by equity capital of ₹ 3.25 crore subscribed by Lakme and optionally fully convertible debentures of ₹ 75 crore subscribed to by Hindustan Lever. At the same time, a new joint venture company Lakme Lever Limited was formed, wherein Hindustan Lever and Lakme both held 50 per cent of the 21 lakh equity shares each. Sales and marketing infrastructure in India as well as abroad owned by Lakme was transferred to the joint venture for a consideration of ₹ 32.39 crore. This included payment for goodwill, net current assets and relevant fixed assets. Also, Hindustan Lever paid ₹ 30 crore (₹ 25 crore to Lakme Ltd. and ₹ 50 lac to Lakme's wholly owned subsidiary Lakme Exports Ltd.) for non-compete agreement.

For Lakme, entry of Unilever group and other MNCs in the field was imminent, which would have led to heightened competition and decline in margins. Therefore, an alliance with an established MNC was a mutually beneficial arrangement. Further, technological/marketing inputs from Unilever group would give an edge over the competitors and allow the joint venture selling company to cash upon its distribution network.

However, HLL's traditional distribution network, although one of the largest, was not tuned to market cosmetic products which are primarily sold through specialised shops/boutiques. So tie up with Lakme enabled the company to leverage on the Lakme distribution channels also.

Stage II - In 1998, Lakme Limited divested its 50 per cent stake in Lakme Lever Ltd. to HLL for a consideration of ₹ 90.5 crore. The entire stake of Lakme Ltd. in its wholly owned subsidiary Lakme Brands Ltd. was also acquired by HLL. Lakme's manufacturing facility at Deonar was taken over for ₹ 24 crore. The manufacturing plant at Kandla owned by Lakme Exports, the 100 per cent subsidiary of Lakme Ltd. was taken over by HLL for a consideration of ₹ 5.71 crore.

Statistics

The table given below displays the total consideration involved in the sale of Lakme Lever stake, manufacturing facility and brand by Lakme Ltd.

<i>Consideration paid for</i>	₹ (crore)
Stake in Lakme Lever Ltd.	90.5
Deonar manufacturing facility	24.03
Kandla manufacturing facility (from Lakme Export)	5.71
Trade mark, Designs, Brands, Copyrights (from Lakme Brands Ltd.)	110.05
R&D infrastructure (from Lakme Brands Ltd.)	<u>.27</u>
Total	<u>230.56</u>

Benefits Occurring

Lakme Limited utilized part of the proceeds to redeem the ₹75 crore Optionally Convertible Debentures subscribed to by HLL in Lakme Brands Ltd. in 1996. Lakme, sans its cosmetics business then ventured into the retailing business, utilizing the funds garnered for acquisition of a Department Store Littlewoods. The entire cosmetic business under the Lakme brand is now owned and managed by HLL.

12. KRONE COMMUNICATION LIMITED—CONDITIONAL EXEMPTION

Krone Communications Ltd., M/s. GenTek Inc., USA (the acquirer company) entered into a re-construction and restructuring agreement with Jenoptik AG, through its subsidiary, for the acquisition of its entire shareholding in Krone AG which holds 51% of the issued, subscribed and paid up equity capital of Krone Communications Limited (target company). Pursuant to this, it made an application dated July 22, 1999 to the SEBI seeking exemption from the applicability of the provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the 'Regulations') for the said acquisition. The Board forwarded the application to the Takeover Panel which *vide* its report dated August 5, 1999 rejected the application on the ground that in the process of the acquisition of Krone AG, the control over the target company would be shifted in favour of the acquirer company through the holding company i.e. Krone AG and that Regulation 12 would be applicable. During the course of the personal hearing held on September 6, 1999, the acquirer brought to the notice of the Board certain additional facts. It was stated that the purpose of acquisition of Krone AG is not to secure the control of the target company and that it would not lead to an indirect acquisition of the target company by the acquirer. Also it contended that the said acquisition would not bring about any change in the shareholding of the target company and that the controlling stake of Krone AG in the target company i.e. 51% would not alter pursuant to the said acquisition. It was stated that they believed that the acquisition would not result in a change in management or

a reconstitution of the Board of Directors of the target company. Therefore the Board referred the case back to the Panel for reconsideration of the case based on the new facts. On consideration of the same as well as the undertaking given by the acquirers that the acquirers were willing to abide with the conditional exemption granted by SEBI to the effect that the shareholders of the target company ratify the change in control by an appropriate resolution passed at the meeting of its shareholders. The Takeover Panel *vide* its report dated January 20, 2000 recommended the grant of exemption as sought by the acquirers subject to the shareholders of the target company passing a special resolution at the meeting of the shareholders permitting voting through postal ballot thereat, ratifying the change in control. Also a further condition was imposed that the notice of such a meeting to the shareholders of the target company should accompany an envelope for postal ballot with pre-paid postage stamps affixed. SEBI also noted that the acquisition of the target company was merely an unintended consequence of the global restructuring of Krone AG, and that the controlling stake of the acquirer company would not alter Krone AG pursuant to such acquisition. It was also noted that the acquisition would not constitute an indirect acquisition in terms of the Regulations and that adequate intimation of the acquisition was given to all the shareholders of the target company. On the basis of the same as well as after considering the recommendations of the Panel, SEBI, granted exemption to the acquirers from the applicability of the provisions of the Regulations for the proposed acquisition subject to the ratification by the shareholders of the target company as recommended by the Panel *vide* its report dated January 20, 2000.

13. REVERSE MERGER

Wherever a profit making company merges with a loss making company, the amalgamated company would be entitled to carry forward and set off the accumulated loss and unabsorbed depreciation allowance. In such a case it is the loss and unabsorbed depreciation of the same company which is being carried forward. Whereas, in a case where a loss making unit is merged in a profit making unit the profit making unit would seek to carry forward the loss and unabsorbed depreciation not of its own but of another company.

An amalgamated company is not entitled to carry forward the accumulated loss and unabsorbed depreciation allowance of the amalgamating company.

Case:

ABC Ltd., a company engaged in manufacture of textiles, had faced marketing constraints and stiff competition from imported material at cheaper prices.

Financial status

ABC Ltd. had suffered huge losses since commissioning, amounting to ₹1342 lacs as at 31.12.92 (book loss) against paid up capital of ₹ 534 lacs. I.T. losses of ₹2248 lacs. Its term liabilities amounted to ₹1722 lacs including defaults of interest payments (₹ 632 lacs) on account of cash losses. Payments to suppliers (₹ 334 lacs) remained unpaid due to liquidity constraints.

Case for amalgamation

Prospects for the company's products appeared reasonably good. Revival of the

unit was possible provided financial help was forthcoming immediately. Borrowing from outside was impossible on account of financial difficulties. XYZ Limited, a healthy unit was found willing for amalgamation with ABC Ltd.

A revival plan for ABC Ltd., was contemplated to which financial institutions and banks had agreed to a package of reliefs and concessions by way of interest concession, funding of interest and rescheduling of term loan repayment.

Incentives

The following incentives were available under the statutes:

(1) The incentive for the healthy unit to take over the assets and liabilities of ABC Ltd. was the tax benefit under Section 72A of Income-tax Act. The total tax benefit to XYZ Ltd. amounted to ₹1298 lacs. Since XYZ Ltd. was incurring huge tax liability on its profits, the amalgamation resulted into immediate improvement in its liquidity on account of ABC Ltd.'s losses.

(2) One of the products of XYZ Ltd. was used as raw material for the products of ABC Ltd. Besides assured supplies, the amalgamation gave an advantage of savings in cost of raw material to ABC Ltd. because after amalgamation the raw material could be given at 'transfer cost'.

Approval under Section 72A

The Specified Authority under Section 72A of the Income-tax Act approved the tax benefits of ₹ 1298 lacs on the basis of the revival plan for ABC Ltd. as prepared by XYZ Ltd.. The revival plan comprised of:—

	(₹ Lacs)
<i>Revival Investment:</i>	
Capital Expenditure	809
Repayment of Loans and Interest	1464
Payment to Creditors	176
Working capital	<u>40</u>
	<u>2489</u>
<i>Sources of Financing:</i>	
Tax benefits	1298
XYZ Ltd.'s contribution	435
Cash generation of ABC	<u>756</u>
	<u>2489</u>

Immediate revival steps

(1) ABC Ltd. had suffered in the past on account of uncertainty of supply of raw material. It therefore created storage capacity of about 4 weeks supplies to do away with fluctuations in the supply of raw material.

(2) XYZ Ltd. assessed the needs of capital expenditure required for improving the working of ABCL, which were mainly on account of balancing of capacities, modification and replacements of existing equipment, etc.

Exchange ratio

The exchange ratio of shares was worked out as under:

1. ABC Ltd. had negative net worth as on the amalgamation date. But, since amalgamation envisaged tax benefits to XYZ Ltd. on account of accumulated losses of ABC Ltd. the quantum of tax benefit was added to the net worth of ABC Ltd. to get a positive net worth.
2. Past earnings basis was not considered on account of losses of ABC Ltd.
3. Market price of shares was given due weightage.

Combined Balance Sheet as on 1.1.93

	<i>XYZ Ltd.</i>	<i>ABC Ltd.</i>	<i>TOTAL</i>
<i>Liabilities</i>			
Share capital	1600	93	1693
Reserves and surplus	9385	(896)	8516
Secured loans	896	1794	2690
Unsecured loans	<u>2376</u>	<u>184</u>	<u>2560</u>
Total	<u>1457</u>	<u>1202</u>	<u>15459</u>
<i>Assets</i>			
Fixed Assets-Gross	16256	1598	17854
Less: Depreciation	<u>9420</u>	<u>352</u>	<u>9772</u>
Net Block	6836	1246	8082
Add: Work-in-progress	58	—	58
	6894	1246	8410
Investments	6894	1246	8140
Current Assets, loans and advances	10009	440	10449
	19157	1686	20843
Less: Current liabilities and provisions	4900	517	5417
Add: Preliminary expenses	<u>—</u>	<u>33</u>	<u>33</u>
Total	<u>14257</u>	<u>1202</u>	<u>15459</u>

Projected profitability - ABC Ltd.

	1992	1993	1994	1995	1996	1997
1. Sales	692	968	1150	1329	1538	1706
2. Profit before Interest and Depreciation	(154)	164	242	303	391	444
3. Interest	232	185	182	177	172	153
4. Depreciation	112	157	179	200	221	242
5. Profit	(498)	(178)	(119)	(74)	(2)	49

Benefits from the Merger

Operations of ABC Ltd. improved on account of the following:

1. XYZ Ltd., pending amalgamation approval, took over the management of ABC Ltd. in 1992.

2. XYZ Ltd. negotiated price concession for raw materials supplied by one of the large scale public sector organizations to ABC Ltd. and supplied by it to ABC Ltd.
3. XYZ Ltd. negotiated a package of reliefs and concessions with the financial institutions, which resulted in savings of interest charges.

14. REVERSE MERGER OF A SICK INDUSTRIAL UNDERTAKING

In April 1994, Kirana Bazar Ltd. (KBL) took over the management control of XYZ Ltd. (XYZ Ltd.), a Delhi based company having its Works at Nasik.

XYZ Ltd. became a sick industrial company as on March 31, 1994 and went to the BIFR in June 1994. ICICI which was appointed as the Operating Agency, invited bids for the revival of XYZ Ltd. KBL made a bid although XYZ Ltd. which was already under its control. KBL's bid was accepted and confirmed by BIFR.

Main objective in the takeover was to make use of XYZ Ltd.'s engine plant for KBL's large engine activity.

The takeover added to KBL's assets, two plants located at Nasik on MIDC leased land of 80,000 sq. mtrs.

A scheme for revival of XYZ Ltd. through reverse merger of KBL with XYZ Ltd. was submitted to BIFR and was sanctioned by it in February 1996.

Accordingly, KBL merged in XYZ Ltd. and XYZ Ltd.'s name stood changed to KBL on March 1, 1996, which was the effective date of the amalgamation, though the appointed date was April 1, 1994. AGM of the merged company for 1994-95, was held in April 1996 and consolidated accounts for the year ended March 31, 1995 were adopted thereat.

The delay of 7 months in holding AGM was condoned by BIFR*.

The cost of XYZ Ltd. revival package was ₹ 2234 lakhs comprising; institutional dues ₹ 590 lakhs, bank dues ₹ 75 lakhs, debentures ₹ 60 lakhs, other liabilities ₹ 99 lakhs, working capital ₹ 800 lakhs, capital expenditure ₹ 610 lakhs.

KBL's contribution was ₹1574 lakhs (including ₹ 460 lakhs tax savings), besides bank borrowing ₹ 90 lakhs and issue of shares to ICICI ₹ 570 lakhs.

The tax benefit was in the nature of carry forward and set-off of XYZ Ltd.'s accumulated losses.

This merger did not affect in any way KBL shareholders.

XYZ Ltd. capital of ₹218 lakhs reduced by 95% to ₹11 lakhs and KBL shares were exchanged for XYZ Ltd. shares in the merged company in the ratio 1 for 20. The merger thus benefitted XYZ Ltd. shareholders by not losing the entire capital.

XYZ Ltd. shareholders were paid 5% dividend for 94-95 and full dividend for 95-96.

56% of the XYZ Ltd.'s capital held by its holding company were transferred at the agreed price of ₹75 lakhs (to 3 of KBL associate companies) which subsequently got shares in the merged company.

Financial institutions' dues of ₹590 lakhs and bank dues of ₹75 lakhs were paid off. Under VRS, retired employees of XYZ Ltd. were paid ₹16 lakhs. The institutions sacrificed ₹286 lakhs consisting of ₹128 lakhs as 50% simple interest and ₹158 lakhs penal interest.

XYZ Ltd. debenture interest for 3 years and first two redemptions aggregating to ₹120 lakhs were paid.

The scheme provided for certain matters without going through formalities under Companies Act which BIFR* approved in exercise of its power under Section 32 of SICA. These matters were:

- Change of name of transferee company from XYZ Ltd. to KBL.
- Memorandum of Association (MOA) and Articles of Association (AOA) of transferor company to become MOA and AOA of transferee company.
- Board of transferee company to be automatically dissolved and directors of transferor company to become directors of transferee company.
- Auditors of transferee company automatically ceasing to hold office and auditors of transferor company to become auditors of transferee company.
- Managing Director and Executive Director of transferor company to continue as such in transferee company without reappointment and without break.
- Authorised capital of transferee company to stand increased from ₹5 crore to ₹27 crores.
- Transferee company to allot to shareholders of transferor company shares in transferee company.
- Share certificates of transferor company not to be called back and replaced by new certificates.
- ICICI to be issued 475,000 equity shares in the transferee company without complying with Section 81(1A) and SEBI Guidelines on preferential issue.

Benefits of Merger

- Stamp duty on transfer of property and share certificates under Bombay Stamp Act saved.
- Premium payable to MIDC saved. Only transfer fee paid.
- XYZ Ltd. revival resulted into both the plants being operative — direct employment to more than 300 people working, which is the highest number ever in the history of XYZ Ltd.

15 SPECIFIC ISSUES IN SPECIFIC CASES:

A. Whether any person other than the shareholders and creditors have right to intervene in the proceedings concerning scheme of arrangement / reconstruction?

Mumbai High Court ruled that a person who is neither a shareholder nor a creditor of the company has no right to appear in the proceeding under Section 391/394. The court held that the basic principle underlying in the provisions under

Section 394 is that the scheme has the approval of the prescribed majority of the company's shareholders and creditors should not also be unfair, contrary to public policy, unconscionable or against law. Once the court finds that the parameters set out in Section 394 have been met, the court would have no further jurisdiction to sit in appeal over the commercial wisdom of the class of persons who with their eyes open have given their approval even if, in the view of the court a better scheme could have been adopted. The anxiety of the court should be that the scheme is approved by all classes and that the company is permitted to continue its corporate existence [*Shree Niwas Girni Kamagar Kruti Samiti v. Ranganath Basudev Somani* (2005) 68 CLA 351 (Bom)].

B. Can shareholders seek an amendment to the swap ratio in a scheme of merger?

The Mumbai High Court held that the swap ratio forms integral part of a scheme of amalgamation and the procedural provisions embodied in the Companies (Court) Rules, 1959 give effect to this basic purpose and object. The exchange ratio is a matter of expert determination. Since it constitutes the foundation of the scheme of amalgamation any amendment to it will nullify that basis. Hence the chairman of the meeting is justified in ruling that any amendment to the swap ratio that was proposed at the meeting by a member was not in order. [*Dinesh Veajlal Lakhani v. Parke Davis (India) Ltd.* [2005] 66 CLA 91 (Bom)].

16. ASCERTAINMENT OF BRAND VALUE

I. DESCRIPTION OF THE FACTS OF CASE

SHRAKE BOARDS LIMITED (Company/Shrake), a Company incorporated on 20/12/1991 under the Companies Act, 1956 having its Registered Office at Shrake, Pasighat, Arunachal Pradesh. Mr. M.A.SURESH promoted the company and with the support of his team of directors, he has created a formidable enterprise. The Company has been growing from strength to strength. During the course of its business, the word marks "SHRAWOOD", "SHRADOOR", "SHRABOARD" and "SHRAPLY" were adopted as the Brands for selling the goods of the Company. Further "SHRA" is the corporate logo of the Company and "YOURS HAPPILY" is the corporate slogan of the Company and "NANOGHAT" is a brand newly adopted by the Company. "SHRAWOOD", "SHRADOOR", "SHRABOARD" and "SHRAPLY" are the Brands in which the Goods of the Company are sold throughout India. As the registered office of the Company is situated in a place known as Shrake, the corporate name of the Company and the brands of the Company have taken a part of the name of the said place.

II. GOODS

The Company manufactures plywood items, finger joint boards, doors, block boards, MDF and other wood products. SHRAKE has a range of products that as a result of which SHRAKE is a one-stop shop. SHRAKE deals with all products related interior infrastructure. SHRAKE imports products such as MDF, particleboards and other wood products and sells them in India.

III. ANALYSIS OF THE REACH and POPULARITY OF THE BRANDS

"SHRAWOOD", "SHRADOOR", "SHRABOARD" and "SHRAPLY" are the four

mainstay brands of the Company. These Brands are also widely advertised. The goods of the Company enjoy a very good reputation in the market and the growth potential offered by the Brands of the Company is phenomenal. The Company does not sell any product in India without applying the said brands. SHRAWOOD records the highest turnover in terms of value, SHRADOOR comes next to it, followed by SHRA and fourth in the list is SHRAPLY and fifth in the list is SHRABOARD.

The Company sells its Goods almost in all the States in India through a well-connected network of branches and authorized dealers.

IV. COMPETITORS and MARKET SHARE

SHRAPLY is a brand that sells plywood items. The total market share for plywood items in India is estimated to be around ₹1500 Crores. It can be seen that in the year 2006-2007 the turnover of the Company arising from SHRAPLY is ₹2,68,25,556/-. This shows that the market share of the Company in plywood items is 0.18% of the total estimated market share in India for plywood items.

SHRAWOOD is a brand that sells Finger Joint Boards. The total market share for Finger Joint Boards in India is estimated to be around ₹60 Crores. It can be seen that in the year 2006-2007 the turnover of the Company arising from SHRAWOOD is ₹6,29,82,979/-. This shows that the market share of the Company in Finger Joint Boards is more than 10%.

SHRADOOR is a brand that sells Doors. The total market share for Doors in India is estimated to be around ₹750 Crores. It can be seen that in the year 2006-2007 the turnover of the Company arising from SHRADOOR is ₹5,11,16,929/-. This shows that the market share of the Company in Doors is slightly more than 1% of the total market for doors in India.

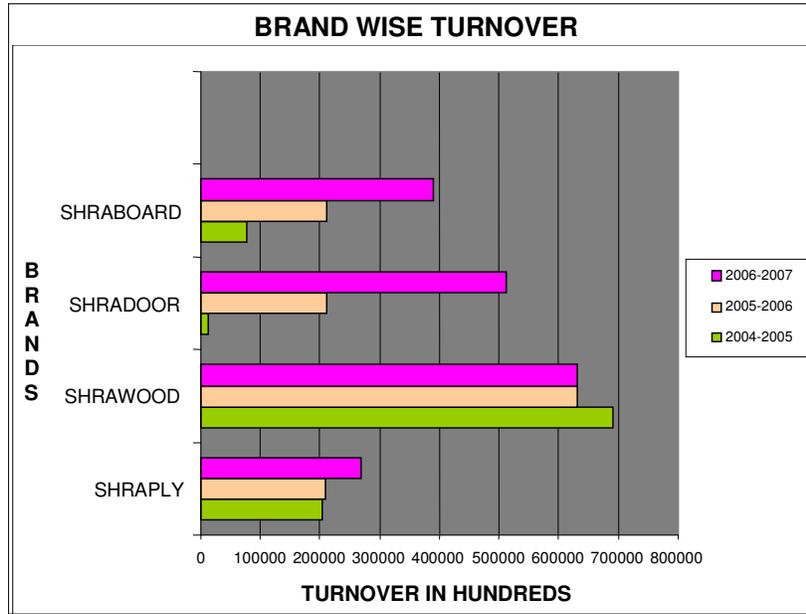
SHRABOARD is a brand that sells Block Board, MDF and Particle Boards. The total market share for Block Board, MDF & P Board in India is estimated to be around ₹800 Crores. It can be seen that in the year 2006-2007 the turnover of the Company arising from SHRABOARD is ₹390,71,326/-. This shows that the market share of the Company in Block Board, MDF & P Board is 0.5% of the total estimated market share in India for Block Board, MDF & P Board.

A perusal of the above statistics given by the Company clearly establishes that the Company has a long way to go in creating and establishing networks across the country.

In the Finger Joint Board segment, INDIA WOOD, RUBCO, ATI are the major competitors of the Company. In the Doors segment, KUTTY's, STANDARD and COBRA are the major competitors of the Company. In Plywood and Block Board segment, GREENPLY, WIP, AK PLY and CENTURYPLY are the major competitors of the Company.

V. BRAND-WISE TURNOVER

Chart showing the Brand Wise turnover for the Financial Years 04 – 05, 05 – 06 & 06 – 07



VI. FINANCIAL DATA (₹ in Lakhs) *[Minimum Details have only been given; a close study of the entire financial data is needed to complete the valuation]*

Sl. No.	Particulars	2007-08	2008-09	2009-10
		Actuals	Projected	Projected
	Turnover	2,036.80	2,240.48	2,464.53
	Profit After Tax	44.03	112.02	123.23

VII. BRAND PROMOTION BUDGET

In the three financial years, 2004-05, 2005-06 and 2006-07, the Company had incurred a total expenditure of about ₹ 46,74,183/- indicating the wide publicity, the Company had given to promoting the Brands and thereby augmenting the sales of its Goods. The Company is planning to integrate all its operations and commence a major publicity campaign so as to improve its market share. The Company is also planning to introduce certain eco friendly and innovative products in the near future.

VIII. PROSPECTS OF WOOD PRODUCTS INDUSTRY VIS-À-VIS THE COMPANY

The Company has acquired very high capacity for high speed cutting, treating, polishing and processing of wood and wooden materials and products. The infrastructure facility with the Company is excellent and it could easily expand its capacity. It is certainly a leader in this segment. It has acquired capabilities to invite foreign direct investment for enhancing its capacities.

Coinciding with capacity integration of its facilities and capacity augmentation, the Company has rightly commenced an exercise for promoting its brands and is all set to expand its market share easily as it has a strong foundation.

IX. TASK

This Company is going to be merged with another company. A proper valuation of the brands will help the Company determine the consideration. Further for the acquirer company, it is possible to account the value of brands in its books by accounting the merger in the nature of purchase as per AS-14 and thereby improve its net worth significantly. Carry out a valuation of the brands of the Company.

VALUATION METHODOLOGY

Valuation of Brands is a difficult task as it involves not only analysis of financial data of the company that owns the brands but also it depends on a study of various related factors including facts such as the market share enjoyed by the goods, the premium commanded by the company for its goods that could be properly attributed to the popularity of brands, the position of competing brands, the level protection available to the brands and so many other critical factors. Therefore it is necessary to adopt a cautious approach. The following are the major steps:

1. Input Collection relating to facts such as nature of brands, extent of use, value of expenditure incurred to promote the brands, market situation, financial data, sales arising from or attributable to each brand, premium price, level of profits, and other important factors.
2. Study of trademarks law, classification of goods, registration requirements and advantages of registration.
3. Study actual registration status in India and abroad.
4. Based on the facts, determine the category of brands.
5. Determine the valuation methods
6. Consider and plot required financial data.
7. Apply the appropriate valuation methodology.
8. Determine the Value of the Brands
9. Adjust them with chosen critical factors to bring fairness to the valuation.
10. Give Report recommending the value to be adopted.
11. Add all workings and analytical charts to add value and maintain transparency.

I. BRAND DATA SHEET

In order obtain first hand actual information from the company a questionnaire should be administered and all information furnished by the company should be duly audited by subjecting the data to a validation and authentication process.

II. LEGAL POSITION IN BRIEF

The Trademarks Act, 1999 is the relevant law relating to Trademarks which include brands, logos, slogans, catchy phrases also. This law came into force w.e.f 15/09/2003. The Trademarks Rules, 2002 contain the relevant Rules. Art works contained in any brand or logo could be registered as a copy right under the Copyrights Act, 1957. For the purpose of registration and protection, goods and services are classified broadly into 34 classes of Goods and 8 classes of Services.

Goods falling under classes 19 and 20 are the relevant classes for the registration of the Brands relating to products of the company.

- Class 19 of Schedule IV to the Trademarks Act, 1999 covers building materials (non-metallic), non-metallic rigid pipes for building; asphalt, pitch and bitumen; non-metallic transportable buildings; monument, not of metal.
- Class 20 of Schedule IV to the Trademarks Act, 1999 covers furniture, mirrors, picture frames; goods (not included in other cases) of wood, cork, reed, cane, wicker, horn, bone, ivory, whalebone, shell, amber, mother-of-pearl, meerschaum and substitutes for all these materials, or of plastics.

As per the extant law, registration of a trademark is not mandatory. However registered marks get better statutory rights than unregistered marks. When there is an unauthorized use or adoption of similar or deceptively similar marks, a proprietor of a registered mark could commence a legal action against the infringement whereas an unregistered mark should settle for a passing off action only under the common law. However well known marks even if they are unregistered can be said to be having better rights than those of registered marks. While an unregistered mark in user could seek better protection in a class of goods against a registered unused mark in the same class, a well-known mark could take on (challenge) marks registered or unregistered across classes.

A brand can be said to be a well known brand if it has reached the minds of people very well in a particular territory. A well-known brand could enable the proprietor to use the same for making inroads into other territories easily cashing on the reputation already created. Again it is for the same reason the Trademarks Act, 1999 contains stringent provisions for recording assignment of trademarks without good will. Because goodwill is something that is submerged in the Brand and people cannot segregate the brand and its goodwill easily unless the brand is to be used by any person other than its proprietor for goods of different class. Once a brand acquisition is complete, the acquirer would be able to use the same for his goods retaining the customer base intact.

III. STATUS OF REGISTRATION OF THE BRANDS IN INDIA

Carry out a detailed audit and ascertain the status of registration in India of the several brands used by the Company covered in this report duly taking into account the provisions of the Trademarks Act, 1999 and the classification of goods as per Schedule IV to the Trademarks Act, 1999. For this purpose, it is necessary go through the file containing the Trademarks correspondence, copies of applications, representations and affidavits filed by the company with the Trademarks Registry (TMR), examination reports received by TMR, Advertisement published by TMR in Trademarks Journal, Certificates of Registration issued by the TMR, Renewal of Registration, Change in proprietors, assignments, user licences, and other necessary details. The Audit Report may be in the form shown as *Annexure 1*.

IV. STATUS OF REGISTRATION OF THE BRANDS IN OTHER COUNTRIES

Study whether the company has applied for registration of any of its several brands in any country or territory other than India. Find out if the Company has used in the course of trade and in actual commerce any of its brands in any other country or territory other than India.

V. CATEGORY OF BRANDS

Carry out a detailed study of the nature and category of brands, If brands are arbitrary and fanciful, meaning they do not mean or suggest anything except their goods, brands may command additional weights in valuation. In this case, it is understood as follows:

The Brands of the Company such as “SHRAWOOD”, “SHRADOOR”, “SHRABOARD” and “SHRAPLY” are partly descriptive of the goods and therefore they cannot be considered as Brands capable of inherently distinguishing their goods. However over a period of time, as they have been used in the course of trade by the Company, they are able to distinguish the goods of the Company from similar goods of competitors of the Company.

YOURS HAPPILY, NANOGHAT and SHRA are Brands which are unique in nature and they are arbitrary or fanciful words though the Brand YOURS HAPPILY could be considered as referring to one of the attributes of the Goods sold under the said Brand.

The Brands comprised in this report are arbitrary or fanciful. While SHRA could be considered as an invented word as it does not communicate anything to the common man, the addition of the words such as WOOD, DOOR and BOARD makes the Brands suggestive of what goods are sold under these brands. However in view of their actual, continuous, extensive and long use in the market, the Brands have come to stay and they command a distinct reputation in the market for the goods that are sold in those Brands. Resultantly the Brands have the essential attributes for claiming registration and in fact some of them have been registered also. In the process, there may not be any challenge to the validity of registration of the registered trademarks.

As such the Brands do not suffer from the threat of being attacked on the following grounds:

- That there has been no actual use of those brands;
- That they lack inherent distinctiveness.

Thus all these Brands enjoy the ability to initiate the common law remedy against passing off and the registered ones enjoy the statutory protection against infringement of those Brands.

In view of the 10% market share enjoyed by SHRAWOOD, the Brand could be said be a well-known mark.

VI. VALUATION METHODS

Basically in an enterprise, physical resources are of the following two types:

- Machinery, that work with applied force;
- Men who work.

Both the above assets are capable of being organized provided the two vital inputs are present; viz., money and knowledge.

Brands belong to a different species. While physical resources could be created easily if augmenting financial resources is not a problem, same is not the case of brands. That is why there is always a premium price for buying brands rather than the business or plants and equipments.

In the case of Brands, the ability of the Company to leverage the same to bring revenues in other territories and markets is of paramount importance.

Normally the value of an enterprise could be estimated on a going-concern basis by computing the earnings capacity. Net Asset Value method may not be ideal in the cases enterprises with depreciating assets unless the enterprise in question is asset intensive. For instance, in the case of company engaged in real estate sector, the lands in the hands of the company on ownership basis could be a stock in trade and they may be highly valuable. However in the case of Brands, which form the lifeline of the Company, there has to be a different approach.

Cost Approach for valuation of Brands may not help. The cost incurred in the last three financial years are not very high as all resources have been used up for establishing a good facility over a period of time in order to give customers high quality Products for value and to ensure that customers are happy. A look at the competitive forces and the predominance of the Brands of the Company would show that the Brands of the Company are premium brands. In the next phase, the Company would incur expenditure in order to capitalize the position and expand the territories and to ward off competition. States in the West and South are the markets where the Company sees a greater potential. For every rupee incurred by the Company on an established brand, returns would be manifold. This enables the Company to introduce its branded products in the new markets very easily as entry barriers could be easily overcome.

Considering the above background, it is advisable to approach the Brand Valuation on the basis of Premium Price Method.

The commitment of the Company to maintain stringent quality gives us confidence in adopting a Premium Price Method for valuing the Brand.

VII. FINANCIAL INFORMATION CONSIDERED FOR VALUATION

Consider the actual profitability figures for the financial year 2006-07, provisional figures for 2007-08 and the projected figures for the financial years 2008-09 (current financial year) and 2009-10. A study of competitive brands and the price at which similar goods (in terms of category, mass, quality, finish) that are sold in outlets without carrying any brands would show that branding has helped the company to command a 10% premium in pricing and therefore 10% of the post tax adjusted profits could be taken as the profits obtained by the company as a result of the value addition contributed by its Brands.

VIII. VALUE OF THE BRANDS BASED ON CASH GENERATION FROM OPERATIONS

Based on the facts, enquiries, information furnished by the Company and the workings attached, we hereby report as follows:

Sl. No.	Brands	Average of the Values of the Brands obtained at the end of the three Financial Years 2007-08 (Actual), 2008-09 (Projected) and 2009-10 (Projected) (₹ in Lakhs)
1.	SHRAWOOD	133.53
2.	SHRADOOR	108.37
3.	SHRAPLY	56.87
4.	SHRABOARD	82.84
5.	SHRA	NOT ASCERTAINED
6.	YOURS HAPPILY	NOT ASCERTAINED
7.	NANOGHAT	NOT ASCERTAINED

The valuation workings based on the above methods are attached as *Annexure-2A*. The Brand Wise Apportionment of aggregate value is attached as *Annexure-2B*.

IX. ADJUSTMENT OF BRAND VALUE FOR CRITICAL SUBJECTIVE FACTORS

In order to neutralize arbitrariness if any and to counteract against assumptions, we have measured certain important parameters of each of the Brands. These parameters have assigned weights. We have studied and measured the proper weights that could be awarded to the Brands of the Company considering factual situation. The overall valuation of each brand will be subject to a multiplication factor obtained by number of weights obtained by each brand as a proportion of total allocated weights. These factors are analyzed for each of those critical factors and weights are ascertained and accordingly applied.

Those critical parameters and the allocated weights and obtained weights are given in *Annexure-2C*.

OUR RECOMMENDATION:

The present value of each of the Brands for the three financial years 2007-08, 2008-09 and 2009-10 have been computed on the basis of cash generation arising from profits after duly writing back the depreciation and taking into consideration the cash needed from internal accruals for meeting incremental asset creation to maintain the cash flow and also the increase in net working capital needs. The workings are enclosed. As could be seen, on an average of the values of the brands for the three chosen years the value of the brand basket used by SHRAKE works out to be ₹ 565.40 Lakhs. However when adjusted for subjective factual parameters using the critical factor analysis test, the aggregate value of the brands comes to ₹446.18 Lakhs.

THEREFORE, while the acceptable valuation could be anywhere between ₹446.18 Lakhs to ₹ 565.40 Lakhs, in our opinion, the AGGREGATE VALUE of the BRANDS as at 31/03/2008 is ₹446.18 Lakhs. Slogans have not been independently valued as they are parasites of the brands and by themselves they do not sell goods.

Place:

for XYZ & Co.,

Date: 23/08/2008

MANAGING PARTNER

ANNEXURE 1

Audit Report ascertaining the status of registration of various marks of the Company

<i>Sl. No</i>	<i>Name of the Brand</i>	<i>Goods & Class in respect of which the Brand is actually and continuously used</i>	<i>Date/Year of Usage of the Brand</i>	<i>Status of Registration</i>
1.	SHRAWOOD	Furniture and all parts thereof falling under class 20	Date is not mentioned in the TM application 20/02/2002 – As per the report from the Company	Registered on 16/10/2006
2.	SHRADOOR	Wooden doors, plywood doors, all kinds of building materials falling under class 19	1996 – As per the TM application No.XXXXX dated 14/03/2006 14/03/2006 – As per the report from the Company	Pending registration
3.	SHRA	Plywood, block board, furniture and all articles made of wood falling under class 20	1996 – As per the TM application No.XXXXX dated 01/04/2002 01/04/2002 – As per the report from the Company	Pending registration. Examination report has been issued.
4.	SHRAPLY	Materials for use in buildings and construction and parts of and fittings for buildings and structures falling under class 19.	Additional representation not available 18/04/1990 – As per the report from the Company	Registered on 15/02/1995
		Furniture, parts thereof and fittings thereof falling under class 20.		Registered on 15/02/1995

5.	SHRAPLY with TREE logo around it, the name of the company	Materials for use in buildings and construction and parts of and fittings for buildings and structures falling under class 19.	Additional representation not available 18/04/1990 – As per the report from the Company	Registered on 31/03/2005
		Furniture, parts thereof and fittings thereof falling under class 20.		Registered on 31/03/2005
6.	SHRABOARD	Furniture and parts thereof falling under class 20	Date is not mentioned in the TM application 20/02/2002 – As per the report from the Company	Registered 24/05/2007
7.	YOURS HAPPILY	Advertising material, signboards, brochures, leaflets, hoardings, artworks, all kinds of stationery, paper and paper articles, cardboard and cardboard articles, printed matter, newspapers and periodicals, books, book-binding material, photographs, stationery adhesive materials (stationery), artists' materials, paint brushes, typewriters and office requisites (other than furniture), instructional and teaching material (other than apparatus), playing cards (printers') type and clichés (stereotype) falling under class 16	1996 – As per the TM application 24/06/2003 – As per the report from the Company	As per the application status taken from the IPR website, the mark has been REGISTERED. But the information / certificate is not available in the physical file.

8.	NANOGHAT	<p>Plywood, block board, flush door, panel board, (finger joined), marine plywood and building materials falling under class 19.</p> <p>Furniture mirror, picture frames, articles (not included in other classes) of wood, cork reeds, cane, wicker, horn, bone, ivory, whalebone, shell, amber, mother-of-pearl, meerschaum, celluloid, and substitutes for all these materials, chemically treated rubber wood falling under class 20</p>	<p>14th August 2007 – as per the TM application No. XXXXX dated 06/09/2007</p> <p>06/09/2007 – As per the report from the Company</p>	Pending registration
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ANNEXURE 2A

Valuation of the brands based on cash generation from operations

<i>Valuation of Brand - Current Year 07-08 and Next Year 08-09</i>				<i>(₹ Lakhs)</i>		
<i>Sl. No.</i>		<i>Particulars</i>		<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>
				<i>Actuals</i>	<i>Projected</i>	<i>Projected</i>
		Turnover		2,036.80	2,240.48	2,464.53
1		Profit After Tax		44.03	112.02	123.23
2	Add back:	Depreciation		47.32	39.83	33.63
3	Less:	Capital Expenditure		0.00	15.19	15.69
4	Less:	Increase in NWC		0.00	10.18	11.20
5		Cash Flow		91.35	177.22	183.74
6		Economic Cash Flow		13.70	26.58	27.56
		Valuation formula:	$CF (t+1) / (r-g)$			
	Where	CF = Economic cash flow at year (t+1);				
		r= Expected rate of return				
		g = growth in cash flow				

		We make the following assumptions:					
7		Cash Flow at (t+1)	=	13.70	26.58	27.56	
8		"r"	=	12.0%	12.0%	12.0%	
9		"g"	=	8.0%	8.0%	8.0%	
10		Fair Market Value (FMV) of the Brand in Lakhs =		342.56	664.59	689.04	

Basic Assumption: For the purpose of computation of value of the Brands, it is assumed as though the company sells all its goods in a single brand.

ANNEXURE 2B

Brand Wise Apportion of Aggregate Value

Name of the Brand		2007 - 08	2008 - 09	2009 - 10			
		Amount in Lakhs			Average	Critical Factor	Adj. Value
SHRAWOOD		119.87	232.55	241.1	197.84	0.95	187.95
SHRA DOOR		97.28	188.73	195.68	160.56	0.70	112.39
SHRAPLY		51.05	99.05	102.69	84.26	0.88	73.73
SHRA BOARD		74.36	144.26	149.57	122.73	0.59	72.10
Total Brand Value		342.56	664.59	689.04	565.40		446.18
	Turnover from each of the brand - year wise						
Name of the Branded Goods	2006 -07	2007 - 08	2008 - 09	2009 - 10			
SHRAPLY	26825556	30355179	33390697	36729767			
SHRAWOOD	62982979	71270082	78397090	86236799			
SHRA DOOR	51116927	57842732	63627005	69989705			
SHRA BOARD	39071326	44212209	48633430	53496773			
Total Turnover	179996788	203,680,201	224048221	246453043			
Allocation of the Brand Value for each of the branded product is made on the basis sales of goods under each brand to total turnover in the financial year 2006-07 after excluding other income							

ANNEXURE 2C

Critical parameters, Allocated Weights and Weights obtained by each brand

<i>Critical Factor</i>	<i>Allocated Weights</i>	<i>SHRA-WOOD</i>	<i>SHRA-DOOR</i>	<i>SHRA-PLY</i>	<i>SHRA-BOARD</i>
The brand is an imaginary, arbitrary, fanciful or invented word	5	0	0	0	0
The brand not being an imaginary, arbitrary, fanciful or invented word has the capacity to distinguish its goods from similar goods of others	5	5	5	5	5
The brand has been in use for more than 5 continuous years, for every 5 years	5	5	10	15	5
Application for Registration of the Brand has been made in relevant classes, for every class of goods or services	5	3	2	5	3
Available user proof is satisfactory and the claim of the company as per application for registration is satisfactory	5	5	5	5	5
The brand has become a well known mark, for every such mark	5	5	0	0	0
The brand boasting a reasonable market share, for every 5% of the total market share in India for the Goods	5	10	1	0	0.5

No litigations or proceedings concerning brands	5	5	5	5	5
Total	40	38	28	35	23.5
Critical Factor		0.95	0.70	0.88	0.59

17. OVERSEAS ACQUISITION OF BRANDS AND TECHNOLOGY – TAX LIABILITY IN INDIA

Recently on May 9, 2008 of the AAR in an application filed by Foster's Australia Limited (the Applicant) handed down a landmark decision. The details of the interesting case (the portion of the decision as regards transfer of license relating to brewing technology has not been covered in this report) are as follows:

By a Sale and Purchase Agreement, (SP Agreement) Foster's Australia Limited – the Applicant which is the legal and beneficial owner of the trademarks agreed to sell the trademarks and the Foster's Brand Intellectual Property and to licence the Foster's Brewing Intellectual Property to the purchaser, SAB Miller (A&A2) Limited, UK (vide clauses 3.1 and 6.5 of the S&P Agreement). The total consideration was a consolidated sum of **120 million US dollars** subject to certain working capital adjustments.

The purchaser nominated SKOL Breweries, an Indian Company to receive the intellectual properties. The Applicant executed a Deed of Assignment with SKOL on 12th September, 2006 at Melbourne, in Australia. Thereby the Applicant (assignor) assigned and conveyed all its right, title and interest in the trademarks, all intellectual property rights relating to the Foster's brand in India in favour of the assignee free from all encumbrances.

In the circumstances, the question that arose before AAR was whether the income arising from Assignment of Trademarks is taxable in India. It is necessary to note that under Sub-section (1) of Section 9 of the Income Tax Act, 1961 which states that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or from any asset or source of income in India or *through the transfer of capital asset situate in India* shall be deemed to accrue or arise in India.

Originally under Brand Licencing Agreement (BL Agreement) dated 13.10.1997 four trademarks including Foster's F. logo alongwith the Foster's brands were permitted to be used by Foster's India. It is recited in the Agreement that CUB Ltd. (previous name of applicant-Company) is the owner of certain trademarks in the Indian territory comprising or including the word "Foster's". In July 1993, Foster's F. logo was registered in India. In course of time, some other Foster's trademarks were also registered in India. Immediately before the impugned assignment, the BL Agreement was terminated. By the said S & P Agreement and the Deed of Assignment, the trademarks came to be vested in the said SKOL Breweries, India.

The Applicant contended that with the termination of the BL Agreement, the situs of the trademarks got shifted to Australia. The deed of assignment was executed outside India. Therefore the transfer of capital asset would be beyond the reach of Indian Income-tax Act.

The AAR observed that the contention that the BL Agreement was terminated on account of execution of SP Agreement and the Deed of Assignment, and that the trademark and brand intellectual property got restored to and vested back with the Applicant in Australia and **therefore their situs got shifted to Australia has no factual or legal basis**. The AAR observed that the very contention presupposes that the trademarks were situated in India. *The predominant component of trademark and brand is goodwill associated with them. In concrete terms, that goodwill cannot be said to have perished in India and shifted its location, lock, stock and barrel at the very moment at which the events of 'completion' and 'assignment' took place in Australia.*

Accordingly the AAR held that the Intellectual property in the form of Foster's trade-marks and brand which were an integral part of the business of Foster's India that was being carried on with the licence granted by the applicant company together with the goodwill they generated by reason of such user, can be said to be situated in India within the meaning of **the Explanation to Section 9(1)**. The AAR held that at best, their location in Australia is only notional or fictional. The fact that the trademarks and names originated in Australia and initially registered there does not make material difference."

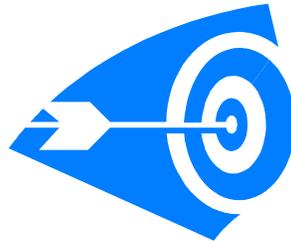
LESSON ROUND UP



- The study has dealt with various case studies which throw light on the latest trends in mergers, takeovers, amalgamations etc.
- Each case study is itself an experience.
- Illustrations enable the students to appreciate and apply various methods and strategies in different kinds of restructuring process.

STUDY XII
REVIVAL AND RESTRUCTURING OF SICK COMPANIES

LEARNING OBJECTIVES



After going through this chapter, you will be able to understand:

- Problems of sick industrial companies
- Major causes of sickness of industrial companies
- Sickness indicators
- Provisions of Sick Industrial Companies Act, 1985
- Revival of sick companies – Companies (Amendment) Act, 2002

1. INTRODUCTION

Prior to the globalisation and liberalization of Indian economy, it was observed that most of the companies owning industrial undertakings were facing numerous problems and becoming virtually sick. This drove them to the brink of closure, resulting in serious repercussions, both economic and social.

The incidence and magnitude of ill effects of sickness and the resultant closure of industrial companies such as loss of production, loss of employment, loss of revenue to the Central and State Governments and locking up of investible funds of banks and financial institutions, was a matter of serious concern to the Government. It was recognized that in order to fully utilize the productive industrial assets, to afford maximum protection of employment and optimize the use of the funds of banks and financial institutions, it would be imperative to revive and rehabilitate the potentially viable sick industrial companies as quickly as possible. However, the multiplicity and complexity of laws and agencies present made the adoption of a co-ordinated approach in dealing with sick industrial companies, difficult.

It was realized that the measures, till then adopted by the government, viz. nationalization or takeover of management, had not been able to achieve the desired results. Both these measures needed periodic and constant financial and other support. In spite of all the possible investments and support, many sick industrial undertakings, did not show any symptoms of viability. A large number of undertakings did not become healthy in spite of their management being continued with the Government or a Government nominated agency for several years as huge sums of money were required to meet their past liabilities of unpaid wages, taxes, duties etc.

and for working capital. Hence, even the sick industrial undertakings whose managements were taken over, were forced to be wound up.

A need was therefore felt, to enact in public interest, a legislation to provide for timely detection of sickness in industrial companies and for expeditious determination by a body of experts of the preventive, ameliorative, remedial and other measures that would need to be adopted with respect to such companies and for enforcement of the measures considered appropriate.

It was in this background that the Sick Industrial Companies (Special Provisions) Act, 1985 was enacted, which provided for the establishment of the Board for Industrial and Financial Reconstruction (BIFR) and also its appellate authority, Appellate Authority for Industrial and Financial Reconstruction (AAIFR). The legislation was predominantly remedial and ameliorative, in so far as it empowered the quasi judicial body, the BIFR to take appropriate measures for revival and rehabilitation of potentially viable sick companies and for liquidation of non-viable companies and was regulatory only to a certain extent. The latter aspect was reflected in the provisions of the Act providing for obligation of sick industrial companies and potentially sick industrial companies, to make references to the Board and treating any non-compliance as a punishable offence.

The major constraint of the Act was that it was applicable only to sick industrial companies keeping away other companies which are in trading, service or other activities. The Act was modified in 1991 to include within its purview the Government companies by Industrial Companies (Special Provisions) Amendment Act, 1991 which came into force w.e.f. 28.12.91.

However, the overall experience was not satisfactory and hence these provisions were proposed to be merged in Companies Act, 1956, vide Companies (Second Amendment) Act, 2002. Accordingly, powers of BIFR (Board for Industrial and Financial Reconstruction) were to be exercised by NCLT (National Company Law Tribunal) to be constituted under Section 10FB of Companies Act, 1956 and appeal against order of NCLT could be referred to NCLAT (National Company Law Appellate Tribunal) to be constituted under Section 10FR of Companies Act, 1956.

Students may note that though amendments in Companies Act have been passed by Parliament, SICA has not yet been repealed and also Part VI A consisting of Section 424A to 424L inserted by the Companies (Second Amendment) Act 2002 has not yet been made effective. Till SICA is repealed the sick companies (including government companies) will continue to be under BIFR.

MAJOR CAUSES OF SICKNESS OF INDUSTRIAL COMPANIES

- Inability of the management of the company to keep a constant vigil over competitive forces;
- Inability of the management to focus on continued viability of the industrial unit;
- Inability of the management to introduce dynamic changes to suit the developments taking place in the industry;

- Lack of serious efforts to combat sickness at the initial stage and thereafter to take efforts to revive the company;
- Lack of adequate and quality manpower;
- Lack of funds required for meeting replenishment and much needed modernization and upgradation programmes;
- Technological obsolescence;
- Sweeping changes across the industry;
- Political and economical factors;
- Change in Consumer behaviour;
- Lack of Timely Government Support;
- Belligerent workforce and unions;
- Family disputes between major shareholders groups;
- Mismanagement by Directors;
- Diversion and Misapplication of Funds;
- Disproportionate Investment in unproductive Fixed Assets;
- Reckless investments in other businesses.

Thus, the health of an industrial company depends upon various factors, which include, inter alia, the quality of its Board of Directors, efficiency in performing its duties and functions, effectiveness of its managerial staff, caliber of skilled, semi-skilled and unskilled work force, timely availability of adequate funds, raw materials, stores, packing material, tools and other consumables, ready market for semi-finished and finished products of the company, cordial industrial relations, effective public relations, conducive Government policies and other related factors.

Whenever an industrial company faces problems with regard to any one or more of the above factors, which could not be resolved by the management, the company starts showing symptoms of sickness.

The major reasons for industrial sickness could be categorized into two parts as given below:

- (A) Internal Causes
- (B) External Causes

(A) Internal Causes – Internal Causes are those that are within the control of the management of an industrial company and therefore attempt could be made by the management to rectify them at the earliest. They relate to the functioning of the company and they could be conveniently grouped into three broad headings:

- (1) Project Related
- (2) Human Resource Related
- (3) Performance Related

1. Project Related Causes:

- (a) Under-estimation of the project cost

- (b) Non-availability or inadequate availability of critical information having a vital bearing on the project
- (c) Delayed project implementation and resultant cost escalation

2. Human Resource Related Causes:

- (a) Poor quality of management:
 - (i) Excessive conservatism
 - (ii) Excessive complacency
 - (iii) Poor functional controls
 - (iv) Excessive centralization
 - (v) Weak Board
 - (vi) Authoritarianism
 - (vii) Weak watchdog functions
 - (viii) Lack of management depth
 - (ix) One-man Rule
 - (x) Bureaucratic, unplanned and inappropriate management
- (b) Excessive Commitment to Policies which worked well at one time but are no longer appropriate.
- (c) Poor financial/marketing/management control.
- (d) Management succession problems.
- (e) Poor inter-personal and inter-departmental coordination, dimensions, interdepartmental coordination, dissensions, inter-departmental squabbles, wrong organizational policies etc.
- (f) Poor industrial relations including existence of 'pampered' labour.

3. Performance Related:

- (a) Faulty choice of product/technology
- (b) Under utilization of plant, machinery and other available resources
- (c) Inadequacy of working capital
- (d) Diversion of funds
- (e) Inadequate market forecast and sales planning

(B) External Causes – These relate to the environmental and other factors which are not within the control of the given industry or given unit as such. They include the following causes:

- Non-co operative Government policies /price control schemes etc.
- Recession/adverse economic conditions
- Powerful competitors in the market
- Non-availability/shortage of inputs
- Regional phenomenon including local environmental factors
- Industry-wise phenomenon

- Technological advancements
- Frequent and long power cuts
- Delayed financial assistance

Inability to adjust or accommodate in changed environment is one of the major causes of sickness for any undertaking. Once a company becomes sick, until and unless the sickness is arrested at such stage, it creates a spiral affect and as a consequence, revival of such unit becomes difficult. The management of such undertaking has a big role to play and the organization should not wait till the sickness is reported as per law; rather the control mechanism should be in-built and pro-active.

The Tiwari Committee under the chairmanship of Shri T. Tiwari in 1983 identified the following causes of industrial sickness:

A. Internal Causes

1. Planning

- (a) Technical feasibility
 - Inadequate technical know-how
 - Locational disadvantage
 - Out dated production process
- (b) Economic viability
 - High cost of inputs
 - High Break-even point
 - Uneconomic size of project
 - Underestimation of financial requirements
 - Unduly large investments in fixed assets
 - Overestimation of demand.

2. Implementation

- (a) Cost overruns resulting from delays in getting licences/sanctions.
- (b) Inadequate mobilisation of finance.

3. Production

- (a) Production management
 - Inappropriate product-mix
 - Poor quality control
 - Poor capacity utilisation
 - High cost of production
 - Poor inventory management
 - Inadequate maintenance
 - Lack of timely and adequate modernization.
- (b) Labour management
 - Excessively high wage structure

- Inefficient handling of labour problems
- Excessive manpower
- Poor labour productivity
- Poor labour relations.
- (c) Marketing management
 - Dependence on a single customer/single product
 - Poor sales realization
 - Defective pricing policy
 - Booking of large orders at fixed prices in inflationary markets
 - Weak market organisation
 - Lack of market feedback and market research.
- (d) Financial management
 - Poor resource management
 - Faulty costing
 - Too-liberal dividend policy
 - General financial indiscipline
 - Deficiency of funds
 - Siphoning away of funds
 - Overtrading
 - Unfavourable gearing or keeping an adverse debt-equity ratio.
- (e) Administrative management
 - Over centralization
 - Lack of professionalism
 - Lack of feedback to management
 - Lack of adequate controls
 - Lack of timely diversification
 - Excessive expenditure on R&D
 - Divided loyalties (where the same management has interest in more than one enterprise); cases may occur where promoters of limited companies who also own private ownership firms tend to look after the interest of the latter, often at the cost of the former
 - Dissension within the management
 - Incompetent management
 - Dishonest management.

B. External Causes

1. Infrastructural bottlenecks

- Non-availability/irregular supply of critical raw materials or other inputs
- Chronic power shortage

- Transport bottlenecks.

2. *Financial bottlenecks*

- Non-availability of adequate finance

3. *Government controls, policies, etc.*

- Government price controls
- Fiscal duties
- Abrupt changes in Government policies
- Procedural delays on the part of the financial/licensing/other controlling or regulating authorities (banks, RBI, financial institutions, Government departments, licensing authorities, Monopolies and Restrictive Trade Practices Board).

4. *Market constraints*

- Market saturation
- Revolutionary technological advances causing product obsolescence.

5. *Extraneous factors*

- Natural calamities
- Political situation (domestic as well as international)
- War
- Sympathetic strike
- Multiplicity of labour unions.

[Source: Tiwari Committee Report]

SICKNESS INDICATORS

As long as a company is able to meet all its current and long term commitments as and when they become due, it may be known as a going concern. The concept of going concern is a very important one and directors of a company are supposed to declare at the end of each financial year through their report to the members whether the company is a going concern or not. Any serious impairment to the status of a company as a going concern should be brought to knowledge of the members. Both the report of the auditors under Section 227 of the Companies Act, 1956 and the report of the directors under Section 217 of the Act would reveal the status of the company. As per the text of the Auditing and Assurance Standard (AAS) 16, the following are the important indications of the circumstances, which may be required to exist when the 'going concern' status of an entity is affected:

(i) Financial Indications

- Negative net worth or negative working capital.
- Fixed term borrowings approaching maturity without realistic prospects of renewal or repayment or excessive reliance on short-term borrowings to finance long-term assets.
- Adverse key financial losses.

- Substantial operating losses.
- Substantial negative cash flows from operations.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Difficulty in complying with the terms of loan agreements.
- Change from credit to cash on delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.
- Entering into a scheme of arrangement with creditors for reduction of liability.

(ii) Operating Indications

- Loss of key management (i.e., managerial personnel) without replacement.
- Loss of a major market, franchise, license or principal supplier.
- Labour difficulties or shortages of important supplies.

(iii) Other Indications

- Non-compliance with capital or other statutory requirements.
- Pending legal proceedings against the entity that may, if successful, result in judgement that could not be met.
- Changes in legislation or government policy.
- Sickness of the entity under any statutory definition.

SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) ACT, 1985 [SICA]

The objectives

The preamble of SICA reads as follows:

The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) is an act which makes in public interest, special provisions, with a view to securing timely detection of sick and potentially sick companies owning industrial undertakings, speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies and expeditious enforcement of measures so determined and for matters connected therewith or incidental thereto.

Principal objectives of SICA

SICA was enacted with the following principal objectives:

- (1) To evaluate the techno-economic viability of sick industrial companies with a view either to rehabilitate them, if the public interest so demanded and their rehabilitation was possible, or to close them down, if continuing them would be impossible.
- (2) To stop continued drain of public and private resources for the overall economy of the country.

(3) To protect employment as far as practicable.

Supreme court in *Namit R Kamani v. R.R. Kamani* (1988) 4 SCC 387 (1989) 2 Comp LJ 391/AIR 1989 SC 9/(1989) 66 Comp Cas 132(SC) had explained the object of SICA as (a) affording maximum protection to employment (b) optimising the use of funds and available production assets (c) realising amounts due to banks, institutions, creditors and (d) providing efficient authority consisting of experts for expeditious determination of measures to avoid time consuming procedures.

The Statement of Objects and Reasons for enacting the Sick Industrial Companies (Special Provisions) Act, 1985, (SICA) stated that in order to fully utilise the productive industrial assets, to afford maximum protection of employment and optimise the use of the funds of the banks and financial institutions, it would be imperative to revive and rehabilitate the potentially viable, sick industrial companies as quickly as possible. It also stated that it would be also equally imperative to salvage any productive assets and realise the amounts due to the banks and financial institutions, to the extent possible, from the non-viable sick industrial companies.

Though it was conceived very well, SICA, failed as it could not be successfully implemented. Section 32 of SICA gave overriding provisions to the Act, whereby BIFR could pass orders even if they were against provisions of other laws. Also, rehabilitation of sick companies was with BIFR; while winding up was with High Court. Therefore, when BIFR passed an order recommending winding up, the matter went to High Court and the whole process had to be started again thereby delaying the matter. The overall experience under SICA was not satisfactory and hence these provisions are now merged in Companies Act, 1956, vide Companies (Second Amendment) Act, 2002. Accordingly, powers of BIFR (Board for Industrial and Financial Reconstruction) will now be exercised by NCLT (National Company Law Tribunal) to be constituted under Section 10FB of Companies Act, 1956 and appeal against order of NCLT may be referred to NCLAT (National Company Law Appellate Tribunal) to be constituted under Section 10FR of Companies Act, 1956.

Students may once again note that though amendments in Companies Act have been passed by Parliament, SICA has not yet been repealed. Till SICA is repealed, the sick companies (including government companies) will continue to be under BIFR. Part VIA, consisting of Sections 424A to 424L, have been inserted by the Companies (Second Amendment) Act, 2002 to deal with sick industrial companies. However, this part VI has not yet been made effective.

DEFINITIONS- Differences under SICA and the Companies Act, 1956

What is a Sick industrial company?

Under SICA

According to Section 3(1)(o) of the Sick Industrial Companies (Special Provisions) Act, 1985, "sick industrial company" means an industrial company (being a company registered for not less than five years), which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Explanation: For the removal of doubts, it is hereby declared that an industrial

company existing immediately before the commencement of the Sick Industrial Companies (Special Provisions) Amendment Act, 1993 registered for not less than five years and having at the end of any financial year accumulated losses equal to or exceeding its entire net worth, shall be deemed to be a sick industrial company.

Under the Companies Act, 1956

According to Section (46AA) of the Companies Act, 1956 "sick industrial company" means an industrial company which has—

- (i) the accumulated losses in any financial year equal to fifty per cent or more of its average net worth during four years immediately preceding such financial year; or
- (ii) failed to repay its debts within any three consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such company;

It may be observed that the following are the differences between the definition of Sick Industrial Company' under SICA and the Companies Act, 1956 differs as follows.

	<i>SICA</i>	<i>Companies Act 1956</i>
1	Loss at the end of any financial year equal to or exceeding the net worth	The accumulated losses in any financial year equal to fifty per cent or more of its average net worth during four years immediately preceding such financial year.
2	Company Registered for five years	No such requirement
3	No such condition	Failure to repay its debts within any three consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such company

According to the SICA, the sickness of a company was related to the age of the company, i.e., the date of its registration as per the certificate of incorporation issued by the Registrar of Companies and not the date on which the company was granted the certificate of commencement of business. Also, the date of actual commencement of its activities, i.e., commercial production or rendering services in which the company was engaged was not considered relevant.

The practical effect of this condition was that even if a company had eroded its entire net worth, but the prescribed period of five years from registration had not been completed, the BIFR was precluded from taking cognizance of the sickness of the company. There had been many instances when the BIFR had to refuse registration of companies on this ground. This was a matter of grave concern because in capital intensive industries where the incidence of depreciation was quite high in the initial years, it was quite possible for a company to completely erode its net worth in less than five years. This was the reason most of the cases referred to BIFR involved almost dead companies, which had either ceased to be operative long ago or were

on the verge of closure. In such situations, the problem of rehabilitating such critically-sick industrial companies became all the more difficult.

It was felt that a sick company should be able to seek registration with the BIFR as and when the sickness sets in irrespective of the fact that it has not completed the prescribed period of five years from its registration. This is the reason why the five years criteria has been removed in the definition of the Companies Act 1956.

Net worth

Under SICA(as provided in the explanation to the definition of Sick Industrial Company)

“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.

Under the Companies Act, 1956 (Section 2(29A))

"Net worth" means the sum total of the paid-up capital and free reserves after deducting the provisions or expenses as may be prescribed.

Explanation.—For the purposes of this clause, "free reserves" means all reserves created out of the profits and share premium account but does not include reserves created out of revaluation of assets, write back of depreciation provisions and amalgamation;

The definition of ‘net worth’ under the Companies Act, 1956 is not the same as in SICA as the companies act requires deduction of provisions and expenses.

Operating agency

Under SICA(Section 3(1)(i))

“Operating agency” means any public financial institution, State level institution, scheduled bank or any other person as may be specified by general or special order as its agency by the Board for Industrial and Financial Reconstruction (BIFR).

Under the Companies Act 1956(Section 31AA)

(31AA) "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 institutions, State level institution, scheduled bank or any other person as may be specified as the operating agency by the Tribunal

SOME PROCEDURAL ASPECTS UNDER SICA

Reference to the Board – Section 15

Under Section 15 of the Act, where an industrial company has become sick, the Board of Directors of the company shall, within 60 days from the date of finalization of duly audited accounts of the company for the financial year at the end of which the company has become sick, make a reference to the Board (BIFR) for determination of measures to be adopted with respect to the company.

Interestingly, if the Board of Directors had sufficient reason even before such finalization to form opinion that the company had become a sick unit after the Board

of Directors shall, within 60 days after it has formed such opinion, make a reference to the Board for determination of measures which shall be adopted in respect of the company.

Further, the Central Government or Reserve Bank or State Government or a public financial institution or a State level institution or a scheduled bank may provide sufficient reason that any industrial company has become sick industrial company, may make a reference to the Board for determination of measures which shall be adopted in respect of the company.

However, the State Government can make a reference in respect of any industrial undertaking which are situated in such state only. Similarly, a public financial institution or state level institution or a scheduled bank can make a reference only if it has provided any financial assistance or some obligation rendered by it or undertaking by it in respect of the referred company.

The finalization of the accounts for the above purpose imply that the date on which the accounts have been approved by the members at the Annual General Meeting of the Company is in accordance to the Companies Act.

Once a company is determined to be referred to BIFR, it needs to file a formal application as specified in BIFR Regulations, 1987 as amended from time to time.

Inquiry into Working of Sick Industrial Companies – Section 16

The salient features of the inquiry into the status of sick industrial companies contained in Section 16 of SICA are as follows:

- BIFR, upon receipt of a reference with respect to such company under Section 15; or upon information received with respect to such company or upon its own knowledge as to the financial condition of the company, may make such inquiry as it may deem fit for determining whether the industrial company has become a sick industrial company.
- BIFR may require, by order, any operating agency to enquire into and make a report and complete its inquiry as expeditiously as possible.
- Endeavour should be made to complete the inquiry within sixty days from the commencement of the inquiry.
- As per the explanation given under this section, an inquiry shall be deemed to have commenced upon the receipt by BIFR of any reference or information or upon its own knowledge reduced to writing by BIFR.
- BIFR has powers to appoint one or more persons to be a special director or special directors of the company if it deems it necessary to make an inquiry or to cause an inquiry as mentioned above to be made into any industrial company.
- BIFR may issue necessary directions to special directors for proper discharge of duties.
- The appointment of a special director referred to in Sub-section (4) shall be valid and effective notwithstanding anything to the contrary contained in the Companies Act, 1956, or in any other law for the time being in force or in the memorandum and articles of association or any other instrument relating to the industrial company.

- Any provision regarding share qualification, age limit, number of directorships, removal from office of directors and such like conditions contained in any such law or instrument aforesaid, shall not apply to any special director appointed by BIFR.
- The special director will hold office only during the pleasure of BIFR. He does 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. He is not liable to retirement by rotation and shall not be taken into account for computing the number of directors liable to such retirement. He is not 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.

Powers of Board to make suitable order on the completion of inquiry – Section 17

If, after making an inquiry under Section 16, the Board is satisfied that a company has become a sick industrial company, the Board shall, after considering all the relevant facts and circumstances of the case, decides, whether it is practicable for the company to make its net worth exceed the accumulated losses within a reasonable time.

If the Board decides that it is practicable for a sick industrial company to make its net worth exceed the accumulated losses within a reasonable time, the Board, shall, by order in writing, give time to the company to make its net worth exceed the accumulated losses. What is reasonable time depends on the facts and circumstances of each case. A period of 7 to 10 years, within which the company should be able to wipe off its accumulated losses is normally regarded by the Board as a reasonable time. This is also the time within which under a sanctioned scheme of the Board, the sick industrial company can be expected to have been revived or rehabilitated.

If the Board decides under Sub-section (1) that it is not practicable for a sick industrial company to make its net worth exceed the accumulated losses within a reasonable time by order in writing, directs any operating agency specified in the order to prepare, a scheme for revival/rehabilitation of sick industrial company. The operating agency would normally be a public financial institution notified as such by the Board through a general or special order.

Preparation and sanction of scheme for revival – Section 18

If the Board appoints an operating agency under Section 17(3) of the Act, then the operating agency is required to prepare and submit a schedule in respect of the referred company by providing any or more of the following measures:

- (a) The financial reconstruction of the sick industrial company;
- (b) The proper management of the sick industrial company by change in, or takeover of, the management of the sick industrial company;
- (c) The amalgamation of—
 - (i) the sick industrial company with any other company, or
 - (ii) any other company with the sick industrial company.

- (d) the sale or lease of a part or whole of any industrial undertaking of the sick industrial company;
- (d) (a) the rationalisation of managerial personnel, supervisory staff and workmen in accordance with law;
- (e) such other preventive, ameliorative and remedial measures as may be appropriate;
- (f) such incidental, consequential or supplemental measures as may be necessary or expedient in connection with or for the purposes of the measures specified in clauses (a) to (e).

The Board may finalise the scheme after considering the views and suggestions of the company, the operating agency and the public by publishing the draft scheme in the newspaper and thereafter formally sanction the same which is referred to as the “sanctioned scheme”.

Does the BIFR has the power for dilution of equity under section 18(2)(f) without following procedure prescribed under sections 81, 100 to 103 of the Companies Act?

In case of *National Small Industries Corpn. Ltd(NSIC) v. Singer India Ltd(SIL)*. [2010] 103 SCL 385 (DELHI) NSIC was holding certain shares in SIL fell into financial difficulties resulting in proceedings under Act and it was thereafter declared as a sick company by BIFR - BIFR also sanctioned draft rehabilitation scheme prepared by SIL. Effect of scheme, insofar as, NSIC as a shareholder was concerned, was that in view of subscribed and paid-up capital of SIL being reduced by 90 per cent by reduction of value of shares, there would be dilution of shareholding of NSIC - An appeal was filed against order of BIFR sanctioning said scheme on grounds that

- (i) BIFR had no power to provide for dilution of equity under section 18(2)(f) without following procedure prescribed under sections 81, 100 to 103 of Companies Act;
- (ii) that petitioner(NSIC) was a public financial institution within meaning of section 19(1) and, thus, there could be no dilution of equity without consent of petitioner in view of section 19(2);
- (iii) that SIL had not complied with section 18(3)(a) which requires publication of draft scheme as per directions of BIFR to enable stakeholders to file their objections –

Appellate Authority for Industrial and Financial Reconstruction (AAIFR) dismissed said appeal on following grounds.

- (i) Since power of reduction of shareholders’ interest or rights in sick industrial company has been specifically conferred upon BIFR under section 18(2)(f) and BIFR has wide and ample powers for restructuring, with Act playing an overriding role in view of section 32, BIFR had acted within its power in directing reduction of share capital and in issuing further capital at specified rates without going through process of special resolution
- (ii) Merely because NSIC was a Government company within meaning of Companies Act, which had invested in share capital of SIL, did not imply that petitioner was covered under section 19(1)

- (iii) Since publication of proposed scheme had taken place in a State level newspaper, it could be said that provisions of section 18(3)(a) had been complied with but direction passed by BIFR that salient features of scheme should be published in one leading newspaper and one State level vernacular newspaper could not be said to be complied with. However, such a technical defect should not now be made a reason to negate scheme when various parties had altered their positions in terms of aspect of reduction of shareholding and consequential acts .

Rehabilitation by giving financial assistance (Section 19)

Where the scheme relates to preventive, ameliorative, remedial and other measures with respect to any sick industrial company, the scheme may provide for financial assistance by way of loans, advances or guarantees or reliefs or concessions or sacrifices from the Central Government, a State Government, any scheduled bank or other bank, a public financial institution or State level institution or any institution or other authority (here in after referred as person required by the scheme to provide financial assistance) to the sick industrial company.

Every scheme referred above shall be circulated to every person required by the scheme to provide financial assistance for his consent within a period of sixty days from the date of such circulation 2[or within such further period, not exceeding sixty days, as may be allowed by the Board, and if no consent is received within such period or further period, it shall be deemed that consent has been given.

Where in respect of any scheme the consent is given by every person required by the scheme to provide financial assistance, the Board may, as soon as may be, sanction the scheme and on and from the date of such sanction the scheme shall be binding on all concerned.

On the sanction of the scheme, the financial institutions and the banks required to provide financial assistance shall designate by mutual agreement a financial institution and a bank from amongst themselves which shall be responsible to disburse financial assistance by way of loans or advances or guarantees or reliefs or concessions or sacrifices agreed to be provided or granted under the scheme on behalf of all financial institutions and banks concerned.

The financial institution and the bank designated shall forthwith proceed to release the financial assistance to the sick industrial company in fulfilment of the requirement in this regard.

Where in respect of any scheme consent is not given by any person required by the scheme to provide financial assistance, the Board may adopt such other measures, including the winding up of the sick industrial company, as it may deem fit.

Arrangement for continuing operations, etc during inquiry (Section 19A)

At any time before completion of the inquiry under section 16, the sick industrial company or the Central Government or the Reserve Bank or a State Government or a public financial institution or a State level institution or a scheduled bank or any other institution, bank or authority providing or intending to provide any financial assistance by way of loans or advances or guarantees or reliefs or concessions to

the sick industrial company may make an application to the Board-

- (a) agreeing to an arrangement for continuing the operations of the sick industrial company; or
- (b) suggesting a scheme for the financial reconstruction of the sick industrial company.

The Board may, within sixty days of the receipt of the application under sub-section (1), pass such orders therein as it may deem fit.

Winding up of Sick Industrial Company – Section 20

The salient features of Section 20 of SICA are as follows:

- After making necessary inquiry under Section 16 and after giving an opportunity to all concerned parties, if BIFR is of the opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time and it is not likely to become viable in future and as such it is just and equitable to wind up the company, BIFR may record and forward its opinion to the concerned High Court.
- The High Court shall, on the basis of the opinion of the Board, order winding up of the sick industrial company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.
- In *Re. Anmol Dairy Ltd.* (2002) 5 Comp LJ 43 (Tuj.) it was held by the High Court that the opinion of BIFR should be given due weightage but it is not binding on the High Court and High Court can go into the correctness of the opinion so submitted by the BIFR. The High Court independently decides as to whether it should proceed with the winding-up of sick industrial company.
- Once an order of winding up is made by the High Court under Section 20(2) of Sick Industrial Companies Act (SICA), acting on the opinion of BIFR under Section 20(1), the control and jurisdiction over the company, its affairs and assets passes over to the High Court and BIFR ceases to have any power to pass any orders or give any directions as held by division bench of High Court in *BPL Ltd., Bangalore v. Inter Modal Transport Technology Systems (Karnataka) Ltd., Bangalore (in liquidation) & others* (2001) (3) Kar LJ 622 (DB).
- For the purpose of winding up, the High Court may, with the consent of the operating agency, appoint any officer of the operating agency, as the liquidator and such officer, if appointed shall be deemed to be, and have all the powers of, the official liquidator under the Companies Act, 1956.
- When BIFR recommends the winding up of a sick industrial company pursuant to Section 20(1) of the SICA, 1985 and forwards its opinion to the connected High Court, the High Court is bound to order the winding up of the company on the basis of the opinion of BIFR.
- Once BIFR forwards its opinion to the connected High Court, the role of BIFR comes to an end in respect of the said sick industrial company.
- As per Sub-section (4) of Section 20, the BIFR has the power to direct the sale of assets of the sick industrial company in such manner as it may deem fit. The power of BIFR under sub-section is exercisable notwithstanding

anything contained in Sub-section (2) or (3) of Section 20. The Supreme Court in *V.R. Ramaraju v. Union of India & others* [1997] 89 Comp Cas 609 (SC) in relation to Section 20(2) of SICA held that the High Court in deciding the question of winding up of the company has to take into account the opinion of BIFR forwarded to it and is not to abdicate its own function of determining the question of winding up.

- Adding clarity to the end of jurisdiction of BIFR and beginning of jurisdiction of High Court, the Division Bench of the Karnataka High Court in *BPL Limited, Bangalore v. Inter Modal Transport Technology Systems (Karnataka) Limited, Bangalore (in liquidation) & others* [2001] (3) Kar LJ 622 (DB); ILR 2001 Kar 5373 (DB) held that the scheme of SICA as contained in Sections 22, 22A, 20 and 32 of that makes it clear that from the date of commencement of an inquiry in regard to any reference received under Section 15, till passing of an order of winding up by the High Court under Section 20(2) of SICA, BIFR retains absolute control over the affairs of the company and can either prevent any sale or permit any sale and the sick industrial company is entirely governed by the provisions of SICA. On the other hand, once an order of winding up is made by the High Court under Section 20(2) of SICA, acting on the opinion of BIFR under Section 20(1), the control and jurisdiction over the company, its affairs and assets passes over to the High Court and BIFR ceases to have any power to pass any orders or give any directions.” The division bench further held that the company court does not sit in appeal over the orders of BIFR nor exercise power under Articles 226 and 227 of the Constitution.
- In the *BPL Limited's* case cited above, the court held that the sale of assets of a company by a secured creditor as per directions of BIFR, prior to the date of winding up order, is not void for want of leave of the court and there is no question of obtaining any leave or permission of this court.
- In *National Organic Chemical Industries Limited and Ors. v. N.O.C.I.L. Employees Union* 2005 (126) Companies Cases 922, *Sharp Industries Limited* (2006) 131 Company Cases, 535 (Bom.) and in *Pharmaceutical Products of India Ltd. in re* (2006) 131 Company Cases 747, the Bombay High Court have held that during pendency of a reference before BIFR, a scheme under Section 319 could be sanctioned. However in *Ashok Organic Industries Ltd v. ARCIL*, [2008] 114 Comp Cas 144 (Bom.), the Bombay High Court had set aside all the above decisions and held that once the Industrial Company makes a reference under Section 15 of the SICA, the Company Court would have no jurisdiction for sanctioning the scheme of arrangement of compromise with its creditors and shareholders and neither will it have jurisdiction to take cognisance of such an application during the pendency of the reference.
- The High Court has no jurisdiction to sanction a scheme of arrangement presented by a sick company when the revival scheme of the company was pending before the AAIFR. [*Tata Motors Ltd. v. Pharmaceutical Products of India Ltd. & Anr.* (2008) 144 Comp Cas 178 (SC)].

Immunity from Certain Litigations – Section 22

In certain circumstances, no proceedings for the winding up of the industrial

company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof and no suit for the recovery money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of BIFR or, as the case may be, the Appellate Authority.

The protection under Section 22 of SICA is a superior protection as it operates notwithstanding anything contained in the Companies Act, 1956, or any other law or the memorandum and articles of association of the industrial company or any other instrument having effect under the said Act or other law.

The above protection is available in respect of an industrial company when an inquiry under Section 16 is pending in relation to the said industrial company or when any scheme referred to under Section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under Section 25 relating to an industrial company is pending. Where the management of the sick industrial company is taken over or changed in pursuance of any scheme sanctioned under Section 18, notwithstanding anything contained in the Companies Act, 1956, or any other law or in the memorandum and articles of association of such company or any instrument having effect under the said Act or other law – (a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company; (b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by BIFR.

BIFR may by order declare with respect to the sick industrial company concerned that the operation of all or any of the contracts, assurances of property, agreements, settlements, awards, standing orders or other instruments in force, applicable to the sick industrial company in question shall remain suspended or that all or any of the rights, privileges, obligations, and liabilities accruing or arising thereunder before the said date, shall remain suspended or shall be enforceable with such adaptations and in such manner as may be specified by BIFR. Provided that such declaration shall not be made for a period exceeding two years which may be extended by one year at a time so, however, that the total period shall not exceed seven years in the aggregate. Any such declaration is valid and is protected notwithstanding anything contained in the Companies Act, 1956, or any other law or agreement or instrument or any decree or order of a court, Tribunal, officer or other authority or of any submission, settlement or standing order.

Accordingly, any remedy for the enforcement of any right, privilege, obligation and liability suspended or modified by such declaration, and all proceedings relating thereto pending before any court, Tribunal, officer or other authority shall remain stayed or be continued subject to such declaration. On the declaration ceasing to have effect – (i) any right, privilege, obligation or liability so remaining suspended or modified, shall become revived and enforceable as if the declaration had never been made; and (ii) any proceeding so remaining stayed shall be proceeded with, subject to the provisions of any law which may then be in force, from the stage which had been reached when the proceedings became stayed. Obviously from a perusal of the language contained in Section 22(1) of SICA, it is clear that Section 22 does not grant any immunity against criminal proceedings against the company or its directors.

The apex court Maharashtra Tubes Limited v. State Industrial and Investment Corporation of Maharashtra Limited [1993] 78 Comp Cas 803 (SC) held that the idea underlying Section 22(1) of SICA is that every such action (against the company or its guarantors for recovery of money or enforcement of security) should be frozen unless expressly permitted by the specified authority until the investigation for the revival of the industrial undertaking is finally determined. The apex court in Patheja Bros. Forgings and Stamping v. ICICI Limited AIR 2000 CLC 1492: (2000) 4 Comp LJ 9 (SC) held that the words Section 22 are clear and unambiguous and that they provide that no suit for the enforcement of a guarantee in respect of any loan or advance granted to the concerned industrial company will lie or can be proceeded with without the consent of BIFR or the appellate authority. When the words of a legislation are clear, the court must give effect to them as they stand and cannot demur on the ground that the legislature must have intended otherwise. The apex court clearly held that any suit for enforcement of the guarantee in respect of loans granted to a sick industrial company cannot be proceeded with unless consent as required under Section 22 of SICA is obtained.

In, Sun Industries v. Sharda Synthetics (P.) Ltd. [2010] 101 SCL 1 (BOM.) the petitioner-company filed winding up petition under section 433 of the 1956 Act against the respondent-company claiming unpaid price of goods sold. The respondent-company contended that it was entitled to protection under section 22 of the 1985 Act in view of the fact that a reference was registered before the BIFR. The petitioner contended that the orders for purchase of goods were placed by the respondent after the reference was registered with the BIFR and, therefore, the respondent must pay for the goods and then seek protection under section 22 of the 1985 Act.

It was held that the respondent-company was not entitled to invoke the protection of section 22 of the 1985 Act in respect of transactions for purchase of goods after the reference was registered with the BIFR. Indeed, section 22 of the 1985 Act cannot be used as a shield against the recovery of debts such as unpaid price of goods, particularly when the goods have been purchased after the reference has been registered since such transactions and the debts incurred thereon are outside the provisions which culminate in a scheme. [Para 6]

The contention of the respondent that the reference was registered with the BIFR on 15-12-2005 and the company had been declared to be a sick company in the year 2007, as yet no scheme had been framed and, therefore, unless the scheme was framed the debt could not be construed to be outside the scheme and, therefore, the proceedings for winding up would not be tenable by virtue of section 22 of the 1985 Act appeared attractive, but it was not liable to be accepted having regard to the purpose of the law. [Para 7]

In Unilab Chemicals and Pharmaceuticals v. Smith Stanistreet Pharma-ceuticals Ltd. [2001] 103 Comp. Cas 122 (Bom.) and Vibgyar Ink Chem (P.) Ltd. v. Safe Pack Polymers Ltd. [1998] 93 Comp. Cas. 407 (AP), the Courts have observed that no proceedings for the recovery, distress or the like should be permitted where a debt features in the sanctioned scheme because that would upset the arrangement made by the scheme. That is the real reason for the view that a debt which does not feature in the scheme would not attract the provisions of section 22 of the 1985 Act. The Courts have held that the bar of section 22 of the 1985 Act would have no application

where in spite of proceedings under the 1985 Act and particularly where a scheme is framed, the company continues to incur the debts and liability and pleads the bar of section 22 to prevent recovery of dues under the transactions. In the circumstances, it was to be held that where a company has consciously entered into transactions, created liabilities and incurred debts, whether an enquiry is pending or whether the scheme has been framed under the 1985 Act, the bar under section 22 of the 1985 Act would not apply. There was, thus, no merit in the respondent's contention. In the result, the petition was to be allowed.

Section 22 of SICA cannot be used as a shield against the recovery of debts such as unpaid price of goods particularly when the goods have been purchased after the reference has been registered.

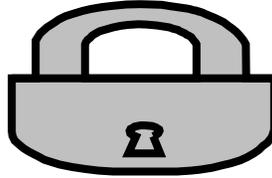
Direction against disposal of assets – Section 22A

In the interest of the sick industrial company or creditors or shareholders or in the public interest, Section 22A of SICA empowers BIFR to order not to dispose off any assets of the company in the interest of creditors, shareholder or in public interest. Such order can be passed (a) during the period of preparation or consideration of the scheme under Section 18; and (b) during the period beginning with the recording of opinion by the board for winding up of the company under Sub-section (1) of Section 20 and upto commencement of the proceedings relating to the winding up before the concerned High Court.

LESSON ROUND UP



- SICA was enacted to evaluate the viability of sick industrial companies with a view to rehabilitate them and to protect the interest of employees as far as practicable.
- Once a company becomes sick, a reference is made to BIFR for determination of measures to be adopted with respect to company.
- Enquiry under Section 16 into working of sick industrial company is made. After being satisfied of sickness and if there is a scope to make the networth exceed the accumulated losses, it appoints an operating agency for preparation of scheme for revival under Section 18. Otherwise an opinion of Board is forwarded to High Court for winding up.
- Section 22, one of the important provisions of SICA, provides for immunity from certain litigations.
- The SICA provisions were declared by section 32(1) of the Act to command overriding efficacy over all other laws except FERA and Urban Land Ceiling Act,

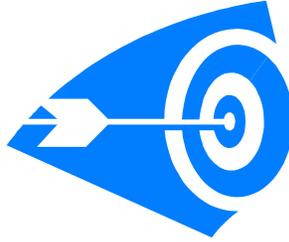
SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Briefly explain the salient features of Section 16 of SICA regarding inquiry into working of sick industrial companies.
2. Enumerate the External Causes of sickness of industrial companies?
3. 'SICA' was conceived well but it failed. Elucidate.
4. Write short notes on—
 - (a) Operating Agency
 - (b) Immunity to Sick Company (Section 22 of SICA).
 - (c) Reference to the Board (Section 15 of SICA).

STUDY XIII
SECURITIZATION AND DEBT RECOVERY
SECURITIZATION ACT

LEARNING OBJECTIVES



The Securities and Reconstruction of Financial assets and enforcement of Security Interest Act, 2002 was enacted to Regulate securitisation of financial assets and enforcement of securities interest and for matters connected therewith or incidental thereto. The chapter covers the following about the Securitisation Act:

- Statement of objects and reasons
- Scheme of the Act
- Apex court upheld the constitutional validity of the Act
- Definitions of terms and expressions
- Important provisions
- Procedure for Registration
- Enforcement of security interest by creditors
- Measures for asset reconstruction
- Offences
- The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003.
- Guidelines on sale of financial assets to securitisation company/reconstruction company and related issues.

INTRODUCTION

In the traditional lending process, a bank makes a loan, maintaining it as an asset on its balance sheet, collecting principal and interest, and monitoring whether there is any deterioration in borrower's creditworthiness.

This requires a bank to hold assets till repayment of loan. The funds of the bank are blocked in these loans and to meet its growing fund requirement a bank has to raise additional funds from the market. Securitisation is a way of unlocking these blocked funds.

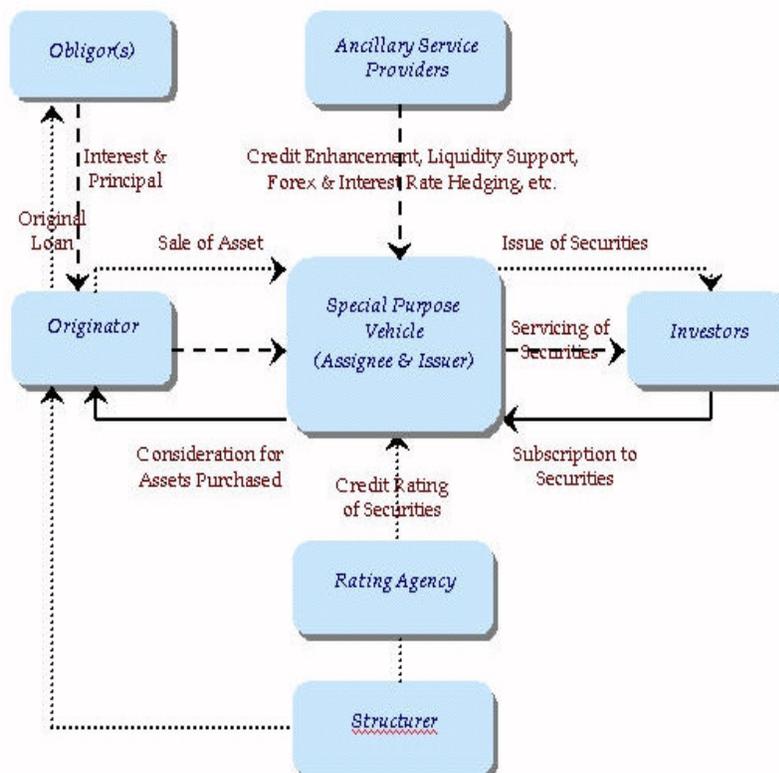
One of the most prominent developments in international finance in recent

decades and the one that is likely to assume even greater importance in future, is securitisation. Securitisation is the process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors. Basically Securitisation is a method of raising funds by way of selling receivables for money.

The process leads to the creation of financial instruments that represent ownership interest in, or are secured by a segregated income producing asset or pool of assets. The pool of assets collateralises securities. These assets are generally secured by personal or real property (e.g. automobiles, real estate, or equipment loans), but in some cases are unsecured (e.g. credit card debt, consumer loans).

Securitisation is a method of raising funds by way of selling receivables for money.

The Securitisation process



Note: Continuing flow of funds from the Obligor to the SPV is routed through the Originator in its capacity as administrator. Any other party appointed by the SPV/Trustee can also perform the role of administrator. It is also possible that the SPV receives the amounts directly from the Obligor.

Source: rbi.org.in

Steps in securitisation:

- (i) Acquisition of Financial Assets by Securitisation Company or reconstruction Company (i.e SPVs) from the originator. Here financial assets are loans backed by properties. The originator is banks or FIs who has lent money to the original borrower.
- (ii) the SPV, with the help of an investment banker, issues security receipts which are distributed to investors; and
- (iii) the SPV pays the originator for the financial assets purchased with the proceeds from the sale of securities.

Parties involved in Securitisation

Primary parties

- The Originator(Banks/FIs who has lent loan against properties)
- SPVs(Securitisation Company or reconstruction Company)
- Investors (To whom securities are issued, which is a participative interest against the pool of receivables which is bought by the SPVs from the originator)

Besides above parties the following are involved in the process of securitizations.

- The obligator(i.e original borrower of the loan)
- Rating agency
- Administrator etc.

Some examples of securitisation in the Indian context are:

- L&T raised Rs 4,090 mn through the securitisation of future lease rentals to raise capital for its power plant in 1999.
- Mortgage backed securities issue (MBS) of Rs 597 mn by NHB and HDFC in 2001.
- Securitisation of aircraft receivables by Jet Airways for Rs 16,000 mn in 2001 through offshore SPV.
- Collateralised Debt Obligation (CDO) deal by ICICI bank in 2002
- securitisation deal by ICICI bank of Rs 19,299 mn in 2007. The underlying asset pool was auto loan receivables.

How Securitisation gained importance?

When a borrower, who is under a liability to pay to secured creditor, makes any default in repayment of secured debt or any instalment 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. High level of NPAs impact adversely on the financial strength of banks who in the present era of globalization, are required to conform to stringent International Standards.

The public at large is also adversely affected because bank's main source of funds are deposits placed by public continued growth in NPA portfolio threatens the repayment capacity of the banks and erode the confidence reposed by them in the banks.

The banks had to take recourse to the long legal route against the defaulting borrowers beginning from filing of claims in the courts. A lot of time was usually spent in getting decrees and execution thereof before the banks could make some recoveries. In the meantime the promoters could seek the protection of BIFR and could also dilute the securities available to banks. The Debt Recovery Tribunals (DRTs) set up by the Govt. also did not prove to be of much help as these get gradually overburdened by the huge volume of cases referred to them. All along, the banks were feeling greatly handicapped in the absence of any powers for seizure of assets charged to them.

All these issues gave the passage for evolution of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 SARFAESI Act, 2002. SARFAESI Act, 2002, is a unique piece of legislation which has far reaching consequences. This Act is having the overriding power over the other legislation and it shall go in addition to and not in derogation of certain legislation.

Statement of objects and reasons- SARFAEST Act 2002

It is necessary at the outset, to reiterate the statement of objects and reasons for the Securitisation Act, which reads as under:

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world. There is no legal provision for facilitating securitisation of financial assets of banks and financial institutions. Further, unlike international banks, the banks and financial institutions in India do not have power to take possession of securities and sell them. Our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow pace of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions. Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms have considered the need for changes in the level system in respect of these areas. These Committees, inter alia, have suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and do sell them without the intervention of the court. Acting on these suggestions.

The Securitisation and Reconstruction of Financial Assets and Enforcement of

Security Interest Ordinance, 2002 was promulgated on the 21st June, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the Ordinance of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.”

The main purpose of the Securitisation Act is to enable and empower the secured creditors to take possession of their securities and to deal with them *without the intervention of the court* and also alternatively to authorise any securitisation or reconstruction company to acquire financial assets of any bank or financial institution.

The SRFAESI Act, 2002 has empowered the Banks and Financial Institutions with vast power to enforce the securities charged to them. The Banks can now issue notices to the defaulters to pay up the dues and if they fail to do so within 60 days of the date of the notice, the banks can take over the possession of assets like factory, land and building, plant and machinery etc. charged to them including the right to transfer by way of lease, assignment or sale and realize the secured assets. In case the borrower refuses peaceful handing over of the secured assets, the bank can also file an application before the relevant Magistrate for taking possession of assets. The Banks can also take over the management of business of the borrower. The bank in addition can appoint any person to manage the secured assets the possession of which has been taken over by the the bank. Banks can package and sell loans via "Securitisation" and the same can be traded in the market like bonds and shares.

Apex Court Upheld Constitutional Validity Of The Securitisation Act

The Securitisation Act, 2002 (the Act) was challenged in various courts on grounds that it was loaded heavily in favour of lenders, giving little chance to the borrowers to explain their views once recovery process is initiated under the legislation. Leading the charge against the said Act was Mardia Chemicals in its plea against notice served by ICICI Bank. The Government had, however, argued that the legislation would bring about a financial discipline and reduce the burden of Non Performing Assets (NPAs) of banks and institutions.

In *Mardia Chemicals Ltd. v. UOI* [2004] 59 CLA 380 (SC), it was urged by the petitioner that

- (i) there was no occasion to enact such a draconian legislation to find a short-cut to realise non-performing assets ('NPAs') without their ascertainment when there already existed the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ('Recovery of Debt Act') for doing so;
- (ii) no provision had been made to take into account lenders liability;
- (iii) that the mechanism for recovery under Section 13 does not provide for an adjudicatory forum of inter se disputes between lender and borrower; and
- (iv) that the appeal provisions were illusory because the appeal would be maintainable after possession of the property or management of the property was taken over or the property sold and the appeal is not

entertainable unless 75 per cent of the amount claimed is deposited with the Debts Recovery Tribunal ('DRT').

The Hon'able Supreme Court held that though some of the provisions of the Act 2002 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 NPAs 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.

The Supreme Court observed that the Act provides for a forum and remedies to the borrower to ventilate his grievances against the bank or financial institution, inter alia, with respect to the amount of the demand of the secured debt. After the notice is sent, the borrower may explain the reasons why the measures may or may not be taken under Sub-section (4) of Section 13. The creditor must apply its mind to the objections raised in reply to such notice. There must be meaningful consideration by the Court of the objections raised rather than to ritually reject them and to proceed to take drastic measures under Sub-section (4) of Section 13. The court held that such a procedure/mechanism was conducive to the principles of fairness and that such a procedure was also important from the point of view of the economy of the country and would serve the purpose in the growth of a healthy economy. It would serve as guidance to secured debtors in general in conducting their affairs.

The court opined that the fairness doctrine, cannot be stretched too far, such communication is only for the purposes of the secured debtors knowledge and cannot give an occasion to the secured debtor to resort to any proceeding, which are not permissible under the provisions of the Act. Thus, a secured debtor is not allowed to challenge the reasons communicated or challenge the action likely to be taken by the secured creditor at that point of time unless his right to approach the DRT as provided under section 17 matures on any measure having been taken under Sub-section (4) of Section 13.

Moreover, another safeguard is also available to a secured borrower within the framework of the Act i.e. to approach the DRT under Section 17 though such a right accrues only after measures are taken under Sub-section (1) of Section 13.

The Hon'ble Supreme Court, however, found that the requirement of deposit of 75 per cent of the amount claimed before entertaining an appeal (petition) under Section 17 is an oppressive, onerous and arbitrary condition and against all the canons of reasonableness. Held this provision to be invalid and ordered that it was liable to be struck down.

Definitions

"Securitisation" under Section 2(1)(z) means acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise;

Let us read the following terms to understand the process of securitisation

- Financial Assets

- Securitisation Company
 - Reconstruction Company
 - Originator
 - Security Receipts
 - qualified institutional buyers
- (i) "financial asset" under Section 2(1)(l) means debt or receivables and includes—
- a claim to any debt or receivables or part thereof, whether secured or unsecured; or
 - any debt or receivables secured by, mortgage of, or charge on, immovable property; or
 - a mortgage, charge, hypothecation or pledge of movable property; or
 - any right or interest in the security, whether full or part underlying such debt or receivables; or
 - any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
 - any financial assistance;
- (ii) "securitisation company" under Section 2(1)(za) means any company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of securitisation;(in common parlance called Special Purpose Vehicle(SPV)
- (iii) "reconstruction company" under Section 2(1)(v) means a company formed and registered under the Companies Act, 1956 for the purpose of 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;
- (iv) "originator" under Section 2(1)(r) means the owner of a financial asset which is acquired by a securitisation company or reconstruction company for the purpose of securitisation or asset reconstruction;(In general Banks and FIs who has lent money against properties)
- (v) "security receipt" under Section 2(1)(zg) means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitization.
- (vi) "qualified institutional buyer" means a financial institution, insurance company, bank, State Financial Corporation, State Industrial Development Corporation, trustee or securitisation company or reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3 or any asset management company making investment on behalf of mutual fund or a foreign institutional investor registered under the

Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, or any other body corporate as may be specified by the Board;

IMPORTANT PROVISIONS OF THE ACT

Non-Performing Assets [Section 2(1)(o)]

"Non-Performing Asset" 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.

Classification of Non-Performing Assets

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

- (a) sub-standard assets,
- (b) doubtful assets, and
- (c) loss assets.

Asset Reconstruction Companies [ARC]: Meaning & Objective

Reconstruction company means a company incorporated under provisions of Companies Act, 1956 (1 of 56) for purpose of assets reconstruction.

The problem of non-performing loans created due to systematic banking crisis world over has become acute. Focused measures to help the banking systems to realise its NPAs 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 their balance sheets 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. If an ARC carries on any business other than the business of asset reconstruction or securitisation or the business mentioned above, it shall cease to carry on any such business within one year of doing such other business.

Registration of Securitisation or Asset Reconstruction Companies (Section 3)

Section 3 of the Securitisation Act provides for registration of securitisation or reconstruction companies. The procedure is as follows:

1. Every securitisation company or reconstruction company is required to make an application for registration to commence or carry on the business of securitisation or asset reconstruction, as the case may be to the Reserve Bank in such form and manner as it may by notification specify.
2. Securitisation company or reconstruction company (the company) cannot commence or carry on the business of securitisation or asset reconstruction without—
 - (a) obtaining a certificate of registration granted under this section; and
 - (b) having the owned fund of not less than two crore rupees or such other amount not exceeding fifteen per cent of total financial assets acquired or to be acquired by the securitisation company or reconstruction company, as the Reserve Bank may, by notification, specify.

The proviso to the Section 3(1) further provides that the Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of securitisation companies or reconstruction companies.

3. The Reserve Bank may, for the purpose of considering the application is required to be satisfied, by an inspection of records or books of such securitisation company or reconstruction company, or otherwise, that the following conditions are fulfilled [Sub-section (3) of Section 3]:
 - (a) that the securitisation company or reconstruction company has not incurred losses in any of the three preceding financial years;
 - (b) that such securitisation company or reconstruction, company has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified institutional buyers or other persons;
 - (c) that the directors of securitisation company or reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction;
 - (d) that the Board of directors of such securitisation company or reconstruction company does not consist of more than half of its total number of directors who are either nominees of any sponsor or associated in any manner with the sponsor or any of its subsidiaries;
 - (e) that any of its directors has not been convicted of any offence involving moral turpitude;
 - (f) that a sponsor, is not a holding company of the securitisation company or reconstruction company, as the case may be, or, does not otherwise hold any controlling interest in such securitisation company or reconstruction company;

- (g) that securitisation company or reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.
 - (h) that securitisation company or reconstruction company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose."
4. The Reserve Bank may, after being satisfied that the conditions above are fulfilled, grant a certificate of registration to the securitisation company or the reconstruction company to commence or carry on business of securitisation or asset reconstruction, subject to such conditions, as it deems fit to impose. The conditions may vary from case to case.
 5. The Reserve Bank may reject the application made, if it is satisfied that the conditions specified above are not fulfilled. However, before rejecting the application, the applicant shall be given a reasonable opportunity of being heard. The company who's application has been rejected is entitled to know the reasons for its rejection.

No Securitisation company or Reconstruction company can commence business without obtaining a Certificate of Registration from RBI.

Prior approval for substantial change

Every securitisation company or reconstruction company, is required to obtain prior approval of the Reserve Bank for any substantial change in its management or change of location of its registered office or change in its name. The decision of the Reserve Bank, whether the change in management of a securitisation company or a reconstruction company is a substantial change in its management or not, shall be final.

The expression "substantial change in management" means the change in the management by way of transfer of shares or amalgamation or transfer of the business of the company.

Cancellation of Certificate of Registration (Section 4)

Reserve Bank has the power under Section 4 of the Securitisation Act to cancel the Certificate of Registration issued by it to any ARC, If the Company

- (i) ceases to receive or hold any investment from qualified institutional buyer or
- (ii) ceases to carry on asset reconstruction business or
- (iii) it fails to comply with the conditions of registration.
- (iv) Fails to fulfill the conditions of Section 3(3)
- (v) Fails to comply with the directions of RBI
- (vi) Fails to maintain accounts
- (vii) Fails to submit documents on inspection by RBI
- (viii) Obtains approval from RBI for any substantial change in its management.

Before cancelling registration, Reserve Bank shall give an opportunity to such

company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

Appeal

A securitisation company or reconstruction company aggrieved by the order of rejection or cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of cancellation is communicated to it, to the Central Government:

Provided that before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

A securitisation company or reconstruction company, which is holding investments of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation, be deemed to be a securitisation company or reconstruction company until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

Acquisition of rights or interest in financial assets and effects of acquisition (Section 5)

Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution,—

- (a) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or
- (b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

If the bank or financial institution is a lender in relation to any financial assets acquired by the securitisation company or the reconstruction company, then on such acquisition, such securitisation company or reconstruction company shall be deemed to be the lender. All the rights of such bank or financial institution shall vest in such company in relation to such financial assets. All contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of abovesaid financial asset shall be of as full force and effect against or in favour of the securitisation company or reconstruction company, as the case may be. Further, if there is any suit, appeal or other proceeding relating to the said financial asset which is pending by or against the bank or financial institution, save as provided in the third proviso to Sub-section (1) of Section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the securitisation company or

reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the securitisation company or reconstruction company, as the case may be.

Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases (Section 5A)

(1) If any financial asset, of a borrower acquired by a securitisation company or reconstruction company, comprise of secured debts of more than one bank or financial institution for recovery of which such banks or financial institutions has filed applications before two or more Debts Recovery Tribunals, the securitisation company or reconstruction company may file an application to the Appellate Tribunal having jurisdiction over any of such Tribunals in which such applications are pending for transfer of all pending applications to any one of the Debts Recovery Tribunals as it deems fit.

(2) On receipt of such application for transfer of all pending applications under sub-section (1), the Appellate Tribunal may, after giving the parties to the application an opportunity of being heard, pass an order for transfer of the pending applications to any one of the Debts Recovery Tribunals.

(3) Notwithstanding anything contained in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), any order passed by the Appellate Tribunal under sub-section (2) shall be binding on all the Debts Recovery Tribunals referred to in sub-section (1) as if such order had been passed by the Appellate Tribunal having jurisdiction on each such Debts Recovery Tribunal.

(4) Any recovery certificate, issued by the Debts Recovery Tribunal to which all the pending applications are transferred under sub-section (2), shall be executed in accordance with the provisions contained in sub-section (23) of section 19 and other provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) shall, accordingly, apply to such execution

Measures for Asset reconstruction (Section 9)

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 Act.
- Settlement of dues payable by the borrower.
- Taking possession of secured assets in accordance with the provisions of the Act.

Securitisation or Reconstruction Company may do the following functions also in accordance with Section 10 of the Act:

- (a) act as an agent for any bank or financial institution for the purpose of

recovering their dues from the borrower on payment of such fees or charges as may be mutually agreed upon between the parties;

- (b) act as a manager referred to in clause (c) of Sub-section (4) of Section 13 on such fee as may be mutually agreed upon between the parties;
- (c) act as receiver if appointed by any court or Tribunal.

Provided that no securitisation company or Reconstruction Company shall act as a manager if acting as such gives rise to any pecuniary liability.

It is important to note here that securitisation company or reconstruction company which has been granted a certificate of registration cannot commence or carry on any business other than that of securitisation or asset reconstruction without prior approval of the Reserve Bank.

Enforcement of Security interest by a Creditors (Section 13)

(1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights.

(3) The notice shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower. If, on receipt of the notice, the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within one week of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower. It may be noted that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A : If, the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt.

(4) In case the borrower fails to discharge his liability in full within the period specified above, the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely :—

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

- (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset : It may be noted that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt;
- (c) 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;
- (d) 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.

(5) Any payment made by any person to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(6) Any transfer of secured asset after taking possession thereof or take over of management, by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.

(7) Where any action has been taken against a borrower, all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(8) If the dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer or sale of that secured asset.

(9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors :

However, in the case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of section 529A of the Companies Act, 1956 (1 of 1956) :

In the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub-section (1) of section 529 of the Companies Act, 1956 (1 of 1956), may retain the sale proceeds of

his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A of that Act : The liquidator shall intimate the secured creditor the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimated dues with the liquidator :

In case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator : and that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

- (a) "record date" means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date;
- (b) "amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(10) 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.

(11) Without prejudice to the rights conferred on the secured creditor under or by this section, the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in point not 4.

(12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.

(13) No borrower shall, after receipt of notice from the secured creditor transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

Accounting aspects

These companies should follow all the Accounting Standards issued by the Institute of Chartered Accountants of India as required under Sub-section (3A) of Section 211 of the Companies Act, 1956. They should also follow the guidelines and prudential norms/accounting standards issued by Reserve Bank from time to time.

ARCs will be public financial institutions

All the ARCs 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 ARCs. The first proviso to Sub-section (3) of Section 67

permits a company to issue securities on a private placement basis to 50 persons only. However, this proviso does not apply to a public financial institution. Therefore, the ARC can invite any number of qualified institutional buyers to subscribe to its debentures, bonds, units, etc., issued for financing the acquisition of assets of the defaulting borrowers of any bank/financial institution. It has to create a debentures redemption reserve for the redemption of debentures and adequate amount should be credited to such reserve from out of its profits every year until such debentures are redeemed, as provided in Section 117C of the Companies Act, 1956.

Assistance by Chief Metropolitan Magistrate or the District Magistrate (Section 14)

Section 14 of the Securitisation Act provides for assistance for taking possession of secured asset from the Chief Metropolitan Magistrate or the District Magistrate.

Manner and effect of takeover of Management (Section 15)

Section 15 of the Securitisation Act provides for the manner and effect of takeover of management. When the management of business of a borrower is taken over by a secured creditor it can appoint as many persons as it thinks fit to be the directors, where the borrower is a company, or the administrators of the business of the borrower, in any other case. The secured creditor is required to publish a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated.

On the publication of the notice all persons who were directors of the company or administrators of the business, as the case may be, are deemed to have vacated their office. It also has the effect of termination of all contracts entered into by the borrower with such directors or administrators.

Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (1 of 1956), is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower:

- It shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be director of the company;
- No resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
- No proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor;

Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realization of his debt in full, restore the management of the business of the borrower to him.

The Change in or takeover of the Management of the business is subject to 'The Change in or takeover of the Management of the business of the borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines 2010'.

Highlights of the guidelines are as under..

(i) Eligibility

- (a) Securitisation Company or Reconstruction Company(SC/AC) may effect change in or takeover the management of the business of the borrower, where the amount due to it from the borrower is not less than 25 per cent of the total assets owned by the borrower; and
- (b) Where the borrower is financed by more than one secured creditor (including SC/RC), secured creditors (including SC/RC) holding not less than 75 per cent of the outstanding security receipts agree to such action.

(ii) Grounds for effecting change in or takeover of management

Subject to the eligibility conditions specified above, SC/RC shall be entitled to effect change in management or takeover the management of business of the borrower on any of the following grounds :

- (a) the borrower makes a wilful default in repayment of the amount due under the relevant loan agreement/s;
- (b) the SC/RC is satisfied that the management of the business of the borrower is acting in a manner adversely affecting the interest of the creditors (including SC/RC) or is failing to take necessary action to avoid any events which would adversely affect the interest of the creditors;
- (c) SC/RC is satisfied that the management of the business of the borrower is not competent to run the business resulting in losses/non-repayment of dues to SC/RC or there is a lack of professional management of the business of the borrower or the key managerial personnel of the business of the borrower have not been appointed for more than one year from the date of such vacancy which would adversely affect the financial health of the business of the borrower or the interests of the SC/RC as a secured creditor;
- (d) the borrower has without the prior approval of the secured creditors (including SC/RC), sold, disposed of, charged, encumbered or alienated 10 per cent or more (in aggregate) of its assets secured to the SC/RC;
- (e) there are reasonable grounds to believe that the borrower would be unable to pay its debts as per terms of repayment accepted by the borrower;
- (f) the borrower has entered into any arrangement or compromise with creditors without the consent of the SC/RC which adversely affects the interest of the SC/RC or the borrower has committed any act of insolvency;
- (g) the borrower discontinues or threatens to discontinue any of its businesses constituting 10 per cent or more of its turnover;
- (h) all or a significant part of the assets of the borrower required for or essential for its business or operations are damaged due to the actions of the borrower;
- (i) the general nature or scope of the business, operations, management, control or ownership of the business of the borrower are altered to an extent, which in the opinion of the SC/RC, materially affects the ability of the borrower to repay the loan;

- (j) the SC/RC is satisfied that serious dispute/s have arisen among the promoters or directors or partners of the business of the borrower, which could materially affect the ability of the borrower to repay the loan;
- (k) failure of the borrower to acquire the assets for which the loan has been availed and utilization of the funds borrowed for other than stated purposes or disposal of the financed assets and misuse or misappropriation of the proceeds;
- (l) fraudulent transactions by the borrower in respect of the assets secured to the creditor/s.

Explanation A : For the purpose of this paragraph, wilful default in repayment of amount due, includes—

- (a) non-payment of dues despite adequate cash flow and availability of other resources, or
- (b) 'routing of transactions through banks which are not lenders/consortium members' so as to avoid payment of dues, or
- (c) siphoning off funds to the detriment of the defaulting unit, or misrepresentation/falsification of records pertaining to the transactions with the SC/RC.

Explanation B: The decision as to whether the borrower is a wilful defaulter or not, shall be made by the SC/RC keeping in view the track record of the borrower and not on the basis of an isolated transaction/incident which is not material. The default to be categorized as wilful must be intentional, deliberate and calculated.

(iii) Policy regarding change in or takeover of management

- (A) Every SC/RC shall frame policy guidelines regarding change in or takeover of the management of the business of the borrower, with the approval of its Board of Directors and the borrowers shall be made aware of such policy of the SC/RC.
- (B) Such policy shall generally provide for the following :
 - (i) The change in or takeover of the management of the business of the borrower should be done only after the proposal is examined by an Independent Advisory Committee to be appointed by the SC/RC consisting of professionals having technical/finance/legal background who after assessment of the financial position of the borrower, time frame available for recovery of the debt from the borrower, future prospects of the business of the borrower and other relevant aspects shall recommend to the SC/RC that it may resort to change in or takeover of the management of the business of the borrower and that such action would be necessary for effective running of the business leading to recovery of its dues.
 - (ii) The Board of Directors including at least two independent directors of the SC/RC should deliberate on the recommendations of the Independent Advisory Committee and consider the various options available for the recovery of dues before deciding whether under the existing circumstances the change in or takeover of the management of

the business of the borrower is necessary and the decision shall be specifically included in the minutes.

- (iii) The SC/RC shall carry out due diligence, exercise and record the details of the exercise, including the findings on the circumstances which had led to default in repayment of the dues by the borrower and why the decision to change in or takeover of the management of the business of the borrower has become necessary.
- (iv) The SC/RC shall identify suitable personnel/agencies, who can takeover the management of the business of the borrower by formulating a plan for operating and managing the business of the borrower effectively, so that the dues of the SC/RC may be realized from the borrower within the time-frame.
- (v) Such plan will also include procedure to be adopted by the SC/RC at the time of restoration of the management of the business to the borrower in accordance with paragraph 3 above, borrower's rights and liabilities at the time of change in or takeover of management by the SC/RC and at the time of restoration of management back to the borrower, rights and liabilities of the new management taking over management of the business of the borrower at the behest of SC/RC. It should be clarified to the new management by the SC/RC that the scope of their role is limited to recovery of dues of the SC/RC by managing the affairs of the business of the borrower in a prudent manner.

Explanation: To ensure independence of members of Independent Advisory Committee (IAC), such members should not be connected with the affairs of the SC/RC in any manner and should not receive any pecuniary benefit from the SC/RC except for services rendered for acting as member of IAC.

(iv) Procedure for change in or takeover of management

- (a) The SC/RC shall give a notice of 60 days to the borrower indicating its intention to effect change in or takeover the management of the business of the borrower and calling for objections, if any.
- (b) The objections, if any, submitted by the borrower shall be initially considered by the IAC and thereafter the objections along with the recommendations of the IAC shall be submitted to the Board of Directors of the SC/RC. The Board of Directors of SC/RC shall pass a reasoned order within a period of 30 days from the date of expiry of the notice period, indicating the decision of the SC/RC regarding the change in or takeover of the management of the business of the borrower, which shall be communicated to the borrower.

(v) Reporting

SC/RCs shall report to the Bank all cases where they have taken action to cause change in or takeover the management of the business of the borrower for realization of its dues from the borrower in terms of circular DNBS (PD) CC. No. 12/SCRC/10.30.000/2008-09, dated September 26, 2008.

Right to appeal (Section 17)

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 (DRT).

Such appeal can also be filed by any person aggrieved by the action of the secured creditor without being required to deposit any amount with the DRT. Such provisions will take care of any third party interest in the secured assets which need to be considered before sale of securities. Any person aggrieved by the order of DRT, may prefer an appeal to the Appellate Tribunal within thirty days from the date of receipt of the order of Debt Recovery Tribunal.

Setting up of Central Registry (Section 20)

Under Section 20 of the Securitisation Act, the Central Government is empowered to setup by notification a registry to known as Central Registry with its own seal for the purpose of registration of transactions of securitisation and reconstruction of financial assets and creation of security interest under this Act. The head office and the branches of the central registry shall be at such places as the Central Government may specify. The territorial limits with in which the registry can exercise its functions shall be specified by the Central Government. The Central Government will appoint a person called the Central Registrar who will exercise the powers granted to the Central Registry. Also the Central Government shall appoint other officials who shall discharge their functions under the directions of the Central Registrar.

Register of Securitisation, reconstruction and security interest transactions (Section 22)

A register called the Central Register will be kept at the head office of the Central Registry for entering the particulars of the transactions relating to securitization and reconstruction of financial assets and creation of security interest under this Act. The Central Register may be maintained in electronic form in Floppies or Diskettes subject to such safe guards as may be prescribed. The Register will be kept under the control and management of the Central Registrar.

Filing of Particulars (Section 23)

The particulars of every transaction of securitization asset reconstruction or creation of security interest is required to be filed with the Central Registrar in the manner and on payment of such fee as may be prescribed within 30 days after the date of such transaction or creation of security by the securitisation/reconstruction company or secured creditor as the case may be. The Central Registrar shall have the power to allow extension of 30 days on payment of such additional fee not exceeding 10 times the amount of such fee.

The particulars of any change in the terms and conditions or the extent or operation of the security interest registered under this chapter shall be sent to the Registrar by the securitisation/reconstruction company or secured creditor.

Satisfaction of Security interest (Section 25)

The Central Registrar shall be intimated of any satisfaction or payment of any security interest relating to the securitisation/reconstruction company or secured creditors and requiring registration under this Act within 30 days of such payment or satisfaction. On receiving the intimation, the Central Registrar shall order that

memorandum of satisfaction should be entered in the Central Register. If the concerned borrower gives intimation to Central Registry for not recording the payment or satisfaction, the Central Registry will issue a notice to the securitisation/reconstruction company or secured creditors calling upon it to show cause within time not exceeding 14 days specified in such notice as to why payment or satisfaction should not be recorded. In case no cause is shown the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register. If cause is shown the Central Registrar shall record a note to that effect in the Central Register and shall inform the borrower that he has done so.

Right to Inspect (Section 26)

The Central Register maintained by the Central Registrar (both in electronic and non-electronic form) shall be open for inspection by any person during the business hours on payment of prescribed fee.

Penalties (Section 27)

If a default is made in filing the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a securitisation company or reconstruction company or secured creditor; or in sending the particulars of the modification or in giving intimation under Section 25, every company and every officer of the company or the secured creditor and every officer of the secured creditor who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

Penalties for non-compliance of direction of Reserve Bank (Section 28)

If any securitisation company or reconstruction company fails to comply with any direction issued by the Reserve Bank under Section 12 or Section 12A, such company and every officer of the company who is in default, shall be punishable with fine which may extend to five lakh rupees and in the case of a continuing offence, with an additional fine which may extend to ten thousand rupees for every day during which the default continues.

Offences (Section 29)

Any person who contravenes the provisions of this Act or of any rules made thereunder shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

5. MISCELLANEOUS PROVISIONS

Non-Applicability in certain cases (Section 31)

The provisions of this Act shall not apply to—

- (a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force;
- (b) a pledge of movables within the meaning of Section 172 of the Indian Contract Act, 1872;
- (c) creation of any security in any aircraft as defined in clause (1) of Section 2 of the Aircraft Act, 1934;

- (d) creation of security interest in any vessel as defined in clause (55) of Section 3 of the Merchant Shipping Act, 1958;
- (e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
- (f) any rights of unpaid seller under Section 47 of the Sale of Goods Act, 1930;
- (g) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act)] or sale under the first proviso to Sub-section (1) of Section 60 of the Code of Civil Procedure, 1908;
- (h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
- (i) any security interest created in agricultural land;
- (j) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

Protection of action taken in good faith (Section 32)

Suit, prosecution or other legal proceedings shall not lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under this Act.

Offences by company (Section 33)

Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company, for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Therefore, as per this section, where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Civil Court Not to have jurisdiction

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993).

BPV Classic Tea Factory (P.) Ltd. v. Corporation Bank, [2008] 87 SCL 14 (MAD.)

It was held that 2002 Act is a special Act while 1956 Act, is a general law and, therefore, with regard to enforcement of a security asset under section 34, provisions as contained in 2002 Act alone would apply with regard to sale of an immovable property by secured creditor and same cannot be challenged before company court under provisions of 1956 Act.

Limitation Act (Section 36)

Limitation Act, 1963 is applicable to the claims made under this Act. Accordingly, no secured creditor shall be entitled to take all or any of the measures under Sub-section (4) of Section 13, unless his claim in respect of the financial asset is made within the period of limitation prescribed under the Limitation Act, 1963.

Applicability of other Acts

The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law (Section 35). In accordance with Section 37, the provisions of this Act or the rules made thereunder shall be in addition to and not in derogation of, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or any other law for the time being in force.

The combined affect of Sections 35 and 37 is that in cases of any conflict with these Acts or any other Act, then the SRFAESI Act, 2002 shall have the over riding effect over such Act or Acts. Therefore the provisions of the SRFAESI Act, 2002 have the binding power and cannot be put on hold because of conflict with any other legislation. Moreover as per the provisions of Section 34 of SRFAESI Act, 2002, no civil court shall have any jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act (i.e. SRFAESI Act, 2002) to determine and no injunction shall be granted by any court or any other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. Therefore it shall not be possible to get any injunction from any Court of Law. Moreover SRFAESI Act, 2002 has also amended following legislations:

1. The Companies Act, 1956: The definition of Public Financial Institution under Section 4A has been altered and it now includes securitisation company or reconstruction Company.
2. The Securities Contract (Regulation) Act, 1956: Section 2 has been amended to include the definition of Security Deposit as defined in 2 (kg.) of SRFAESI Act, 2002.
3. The Sick Industrial Companies (Special Provisions) Act, 1985 has been amended to the extent it provides that after the commencement of SRFAESI Act, 2002 and if the financial assets have been acquired by securitisation or reconstruction company, no reference shall be made to BIFR. Moreover,

after the commencement of SRFAESI Act, 1956 and if the reference is pending, then the reference shall abate, if 75% of the Secured Creditors have taken measures to recover their Secured Debts.

Rule making power

Under Section 38, the Central Government has power to make rules by notification for carrying out the provisions of this Act.

SECURITY INTEREST (ENFORCEMENT) RULES, 2002.

Demand notice (Rule 3)

(1) The service of demand notice as referred to in sub-section (2) of section 13 of the SRFAESI Act [Act] shall be made by delivering or transmitting at the place where the borrower or his agent, empowered to accept the notice or documents on behalf of the borrower, actually and voluntarily resides or carries on business or personally works for gain, by registered post with acknowledgement due, addressed to the borrower or his agent empowered to accept the service or by Speed Post or by courier or by any other means of transmission of documents like fax message or electronic mail service :

Provided that where authorised officer has reason to believe that the borrower or his agent is avoiding the service of the notice or that for any other reason, the service cannot be made as aforesaid, the service shall be effected by affixing a copy of the demand notice on the outer door or some other conspicuous part of the house or building in which the borrower or his agent ordinarily resides or carries on business or personally works for gain and also by publishing the contents of the demand notice in two leading newspapers, one in vernacular language, having sufficient circulation in that locality.

(2) Where the borrower is a body corporate, the demand notice shall be served on the registered office or any of the branches of such body corporate as specified under sub-rule (1).

(3) Any other notice in writing to be served on the borrower or his agent by authorised officer, shall be served in the same manner as provided in this rule.

(4) Where there are more than one borrower, the demand notice shall be served on each borrower.

Reply to Representation of the borrower (Rule 3A)

- (a) After issue of demand notice under sub-section (2) of section 13, if the borrower makes any representation or raises any objection to the notice, the Authorized Officer shall consider such representation or objection and examine whether the same is acceptable or tenable.
- (b) If on examining the representation made or objection raised by the borrower, the secured creditor is satisfied that there is a need to make any changes or modifications in the demand notice, he shall modify the notice accordingly and serve a revised notice or pass such other suitable orders as deemed necessary, within seven days from the date of receipt of the representation or objection.

- (c) If on examining the representation made or objection raised, the Authorized Officer comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within one week of receipt of such representation or objection, the reasons for non-acceptance of the representation or objection, to the borrower

Procedure after issue of notice (Rule 4)

If the amount mentioned in the demand notice is not paid within the time specified therein, the authorised officer shall proceed to realise the amount by adopting any one or more of the measures specified in sub-section (4) of section 13 of the [Act] for taking possession of movable property, namely :—

- (1) Where the possession of the secured assets to be taken by the secured creditor are movable property in possession of the borrower, the authorised officer shall take possession of such movable property in the presence of two witnesses after a Panchnama drawn and signed by the witnesses as nearly as possible in Appendix I to these rules.
- (2) After taking possession under sub-rule (1) above, the authorised officer shall make or cause to be made an inventory of the property as nearly as possible in the form given in Appendix II to these rules and deliver or cause to be delivered, a copy of such inventory to the borrower or to any person entitled to receive on behalf of borrower.
- (3) The authorised officer shall keep the property taken possession under sub-rule (1) either in his own custody or in the custody of any person authorised or appointed by him, who shall take as much care of the property in his custody as an owner of ordinary prudence would, under the similar circumstances, take of such property:
 Provided that if such property is subject to speedy or natural decay, or the expense of keeping such property in custody is likely to exceed its value, the authorised officer may sell it at once.
- (4) The authorised officer shall take steps for preservation and protection of secured assets and insure them, if necessary, till they are sold or otherwise disposed of.
- (5) In case any secured asset is :—
 - (a) a debt not secured by negotiable instrument; or
 - (b) a share in a body corporate;
 - (c) other movable property not in the possession of the borrower except the property deposited in or in the custody of any court or any like authority, the authorised officer shall obtain possession or recover the debt by service of notice as under :—
 - (i) in the case of a debt, prohibiting the borrower from recovering the debt or any interest thereon and the debtor from making payment thereof and directing the debtor to make such payment to the authorised officer; or
 - (ii) in the case of the shares in a body corporate, directing the borrower to transfer the same to the secured creditor and also the body

corporate from not transferring such shares in favour of any person other than the secured creditor. A copy of the notice so sent may be endorsed to the concerned body corporate's Registrar to the issue or share transfer agents, if any;

- (iii) in the case of other movable property (except as aforesaid), calling upon the borrowers and the person in possession to hand over the same to the authorised officer and the authorised officer shall take custody of such movable property in the same manner as provided in sub-rules (1) to (3) above;
- (iv) movable secured assets other than those covered in this rule shall be taken possession of by the authorised officer by taking possession of the documents evidencing title to such secured assets.

Valuation of movable secured assets (Rule 5)

After taking possession under sub-rule (1) of rule 4 and in any case before sale, the authorised officer shall obtain the estimated value of the movable secured assets and thereafter, if considered necessary, fix in consultation with the secured creditor, the reserve price of the assets to be sold in realisation of the dues of the secured creditor.

Sale of movable secured assets (Rule 6)

(1) The authorised officer may sell the movable secured assets taken possession under sub-rule (1) of rule 4 in one or more lots by adopting any of the following methods to secure maximum sale price for the assets, to be so sold—

- (a) obtaining quotations from parties dealing in the secured assets or otherwise interested in buying such assets; or
- (b) inviting tenders from the public; or
- (c) holding public auction; or
- (d) by private treaty.

(2) The authorised officer shall serve to the borrower a notice of thirty days for sale of the movable secured assets under sub-rule (1) :

Provided that if the sale of such secured assets is being, effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in two leading newspapers, one in vernacular language, having sufficient circulation in that locality by setting out the terms of sale, which may include,—

- (a) details about the borrower and the secured creditor;
- (b) description of movable secured assets to be sold with identification marks or numbers, if any, on them;
- (c) reserve price, if any, and the time and manner of payment;
- (d) time and place of public auction or the time after which sale by any other mode shall be completed;
- (e) depositing earnest money as may be stipulated by the secured creditor;
- (f) any other thing which the authorised officer considers it material for a

purchaser to know in order to judge the nature and value of movable secured assets.

(3) Sale by any methods other than public auction or public tender, shall be on such terms as may be settled between the parties in writing.

Issue of certificate of sale (Rule 7)

(1) Where movable secured assets is sold, sale price of each lot shall be paid as per the terms of the public notice or on the terms as may be settled between the parties, as the case may be and in the event of default of payment, the movable secured assets shall be liable to be ordered for sale again.

(2) On payment of sale price, the authorised officer shall issue a certificate of sale in the prescribed form as given in Appendix III to these rules specifying the movable secured assets sold, price paid and the name of the purchaser and thereafter the sale shall become absolute. The certificate of sale so issued shall be prima facie evidence of title of the purchaser.

(3) Where the movable secured assets are those referred in sub-clauses (iii) to (v) of clause (1) of sub-section (1) of section 2 of the 1[Act], the provisions contained in these rules and rule 7 dealing with the sale of movable secured assets shall, mutatis mutandis, apply to such assets.

Sale of immovable secured assets (Rule 8)

(1) Where the secured asset is an immovable property, the authorised officer shall take or cause to be taken possession, by delivering a possession notice prepared as nearly as possible in Appendix IV to these rules, to the borrower and by affixing the possession notice on the outer door or at such conspicuous place of the property.

(2) The possession notice as referred to in sub-rule (1) shall also be published as soon as possible but in any case not later than seven days from the date of taking possession, in two leading newspapers in two leading newspapers, one in vernacular language having sufficient circulation in that locality, by the authorised officer.

(3) In the event of possession of immovable property is actually taken by the authorised officer, such property shall be kept in his own custody or in the custody of any person authorised or appointed by him, who shall take as much care of the property in his custody as a owner of ordinary prudence would, under the similar circumstances, take of such property.

(4) The authorised officer shall take steps for preservation and protection of secured assets and insure them, if necessary, till they are sold or otherwise disposed of.

(5) Before effecting sale of the immovable property referred to in sub-rule (1) of rule 9, the authorised officer shall obtain valuation of the property from an approved valuer and in consultation with the secured creditor, fix the reserve price of the property and may sell the whole or any part of such immovable secured asset by any of the following methods:—

- (a) by obtaining quotations from the persons dealing with similar secured assets or otherwise interested in buying the such assets; or

- (b) by inviting tenders from the public;
- (c) by holding public auction; or
- (d) by private treaty.

(6) The authorised officer shall serve to the borrower a notice of thirty days for sale of the immovable secured assets, under sub-rule (5) :

Provided that if the sale of such secured asset is being effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in two leading newspapers one in vernacular language having sufficient circulation in the locality by setting out the terms of sale, which shall include,—

- (a) the description of the immovable property to be sold, including the details of the encumbrances known to the secured creditor;
- (b) the secured debt for recovery of which the property is to be sold;
- (c) reserve price, below which the property may not be sold;
- (d) time and place of public auction or the time after which sale by any other mode shall be completed;
- (e) depositing earnest money as may be stipulated by the secured creditor;
- (f) any other thing which the authorised officer considers it material for a purchaser to know in order to judge the nature and value of the property.

(7) Every notice of sale shall be affixed on a conspicuous part of the immovable property and may, if the authorised officer deems it fit, put on the web-site of the secured creditor on the Internet.

(8) Sale by any method other than public auction or public tender, shall be on such terms as may be settled between the parties in writing.

Time of sale, issue of sale certificate and delivery of possession, etc. (Rule 9)

(1) No sale of immovable property under these rules shall take place before the expiry of thirty days from the date on which the public notice of sale is published in newspapers as referred to in the proviso to sub-rule (6) or notice of sale has been served to the borrower.

(2) The sale shall be confirmed in favour of the purchaser who has offered the highest sale price in his bid or tender or quotation or offer to the authorised officer and shall be subject to confirmation by the secured creditor :

Provided that no sale under this rule shall be confirmed, if the amount offered by sale price is less than the reserve price, specified under sub-rule (5) of rule 9 :

Provided further that if the authorised officer fails to obtain a price higher than the reserve price, he may, with the consent of the borrower and the secured creditor effect the sale at such price.

(3) On every sale of immovable property, the purchaser shall immediately pay a deposit of twenty-five per cent of the amount of the sale price, to the authorised

officer conducting the sale and in default of such deposit, the property shall forthwith be sold again.

(4) The balance amount of purchase price payable shall be paid by the purchaser to the authorised officer on or before the fifteenth day of confirmation of sale of the immovable property or such extended period as may be agreed upon in writing between the parties.

(5) In default of payment within the period mentioned in sub-rule (4), the deposit shall be forfeited and the property shall be resold and the defaulting purchaser shall forfeit all claim to the property or to any part of the sum for which it may be subsequently sold.

(6) On confirmation of sale by the secured creditor and if the terms of payment have been complied with, the authorised officer exercising the power of sale shall issue a certificate of sale of the immovable property in favour of the purchaser in the form given in Appendix V to these rules.

(7) Where the immovable property sold is subject to any encumbrances, the authorised officer may, if he thinks fit, allow the purchaser to deposit with him the money required to discharge the encumbrances and any interest due thereon together with such additional amount that may be sufficient to meet the contingencies or further cost, expenses and interest as may be determined by him.

1[Provided that it after meeting the cost of removing encumbrances and contingencies there is any surplus available out of the money deposited by the purchaser such surplus shall be paid to the purchaser within fifteen day, from date of finalisation of the sale.]

(8) On such deposit of money for discharge of the encumbrances, the authorised officer [shall issue or cause the purchaser to issue notices to the persons interested in or entitled to the money deposited with him and take steps to make the payment accordingly.

(9) The authorised officer shall deliver the property to the purchaser free from encumbrances known to the secured creditor on deposit of money as specified in sub-rule (7) above.

(10) The certificate of sale issued under sub-rule (6) shall specifically mention that whether the purchaser has purchased the immovable secured asset free from any encumbrances known to the secured creditor or not.

Appointment of Manager (Rule 10)

(1) The Board of Directors or Board of Trustees, as the case may be, may appoint in consultation with the borrower any person (hereinafter referred to as the Manager) to manage the secured assets the possession of which has been taken over by the secured creditor.

[Provided that the manager so appointed shall not be a person who is, or has been, adjudicated insolvent, or has suspended payment or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude.

(2) The Manager appointed by the Board of Directors or Board of Trustees, as the case may be, shall be deemed to be an agent of the borrower and the borrower shall be solely responsible for the commission or omission of acts of the Manager unless such commission or omission are due to improper intervention of the secured creditor or the authorised officer.

(3) The Manager shall have power by notice in writing to recover any money from any person who has acquired any of the secured assets from the borrower, which is due to may become due to the borrower.

(4) The Manager shall give such person who has made payment under sub-rule (3) a valid discharge as if he has made payments to the borrower.

(5) The Manager shall apply all the monies received by him in accordance with the provisions contained in sub-section (7) of section 13 of the [Act].

Procedure for recovery of shortfall of secured debt (Rule 11)

(1) An application for recovery of balance amount by any secured creditor pursuant to sub-section (10) of section 13 of the [Act] shall be presented to the Debts Recovery Tribunal in the form annexed as Appendix VI to these rules by the authorised officer or his agent or by a duly authorised legal practitioner, to the Registrar of the Bench within whose jurisdiction his case falls or shall be sent by registered post addressed to the Registrar of Debts Recovery Tribunal.

(2) The provisions of the Debts Recovery Tribunal (Procedure) Rules, 1993 made under Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), shall mutatis mutandis apply to any application filed by under sub-rule (1).

(3) An application under sub-rule (1) shall be accompanied with fee as provided in rule 7 of the Debts Recovery Tribunal (Procedure) Rules, 1993.

Application to the Tribunal/Appellate Tribunal (Rule 12)

(1) Any application to the Debt Recovery Tribunal under sub-section (1) of section 17 shall be, as nearly as possible, in the form given in Appendix VII to the Rules.

(2) Any application to the Appellate Tribunal under sub-section (6) of section 17 of the Act shall be, as nearly as possible, in the form given in Appendix VIII to the said Rules. Any appeal to the Appellate Tribunal under section 18 of the Act shall be, as nearly as possible, in the form given in Appendix IX to the said Rules.

THE SECURITISATION COMPANIES AND RECONSTRUCTION COMPANIES (RESERVE BANK) GUIDELINES AND DIRECTIONS, 2003

The Reserve Bank of India considered it necessary to issue the guidelines and directions to Securitisation Companies or Reconstruction Companies in the public interest and for the purpose of enabling the Reserve Bank to regulate the financial system to the advantage of the country and to prevent the affairs of any Securitisation Company or Reconstruction Company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such Securitisation Company or Reconstruction Company.

Having considered it necessary, the Reserve Bank in exercise of the powers

conferred by Sections 3, 9, 10 and 12 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, on April 23, 2003, has issued Guidelines to every Securitisation Company or Reconstruction Company namely the Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 relating to registration, owned fund, permissible business, operational structure for giving effect to the business of securitization and asset reconstruction, deployment of surplus fund, internal control system, prudential norms, disclosure requirement etc. acquisition of financial assets and matters related thereto.

The provisions of these guidelines and directions shall apply to Securitisation Companies or Reconstruction Companies registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Further, the bank may, if it considers necessary for avoiding any hardship exempt all Securitisation Companies or Reconstruction Companies or a particular Securitisation Company or Reconstruction Company from all or any of the provisions of these guidelines and directions, subject to such conditions as the Bank may impose.

GUIDELINES ON SALE OF FINANCIAL ASSETS TO SECURITISATION COMPANY (SC)/RECONSTRUCTION COMPANY (RC) (CREATED UNDER THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002) AND RELATED ISSUES

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, provides, among others, sale of financial assets by banks/FIs to Securitisation Company/Reconstruction Company. Since the above Act has been enacted with a special emphasis on asset reconstruction activity, which mainly centers around impaired assets, the whole process of asset reconstruction and matters related thereto has to be initiated with due diligence and care warranting the existence of a set of clear instructions which shall be complied with by all banks/FIs so that the process of asset reconstruction proceeds on smooth and sound lines. The need for some healthy and uniform guidelines had been further necessitated by the fact that there was no prior experience in this area. Accordingly, a set of guidelines to be followed by banks/FIs has been formulated.

Scope of Guidelines

These guidelines would be applicable to sale of following financial assets, by banks/FIs, for asset reconstruction/securitisation under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002:

- (i) A NPA, including a non-performing bond/debenture, and
- (ii) A Standard Asset where:
 - (a) the asset is under consortium/multiple banking arrangements,
 - (b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks/FIs, and
 - (c) at least 75% (by value) of the banks/FIs who are under the consortium/multiple banking arrangements agree to the sale of the asset to SC/RC.

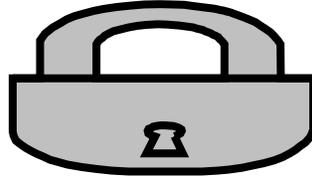
The prudential guidelines have been grouped under the following headings:

- (i) Financial assets which can be sold.
- (ii) Procedure for sale of banks'/FIs' financial assets to SC/RC, including valuation and pricing aspects.
- (iii) Prudential norms, in the following areas, for banks/FIs for sale of their financial assets to SC/RC and for investing in bonds/debentures/security receipts and any other securities offered by the SC/RC as compensation consequent upon sale of financial assets:
 - (a) Provisioning/Valuation norms
 - (b) Capital adequacy norms
 - (c) Exposure norms
- (iv) Disclosure requirements

LESSON ROUND UP



- To reduce the level of non-performing assets and to empower the secured creditors, the SRFAESI Act, 2002 was evolved.
- The Supreme Court in *Mardia Chemicals Ltd. v. UOI* (2004) held that though some of the provisions of the Securitisation Act may be a bit harsh for some of the borrowers but on those grounds the impugned provisions of the Act cannot be said to be unconstitutional in the view of the fact that the objective of the Securitisation Act is to achieve speedier recovery of dues declared as NPAs to help in growth of economy of country and welfare of people in general.
- Definitions of some important terms used in the Act like asset reconstruction, non performing asset, obligor, qualified institutional buyer are covered in the chapter.
- Section 3 of the Act provides for registration of securitisation or reconstruction companies.
- Section 4 provides for cancellation of certificate of registration.
- Section 5 provides for acquisition of rights in financial assets by special purpose vehical i.e. securitisation or reconstruction company.
- Section 13 provides for enforcement of security interest by creditors.
- What measures an asset reconstruction company can take are given under Section 9 of the Act.
- Section 15 provides for manner and effect of takeover of management.
- Section 20 provides for setting up of central registry which will register transactions of securitisation and reconstruction of financial assets.
- The Reserve Bank has issued the Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 and Guidelines on sale of financial assets to securitisation/reconstruction company and related issues.

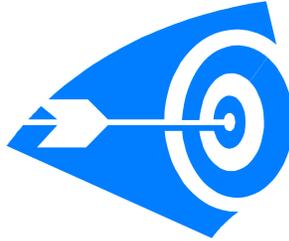
SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Write short notes on the following:
 - (a) Non-performing Assets
 - (b) Assets reconstruction companies
 - (c) Securitisation
 - (d) Obligor
 2. What measures are given to asset reconstruction company under the SRFAESI Act, 2002.
 3. Comment on constitutional validity of SRFAESI Act, 2002 and refer to Supreme Court judgement including the ratio of the judgement of the Act.
 4. Explain the term Central Registry. Write the provisions for setting up of Central Registry.
 5. State the reasons for which Reserve Bank of India can cancel registration of Securitisation company.
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STUDY XIV
SECURITIZATION AND DEBT RECOVERY
DEBT RECOVERY

LEARNING OBJECTIVES



In order to ensure speedy adjudication of the matters relating to recovery of debts due to banks and financial institutions, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 was passed. It provides a procedure which is different from the existing code of civil procedure. This chapter contains overview of the Act, establishment of Tribunals and procedure thereof etc.

After going through this chapter, you will be able to understand:

- Need and object of the Act
- About Establishment of Tribunals and appellate tribunal
- Procedure aspects involved
- Powers of Tribunal
- Recovery of debt determined by Tribunal
- Effective non-legal remedies for improving recovery management.

A. THE RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993

1. NEED AND OBJECT

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (henceforth the “Act”) was passed by the Parliament of India to provide for the speedy adjudication of matters relating to recovery of debts due to banks and financial institutions. The Act provides a procedure that is distinct from the existing Code of Civil Procedure in order to ensure a speedy adjudication. The Act also 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 provisions of this Act does not apply where the amount of debt due to any bank or financial institution or to a consortium of banks or financial institutions is less than ten lakh rupees or such other amount, being not less than one lakh rupees, as the Central Government may, by notification, specify.

With a view to help financial institutions recover their bad debts quickly and efficiently, the Government of India has constituted thirty three Debt Recovery Tribunals and five Debt Recovery Appellate Tribunals all over the country.

Each Debts Recovery Tribunal is presided over by a Presiding Officer. The Presiding Officer is generally a judge of the rank of District and Sessions Judge. A Presiding Officer of a Debts Recovery Tribunal is assisted by a number of officers of other ranks, but none of them need necessarily have a judicial background. Therefore, the Presiding Officer of a Debt Recovery Tribunal is the sole judicial authority to hear and pass any judicial order.

Each Debts Recovery Tribunal has two Recovery Officers. The work amongst the Recovery Officers is allocated by the Presiding Officer. Though a Recovery Officer need not be a judicial Officer, but the orders passed by a Recovery Officer are judicial in nature, and are appealable before the Presiding Officer of the Tribunal.

The Debts Recovery Tribunals are fully empowered to pass comprehensive orders like in Civil Courts. The Tribunals can hear cross suits, counter claims and allow set offs. However, they cannot hear claims of damages or deficiency of services or breach of contract or criminal negligence on the part of the lenders.

The Debts Recovery Tribunals can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to review its own decision and hear appeals against orders passed by the Recovery Officers of the Tribunals.

The recording of evidence by Debts Recovery Tribunals is somewhat unique. All evidences are taken by way of an affidavit. Cross examination is allowed only on request by the defense, and that too if the Tribunal feels that such a cross examination is in the interest of justice. Frivolous cross examination may be denied. There are a number of other unique features in the proceedings before the Debts Recovery Tribunals all aimed at expediting the proceedings.

“Any liability (inclusive of interest) which is claimed as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned, or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgage and subsisting on, and legally recoverable on, the date of the application.

Important Definitions

As per Section 2(ea) of the Act

‘Chairperson’ means a chairperson of an Appellate Tribunal appointed under Section 9

As per Section 2(ja) of the Act

‘Presiding officer’ means the presiding officer of the Debts Recovery Tribunal appointed under Sub-section (1) of Section 4.

.Under Section 2(h) “Financial institution” means—

- (i) a public financial institution within the meaning of Section 4A of the Companies Act, 1956;
- (ia) the securitisation company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)
- (ii) such other institution as the Central Government may, having regard to its business activity and the area of its operation in India, by notification, specify.

2. ESTABLISHMENT OF TRIBUNAL

The Act provides that the Central Government shall by notification, establish one or more Tribunals, to be known as 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 setting up of a Debt Recovery Tribunal is dependent upon the volume of cases. Higher the number of cases within a territorial area, more the Debt Recovery Tribunals would be set up. Some cities have more than one Debt Recovery Tribunal located therein. On the other hand, there are number of states that do not have Debt Recovery Tribunals.

The details of the Tribunals constituted as of now—

Debt Recovery Appellate Tribunals (DRATs)

DRAT Allahabad, DRAT Chennai, DRAT Delhi, DRAT Kolkata, DRAT Mumbai.

Debt Recovery Tribunals

DRT-I Ahmedabad, DRT-II Ahmedabad, DRT Allahabad, DRT Aurangabad, DRT Bangalore, DRT-I Chandigarh, DRT-II Chandigarh, DRT-1 Chennai, DRT-2 Chennai, DRT Coimbatore, DRT Cuttak, DRT Ernakulam, DRT Guwahati, DRT Hyderabad, DRT Jabalpur, DRT Jaipur, DRT-1 Kolkata, DRT-2 Kolkata, DRT-3 Kolkata, DRT Lucknow, DRT-1 Mumbai, DRT-2 Mumbai, DRT-3 Mumbai, DRT Nagpur, DRT-1 New Delhi, DRT-2 New Delhi, DRT-3 New Delhi, DRT Patna, DRT Pune, DRT Visakhapatnam, DRT Ranchi, DRT Madurai.

Composition of Tribunal

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 is, or 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.

3. ESTABLISHMENT OF APPELLATE TRIBUNAL

The Central Government may establish one or more Appellate Tribunals, to be known as the Debts Recovery Appellate Tribunals, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act.

Composition of Appellate Tribunal

An Appellate Tribunal shall consist of one person to be called as the Chairperson of the Appellate Tribunal. Any person, who is, or has been, or is qualified to be, a Judge of a High Court; or has been a member of the Indian Legal Service and has held a post in Grade I of that Service for at least three years; or has held office as the Chairperson of a Tribunal for at least three years, shall be qualified for appointment as the Presiding Officer of an Appellate Tribunal.

The Presiding Officer of an Appellate Tribunal 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-five years, whichever is earlier.

4. APPLICATION TO THE TRIBUNAL

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.

Provided that the bank or financial institution may, with the permission of the Debts Recovery Tribunal, on an application made by it, withdraw the application, whether made before or after the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Ordinance, 2004 for the purpose of taking action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), if no such action had been taken earlier under that Act:

Provided further that any application made under the first proviso for seeking permission from the Debts Recovery Tribunal to withdraw the application made under sub-section (1) shall be dealt with by it as expeditiously as possible and disposed of within thirty days from the date of such application:

Provided also that in case the Debts Recovery Tribunal refuses to grant permission for withdrawal of the application filed under this sub-section, it shall pass such orders after recording the reasons therefor

Further, when a Bank or a financial institution, which has to recover its debt from

any person, has filed an application to the Tribunal and against the same person and another bank or financial institution also has a claim to recover its debt, then, the later 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. Where the defendant claims to set-off against the applicant's demand any ascertained sum of money legally recoverable by him from such applicant, the defendant may, at the first hearing of the application, but not afterwards unless permitted by the Tribunal, present a written statement containing the particulars of the debt sought to be set-off. 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. The defendant in an application may, in addition to his right of pleading a set off, set up, by way of counter-claim against the claim of the applicant, any right or claim in respect of a cause of action accruing to the defendant against the applicant either before or after the filing of the application but before the defendant has delivered his defence or before the time limited for delivering his defence has expired, whether such counter-claim is in the nature of a claim for damages or not.

Tribunal may, after giving the applicant and the defendant an opportunity of being heard, pass such orders on the application as it deems fit to meet the ends of justice. A counter-claim shall have the same effect as a cross-suit so as to enable the Tribunal to pass a final order on the same application, both on the original claim and on the counter-claim.

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 contents 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.

The objective behind empowering the Tribunals for issuing such a wide variety of interim orders is to prevent unscrupulous persons from stripping the properties and/or encumbering them in such a manner so as to defeat the lenders attempt at

recovering the amounts advanced by them. The Tribunals can get the property vacated, attach rents, appoint Commissioner to take inventory of the property and the stocks. The Tribunals can go ahead and attach Bank Accounts, seal lockers and much more.

However, there are a number of judgements of the Supreme Court and the High Court which have laid down conditions which must be followed by the Tribunals before passing orders which have pernicious effects on current and running business establishments. Therefore, even though the Tribunals can pass orders of wide variety, they are slow and cautious while passing such orders. Generally, they would first listen to the defendants before the orders are passed.

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 applicant shall, unless the Tribunal otherwise directs, specify the property required to be attached and estimate the value thereof.

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, including the order for payment of interest from date on or before which payment of the amount is found due upto the date of realization or actual payment, on the application as it thinks fit to meet the ends of justice.

The Tribunal shall send a copy of every order passed by it to the applicant and the defendant. The Chairperson 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. Provided that in case where the Tribunal to which the certificate of recovery is sent for execution finds that it has no jurisdiction to comply with the certificate of recovery, it shall return the same to the Tribunal which has issued it.

The application made to the Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the application finally within one hundred and eighty days from the date or receipt of the application. The Tribunal may make such orders and give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or to secure the ends of justice.

5. APPEAL TO THE APPELLATE TRIBUNAL

Section 20 of the Act provides that any person aggrieved by an order made, or deemed to have been made, by a Tribunal under this Act, may prefer an appeal to an Appellate Tribunal having jurisdiction in the matter. No appeal shall lie to the Appellate Tribunal from an order made by a Tribunal with the consent of the parties. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made, or deemed to have been made, by the Tribunal is received by him and it shall be in such form and accompanied by such fee as may be prescribed. Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal, the Appellate Tribunal may, after giving the parties to the

appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against. The Appellate Tribunal shall send a copy of every order, made by it to the parties to the appeal and to the concerned Tribunal. The appeal filed before the Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Deposit of amount of debt due, on filing appeal: Where an appeal is preferred by any person from whom the amount of debt is due to a Bank or a Financial Institution or a consortium of Banks or Financial Institutions, such appeal shall not be entertained by the Appellate Tribunal unless such person has deposited with the Appellate Tribunal seventy-five percent of the amount of debt so due from him as determined by the Tribunal. Provided that the Appellate Tribunal may, for reasons to be recorded in writing, waive or reduce the amount to be deposited.

6. POWERS OF THE TRIBUNAL AND THE APPELLATE TRIBUNAL

The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice. The proceedings before the Debt Recovery Appellate Tribunal is governed by Debt Recovery Appellate Tribunal (Procedures) Rules, 1993. In addition, Section 22 of the Act permits the Tribunal and the Appellate Tribunal to regulate their own procedure including the places at which they shall have their sittings.

The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) reviewing its decisions;
- (f) dismissing an application for default or deciding it *ex parte*;
- (g) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*;
- (h) any other matter which may be prescribed.

Any proceeding before the Tribunal or the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196, of the Indian Penal Code, 1860 and the Tribunal or the Appellate Tribunal shall be deemed to be a civil court for all the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

7. RIGHT TO LEGAL REPRESENTATION AND PRESENTING OFFICERS

A Bank or a Financial Institution making an application to a Tribunal or an appeal

to an Appellate Tribunal may authorise one or more legal practitioners or any of its officers to act as Presenting Officers and every person so authorised by it may present its case before the Tribunal or the Appellate Tribunal.

The defendant may either appear in person or authorise one or more legal practitioners or any of his or its officers to present his or its case before the Tribunal or the Appellate Tribunal.

Limitations

The provisions of the Limitation Act, 1963, shall, as far as may be, apply to an application made to a Tribunal.

8. RECOVERY OF DEBT DETERMINED BY TRIBUNAL

Modes of recovery of debts

As per the provisions of Section 25, the Recovery Officer shall, on receipt of the copy of the certificate under sub-section (7) of Section 19, proceed to recover the amount of debt specified in the certificate by one or more of the following modes, namely:

- (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.

Validity of certificate and amendment thereof

The defendant cannot dispute before the Recovery Officer the correctness of the amount specified in the certificate, and no objection to the certificate on any other ground, shall also be entertained by the Recovery Officer. However, the chair person shall have power to withdraw the certificate or correct any clerical or arithmetical mistake in the certificate by sending an intimation to the Recovery Officer. The chair person of tribunal shall intimate to the Recovery Officer any order withdrawing or cancelling a certificate or any correction made by him.

Stay of proceedings under certificate and amendment or withdrawal thereof

Section 27 provides that notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of any amount, the chair person may grant time for the payment of the amount, and thereupon the Recovery Officer shall stay the proceedings until the expiry of the time so granted. Where a certificate for the recovery of amount has been issued, the chair person shall keep the Recovery Officer informed of any amount paid or time granted for payment, subsequent to the issue of such certificate to the Recovery Officer. Where the order giving rise to a demand of amount for recovery of debt has been modified in appeal, and, as a consequence thereof the demand is reduced, the chair person shall stay the recovery of such part of the amount of the certificate as pertains to the said reduction for the period for which the appeal remains pending.

Where a certificate for the recovery of debt has been received by the Recovery Officer and subsequently the amount of the outstanding demands is reduced or

enhanced as a result of an appeal, the chair person shall, when the order which was the subject matter of such appeal has become final and conclusive, amend the certificate or withdraw it, as the case may be.

Other modes of recovery

Where a certificate has been issued to the Recovery Officer under sub-section (7) of Section 19, the Recovery Officer may, without prejudice to the modes of recovery specified in Section 25, recover the amount of debt by anyone or more of the modes provided under this section.

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.

Provided that nothing in this sub-section shall apply to any part of the amount exempt from attachment in execution of a decree of a civil court under Section 60 of the Code of Civil Procedure, 1908.

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 (not being before the money becomes due or is held) 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.

A copy of the notice shall be forwarded to the defendant at his last address known to the Recovery Officer and in the case of a joint account to all the joint holders at their last addresses known to the Recovery Officer.

Save as otherwise provided in this sub-section, 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.

Any claim respecting any property in relation to which a notice under this sub-section has been issued arising after the date of the notice shall be void as against any demand contained in the notice. Where a person to whom a notice under this sub-section is sent, objects to it by a statement on oath that the sum demanded or the part thereof is not due to the defendant or that he does not hold any money for or on account of the defendant, then, nothing contained in this sub-section shall be

deemed to require such person to pay any such sum or part thereof, as the case may be, but if it is discovered that such statement was false in any material particular, such person shall be personally liable to the Recovery Officer to the extent of his own liability to the defendant on the date of the notice, or to the extent of the defendant's liability for any sum due under this Act, whichever is less.

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. This Recovery Officer shall grant a receipt for any amount paid in compliance with a notice issued under this sub-section, and the person so paying shall be fully discharged from his liability to the defendant, to the extent of the amount so paid.

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 defendant's 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.

The Recovery Officer may apply to the court in whose custody there is money belonging to the defendant for payment to him of the entire amount of such money, or if it is more than the amount of debt due, an amount sufficient to discharge the amount of debt so due.

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 distraint and sale of his movable property in the manner laid down in the Third Schedule to the Income-Tax Act, 1961.

9. APPEAL AGAINST THE ORDER OF RECOVERY OFFICER

Any person aggrieved by an order of the Recovery Officer made under this Act may, within thirty days from the date on which a copy of the order is issued to him, prefer an appeal to the Tribunal. On receipt of an appeal, the Tribunal may, after giving an opportunity to the appellant to be heard, and after making such inquiry as it deems fit, confirm, modify or set aside the order made by the Recovery Officer in exercise of his powers under Sections 25 to 28 (both inclusive).

B. EFFECTIVE NON-LEGAL REMEDIES FOR IMPROVING THE RECOVERY MANAGEMENT

Compromise as a Strategy

Reduction of non-performing assets in banks can be achieved through a

compromise strategy where the objective of the genuine borrower is to optimize his gain having suffered a loss in the Unit's working, and that of the banker to minimize his loss. The ultimate strike-point is possible only through negotiation. Compromise, as a bad-debt reduction strategy needs to be wielded deftly. When a compromise is arrived at, certain amount of sacrifice in the form of write off and/or waiver of uncharged interest would be inevitable. Some feel that in a compromise, if one can recover the book outstanding, it would be adequate because it would not entail a write-off but would only involve waiver of the uncharged interest component, which is after all notional. This is one extreme. While others feel that sacrificing a claim is more akin to sin and therefore, one has to stay hard and fast in negotiations. This is the other extreme.

Compromise should be wielded as a strategy and not sold as a product. However, compromise can be marketed as a product prudently in cases where the asset back-up is questionable and prospects for recovery out of the borrower's own means are remote.

Thus, it is necessary to determine the approach in the light of analysis of factors connected to each case. There are only two approaches relevant:

- (a) Recovering as much as possible by negotiation (or in other words recovery optimization) – this is possible when the banker can negotiate from a position of strength, and
- (b) Clearing the problem loan in order to cleanse the portfolio – this is essential when the banker does not negotiate from a position of strength.

Lok Adalat

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, bringing the case before the forum of Lok Adalat can be helpful. Experience has shown that in many cases, particularly where the amount is not large, Lok Adalat has been successful in bringing the borrower to terms by using some kind of social pressure.

Compromise through Lok Adalats

The Reserve Bank has advised all scheduled commercial banks and all India financial institutions that they can take up the matter where outstandings are ₹ 10 lakhs and above with Lok Adalats organized by the Debt Recovery Tribunals/Debt Recovery Appellate Tribunals. The advice was issued to clarify the doubt raised by banks whether, in view of the limitation of ceiling of ₹ 5 lakhs for disposal by Lok Adalats, they should participate in the Lok Adalats convened by various DRTs/ DRATs for resolving cases involving ₹ 10 lakhs and above.

Settlement of NPAs through Lok Adalats

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.

Lok Adalats do not have statutory status, as judgements rendered by them do not take the form of a court decree so as to make it binding on the parties. If either of the parties does not give consent for settlement of dispute through Lok Adalat, the Lok Adalat cannot settle the matter. Even after parties to a dispute have given their consent for submitting their case before Lok Adalat, the procedure followed is not like civil suits, which are tried by the ordinary civil court. Neither the Lok Adalat records any evidence, nor any arguments are heard for deciding intricate legal question. The presiding members of Lok Adalat, who are usually social workers, 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.

Thus, several dates of hearing are not fixed and attempt is made to bring round the parties to an agreeable solution at the same sitting. In this process, the social workers use their moral authority and 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. While a Lok Adalat can take up all such disputes for consideration, which have not yet reached any court, pending civil suits are also referred to Lok Adalats for decision.

How settlements can be made legally binding

As already discussed above, settlements arrived at Lok Adalats are not legally enforceable, by themselves. Therefore, 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.

Exemption and refund of court fees

It is pertinent to note that several State governments have announced remissions in court fees where matters are settled through Lok Adalats. As such costs on court fees are saved to the benefit of the Bank, as well as the borrower.

Precautions to be taken

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.

Validity of Debt Recovery Tribunal Act

A three judge bench of Supreme Court has upheld the validity of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, which provides for establishment of DRTs for recovery of outstanding loans. The court allowed a batch of appeals from Union of India and several commercial banks against a judgement of the Delhi High Court striking down the Act as '*ultra vires*' the constitution. The court added that the special machinery of a tribunal under the Act for expeditious adjudication and recovery of debts due to banks and FIs squarely fall within the ambit of powers of the Parliament to legislate such a law.

The DRTs were handicapped in view of the stay orders granted by several High Courts against the operation of the Act in their respective States. While upholding the validity of the Act, the Supreme Court has made it clear that 'No High Court shall entertain a petition under Article 226 and 227 of the Constitution, challenging the tribunal's jurisdiction in this regard'. The court also made it clear that it would be open to the parties to raise their contentions on the merits of their cases before the tribunals. It is only after the tribunals have dealt with such contentions, the High Courts can adjudicate in the matter.

DRTs have also been asked by the Supreme Court to deal with the petitions of the banks expeditiously.

DRTs – Cross examination not needed

Supreme Court ruled during March 2002 that it was not necessary for DRTs to always cross-examine a witness. Evidence could be taken by affidavits also on the pattern of High Courts and Supreme Court where the cases can be decided merely on the basis of documents and affidavits filed before them, ordinarily. The court observed that it is common knowledge that hardly any transaction with the bank would be oral and without proper documentation. In such an event, the need for oral examination of a witness would rarely arise. The Tribunal may at any time for sufficient reason, order that any particular fact be proved by affidavit, on such conditions, as the tribunal thinks reasonable. The Tribunal may at any time for

sufficient reason, order that any particular fact be proved by affidavit, on such conditions, as the tribunal thinks reasonable. The Tribunal may at any time, for sufficient reason, order that the affidavit of any witness may be read at the hearing, on such conditions, as the tribunal thinks reasonable.

DEBTS RECOVERY TRIBUNAL (PROCEDURE FOR INVESTIGATION OF MISBEHAVIOUR OR INCAPACITY OF PRESIDING OFFICER) RULES, 2010

Committee for investigation of complaints(Rule 4)

(1) If a written complaint, alleging any definite charges of misbehaviour or incapacity to perform the functions of the office in respect of a Presiding Officer is received by the Central Government, it shall make a preliminary scrutiny of such complaint.

(2) If, on preliminary scrutiny, the Central Government considers it necessary to investigate into the allegation, it shall place the complaint together with other material as may be available, before a Committee consisting of the following officers to investigate the charges of allegations made in the complaint, namely:—

- (i) Secretary (Coordination and Public Grievances), —Chairman;
Cabinet Secretariat
- (ii) Secretary, Ministry of Finance, Department of —Member;
Financial Services
- (iii) Secretary, Department of Legal Affairs, Ministry of Law —Member.
and Justice

(3) The Committee shall devise its own procedure and method of investigation which may include recording of evidence of the complainant and collection of material relevant to the inquiry which may be conducted by a Judge of the High Court under these rules.

(4) The Committee shall submit its findings to the President as early as possible within a period that may be specified by the President in this behalf.

Judge to conduct inquiry (Rule 5)

(1) If the President is of the opinion that there are reasonable grounds for making an inquiry into the truth of any imputation of misbehaviour or incapacity of a Presiding Officer, he shall make a reference to the Chief Justice of India, requesting him to nominate a Judge of a High Court to conduct the inquiry.

(2) The President shall, by order, appoint the Judge of the High Court nominated by the Chief Justice of India for the purpose of conducting the inquiry.

(3) Notice of appointment of a Judge under sub-rule (2) shall be given to the Presiding Officer concerned.

- (4) The President shall forward to the Judge a copy of—
 - (a) the articles of charges against the Presiding Officer concerned and the statement of imputation;
 - (b) the statement of witnesses, if any; and
 - (c) material documents relevant to the inquiry.

(5) The Judge appointed under sub-rule (2) shall complete the inquiry within such time or further time as may be specified by the President.

(6) The Presiding Officer concerned shall be given a reasonable opportunity of presenting a written statement of defence within such time as may be specified in this behalf by the Judge.

(7) Where it is alleged that the Presiding Officer concerned is unable to discharge the duties of his office efficiently due to any physical or mental incapacity and the allegation is denied, the Judge may arrange for the medical examination of the Presiding Officer by such Medical Board as may be appointed for the purpose by the President and the Presiding Officer concerned shall submit himself to such medical examination within the time specified in this behalf by the Judge.

(8) The Medical Board shall undertake such medical examination of the Presiding Officer as may be considered necessary and submit a report to the Judge stating therein whether the incapacity is such as to render the Presiding Officer unfit to continue in office.

(9) If the Presiding Officer refuses to undergo such medical examination as considered necessary by the Medical Board, the Board shall submit a report to the Judge stating therein the examination which the Presiding Officer has refused to undergo, and the Judge may, on receipt of such report, presume that the Presiding Officer suffers from such physical or mental incapacity as is alleged in the complaint.

(10) The Judge may, after considering the written statement of the Presiding Officer and the Medical Report, if any, amend the charges referred to in clause (a) of sub-rule (4) and in such a case, the Presiding Officer shall be given a reasonable opportunity of presenting a fresh written statement of defence.

(11) The Central Government shall appoint an officer of that Government or an advocate to present the case against the Presiding Officer.

(12) Where the Central Government has appointed an advocate to present its case before the Judge, the Presiding Officer concerned shall also be allowed to present his case by an advocate chosen by him.

Application of the Departmental Inquiries (Enforcement of Witness and Production of Documents) Act, 1972 to inquiries under these rules(Rule 6)

The provision of the Departmental Inquiries (Enforcement of Witness and Production of Documents) Act, 1972 (18 of 1972), shall apply to the inquiries made under these rules as they apply to departmental inquiries.

Powers of Judge (Rule 7)

The Judge shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908) but shall be guided by the principles of natural justice and shall have power to regulate his own procedure including the fixing of places and times of his inquiry.

Suspension of Presiding Officer (Rule 8)

Notwithstanding anything contained in rule 4 and without prejudice to any action

being taken in accordance with the said rule, the President, keeping in view the gravity of charges, may suspend the Presiding Officer against whom a complaint is under investigation or inquiry.

Subsistence allowance (Rule 9)

The payment of subsistence allowance to the Presiding Officer under suspension shall be regulated in accordance with the rules and orders for the time being applicable to an officer of the Government of India of equivalent post and drawing an equivalent grade pay.

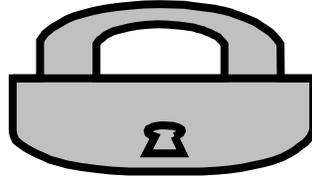
Inquiry report (Rule 10)

After the conclusion of the investigation, the Judge shall submit his report to the President stating therein his findings and the reasons therefore on each of the articles of charges separately with such observations on the whole case as he thinks fit.

LESSON ROUND UP



- The Act was passed to provide for the speedy adjudication of matters relating to recovery of debts due to banks and financial institutions.
- As of now, there are twenty nine Debt Recovery Tribunals and five Debt Recovery Appellate Tribunals across the country constituted by the Government of India.
- Section 19 of the Act deals with the procedure for making application to the Tribunal.
- Section 20 of the Act deals with provisions for an appeal to an Appellate Tribunal having jurisdiction in the matter.
- The Tribunal and the Appellate Tribunal have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908.
- The Recovery Officer may proceed to recover the amount of debt by any of the specified modes under Section 25 of the Act.
- Any person who is aggrieved by an order of Recovery Officer may prefer an appeal to the Tribunal.

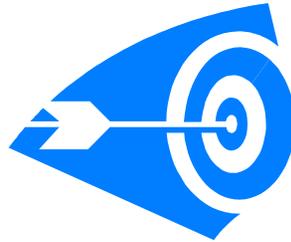
SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. State the object behind establishment of Recovery of debts due to Banks and Financial Institutions Act, 1993.
 2. State the Composition of Tribunal.
 3. Explain the procedure for filing application to the tribunal under the Act.
 4. What are the powers of Tribunal and Appellate Tribunal vested by the Act?
 5. State various modes of recovery under the Act.
 6. State the effective non-legal remedies for improving the recovery management.
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STUDY XV WINDING UP

LEARNING OBJECTIVES



After going through this chapter, you will be able to understand:

- Meaning of winding up
- Modes of winding up (compulsory Winding up and Voluntary Winding up)
- compulsory Winding up (Winding up by the Court)
- Voluntary winding up (Both Members' and creditor' voluntary winding up)
- Procedural aspects of Compulsory and voluntary winding up
- Provisions applicable to members' and creditors voluntary winding up
- Provisions applicable to all types of winding up (ie Compulsory and Voluntary winding up)
- Powers and duties of liquidators
- Winding up of unregistered companies
- Role of insolvency practitioners
- Corporate insolvency in UK and USA.

INTRODUCTION

Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

Winding-up is the process by which management of a company's affairs is taken out of its directors' hands, its assets are realized by a liquidator and its debts are realized and liabilities are discharged out of proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will, therefore, be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.

The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law. However, the purpose must not be exploited for the benefit or advantage of any class or person entitled to submit petition for winding up of a company. It may be noted that on winding up, the company does not cease to exist as such except when it is dissolved. The administrative machinery of the company gets changed as the administration is transferred in the hands of the liquidator. Even after commencement of the winding-up, the property and assets of the company belong to the company until dissolution takes place. On dissolution the company ceases to exist as a separate entity and becomes incapable of keeping property, suing or being sued. Thus in between the winding up and dissolution, the legal status of the company continues and it can be sued in the court of law.

Can the Company be adjudged Insolvent?

The winding up of a company is not the same thing as the insolvency of a company, for the general rule in regard to winding up is that if the members of a company desire that the company should be dissolved or if it becomes insolvent or is otherwise unable to pay its debts, or if for any reason it seems desirable that it should cease to exist, it is wound up. It is obvious that a company may be wound up even when it is perfectly solvent, e.g. for purpose of reconstruction. *Furthermore, a company can never be declared bankrupt although it is unable to pay its debts.* It can only be wound up, of course, some provisions of insolvency laws are made applicable to companies in liquidation (See Sections 442, 446, 477, 528 to 531 and 534 to 537 of the Companies Act). Thus, we may put the proposition that in so far as inability to pay debts is concerned, a bankruptcy of an individual under the insolvency law is the same thing as a winding up of a company under the company law but a company can also be wound up for reasons other than mere inability to pay its debts.

Following are some of the differences between the effects of insolvency of an individual or a firm and winding up of a company:

1. In the case of insolvency, the whole of the insolvent's property is taken out of his hands and rests in the Court (under the Provincial Insolvency Act, 1920) or the Official Assignee (Under the Presidency towns Insolvency Act, 1909). In winding up, on the other hand, the property remains vested in the company, subject to its being administered for the purposes of winding up as the company retains its complete existence. Its legal death comes only when it is formally dissolved.
2. In insolvency, an insolvent individual can obtain his discharge and continue living and working free from the burden of his debts. A company in liquidation cannot obtain its discharge and continue free from the burden of its debts. The liquidator winds up its affairs and then terminates it through dissolution.
3. Although in the administration of the assets of an insolvent company the insolvency rules apply, they are, however, not identical with those of insolvency. For example, the "reputed ownership" clause of insolvency law has no application in the case of a company in liquidation.
4. In the case of an individual, the administration of his property by the Official Assignee or the Official Receiver occurs only if he is declared an insolvent

by the Court. But the assumption of the directors' powers by the liquidator, occurs even if the company is fully solvent. Liquidation or winding up, even of an solvent company can be proceeded with the aid of the court, as in voluntary winding up.

Is Winding up and dissolution are synonymous?

The terms "Winding up" and "Dissolution" are sometimes erroneously used to mean the same thing. But according to the Companies Act, 1956, the legal implications of these two terms are quite different and there are fundamental differences between them as regards the legal procedure involved. The main points of distinction are given below:

1. The entire procedure for bringing about a lawful end to the life of a company is divided into two stages – 'winding up' and 'dissolution'. 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.
2. The liquidator appointed by the company or the Court carries out the winding up proceedings but the order for dissolution can be passed by the Court only.
3. According to the Companies Act the liquidator can represent the company in the process of winding up. This can be done till the order of dissolution is passed by the Court. Once the Court passes dissolution orders the liquidator can no longer represent the company.
4. Creditors can prove their debts in the winding up but not on the dissolution of the company.
5. Winding up in all cases does not culminate in dissolution. Even after paying all the creditors there may still be a surplus; company may earn profits during the course of beneficial winding up; there may be a scheme of compromise with creditors while company is in winding up and in all such events the company will in all probability come out of winding up and hand over back to shareholders/old management. Dissolution is an act which puts an end to the life of the company.

As such winding up is only a process while the dissolution puts an end to the existence of the company. Unless and until it has been set aside under Section 559 of the Act, it prevents any proceedings being taken against promoters, directors or officers of the company to recover money or property due or belonging to the company or to prove a debt due from the company. When the company is dissolved, the statutory duty of the liquidator towards the creditors and contributories is gone, but if he has committed without complying with the requirements of the Act, he is liable to damages to the creditors.

Can a Company be dissolved without winding up?

When the court sanctioning s scheme of amalgamation orders dissolution of the transferor company without winding up, such order becomes effective under Section 394(1)(iv).

MODES OF WINDING UP

A company registered under the Companies Act, 1956 may be wound up in any of the following modes:

1. By the Court¹ i.e. compulsory winding up;
2. Voluntary winding up, which may be either:
 - (a) Members' voluntary winding up; or
 - (b) Creditor's voluntary winding up;

Provisions relating to winding up subject to the supervision of the court has been omitted by the Companies (Second amendment Act) 2002 and the effective date is yet to be notified.

WINDING UP BY THE COURT¹

Important Note: The Companies (Second Amendment) Act, 2002, has transferred to the National Company Law Tribunal the powers vested in the Court. **However, the Amendment Act has not become effective as yet.** Accordingly, all references to the "High Court or Court" in this study will stand replaced with "Tribunal" after the Companies (Second Amendment) Act, 2002 is enforced. Likewise, all references to the Companies Court Rules will stand replaced by the rules/regulations that will be framed by the Tribunal. However, as on date, the existing provisions are applicable.

❖ **Winding up by court is also called Compulsory Winding up.**

Let us study the following

1. What are the grounds of winding up by court?
2. Who can file winding up petition with the court?
3. What is the jurisdiction of the court?
4. What are the procedural aspects involved in compulsory winding up?

Grounds on which a Company may be wound up by the Court

A company under Section 433 may be wound up by the Court if

- (a) the company has passed a special resolution of its being wound up by the Court; or
- (b) default is made in delivering the statutory report to the Registrar or in holding the statutory meeting; or
- (c) it does not commence business within a year from its incorporation or suspends business for a whole year; or
- (d) the number of its members in the case of a public company is reduced below seven and in the case of a private company, below two; or
- (e) it is unable to pay its debts; or

¹ Substituted by 'Tribunal' by Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

- (f) the Court is of the opinion that it is just and equitable that it should be wound up; or
- (g) if the company has made a default filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years; or
- (h) if the company has acted against the interests of the sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order, decency or morality; or (It may be noted that the tribunal shall make an order for winding up of a company under clause (h) on application made by the Central Government or a State Government)
- (i) If the tribunal is of opinion that the company should be wound up under the circumstances specified in Section 424 G (i.e winding up of a sick company):

(a) 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.

Winding up order on this ground is not a common feature because if such a large number of shareholders want the company to be wound up they would prefer the mode of voluntary winding up, which involves less time and is cheaper than winding up by order of the Court.

(b) Default in filing statutory report or holding statutory meeting

A petition for winding up of a company on this ground can only be made either by the Registrar with the previous sanction of the Central Government or by 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 [Section 443(3)].

(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. Here again 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. (See *The Malabar Iron and Steel Works Ltd. v. The Registrar of Companies*, AIR 1965 Ker. 35).

Similarly, when the delay appears to be due to temporary or unavoidable causes, the Court will not order a winding up. In *Re. Capital Fire Insurance Association*, (1883) 24 Ch.D. 408. Also see *Aluminium Corporation of India Ltd. v. Lakshmi Rattan*

Cotton Mills Co. Ltd. AIR 1970 All 452]. Where, at the instance of the shareholders, a company's business was suspended due to recession, and a petition for winding up made by a shareholder after a year of suspension, was opposed by four-fifths in value of shareholders, the order for winding up was refused. In *Re. Middlesborough Assembly Rooms Co.*, (1880) 14 Ch.D. 104]. Where a company ceases to operate in the field of its activities but becomes a holding company in relation to other companies which are engaged in pursuit of objects for which it was incorporated, such company cannot be said to have suspended its business for a whole year so as to justify an order for its winding up. In *Re. Eastern Telegraph Co. Ltd.*, (1947) 2 All ER 104]. The suspension must be of entire business and not a part of it. 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) Tax. L.R. 2506 (All)]. In *Registrar of Companies v. Bihar Wire* (1975) 45 Comp. Cas. 194 (P&HHC) it was held that mere fact that business has not been commenced within a year or has been suspended for a year or more is not a ground for a Court to order winding up of a company. It has to be found out whether the non-commencement or suspension of business is for good reason. 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.

Further, a company will not be wound up because it has ceased to carry on one of its several businesses unless that business is the main object of the company. In *Re. Amalgamated Syndicate* [(1897) 2 Ch. D. 600], nor can a company which has amalgamated with another company be wound up on the ground that it has ceased to carry on business as a separate company. If the company has made all possible efforts to proceed with business but due to unforeseen circumstances beyond its control, company could not proceed, company can not be ordered to be wound up under Section 433(c). [*Bikkim Gopalakrishna Rao v. Seavally Resorts* (2000) 27 SCL 242].

In *Surendra Kumar Pareek v. Shree Guru Nanak Oils (P) Ltd.* (1995) 82 Comp. Cases 642 (Raj.), the business of the company was suspended for over a year, the number of members was reduced to less than two, all directors but one were absconding and the assets were taken over by the lending institutions, the winding up was admitted despite objection from the lending institution that the winding up was being resorted to, to estabale the remaining liability to the Institution.

(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 [See *Bowling and Welby's Contract*, (1895) 1 Ch.D. 663]. 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 ₹ 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. Where the object of the petition to wind up a company really is to bring pressure upon the company in order to make it pay the debt cheaply and expeditiously when the company desires to dispute the debt in the Civil Court, the petition was held to be abuse of the process of the Court and liable to be dismissed. [*P. Satya Raju v. Guntur Cotton, Jute and Paper Mills* AIR 1955 (Mad.) 199].
- (ii) If an execution or other process issued on a decree or order of any court in favour of creditor is returned unsatisfied in whole or in part. The decree or order contemplated by this clause is confined not to money decree only but is of a general nature. [*Seethal Mills Ltd. v. N. Perumalswamy*, (1980) 50 Comp. Cas. 422 Mad.].
- (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. In this case, it is the commercial insolvency of the company which is important rather than the difference between the assets and liabilities. 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. The important aspect to be examined in this situation is whether in a commercial sense the company is in a position to pay its existing liabilities while it continues to carry on its business.

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.* (1978) 48 Comp. Cas. 231]. If the Court is satisfied that the company cannot pay its admitted or undisputed debts, it may order the company to be wound up, however small such debts may be. It is not necessary that demand should have been made or the execution levied. In *Re. Globe Steel & Co.* (7 Eq. 337), the company accepted a bill of exchange in part payment for goods bought. No demand had been made nor execution levied. This bill was dishonoured. It was held that it was sufficient proof of the company's inability to pay its debts. The Central Government is entitled to apply and obtain an order, for the compulsory winding up of a company if the company is unable to pay a large sum lawfully due to it as income-tax [*Coimbatore Transport Co. Ltd. v. Governor General in Council* (1948) 1 M.L.J. 407].

Where a debt is bona fide disputed by the company and the Court is satisfied with the company's defence, there is no 'neglect to pay' and therefore a winding up order will not be made [*Piara Singh (S) v. S.H.R. Properties Pvt. Ltd.* (1993) 10 CLA 83]. Bona fide dispute implies the existence of a substantial ground for the dispute raised. In other words, where there is scope for honest differences of opinion and disputes in respect of the claim made, the Court will not entertain a winding up

petition. [*Bhabesh Chandra Guha Roy v. Bisserwarlal Sharma*, 1973 Tax LR 2331 (Cal)]. The Court may however at its discretion direct the company to furnish security.

While hearing a winding up petition, the court decides only whether the company is liable to be wound up or not. A winding up application can not be used for obtaining decision for recovery of debts due to any banks or financial institution. The Tribunals constituted under the Recovery of Debts due to Banks and Financial Institutions Act, 1993, does not have the jurisdiction to entertain an application for winding up of a company. Such an application can be made only under the Companies Act, 1956 [*Andhra Steel Corpn. Ltd. v. Bank of Baroda* (1996) 1 Comp. LJ 313].

A notice under Section 434 is a serious matter. If the notice is validly given, its effect would be to raise a presumption as to the inability of the company to pay the debt and as to its insolvency rendering it liable to be wound up by the Court. Such a notice must comply with the requirements of the statute. All that is required by a statute is that the notice must be in respect of an existing and presently payable debt exceeding ₹ 500/-. The notice will not be invalid merely because sum demanded is more than the sum actually due. In such a case the sum due remains included in the demand (*Ofu Lynx Ltd. v. Simon Carves India Ltd.*, AIR 1970 Cal 418). The expression three weeks means three clear weeks from the date of the demand. The date on which the demand is made is excluded. [In *Re. Lympne Investments Ltd.*, (1972) 2 All. E.R. 385]. As for the second proposition it is sufficient if the company has informed a judgment-creditor that it has no assets on which to levy execution or the payment was demanded from it by the petition or without any success. [In *Re. Flag Staff Co. of Utah*, (1875) R. 20 Eq. 268]. If company persistently fails to honour its commitment made at various stages to discharge its financial obligations, it has to held that it was unable to pay its debts and is therefore liable to be wound up. [*Bharwan Bros. v. Motorola (India) Ltd.* (2000) 25 SCL 517 (Guj HC)].

It is not the requirement of Section 434 that the creditor in his notice must mention that in the event of non-compliance, the creditor will apply for winding up. No form has been prescribed for the notice. [*Color Coats v. Venkataramanas Hotels Ltd.* AIR 1999 AP 16]. Notice is valid even in absence of stipulation of period of three weeks notice and expression 'winding up proceedings', if the notice specifically states that in the event of default in payment of debt due, appropriate legal proceedings will be taken. [*J.G. Finance v. Hansaflon Plastochem* (2001) 30 SCL 430].

(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.

The word "just and equitable" are not confined to matters *ejusdem generis* (of the same kind) as the preceding clauses of the section, nor to proved cases of *mala fides*. They are general words which must not be reduced to the sum of particular instances, nor confined to circumstances affecting the petitioner in his capacity as shareholder. They enable the Court to subject the exercise of legal rights to equitable considerations through the words themselves, and not because the company's structure is in any way analogous to a partnership. [*Ebrahimi v. Westbourne Galleries Ltd. & Others* (1972) 2 W.L.R. 1289].

Lord Wilberforce observed in *Ebrahimi v. B. Westbourne Galleries Ltd.*: “the tendency to create categories or headings is wrong: the general words of the subsection should remain general and not be reduced to the sum of particular instances.” The discretion of the Court under this clause is very wide and the courts have exercised this discretion on a variety of grounds. 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 [In *Re. German Date Coffee Co.*, (1882) 20 Ch.D. 169].
- (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 (*Seth Mohan Lal v. Grain Chambers Ltd.*, AIR 1968 S.C. 772).
- (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) 2 Ch. 426]. Fractions among shareholders is, however, not a sufficient ground.
- (v) Where the company is a “bubble” and has no business to carry on e.g. 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 [*Lock v. John Blackwood Ltd.*, (1924) A.C. 73].
- (viii) Where the petitioner was excluded from all participation in the business of a private company.
- (ix) If the company has committed default in making payment to various investors, allegations that directors have cheated several thousand investors, banks and FIs, company has not filed balance sheet for two years and no reply from company to advertisement under Rule 24, the company is liable to be wound up [*ROC v. Country Informtech Services P. Ltd.* (2002) 39 SCL 504 (All HC)].

The following are some of the cases in which winding up was not ordered under just and equitable clause:

- (i) Where the company was under a loss but there was a chance of its making profit and the majority of shareholders were against winding up.

- (ii) Where the directors in the exercise of their powers to do so, refused to register the executors of the deceased shareholder even when this caused hardship to the shareholders.
- (iii) Where there is honest difference between the petitioner, a director and the other directors and he has been outvoted.
- (iv) Where the business of the company was temporarily suspended owing to trade depression and was intended to be continued when conditions improved.
- (v) Where there was a deadlock in management of a public company.
- (vi) If the 'just and equitable' ground does not exist at the time of hearing the petition though it might have existed at the time of presenting the petition.

Winding up by the Court¹ or compulsory winding up is initiated by an application by way of petition to the appropriate Court¹ 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. The extreme and irretrievable step of winding up must be resorted to only in very compelling circumstances. [*Daulat Makanmal Luthrid v. Solatire Hotels* (1993) 76 Comp. Cas. 215 (Bom. HCD)]. It is primarily the High Court which has the jurisdiction to wind up companies under Section 10 of the Companies Act, 1956 in relation to the place at which registered office of the company concerned is situated except to the extent to which jurisdiction has been conferred on any District or District Courts subordinate to the High Court. The Central Government may empower any District Court to exercise that jurisdiction, presumably to reduce the burden of the High Court, only in respect of small companies with the paid-up capital of not more than one lakh of rupees and having their registered office within the District, with a view to achieving expeditious and efficient disposal of winding up proceedings. The Act, therefore, under Sections 435 to 438,¹ confers wide powers upon the High Court to regulate the conduct of such proceedings. Accordingly the High Court which is the winding up Court may direct a District Court to retain and continue winding up proceedings which should not really have been commenced in that Court (Section 437). It may also withdraw any winding up which is in progress in a District Court from that Court and proceed with the winding up itself, or transfer it to another District Court (Section 436), and with respect to all proceedings subsequent to its own order of winding up, direct them to be had in a District Court or with the consent of any other High Court, in such High Court or in a District Court subordinate to that High Court, whereupon the Court in respect of which such direction is given shall be deemed to be the Court with all powers and jurisdiction of the High Court under the Act (Section 435). Lastly, the High Court can pass orders under any of the foregoing sections at any time and at any stage, whether or not an application in that behalf is made by any of the parties to the proceedings (Section 438). 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) 40 SCL (Ker. HC DB).

¹ Sections 435 to 438 have been omitted by Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

Who may file Petition for the Winding up?

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 439 by any of the following persons:

- (a) the company; or
- (b) any creditor or creditors, including any contingent or prospective creditor or creditors; or
- (c) any contributory or contributories; or
- (d) all or any of the parties specified above in clauses (a), (b), (c) whether together or separately; or
- (e) the Registrar; or
- (f) any person authorised by the Central Government in the case falling under Section 243, i.e., following upon a report of inspectors; or
- ¹(g) in case falling under clause (h) of Section 433, by the Central Government or State Government. i.e Company acting against the interest of the sovereignty and integrity of India.

(i) Petition by the Company

The company may make a petition through its directors with the authority of a special resolution passed at a general meeting. It may also, apply to liquidator if it is being wound up voluntarily. The directors may, on their authority present a petition on behalf of the company. However, when the ground for winding up is that the company has passed special resolution, the petition must be presented by the company itself.

It may be mentioned here that without the authority of the general meeting the directors are not entitled to present a winding up petition in the name of the company. But where the directors have presented such a petition, it is open to general meeting of shareholders to ratify their action.

(ii) Petition by Creditor

A creditor or creditors (including any contingent or prospective creditor) may make petition, and the Court would make a winding up order on such petition if the creditor proves that the claims are undisputed debt and any of the contingencies stated in Section 433 (grounds of winding up) had arisen to justify the order. The expression "creditors" includes the assignee of debt, a decreeholder, a secured creditor, a debenture holder or the trustee for debenture holders. But a creditor whose debt is unliquidated cannot apply for winding up order. A contingent or prospective creditor can present petition on giving security for costs and showing that a *prima facie* case has arisen. A petition by a secured creditor for winding up may not be allowed by the Court where the security is ample and the petition is not supported by the other creditors.

A Guarantor of a Company's loan is a contingent creditor within the meaning of

¹ Inserted by Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

Section 439. Dollar Land Holdings Plc Re 1994, 1 BCLC 404(Ch D). Under Section 439(8) a contingent or prospective creditor must obtain leave from the court before his petition is admitted. It is a condition precedent to the passing of any further orders in the petition. (Kermeen Foods P Ltd., In re(1985)58 Com Cases156(Guj)(DB)

Debentureholder can file an application for winding up

In *Gramercy Emerging Market Fund v. Essar Steels* (2002) 39 SCL 435 (Guj. HC). It was held that debentureholder can file application for winding up. However trustee is a necessary party if there is no direct covenant between the company and debentureholder, but the covenant is between company and trustee. This principle is not applicable where there is a direct covenant between company and debentureholder. Moreover trustee can sue the company in its own right as a covenanting party.

Although an unpaid creditor, as between himself and the company, is *prima facie* entitled to a winding up order, *ex debito justitiae* (i.e., as a matter of right), he is not so entitled as between himself and others creditors of the same class, for the Court may have regard to the wishes of creditors in all matters relating to the winding up, and may refuse to make a winding up order if a majority in value of the creditors oppose the petition. For instance, if a creditor to whom the company owes ₹ 10,000, petitions for winding up of the company and other creditors to whom the company owes ₹ 10 lakhs oppose the petition, the Court would obviously refuse to order winding up of the company (*Ram Kumar v. Busar Oil and Rice Mills*, AIR 1960 Cal. 764).

The term creditor includes the Central Government or any State Government or municipal or local authority to whom any tax or other public charge is due. A foreign creditor and a guarantor who is a prospective creditor has a right to apply for winding up.

In *Padam Team Tea Co. Ltd. v. Darjeeling Commercial Co. Ltd.*, (1977) 47 Comp. Cas. 15, it was held that on the basis of an admission by the company of its indebtedness to a creditor, the creditor is entitled to petition for the winding up of the company, even if he has given full details of his petition as required under Section 434.

Petition by Workers not maintainable

Section 439 of the Companies Act, 1956 confers right upon certain persons to file a petition for winding up. The said section does not authorize the workers to make a winding up petition. Accordingly, the workers can not make a winding up petition. [*National Textile Workers' Union v. P.R. Ramakrishnan* (1983) 53 Comp. Cas. 184].

Vans Gopal Singh V Jaipur Udyog, (2008) 88 SCL 194(Raj) the petition filed on the ground that the company was not able to pay dues of its employees was held to be not a proper remedy, as there are adequate provisions in the Industrial Disputes Act, 1947, Payment of Wages Act, 1936 for recovery of wages by sale of Company's property. The petition had to be dismissed even otherwise because the requirement as to notice under Section 434 was not complied with.

In *Mumbai Labour Union v. Indo French Time Industries* (2002) 38 SCL 924, it was held that a trade union can not file winding up petition for unpaid wages of

workmen/employees. They are disentitled as other legitimate and efficacious remedy under labour laws is available. In such case, filing winding up petition is abuse of law.

Appeal by workers against winding up order maintainable

There is nothing in the Act which prohibits workers from being heard in a winding up petition. Accordingly, the workers would be entitled to be heard though as interveners and not as parties. Further after the winding up order is made, the workers may appeal against it. But once the order becomes final, the workers shall not participate in any further proceedings [*National Textile Workers' Union v. P.R. Ramakrishnan* (1983) 53 Comp. Cas. 184].

A time barred debt cannot be the basis for winding up petition.

A time barred debt cannot be the basis of a winding up petition. The fact that the petitioner filed a civil suit before filing the winding up petition was immaterial because such suit does not have the effect of extending the period of limitation. (*Hariom Firestocks Ltd., v Sunjal Engineering P Ltd.,* (1994) 4 Comp LJ 469 (Kant))

Pre-incorporation debt unsustainable –

A pre-incorporation debt taken over by the company was held to be unsustainable for a winding up petition, *Jan Bazar Manna Estate Ltd., In re* AIR 1931 Cal. 92.

(iii) Petition by Contributory

Who is a Contributory?

Section 428 of the Companies Act defines a 'contributory' as "every person liable to contribute to the assets of a company in the event of its being wound up, and includes holders of any shares which are fully paid-up and for the purposes of all proceedings for determining, and all proceedings prior to the final determination of, the persons who are deemed to be contributories, includes any person alleged to be a 'contributory'".

In terms of the provisions of this section, the holder of fully paid-up share is also a contributory though he has no further liability to contribute to the assets of the company in winding up. The holder of a fully paid-up shares is included in the list of contributories for distribution of the residuary assets of the company after satisfying the claims of the creditors. He is also entitled to file a winding up petition.

While every member of a company becomes a contributory on the company going into liquidation, every contributory need not be a member. Besides, the members presently borne on the register, the past members of a company, who ceased to be members within one year of the commencement of the winding up, are also liable as contributories by virtue of Section 426.

By virtue of Section 439(1)(c), a contributory has a statutory right to present a petition for the winding up of the company, which right cannot be excluded or limited by the articles, but is subject to certain conditions as laid down in the section [Sub-section (4)].

When a contributory can file a winding up petition?

A contributory is entitled to present a winding up petition in case where:

- (a) the number of members of the company is reduced below the statutory minimum of 7, in the case of a public company and below 2 in the case of private company; or
- (b) the shares in respect of which he is a contributory or some of them:
 - (i) were originally allotted to him; or
 - (ii) have been held by him and registered in his name for at least six months during the 18 months before the commencement of the winding up; or
 - (iii) have devolved upon him through the death of a former holder.

The object of making these provisions is to prevent a person buying a share or two in order to qualify himself as a contributory to wreck the company.

In *Re. Gattapardo Ltd.* (1969) 2 All. ER 344, a transfer of shares had been executed, stamped and dated in June, 1967. The company did not register it until October, 1968. The shareholder presented a petition for the winding up of the company in December, 1968. It was held that the petition did not lie, as the petitioner shareholder did not hold her shares for six months as required by the Act. However, where the company has been ordered by the Court to allot shares and had failed to do so, the person in whose favour the order had been made was qualified to apply [In *Re. Petent Steam Engines Co.* (1878) 8 Ch.D. 464].

A petition for the winding up of a company can be presented by a contributory notwithstanding the fact that he may be holder of fully paid-up shares or the company may have no assets at all or may have no surplus assets at all or may have no surplus assets left for distribution amongst the shareholders after satisfaction of its liabilities towards creditors. A contributory is, thus, entitled to present a winding up petition even when the company is insolvent and is not in a position to satisfy even the creditors and the contributory have no tangible interest is as much as nothing is left back for distribution amongst the shareholders.

It may be noted that an insolvent shareholder whose name still appears on the register of members as holder of the shares may present petition as a contributory at the instance of the Official Assignee or Receiver, but the Official Assignee or Receiver himself cannot petition as he is not a contributory. Again, a legal representative of a deceased shareholder can present petition for a winding up order.

(iv) Petition by Registrar

The Registrar may, with the previous sanction of the Central Government present a petition for winding up of a company but only on the following grounds, namely:

- default is made in delivering the statutory report to the Registrar or in holding the statutory meeting; or
- it does not commence business within a year from its incorporation or suspends business for a whole year; or

- the number of its members in the case of a public company is reduced below seven and in the case of a private company, below two; or
- it is unable to pay its debts; or
- the Court is of the opinion that it is just and equitable that it should be wound up; or
- if the company has made a default filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years;
- If authorized by the Central Government under Section 243

In all these cases the Registrar has to obtain previous sanction of the Central Government to the presentation of a petition. However the registrar shall not present a petition unless it appears to him either from the financial condition of the company as disclosed in its balance sheet or from the report of special auditor appointed under 233A or an inspector appointed under Section 235/237 that the Company is unable to pay its debts.

(v) Petition by persons authorised by Central Government¹

By virtue of Section 243, if any report of an inspector appointed under Section 235 or 237 to investigate affairs of a company discloses:

- (i) that the business of the company is being conducted to defraud its creditors or members or any other person otherwise for a fraudulent or unlawful purpose or in a manner oppressive of any of its members or that the company was formed for any fraudulent or unlawful purposes or
- (ii) that the persons concerned in the formation of the company or management have been guilty of fraud, misfeasance or misconduct towards the company or towards any of its members;

and it appears to the Central Government from such report that it is expedient so to do, then the Central Government may, unless the company or body corporate is already being wound up by the court, authorise any person (including the Registrar) to petition for the winding up of the company on the ground that it is just and equitable that the company should be wound up.

(vi) Jurisdiction of Court for entertaining Winding up Petition

In terms of the provisions of Section 10 of the Companies Act, 1956, the jurisdiction for entertaining winding up petition vests either in the High Court having jurisdiction in relation to the place where the registered office of the company is situate or the District Court of the area subordinate to the High Court, in which the jurisdiction has been vested either by the Act or by the Central Government by notification in the Official Gazette. In *GTC Industries Ltd. v. Parasrampuriah Trading* (1999) 34 CLA 380 (All HC), it was held that only High Court where the registered office is situated has jurisdiction in winding up, even if there was agreement between parties that dispute between parties will be resolved before High Court where registered office is not situated. Regardless of where agreement is executed, Company Court having jurisdiction over the place where the registered office is

¹ Powers are now delegated to Regional Directors.

situated, will have the jurisdiction to entertain a petition for winding up. *LKP Merchant Financing v. Arwin Liquid Gases* (2001) 103 Comp. Cas. 211 (Guj.).

For the purposes of jurisdiction to wind up companies, the expression 'Registered Office' means the place which has longest been the registered office of the company during the six months immediately preceding the presentation of the petition for winding up. In *Kalpna Trading v. N.C.L. Industries Ltd.* [(1996) 1 Comp. LJ 152], the Orissa High Court refused to entertain the petition for winding up as the Company had its place of Registered Office at Hyderabad.

Compulsory Winding up by the Court

(i) A winding up of a company by the Court shall be deemed to commence at the time of the presentation of the petition for winding up [Section 441(2)].

(ii) As per rules of the High Court, every petition shall be advertised 14 days before the hearing, stating the date on which the petition was presented and names and addresses of petitioners. The petition has to be verified by an affidavit. The petition must contain the allegations and true facts together with the date of incorporation of the company, the situation of its registered office, the amounts of its paid-up capital a prayer that the company be wound up in the end. A copy of such petition must be served at the registered office of the company.(Rule 24 of Companies(Court) Rules, 1959.

(iii) An order for winding up a company shall operate in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of a contributory (Section 447).

(iv) At any time after the presentation of a winding up petition and before a winding up order had been made, the company or any creditor or contributory may apply to the High Court or supreme Court, in which the suit or proceeding is pending against the company in any other Court, such an application may be made to the Court having jurisdiction to wind up the company, to stay or restrain further proceeding in the suit or proceeding. The Court to which application is so made may stay or restrain the proceedings accordingly on such terms as it thinks fit (Section 442): [See also *Governor General-in Council v. Shiromani Sugar Mills*, AIR (1946) FC 16].(This provision has been omitted by Companies(Second Amendment) Act, 2002. How ever effective date is yet to be notified)

(v) Two companies cannot be wound up by the same order.

(vi) In case several petitions are presented; they rank according to the date of presentation.

(vii) On hearing the petition, the Court may either

- (a) dismiss it, with or without costs, or
- (b) adjourn the hearing conditionally or unconditionally, or
- (c) make any interim order that it thinks fit, or
- (d) make a compulsory order for winding up the company with or without costs, or any other order that it may deem fit [Section 443(1)].

[(xi) ¹[As soon as the Court makes an order for the winding up of a company, the court shall forthwith cause intimation thereof to be sent to the Official Liquidator and the Registrar. This is necessary so that Official Liquidator can take up the administration of the Company in winding up immediately (Section 444).]

(xii) On the making of a winding up order, it is the duty of the petitioner in the winding up proceedings and of the company to file with the Registrar a certified copy of the order in e-form 21, within 30 days from the date of making of the order. The Registrar shall thereupon make a minute thereof in his books relating to the company and shall notify in the *Official Gazette* that such an order has been made. Such order shall be deemed to be the notice of discharge to the officers and employees of the company, except when the business of the company is continued. In computing the period of 30 days from the date of the making of a winding up order under this section, the time requisite for obtaining certified copy of the order shall be excluded [Section 445].

(xiii) When a winding up order has been made or the Official Liquidator has been appointed as Provisional Liquidator, no suit or other legal proceedings shall be commenced, or if pending at the date of the winding order, shall be proceeded with, against the company, except by leave of the Court and subject to such terms as the Court may impose [Section 446].

(xiv) As per Section 449 of the Companies Act, 1956, on the issue of the winding up order, the Official Liquidator becomes the liquidator of the company by virtue of his office.

In *Mafatbhai V. Shah v. Secretary* (2000) 27 SCL 361, it was held that if Official Liquidator does not have adequate staff and is not in a position to look after properties of the company which are wound up under orders of the Court, he can get Receiver appointed with the leave of the Court. The Court can pass appropriate orders.

(xv) The Court shall also settle the list of contributories, make calls and determine any other question arising in winding up on the application of the liquidator (Section 467).

(xvi) Where the Court has made the order or appointed the Official Liquidator, the directors, secretary, manager or chief officer of the company shall make out and submit to the Official Liquidator, a statement as to the affairs of the company in the prescribed form, verified by an affidavit, containing the following particulars:

- (a) the assets of the company stating separately the balance in hand and at the bank and the negotiable securities, if any, held by the company;
- (b) its debts and liabilities;
- (c) the names, residences and occupations of its creditors, stating separately the amount of secured and unsecured debts; and in the case of secured debts particulars of securities, their values and their dates;

¹ Substituted by Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified as:

Where the tribunal makes an order for the winding up of the company, the tribunal shall within a period not exceeding two weeks from the date of passing the order, cause intimation thereof to be sent to the official liquidator and the Registrar.

- (d) the debts due to the company and the names and addresses of the debtors and the amount likely to be realised thereupon [Section 454(1)];
- (e) such further or other information as may be prescribed, or as the official liquidator may require.

This statement has to be submitted within 21 days from the date of the appointment of provisional liquidator or if no such appointment is made, the date of winding up order. The Official Liquidator or the Court, for special reasons, may extend this time up to three months. The persons making the statement and affidavit are to be paid by the Official Liquidator or Provisional Liquidator out of the assets of the company, such costs and expenses incurred as the Official Liquidator may consider reasonable subject to an appeal to the Court. If any person without reasonable excuse makes a default in complying with any requirements of this section, he is liable to be punished with imprisonment for a term which may extend to two years or to a fine not exceeding ₹ 1,000 for every day during which the default continues. This is a criminal liability triable by the winding up Court, which is a High Court itself. For speedy administration of liquidation proceedings it is necessary that Official Liquidator should know all the assets and liabilities with necessary details at an early date. If directors and officers commit default, without reasonable excuse then they are criminally liable to severe punishment.

In *Official Liquidator v. P.R. Mehta* (2000) 36 CLA 210, it was held that the prosecution has to prove that the person has failed to submit the statement without reasonable cause. If a person was not director on relevant date or if there was reasonable cause for non-filing for statement, liability under this provision would not be there. In *Indla Satya Raju v. Sramika Agro Farm* (2002) 39 SCL 940, it was held that a person cannot be prosecuted and convicted under Section 454 merely for reason that he committed default in complying with any requirements of Section 454. In addition to establishing default, prosecution is also required to establish that the said person, without reasonable excuse, committed such fault.

(xvii) After the receipt of the above statement the Official Liquidator prepares and submits a preliminary report to the winding up Court within six months or such extended period as may be allowed by the Court stating the amount of capital issued, subscribed and paid-up and the estimated amount of assets and liabilities of the company in liquidation giving separately, under the heading of assets, particulars of:

1. Cash and negotiable securities;
2. Debts due from contributories;
3. Debts due to the company and security, if any, available in respect thereof;
4. Moveable and immovable properties belonging to the company; and
5. Unpaid calls (Section 455).

If the liquidator is of the opinion that a fraud has been played in relation to the company and if he thinks fit he may submit a further report to the Court in this regard [Section 455(2)]. This report of the Official Liquidator is absolutely privileged. The preliminary report of the Official Liquidator shall be heard by the judge in Chambers. The Judge can give such directions as he may consider necessary. On further report there can be a direction about the public examination of the directors (Section 478).

(xviii) The Official Liquidator shall take into his custody or control all the property, effects an actionable claims to which the company is or appears to be entitled. For this purpose, he can take help of the Chief Presidency Magistrate or District Magistrate (Section 456). The Official Liquidator then acts as a custodian. His position is that of a receiver and an officer of the Court. The liquidator has to realise all the assets. For that he may institute various legal proceedings, sell the immovable and movable property and actionable claims of the company and distribute these assets (Section 457). For this purpose he has to invite claims from creditors, settle them and make payments to creditors as per their respective rights (Sections 528 to 530).

A Liquidator is an agent employed for the purpose of winding up of the company. In some respects he is a trustee, but he is not a trustee for each individual creditor. His principal duties are to take possession of assets, to make out the requisite list of contributories and of creditors, to have disputed cases adjudicated upon, to realize the assets subject to the control of the Court in certain matters and to apply the proceeds in payment of the company's debts and liabilities in due course of administration and having done that, to divide the surplus amongst the contributories and to adjust their rights [*Discount Bank of India Ltd. (in liquidation) v. Trilok Nath* (1952) 54 Punj LR 335].

In *Remu Pipes v. IFCI* (2002) 35 SCL 358, it was held that ownership of assets of company in liquidation remains with the company but by a legal fiction the properties are taken to be vested in the Court. The Official Liquidator takes properties under his control and custody with the permission of Court and under its superintendence. The Official Liquidator is custodian of property and statutory trustee. Assets of company in liquidation vest in Court and not in Official Liquidator. Official Liquidator can not sell property without sanction of Court. He has no absolute say in the matter of disposal of the company's property. While granting sanction, the Court can issue suitable directions as it may think fit and proper.

On commencement of winding up, the limitation ceases to run in favour of the company. The period from the date of commencement of winding up to date of the making of the winding up order (both inclusive) and a period of one year from the date of winding up order is excluded for computing the period of limitation for any suit or application in the name and on behalf of the company, notwithstanding the provisions of the Limitation Act, 1963 or any other law for the time being in force. The suit or application must satisfy both the conditions, i.e., it must be in the name and on behalf of the company [Section 458(A)].

This relaxation and extension is only in favour of the company i.e. it is only in respect of suit or application in the name and on behalf of the company. It is not applicable to suits filed against the company. However, if the debt was time barred on date of winding up (i.e. when application for winding up was made) and was not enforceable, it does not get revived on filing of winding up application and passing of winding up order. [*Karnataka Steel v. Kohinoor Rolling Shutters* (2002) AIR SCW 4613].

(xix) By virtue of Section 482, any order made by a Court for, or in the course of, winding up a company is enforceable at any place in India other than that over which such Court has jurisdiction, by the Court which would have jurisdiction if the

registered office of the company had been situated at such place, and in the same manner in all respects as if the order had been made by that Court. The section may be illustrated by a decision of the Andhra Pradesh High Court in *Tulasamma v. Subhadaya Publications Ltd.*, AIR 1969 AP 207 that the District Court in Andhra Pradesh has jurisdiction to execute the order of the Madras High Court calling upon a judgment-debtor to pay call money which was sent to the Andhra Pradesh High Court for enforcement.

The expression 'in the course of winding up' as used in the section is not limited to what happens after a winding up order is made. As was pointed out by Sir George Jessel, M.R. in [In Re. *International Pulp and Paper Co.* (1876) 3 Ch.D. 594], "it would defeat the object of enabling the Court, once a winding up petition is presented, to see that the creditors of the company share rateably in the assets and that one particular creditor is not enabled 'to jump the gun' by taking an enforcement proceeding to any part of the country". The words have accordingly been widely interpreted to mean that once a winding up petition has been presented, everything thereafter is 'in the course of winding up a company', although it does not necessarily follow that a winding up order will eventually be made [In Re. *Dynamics Corporation of America*, (1976) 2 All ER 669].

Appeals from Orders or Decisions in the Matter of Winding Up

Section 483 of the Act provides that appeals from any order made, or decision given, in the matter of the winding up of a company by the Court shall lie to the same Court to which, in the same manner in which, and subject to the same conditions, under which, appeals lie from any order or decision of the Court in cases within its ordinary jurisdiction. Such order or decision, however, must be a judicial and not an administrative or a procedural one. An administrative order would be an order which is directed to the regulation or supervision of matters as distinguished from an order which decides the rights of parties or confers or refuses to confer rights to property which are the subject of adjudication before the Court. Thus, where the Court confirms the winding up sale after hearing the two contending parties and the order vitally affects the rights of such parties, the Court in making the order acts in a judicial way, and the order is a judicial order, and not a procedural or administrative one so as to be inherently incapable of being brought up in appeal [*Shankarlal v. Shankarlal*, AIR 1965 SC 507]. On the same principle, an order refusing stay of the winding up proceedings is a judicial order in the matter of winding up and is appealable (*Jagannath Gupta & Co. v. Mulchand Gupta*, AIR 1969 Cal 363). The stay order made in this case was set aside by the Supreme Court. On the other hand, no appeal would lie against an order removing a liquidator since such order cannot be said to be an order determining or affecting any rights of the parties in the winding up (*Gordhan Das v. Shilwate Deve*, AIR 1963 All. 606).

Similarly, an order dropping the misfeasance proceedings under Section 543 against some of the directors at an initial stage on the ground that there is no *prima facie* case against them directing them to continue against the other is not appealable since it cannot be said to decide finally the rights and liabilities even in respect of the former and the Court can reopen the inquiry in respect of them on the basis of fresh materials or otherwise according to law (*D.C. Mehta v. Lakshmipat*, AIR 1968 Pat. 280).

The expression 'in the matter of the winding up of a company' as used in the

Section would include the case of an application made under Section 446 of the Act for leave to file a suit against the company, and the order made on such application would be appealable under the Section (*Balkrishna Mahadeo Vertak v. Indian Associate Chemical Industries Ltd.*, 60 Bom. LR 30). The expression also includes an order directing advertisement of the winding up petition and an appeal would lie against such order (*Western India Theatres Ltd. v. Ishwarbhai Somabhai Patel*, AIR 1959 Bom. 386); [*Golcha Investment (P) Ltd., v. S.C.Bafna*, AIR 1970 SC 1850]. In the latter case, the Supreme Court further held that, by virtue of Rule 966-A in Chapter XII of the Bombay High Court Rules, such an appeal was entitled to be admitted as a matter of course and could not be summarily dismissed as was done by the High Court treating the order appealed against as interlocutory order.

The second part of the section which refers to 'the manner' in which and 'the conditions' subject to which appeals may lie must be construed as merely regulating the procedure to be followed in the presentation of the appeal and of hearing them, the period of limitation within which the appeal is to be presented and the forum to which the appeal would lie, and not as restricting or impairing the substantial right of appeal which has been conferred by the opening words of the section. It must be noted, however, that though the rights of appeal under the section is a substantive right, since the procedure applicable to regular appeals under the Civil Procedure Code is applicable to the appeals under the section, the right to file a cross-appeal or a cross-objection to any such appeal is a matter of procedure as comprised in Order 41, Rule 22 of that Code. Consequently, the respondent to any such appeal is entitled to file a cross objection under that provision of the Code [*The Central Provinces Syndicate (Private) Ltd. v. Sita Devi*, AIR 1973 MP 134].

Dissolution of Company in Compulsory Liquidation

The Court may make an order for dissolution of a company in the following conditions:

- (a) when the affairs of the company have been completely wound up; or
- (b) when the Court is of the opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason and it is just and equitable in the circumstances of the case that an order of dissolution of the company should be made.

Where an order in the above circumstances is made by the Court, the company will be dissolved from the date of the order of the Court. Within 30 days from the date of the order, the liquidator must send a copy of the order to the Registrar. On the dissolution, the corporate existence of the company comes to an end.

After order of dissolution, the company has no legal existence. Thus no suit can lie by or against the company after order of dissolution. In *Narendra Bahadur Tandon v. Shanker Lal* AIR (1980) SC 575, it was held that after company is dissolved, liquidator can not represent company and execute a deed of sale. Once company is dissolved, it ceases to exist and official liquidator can not represent a non-existent company.

The property of dissolved company vest in Government and not in the trustee. Hence shareholders or creditors of dissolved company cannot be regarded as heirs and successors. They cannot maintain any action for recovery of assets.

The Court may at any time declare the dissolution void within two years from the date of dissolution on application by the liquidator of the company or by any other person who appears to the Court to be interested. Thereupon such proceedings may be taken as might have been taken if the company had not been dissolved (Section 559).

In *Rishabh Agro Industries Ltd. v. PNB Capital Services Ltd.* (2000) AIR SCW, it was observed that winding up order passed under the Companies Act is not the culmination of proceedings pending before company Judge but is in effect the commencement of the process. The ultimate order to be passed in such a petition is the dissolution under Section 481.

Court's Power to declare Dissolution Void

The Court has also got the power to declare the dissolution of a company void in appropriate cases under Section 559 of the Act. Where a company has been dissolved as a result of the Court's order as aforesaid, or under Section 394 or otherwise, the Court, by that section, may at any time within two years of the date of dissolution, make an order, on the application of the liquidator or of any other person interested and upon such terms as it thinks fit, declaring the dissolution to have been void.

The effect of an order under Section 559 is that it makes the dissolution void *ab initio* and all consequences resulting from the dissolution are avoided, including proceedings taken during the interval between the date of dissolution and the date of declaration of dissolution as void. [*Morris v. Harris*, 1927 AC 252].

The person who obtains the order avoiding the dissolution must file a certified copy thereof with the Registrar within thirty days or such further time as the Court may allow. In case of default, he will be punishable with fine to the extent of ₹ 500 for every day during which the default continues.

Duties of the Secretary in respect of Compulsory Winding Up

The duties of the Secretary in respect of compulsory winding up of the company may be enumerated as follows:

- (i) If the company itself makes the petition for compulsory winding up, the Secretary should help the directors in drawing up the petition.
- (ii) He should see that a copy of winding up order, when passed by the Court is filed with the Registrar within 30 days of the making of the order.
- (iii) He should help in preparation of the statement of affairs of the company in the prescribed form for submission to the Official Liquidator. He should see that it is properly verified by an affidavit.
- (iv) He should give all necessary information to the Court, when called upon by it during the course of the winding up.
- (v) He should see that all documents, correspondence etc., issued by the company during the period of winding up contain a statement that the company is being wound up.

VOLUNTARY WINDING UP

The companies are usually wound up voluntarily as it is an easier process of

winding up. It is altogether different from a compulsory winding up. In voluntary winding up the company and its creditors are left to settle their affairs without going to a Court, although they may apply to the Court for directions or orders, as and when necessary. One or more liquidators are to be appointed by the company in general meeting for the purpose of winding up the affairs and distributing the assets of the company. The remuneration of the liquidators is also required to be fixed by the company in general meeting. Unless the remuneration as aforesaid is fixed the liquidators shall not take charge of his/their offices (Section 490). The circumstances in which a company may be wound up voluntarily are:

- (a) when the period fixed for the duration of the company as mentioned in its articles has expired; or
- (b) the event, on the happening of which the articles provide that the company is to be dissolved has occurred; and
- (c) the company passes a special resolution that the company be wound up voluntarily [Section 484 (1)].

Thus, a company may be wound up voluntarily on the expiry of the term fixed for duration of the company or on the occurrence of the event as provided in its articles. In these two cases only an ordinary resolution may be passed in the general meeting of the company. Apart from these two cases, a company may be voluntarily wound up for any other reason as well for which a company has to pass a special resolution. A proper notice required for the respective meetings must be given to all the members and in the latter case the text of the special resolution to be passed together with the reason to wind up voluntarily must be mentioned therein.

The resolution (whether ordinary or special), when passed, must be advertised within 14 days of the passing of the resolution in the *Official Gazette* and also in some newspaper circulating in the district where the registered office of the company is situated. A default in complying with the above requirements renders the company and every officer of the company, who is in default, liable to a penalty which may extend to five hundred rupees for every day during which the default continues. A liquidator of the company is deemed to an officer of the company for the purposes of the above requirements (Section 485).

A voluntary winding up commences from the date of the passing of the resolution for voluntary winding up. This is so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court.

The effect of the voluntary winding up is that the company ceases to carry on its business except so far as may be required for the beneficial winding up thereof. The corporate status and the powers of the company, however, continue until it is dissolved [Section 487].

Kinds of Voluntary Winding Up

Section 488(5) divides voluntary winding up into two kinds:

- (i) Members' voluntary winding up; and
- (ii) Creditors' voluntary winding up.

Members' Voluntary Winding Up

When the company is solvent and is able to pay its liabilities in full, it need not

consult the creditors or call their meeting. Its directors, or where they are more than two, the majority of its directors may, at a meeting of the Board, make a declaration of solvency verified by an affidavit stating that they have made full enquiry into the affairs of the company and that having done so they have formed an opinion that the company has no debts or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration.

In *Shri Raja Mohan Manucha v. Lakshminath Saigal* (1963) 33 Comp. Cas. 719, it was held that where the declaration of solvency is not made in accordance with the law, the resolution for winding up and all subsequent proceedings will be null and void. Such a declaration must be made within five weeks immediately preceding the date of the passing of the resolution for winding up the company and be delivered to the Registrar for registration before that date. The declaration must embody a statement of the company's assets and liabilities as at the latest practicable date before the making of the declaration. Any director making a declaration without having reasonable grounds for the aforesaid opinion, shall be punishable with imprisonment extending up to six months or with fine extending up to ₹ 50,000 or with both [Section 488].

A winding up in the case of which such a declaration has been made and delivered in accordance with Section 488 is referred to as "a member's voluntary winding up". A winding up in the case of which such a declaration has not been so made and delivered is referred to as a "creditors' voluntary winding up" [Section 488(5)].

Members' Voluntary Winding Up(Section 489 – 498)

(i) When declaration of solvency is made and filed with the Registrar in eform 62, the directors arrange to convene a meeting of the members of the company and pass the necessary resolution of winding up (Section 484).

(ii) The company shall appoint in general meeting one or more liquidators for the purpose of winding up the affairs and distributing the assets of the company and fix the remuneration to be paid. Any remuneration so fixed shall not be increased in any circumstances. The liquidators shall not take charge of his office unless the remuneration is fixed (Section 490).

(iii) On the appointment of liquidation, all the powers of the Board of directors, managing directors, or wholetime directors, and managers (if any) of the company cease except for the purpose of giving notice of the appointment of liquidator to the Registrar or so far as the company in general meeting or the liquidator may sanction their continuance (Section 491).

(iv) If any vacancy occurs by death, resignation or otherwise in the office of any liquidator appointed by the company, the company in general meeting, subject to any arrangement with its creditors, can fill the vacancy. The general meeting for this purpose may be convened by the continuing liquidator or by any contributory and must be held in the manner provided by the article or in any manner prescribed by the Court (Section 492).

(v) The company has to give notice to the Registrar relating to the appointment of liquidator or liquidators made by it under Section 490, of every vacancy occurring in

the office of the liquidator, and of the name of the liquidator or liquidators appointed to fill every such vacancy under Section 492. The notice aforesaid shall be given by the company in within 10 days of the event to which it relates. In case of default, the company and every officer of the company (including every liquidator or continuing liquidator) who is in default, shall be punishable with fine extending up to ₹ 1,000 for every day till the default continues [Section 493]. The liquidator must also inform the Registrar of his appointment within thirty days thereof and publish the notice in *the Official Gazette* (Section 516). He is also required to file Form No. 152 of the Companies (Court) Rules, 1959 with Registrar. He is also required to notify his appointment to the Income-tax Officer who is entitled to assess the income of the company. He must also comply with the other provisions of the Section 178 of the Income Tax Act.

(vi) The liquidator (under members' voluntary winding up) may transfer the whole or any part of the company's business or property to another company (called the transferee company) and receive, with the sanction of the special resolution of the transferor company by way of compensation for the transfer or sale, shares, policies or other like interests in the transferee company, for distribution among the members of the transferor company or may enter into any other arrangement whereby the members of the transferor company may in lieu of receiving cash, shares, policies, or other like interests participate in the profits or receive any benefit from the transferee company. Any sale or arrangement made by the liquidator shall be binding on the members of the transferor company [Section 494(1) and (2)].

If any member of the transferor company, who did not vote in favour of the special resolution, objects to the arrangement entered into by the liquidator, he may express his dissent in writing addressed to the liquidator and leave it at the registered office of the company within seven days after the passing of the resolution and he may also require the liquidator either to abstain from carrying the resolution into effect or to purchase his interest at a price to be determined by arrangement or by arbitration. If the liquidator decides to purchase the dissenting member's interest, the purchase money shall be paid before the company is dissolved [Section 494(3) and (4)].

(vii) In the event of the winding up continuing for more than one year, the liquidator is required to call general meeting of the company at the end of the first year from the commencement of the winding up, and at the end of the each succeeding year, or as soon thereafter as may be convenient within three months from the end of the year or such longer period as the Central Government¹ may allow, and must lay before the meeting an account of his acts and dealings and of the conduct of the winding up during the preceding year, together with a statement in the prescribed form containing the prescribed particulars with respect to the proceedings and position of liquidation. In case of default, the liquidator is liable to a fine not exceeding ₹ 1,000 (Section 496).

(viii) As soon as the affairs of the company are fully wound up, the liquidator has to make an account of the winding up showing how the winding up has been conducted and the property of the company has been disposed of and is required to summon a general meeting of the company for the purpose of laying the account

¹ Powers are delegated to Regional Director.

before it and giving any explanation thereof. The meeting must be called by giving a month's notice specifying the time, place and object of the meeting and the notice must appear in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situate. Within one week after the meeting, the liquidator must send to the Registrar and the Official Liquidator a copy of the account and shall make a return to each of them of the date and holding of the meeting. If a quorum is not present at this meeting, the liquidator shall make a return that the meeting was duly called but the quorum was not present [Section 497(1) to (4)].

(ix) The Registrar, on receiving account and the return shall forthwith register them. The Official Liquidator, on receiving the account and the return shall, as soon as may be, make and the liquidator and all officers, past or present, of the company shall give the official liquidator all reasonable facilities to make a scrutiny of books and papers of the company and if on such scrutiny the official liquidator makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest then from the date of submission of such report the company shall be deemed to be dissolved. The Official Liquidator scrutinise the accounts of pre-liquidation as well as of post-liquidation period and for discharging this duty the Voluntary Liquidator and all past and present Officers of the company shall give to the Official Liquidator all reasonable facilities.

If on such scrutiny the Official Liquidator makes a report to the Court that the affairs of the company have been conducted in a manner prejudicial to the interest of its members or to public interest, the Court shall by order direct the Official Liquidator to make a further investigation of the affairs of the company and for that purpose shall invest him with all such powers as the Court may deem fit.

On the receipt of the report of the Official Liquidator on such further investigation, the Court may either make an order that the company shall stand dissolved with effect from the date to be specified by the Court therein or make such other order as the circumstances of the case brought out in the report permit. If the liquidator fails to call a general meeting of the company, he is also liable to fine extending up to ₹5,000 [Section 497(5) to (7)].

Creditors' Voluntary Winding Up (Sections 500 to 509)

The following provisions as contained in Sections 500 to 509 of the Companies Act, 1956 apply to a creditors' voluntary winding up:

(i) In this case the company must call a meeting of its creditors for the day or the day next following the day on which there is to be held the general meeting of the company at which the resolution for voluntary winding up is to be proposed and notices of the meeting of creditors be sent by post to the creditors simultaneously with the notices of the general meeting of the company. The notice of the meeting must also be advertised once atleast in the *Official Gazette* and once at least in two newspapers circulating in the district where the registered office or principal place of business of the company is situate [Section 500(1) and (2)].

(ii) The directors of the company shall prepare a full statement of the position of the company's affairs together with a list of the creditors of the company and an

estimated amount of their claims to be laid before the meeting of the creditors to be held as aforesaid. They must also appoint one of their number to preside at the said meeting. It shall be the duty of the director appointed to preside at the meeting of the creditors to attend the meeting and preside thereat [Section 500(3) and (4)].

(iii) If the meeting of the company at which the resolution for voluntary winding up is to be proposed is adjourned owing to some reason and the resolution is passed at an adjourned meeting, any resolution passed at the meeting of the creditors held in pursuance of Sub-section (1) of Section 500 shall have effect as if it had been passed immediately after the passing of the resolution for winding up the company [Section 500(5)].

Default in complying with Section 500 will render the company, the directors and officers liable to a fine up to ₹ 10,000.

(iv) Notice of any resolution passed at a creditors meeting must be given by the company to the Registrar within ten days of the passing thereof. In case of default, the company and every officer of the company who is in default is liable to a fine which may extend to ₹ 500 for every day till the default continues. For this purpose, a liquidator of the company shall be deemed to be an officer of the company [Section 501].

(v) The creditors and the company at their respective meetings mentioned in Section 500 may nominate a person to be liquidator, but the person nominated by the creditors shall become the liquidator subject to an application to the Court. If no person is nominated by the creditors, the person nominated by the company shall be liquidator. Further if no person is nominated by the company, the person nominated by the creditors shall be liquidator. (Section 502).

(vi) The creditors may at the same or subsequent meeting appoint a Committee of Inspection consisting of not more than five members. If such a committee is appointed, the company may also at the same or any subsequent general meeting appoint such number of persons not exceeding five as they think fit to act as members of the committee. In any case, the creditors may resolve that all or any of the persons so appointed by the company ought not to be members of the committee of Inspection, whereupon the persons mentioned in the company's resolution shall not be qualified to act as members of the committee unless the Court otherwise directs. The Act provides that the powers and proceedings of such Committee of Inspection are the same as those of a Committee of Inspection appointed in a winding up by Court (compulsory winding up) and as provided in Section 465 (Section 503).

(vii) The remuneration to be paid to the liquidator in creditors voluntary winding up is to be fixed either by the Committee of Inspection or by creditors. Where the remuneration is not so fixed, it shall be determined by the Court. Any remuneration fixed by the Committee or creditors cannot be increased in any circumstances whatsoever whether with or without the sanction of the Court (Section 504).

(viii) On the appointment of a liquidator, all the powers of the Board of directors shall cease, except in so far as the Committee of Inspection, or if there is no such committee, the creditors in general meeting may sanction the continuance thereof (Section 505).

(ix) If a vacancy in the office of Liquidator occurs by death, resignation or

otherwise (other than a liquidator appointed by or by the direction of the Court) the creditors in general meeting may fill the vacancy. (Section 506)

Section 508 of the Act requires the liquidator, in creditors winding up, to call a general meeting of the company and a meeting of the creditors at the end of the first year from the commencement of the winding up and at the end of each succeeding year or as soon thereafter as may be convenient, within three months from the end of the year or such longer period as the Central Government may allow. At this meeting he must lay accounts of his acts and dealings and of the conduct of winding up during the preceding year together with a statement in Form No. 153 of the Companies (Court) Rules, 1959, containing the prescribed particulars with respect to the proceedings in, and position of, the winding up.

Section 509 provides that as soon as the affairs of the company in creditors' winding up are fully wound up the liquidator shall make up an account of the winding up showing how the winding up has been conducted and the property of company has been disposed of. Thereafter he will call general meeting of the company and of the creditors for the purposes of laying the accounts before the meeting and giving explanations thereof as may be required. The procedure for calling the meeting, filing of the return with the Registrar and the Official Liquidator, making of the report to the Court by the Official Liquidator for dissolution of the Company etc., is the same as prescribed in the case of final meeting of a company in members' voluntary liquidation.

Distinction between Members' and Creditors' Voluntary Winding Up

The main differences between the two are as follows:

1. A member's voluntary winding up results where, before convening the general meeting of the company at which the resolution of winding up is to be passed, the majority of the directors file with the Registrar a statutory declaration of solvency. A creditors' voluntary winding up is one where no such declaration is filed.

2. In a member's voluntary winding up, the creditors do not participate directly in the control of the liquidation, as the company is deemed to be solvent; but in a creditors' voluntary winding up, the company is deemed to be insolvent and, therefore, the control of liquidation remains in the hands of the creditors.

3. There is no meeting of creditors in a members' voluntary winding up and the liquidator appointed by the company acts in the liquidation of its affairs; whereas in a creditors' voluntary winding up, meetings of creditors have to be called at the beginning and subsequently the liquidator is appointed by the creditors.

4. In a members' voluntary winding up the liquidator can exercise some of his powers with the sanction of a special resolution of the company; but in a creditors' voluntary winding up he can do so with the sanction of the Court or the Committee of Inspection or of a meeting of creditors.

5. In a winding up where the creditors are interested and the directors are not able to guarantee the company's solvency, the creditors are entitled to secure control of the winding up, so that their interests may be safeguarded. (Section 495)

Provisions applicable to every type of voluntary winding up (ie both Members/Creditors Voluntary Winding up)

The provisions applicable to every type of voluntary winding up are

comprehensively stated in Sections 511 to 521 of the Act and these apply to every type of voluntary winding up whether it be a members' or a creditors' winding up:

(i) Distribution of Property of Company

Subject to the provisions of the Act as to preferential payments, the assets of the company shall, on its winding up, be applied in satisfaction of its liabilities *pari passu* and subject to such application, shall unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company (Section 511).

(ii) Powers and Duties of Liquidators in Voluntary Winding Up

(a) The liquidator of a company in a voluntary winding up may exercise the same powers as are exercised by an Official Liquidator in a compulsory winding up - some with the sanction of a special resolution of the company or with sanction of the Court or the Committee of Inspection, and some without any such sanction.

In the case of a member's voluntary winding up, with the sanction of a special resolution of the company, and in the case of a creditor's voluntary winding up, with the sanction of the Court or, the Committee of Inspection or, if there is no such committee, of a meeting of the creditors, exercise any of the following powers as specified in Sections 457(1)(a) to (d)—

- (i) To institute or defend any suit, prosecution or other proceeding, civil or criminal, in the name and on behalf of the company.
- (ii) To carry on the business of the company so far as may be necessary for the beneficial winding up of the company.
- (iii) To sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer the whole thereof to any person or body corporate, or to sell the same in parcels.
- (iv) To raise on the security of the asset of the company any money requisite.

(b) The liquidator may, without sanction referred to in (a) above, exercise any of other powers.

(c) He may exercise the power of the Court, under this Act, of settling a list of contributories and of making calls.

(d) He may call general meeting of the company for the purpose of obtaining the sanction of the company by ordinary or special resolution, as the case may require or for any other purpose he may think fit.

(e) The liquidator shall pay the debts of the company and shall adjust the rights of the contributories among themselves.

(f) When several liquidators are appointed, one or more of them may exercise such powers as may be determined at the time of their appointment (Section 512).

(iii) Body Corporate not to be appointed

A body corporate is not qualified for appointment as liquidator of a company in a

voluntary winding up. Any appointment made in contravention to the body corporate is void and every director, or manager of that body corporate shall be punishable with fine which may extend to ₹ 10,000* [Section 513].

➤ ***A body corporate cannot be appointed as liquidator***

(iv) Corrupt Inducement Affecting appointment as Liquidator

Any person who gives, or agrees or offers to give, to any member or creditor of a company any gratification whatever with a view to securing his own appointment or nomination as the company's liquidator; or securing or preventing the appointment or nomination of some person other than himself, as the company's liquidator shall be punishable with fine which may extend to ₹ 10,000*¹ (Section 514). The inducement must be by way of giving any gratification. 'Gratification' means satisfaction of appetite or desire. It is not always money given by way of bribe. It is anything which gives satisfaction to the recipient. *State v. Pundlik Bhikaji Ahire*, AIR 1959 Bom 543.

(v) Power of Court to appoint and remove liquidator in voluntary winding up

If from any cause whatever, there is no liquidator acting, the Court may appoint the official liquidator or any other person as a liquidator.

The Court may, on cause shown, remove a liquidator and appoint the Official Liquidator or any other person as a liquidator in place of the removed liquidator.

The Court may also appoint or remove a liquidator on the application made by the Registrar in this behalf. If the Official Liquidator is appointed as Liquidator under Section 502(2) or under Section 515, the remuneration to be paid to him shall be fixed by the Court and shall be credited to the Central Government [Section 515(4)].

(vi) Notice by Liquidator of his Appointment

The liquidator shall, within 30 days after his appointment, publish in the Official Gazette, and deliver to the Registrar in e-form 62 for registration, a notice of his appointment in the form prescribed. He cannot escape the statutory liability by disputing the legality of his own appointment. *Emperor v. Satish Ch. Ghose*, ILR 39 ALL 412. In case of default, the liquidator is liable to punishment with fine up to ₹ 500* per day till the default continues (Section 516).

(vii) Arrangement when Binding on Company and Creditors

Any arrangement entered into between a company about to be or in the course of being, wound up and its creditors shall, subject to the right of appeal under Section 517, be binding on the company and on the creditors if it is sanctioned by a special resolution of the company and acceded to by three-fourth in number and value of creditors. Any creditor or contributory may within three weeks from the completion of the arrangement; appeal to the Court against it and the Court may thereupon, as it thinks just, amend, vary, confirm or set aside the arrangement (Section 517).

(viii) Public Examination of Directors etc.

The Court may on application by a liquidator, contributory or creditor determine any

* Increased vide Companies (Amendment) Act, 2000.

question arising in the winding up of a company and order public examination of promoters, directors, etc. on a complaint of liquidator that in his opinion a fraud has been committed by any person in the promotion or formation of the company or by an officer of the Company in relation to Company since its formation. (Sections 518-519).

(ix) Cost of Voluntary Winding Up

All costs, charges and expenses properly incurred in the winding up including the remuneration of the liquidator is, subject to the rights of secured creditors, payable out of the assets of the company in priority to all other claims (Section 520).

It is only where the assets of a Company in voluntary liquidation are insufficient to discharge its liabilities, the question of priority of payment of costs, charges and expenses will arise. Costs and expenses of an investigation brought about by the liquidator which was not at all necessary were held to be not allowable. *Tony Rowse NMC Ltd., Re*, (1996) 2 BCLC 225 (CH D). Even if the Court has a discretion under the inherent jurisdiction to permit the liquidator to recover the costs of the proposed litigation from the assets of the company, the Court would not exercise that discretion since there was insufficient information before the Court to reach a proper decision. *Floor Fourteen Ltd. Re*, (2001) 2 BCLC 392 (CA); *Levis v. IRC*, (2001) 2 CCLC 392 (CA).

Duties of the Secretary in case of Voluntary Winding Up

Some of the important duties of the secretary are given below:

- (i) He should arrange for the calling of a Board meeting to fix the date, time, place and agenda of the general meeting of members where the resolution for winding up the company is to be passed and the creditors' meeting to be held immediately thereafter.
- (ii) He should see that the Board meeting approves the draft resolution to be placed at the general meeting, as well as nominates a director to preside over the creditors' meeting.
- (iii) He should help in preparing the statement of affairs of the company and the list of creditors to be placed at the creditors' meeting.
- (iv) Notices of the general meeting of members' and the creditors' meeting should be issued by post simultaneously. He should also send these notices to be published in the *Official Gazette* as well as in two newspapers circulating in the district in which the registered office of the company is situated [Section 500].
- (v) To see that the general meeting of members is duly held and a special resolution, for winding up the company and appointing a liquidator, is duly passed thereat [Section 502].
- (vi) According to Sections 500, 502 and 504 of the Companies Act, he should see that the creditors' meeting is duly held, the statement of affairs and creditors' list is duly placed before the meeting and a resolution, approving the winding up appointing a liquidator and fixing his remuneration, is duly passed thereat.
- (vii) He should see that a statement of affairs of the company in Form No. 57 is

duly verified by affidavit and submitted in duplicate to the liquidator within 21 days of the commencement of the winding up [Section 454].

- (viii) He should intimate to the Income-tax Officer about the winding up of the company within 15 days.
- (ix) He should file the notice of the resolution passed at the creditors' meeting with the Registrar within 10 days of passing of the resolution (Section 501).
- (x) He should file a copy of special resolution for winding up in e-Form No. 23 with the Registrar within 30 days of the passing of it (Section 192).
- (xi) He should get a copy of the resolution published in the *Official Gazette* and newspapers within 14 days of its passing (Section 485).
- (xii) All correspondence and documents issued by the company during the period of the winding up contain a statement that the company is being wound up.
- (xiii) He should assist the liquidator in every possible way and see that all books, papers and documents, as well as movable and immovable properties of the company are delivered to liquidator as and when directed, and to appear before the Court, if directed, and give evidence regarding the affairs of the company (Sections 519 and 538).

IMPORTANT PROVISIONS APPLICABLE IN CASE OF EVERY MODE OF WINDING UP (IE COMPULSORY AND VOLUNTARY WINDING UPS INCLUDING MEMBERS AND CREDITORS VOLUNTARY WINDING UPS)

(i) Overriding Preferential Payments (Section 529A)

According to Section 529A, 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; (b) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to Sub-section (1) of Section 529 *pari passu* with such dues shall be paid in priority to all other debts.

In the case of *Allahabad Bank v. Canara Bank* [2000 (101) Comp. Cas. 64 (SC)] the Supreme Court held that when the secured creditors stand outside the winding up and realise their security on the assets of the company sold in pursuance of the order of Debt Recovery Tribunal, dues of workers, if any, are to be satisfied first before the sale proceeds are appropriated by the secured creditors. The impact is that Section 529A of the Companies Act has overriding effect on the provisions of Recovery debts due to Banks and Financial Institutions Act, 1993.

Section 529(2) provides that the debts payable under clause (a) and clause (b) of Sub-section (1) shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

The statutory charge under Section 529 acquires the status of *pari passu* charge for labour dues alongwith secured creditor.

(ii) 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 ₹ 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.

Persons who claim to be creditors must prove their debts within the time fixed by the Court, or in voluntary winding up, by the liquidator. If a creditor does not prove within the time fixed, he may still prove. In a winding up by the Court, if a creditor fails to file his proof of debt within time then he should apply to the Court for relief, i.e., condonation of delay under rule 177 of the Companies (Court) Rules, 1959. The creditor may then be paid out of any assets remaining in the hands of the liquidator but

he cannot upset any dividend which has already been paid. Even where no claim is made by a creditor, the liquidator must pay him after all the other creditors have been paid and assets available, provided he is satisfied that the debt is due to the creditor. But the liquidator must not pay a statute barred debt if the shareholders object.

(iii) Fraudulent Preference

The insolvency rules as to fraudulent preference apply to companies. The object of the Act being a *pari passu* distribution, Section 531 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 by 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. Thus where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilized to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was ceased after it was fairly clear that the company had become insolvent. [*Re. F.L.E. Holdings Ltd.* (1967) 3 ALL ER 353.]

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. In order to establish fraudulent preference it is not enough only to show that the preference was to a particular creditor, it must also be proved that it was done with a view to giving him a "favoured treatment". The dominant motive attending transfer has to be ascertained and if it is tainted with an element of dishonesty, the question of fraud arises. The probe into the debtors' mind and an assessment of the various motives that animate his conduct is thus involved. There must be solid grounds for drawing an inference of dishonesty. Mere suspicion, however strong, is not sufficient. There is no fraudulent preference if the transfer is not voluntary. [*Official Liquidator, Kerala High Court v. Victory Hire Purchasing Co. (P) Ltd.*, (1982) 52 Comp. Cas. 88 (Ker)].

(iv) Avoidance of Voluntary Transfer

Any voluntary transfer of property of any kind by a company, otherwise than in the ordinary course of business for valuable consideration, made within a period of one year before the commencement of winding up, shall be void against liquidator [Section 531A].

The purpose of the provision is to be preserve the assets of the Company and to enable the company to carry out transactions that might be for the benefit of those interested in the assets of the company. *Sugar Properties (Derisley Wood) Ltd.*, 1988 BCLC 146 (Ch. D

- (v) *Any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void (Section 532).* The words 'any transfer of all its property' includes the transfer of an interest in all its property. Accordingly, a floating charge or a debenture upon the whole of a company's property for the benefit of all its creditors comes within this section. *London Joint City and Midland Bank v. Dickinson (H.)* 1922 WN 13.
- (vi) *On the commencement of winding up any floating charge created within the preceding 12 months becomes invalid except as to any cash advanced at the time of or subsequent to the creation of the charge, together with interest on that amount at the rate of 5 per cent per annum or at such other rate as from time to time be notified by the Central Government in the Official gazette (Section 534).*
- (vii) Section 535 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, and may accordingly prove the amount as a debt in the winding up. The Court may, require notices to be given to persons interested in the property before granting the disclaimer.

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.

(viii) Disposition of Property after the commencement of winding up shall be void.

According to Section 536, any disposition of the property (including actionable claims) of the company, any transfer of shares in the company or alteration in the status of its members, made after the commencement of the winding up shall be void, unless the court otherwise orders. Thus, the court can direct that any such disposition of property or actionable claims or transfer of shares or alteration of status of members will be valid. But unless the Court so directs, such disposition, transfer or alteration will be void.

(ix) Any attachment and sale of the estate properties or effects of the company, after the commencement of the winding up will be void

Section 537 declares that any attachment and sale of the estate properties or effects of the company, after the commencement of the winding up will be void. In the case of winding up by the Court any attachment, distress or execution put in force, without leave of the Court against the estate or effects of the company after the commencement of the winding up will be void. Similarly any sale held, without leave of the Court, of any of the properties or effects of the company after the commencement of the winding up will be void. But with leave of the Court, attachment and sale of the properties of the company will be valid even if such attachment and sale are made after the commencement of the winding up of the company. Besides, this section does not apply to any proceedings for the recovery of any tax or impost or any dues payable to the Government. In *Titan Industries v. Punwire Mobile Communications* (2002) 40 SCL 117, it was held that Section 537 being a central legislation prevails over state law in case of conflict/overlapping and Registrar of Cooperative Societies cannot attach property of company under liquidation.

(x) Avoidance of Transfer of Shares in Voluntary Winding Up

Section 536 provides that any transfer of shares in the company not being a transfer made to or with the sanction of the liquidator and any alteration in the status of the members of the company made after the commencement of the winding up shall be void. In the case of winding up by, or subject to the supervision of the Court, any disposal of property (including actionable claims) of the company and any transfer of shares in the company or alteration in the status of its members made after the commencement of the winding up is void unless Court otherwise orders.

CONSEQUENCES OF WINDING UP

The process of winding up has important consequences for different parties - contributories, creditors, officers of the company and so on. Firstly, we shall deal with the consequences of winding up as to different parties and other aspects of the administration of company law subsequently.

Consequences as to Shareholders described as Contributories

A shareholder in a company limited by shares is liable to pay full amount on the shares held by him but nothing more. This liability of his continues after winding up, but then a shareholder or member is described by the Companies Act, 1956 as a "Contributory", and the nature of his liability changes.

Nature of Contributory's Liability

According to Section 428, a "Contributory" means every person liable to contribute to the assets of a company in the event of its being wound up, and includes the holder of fully paid-up shares. In the case of a deceased member, his legal representatives will be liable in due course of administration to contribute to the assets of the company in discharge of his liability and will be contributories accordingly [Section 430]. Thus, in the case of a deceased member his legal representatives will be liable for the debts of the deceased contributory but their liabilities will be limited to the extent of the assets of the deceased coming in their hands [see *Bayswater Trading Co. Ltd.*, (1970) 1 all ER 608]. If the legal representatives make default in paying the money demanded to be paid by them, proceedings may be taken for administering the estate left by the deceased contributory and compelling payment there out of the money due (Section 430). In the case of an insolvent member his assignees in insolvency represent him for all the purposes of the winding up as contributories and will be liable to the debts of the insolvent contributory out of the assets that have come into their hands (Section 431).

If a contributory happens to be a body corporate which has been ordered to be wound up, the liquidator of the body corporate will be treated as contributory and may be called on to admit to proof against the assets of the body corporate or otherwise to allow to be paid out of its assets any money due from the body corporate in respect of its liability to contribute to the assets of the company (Section 432).

But the term "Contributory" does not include ordinary debtor of the company. It, however, comprises present and past members of the company who are liable to the company in their capacity as members. A present member is one whose name appears on the register of members at the commencement of the winding up, and his name is put on the list of contributories, known as "A List". A past member is one who ceased to be a member of the company within a year before the commencement of winding up, and his name is put by the Liquidator on the list of contributories known as "B List".

With regard to liability, before winding up, the liability of a member is contractual obligation arising out of membership. But winding up creates a new liability and the liquidator can call upon him to pay the unpaid calls even if they had become time barred before liquidation. [*In Re East Bengal Sugar Mills Ltd.* I.L.R. (1940) 2 Cal. 175 (AIR 1941 Cal 143). The liability arises from the fact that his name appears on the register of members [*Goenka v. Majumdar*, (1958) 28 Comp. Cas. 536].

The members of a company in liquidation are liable in respect of unpaid calls even though the calls were made by the company before it went into liquidation and suit of the company for its realisation had become time barred. Thus, on the commencement of winding up, a new liability is cast on the members in respect of unpaid calls. The liquidator gets a fresh right to enforce the payment of unpaid calls.

His rights are independence of the rights which the company had before winding up. [*Pokhar Mal v. Flour and Oil Mills Co. Ltd.* AIR (1934) Lah. 1015].

Section 429 expressly defines the liability of contributory, and states that the liability of a contributory shall create a debt accruing due from him at the time when his liability commenced, but payable at the time specified in the calls made on him for enforcing the liability (by the liquidator). This means that the liability of a member arises as soon as he makes a contract with the company under which he becomes a member and during winding up it is only contingent until a call is made by the liquidator.

It has been held in numerous cases that after winding up the liability of a contributory is *ex lege* (legal) and not *ex contract* (contractual) and is the direct result of his being a member of the company with his name appearing on the register of members [*Lakshmi Narasa Reddy v. O.L. Shree films Ltd.*, AIR (1951) Mad. 890]. As the liability of a contributory is legal and statutory because his name appears on the register of members, he will not be allowed to say that, although his name is on the register of members, he is not liable because the allotment of shares to him was void. The Court has power to rectify the register of members, if required (Section 467). Unless the Court orders the rectification of register of members, the liability of a contributory is absolute. [*Mohd. Akbar v. Official Liquidator*, AIR 1950 Bom. 386]. In *Re. Whitehouse & Co.*, (1878) 9 ch. D. 595, Jessel M.R. said: "After winding up the liability is a 'new liability': the contributory is to contribute, it is a new contribution; it is a liability to be enforced by the liquidator". Thus, the time will not run as against the liquidator as soon as the company goes into liquidation, for the liability to contribute does not arise unless and until a call is made by the liquidator (*L.Gupta v. Vishnu Sarvate*, AIR 1956 Nag. 204).

In the absence of a proceeding for rectification of the register of members before winding up, the contributory has been held out of the public as a member of the company. Whatever may have been the rights and liabilities of the shareholders before the winding up, the position is altered by the happening of that event. His name appears on the register of members at the commencement of the winding up with his full knowledge and assent. On the winding up, his liability under Section 426 in respect of shares held by him is statutory and absolute and flows from the fact of his being on the register of members in respect of those shares. Hence, his liability in respect of unpaid calls is absolute even though the calls were made by the company for their realisation had become barred by time under Article 112 of the Schedule to the Limitation Act, 1963.

The estate of the deceased contributory is liable to the same extent as it would have been if he had been alive. The legal representatives of a deceased contributory are liable to contribute to the assets of the company in discharge of the liability. If a contributory becomes insolvent after the commencement of winding up, he becomes a stranger to the company, and his assignee in insolvency (Official Assignee or Official Receiver) represents him for all purposes and is deemed to be a contributory.

List of Contributories

On winding up a list called the list of contributories is prepared by the liquidator and settled by the Court in a compulsory winding up. In a voluntary winding up the list is both prepared as well as settled by the liquidator. The list consists of two parts,

namely:

- (a) the list of present members, i.e. those whose names appear on the register of members at the commencement of winding up, called the "A" List, and
- (b) the list of past members, i.e. those who ceased to be members of the company within one year before the commencement of winding up, called the "B" List. Past members, therefore, include persons whose shares have been forfeited, surrendered or transferred within twelve months before the commencement of winding up, but not a person who has died.

Extent of Liability

By virtue of Section 426, in the event of the company being wound up every present and past member is liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges and expenses of winding up, and for the adjustment to the rights of the contributories among themselves. Subject to the provisions of Section 427 and subject also to the following qualifications, namely:

- (a) a past member shall not be liable to contribute if he has ceased to be a member for one year or more before the commencement of the winding up;
- (b) a past member shall not be liable to contribute in respect of any debt or liability contracted by the company after he ceased to be a member;
- (c) a past member shall not be liable to contribute unless it appears to the court that the present members are unable to satisfy the contribution required to be made by them in pursuance of the Act;
- (d) In the case of a company limited by shares, the present and past members shall not be liable to contribute more than the unpaid amount, if any, in respect of his shares.
- (e) In the case of a company limited by guarantee, the present and the past members shall not be liable to contribute more than the amount, undertaken to be contributed by them in the event of the company being wound up;
- (f) Any sum due to the present or past member by way of dividend, profits or otherwise shall not be deemed to be a debt payable by the company in case of competition between himself and the creditors but any such amount shall be taken into consideration for the purpose of final adjustment of the rights of the contributories among themselves.

The relation of present and past members is one of primary and secondary liability, and they do not in any way, stand to each other in the relation of principal and surety. The liquidator cannot call upon the past members to contribute before the present ones. The measure of liability of "A" List contributory is the full amount unpaid on his shares. He is primarily liable and must be tried first. The liability of "B" List contributory is equated by the Act and arises only:

- (i) if it appears to the Court that the present members are unable to satisfy the contribution required to be made by them, within a reasonable time;
- (ii) the debt or liability was incurred while he was a member; and
- (iii) he had not ceased to be a member for one year or upward before the

commencement of the winding up, i.e., to be liable he must have ceased to be a member within 12 months immediately before the commencement of the winding up.

It is to be noted that "B" List can be resorted to only when the "A" List has been exhausted and part of the debts have been paid. Even when he resorts to "B" List, he can only claim from a "B" List member when the corresponding "A" List member has been unable to pay.

Let us suppose that there is a debt of ₹ 50,000 contracted before six "B" List contributories had transferred their shares. There are many debts amounting to ₹ 50,000 in all contracted after all the "B" List members had transferred their shares. The total liability on shares of the six "B" List members is ₹ 10,000. In such case the liquidator can demand from them only ₹ 5,000, and he must apply this ₹ 5,000 pari passu towards all the debts. It is clear that if he has ₹ 5,000 to apply towards debts of ₹ 50,000 + ₹ 5,000 = ₹ 55,000, each creditor will receive one-eleventh ($\frac{₹ 5,000}{₹ 55,000}$) of the amount which he is owed. The single "B" List creditor will, therefore, receive one-eleventh of ₹ 5,000, yet there is still a liability on the "B" List shares of ₹ 5,000.

As per Section 427, in the winding up of a limited company, any director, or manager whether past or present, whose liability is unlimited (under the provisions of the Act) shall be liable to contribute to the assets of the company to an unlimited extent, over and above his ordinary liability to contribute as an ordinary member.

There are three exceptions to the rule contained in Section 427 of the Companies Act, 1956 Firstly, past director or manager shall not be liable to make such further contribution if he has ceased to hold office for a year or more before the commencement of winding up. Secondly, past director or manager shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office. Subject to the articles of the company, a director or manager shall not be liable to make such further contribution, unless the Court deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company and the costs, charges and expenses of the winding up.

Enforcement of Liability of Contributory

The liability of the contributories is enforced by means of calls. In the case of winding up by the Court the call is made by the liquidator with the sanction or order of the Court. In the case of a voluntary winding up, the call may be made by the liquidator without the sanction of the Court.

Set Off

A person, as observed earlier, who is both a contributory and a creditor of the company (in respect of dividends, profits or otherwise) cannot set off his debts against his liability for calls even if there is an express agreement to do so whether the call was made before or after winding up [*Rameshwar Prasad v. Simla Banking & Industrial Co. etc. Ltd.*, (1955) 25 Comp. Cas. 475]. The principle underlying denial of right of set off is that where a person entitled to participate in a fund is also bound to make a contribution in aid of that fund, he cannot be allowed to participate until he has discharged his obligation [*Re. Peruvian Railway Constructions Co.* (1915) 2 Ch. 442]. When all the creditors have been paid in full, the debts due from the company

to the contributory in respect of independent dealing or contracts may be set off against debts due to the company in the case of an unlimited company. Such an allowance may be made, in the case of a limited company, to any director or manager whose liability is unlimited.

A creditor to whom money is due from the company, other than in his capacity as a member of the company, may claim set off against the money owed by him to the company. In *Official Liquidator, High Court of Karnataka v. Smt. V. Lakshmi Kutty*, (1981) - 51 Comp. Cas. 566 (SC), it has been held by the Supreme Court that Sections 529 and 530 of the Companies Act should be read together whenever any creditor seeks to prove his debt against the company in liquidation, the rule enacted in Section 46 of the Provincial Insolvency Act, 1920, should apply and only that amount which is found due from him at the foot of the account in respect of the mutual dealings should be recoverable from him and not that the amount due from the company in liquidation should rank in payment after the preferential claims prescribed under Section 530 have been paid. The set off is allowed where the dealings are mutual. In the case of chit fund transactions the subscribers can set off the debts owing to them by chit fund company against the debts due by them to the chit fund company. The cut off date for the purpose of set off is the date of commencement of the winding up. Therefore, any claim arising after the commencement of the winding up cannot be set off.

Consequences as a Creditor

A company, as observed earlier, cannot be adjudged an insolvent, although it may become insolvent in the sense that it is unable to pay its debts. As to the rights of the creditors in winding up, a distinction between solvent and insolvent companies has to be made.

Where a solvent company is being wound up, all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, are admissible to proof against the company, a just estimate being made as far as possible, of the value of such debts or claims as may be subject to any contingency or for some other reason do not bear a certain value. No difficulty arises in the case of an insolvent company, as when the claims are proved they are paid off according to the availability of the assets.

In the winding up of an insolvent company, the same rules shall prevail as in the case of insolvency law, in respect of:

- (i) debts provable,
- (ii) the valuation of annuities and future and contingent liabilities, and
- (iii) the respective rights of secured and unsecured creditors [Section 529].

Secured Creditors

A secured creditor is defined in the Insolvency Act to mean "a person who holds a mortgage, charge or lien on the company's property or any part of it as security for any debt due to him from the company."

The effect of the provisions of Section 529 is that the secured creditor may either:

- (i) rely on the security and ignore the liquidation altogether;

- (ii) value his security and prove for the balance of his debt; or
- (iii) give up his security and prove for the whole amount as an unsecured creditor.

The secured creditor can, on his option, stand wholly outside the winding up proceedings. He need not prove his debts out of that security with the leave of the winding up Court. If the security is insufficient to pay his debt fully, he may exhaust the security and prove for the deficiency in the winding up. Alternatively, he can assess the value of his security and prove for the balance. The liquidator can redeem the security from the secured creditors at the value assessed by him. With the amendment of Section 529 by the Companies (Amendment) Act, 1985 the law about realisation of dues by the secured creditors has now been amended w.e.f. 1st May, 1985. Now Section 529 has been amended by making wide amendments and also by inserting a new Section 529A. Henceforth the security of other secured creditors shall be deemed to be subject to a *pari passu* charge in favour of the workmen to the extent of their dues. The Official Liquidator has been given the duty of representing the workmen to enforce their charge over the property. The dues of the workmen are to be paid in full but if the assets are insufficient to meet them, then, in such a case the dues of the workmen shall abate in equal proportions alongwith the secured creditors. A secured creditor who realises his security is liable to reimburse the liquidator for all expenses incurred by the latter for the preservation of the security before the realisation. The secured creditor is liable to pay the whole of the expenses but if workmen are participating in the security, then such expenses should be apportioned between the secured creditors and workers in the proportion of the amount to be distributed to them.

Secured creditors can apply for Winding Up

A Secured Creditor can apply for winding up if the adequacy of security is open to grave doubt. *Banaras Beads v. Shrishti Carriers* (2000) 38 CLA 352. The secured creditor can file winding up petition. He is not required to relinquish his security at the time of filing a company petition for winding up. He can realize his security and prove for balance due to him. However, if the secured creditor seeks to prove whole of his debt in winding up proceedings, he must relinquish his security for benefit of general body of creditors, before proving his debt. [*Canfin Homes v. Lloyds Steel Industries Ltd.* (2001) 32 SCL 283 (Bom. HC).]

Position of State Financial Corporation

Section 29 of State Financial Corporation Act empowers State Financial Corporation to take over management and/or possession of property of industrial concern. However once winding up order is issued, these powers can be exercised only with permission of Court. In *A.P. State Financial Corporation v. Official Liquidator* 2000 (5) Scale 486, it was held that the provisions of Section 529A of the Act prevails over provisions of Section 29 of SFC Act.

Unsecured Creditors

Unsecured creditors of an insolvent company are paid in the following order:

- (i) Over-riding preferential payments under Section 529A.

- (ii) Preferential payments under Section 530;
- (iii) Other debts *pari passu*.

Order of Priority of Debts

- (a) Secured creditors subject to a *pari passu* charge in favour of the workmen to the extent of workmen's portion therein;
- (b) Workmen's dues; and debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to Sub-section (1) of Section 529 *pari passu* with such dues;
- (c) Costs and charges of winding up. In a voluntary winding up this item is a priority automatically but in compulsory winding up, the court has, to give priority by order under Section 476;
- (d) Preferential debts – Section 530;
- (e) Floating charges – Section 530(5)(b); and
- (f) Unsecured creditors.

If there is any surplus (as it may happen in the case of a solvent company), capital is returned to preference shareholders, and then equity shareholders are returned their capital, if assets are still available. If there is still some more surplus, it depends on the articles as to whether preference shares are participating or not. In the case of a solvent company, interest can be claimed subsequent to winding up order, if there is agreement to pay interest.

POWERS AND DUTIES OF LIQUIDATORS

Powers and duties of the Liquidators in Compulsory winding up of a Company

Section 456 of the Act requires the liquidator to take into the custody or under the control, all the property, effects and actionable claims to which the company is or appears to be entitled. After this, all the property and effects of the company shall be deemed to be in the custody of the court as from the date of the order for the winding up of the company.

Liquidator is not employer

When Official Liquidator is merely directed to wind up the affairs of company in liquidation, he is not 'employer' liable to make contribution of provident fund of ESIC contribution [*Rohtas Industries Ltd. (In liquidation)* - In re. (2000) 99 Comp. Cas. 503 (Pat HC)].

Section 457 confers on the liquidator in a winding up by the Court, certain specific powers necessary for the performance of his duties in relation to winding up. Under Sub-section (1) of Section 457, the liquidator has following powers with the sanction of the Court:

- (a) to institute or defend any suit, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company;
- (b) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;

- (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power, to transfer the whole thereof to any person or body corporate or to sell the same in parcels;
- (d) to raise on the security of the assets of the company any money requisite;
- (e) to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets;

As per Section 459, the liquidator may, with the sanction of Court, appoint an advocate, attorney or pleader entitled to appear before the Court to assist him in the performance of his duties.

Under Section 546, the liquidator may exercise the following powers with the sanction of the Court in winding up by or under the supervision of the Court, and with the sanction of the special resolution of the company in voluntary winding up:

- (i) to pay any classes of creditors in full;
- (ii) to make any compromise or arrangement with creditors or persons claiming to be creditors or having or alleging themselves to have any claim, present or future, certain or contingent, ascertained or sounding only in damages, against the company or whereby the company may be rendered liable; or
- (iii) to compromise any call or liability to call, debt and liability capable of resulting in a debt, and any claim, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or alleged to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company, and all questions in any way relating to or affecting the assets or liabilities or the winding up of the company, on such terms as may be agreed, and take any security for the discharge of any such call, debt, liability or claim, and give a complete discharge in respect thereof.

The exercise of aforesaid powers by the liquidator in the case of voluntary winding up is subject to the control of the Court.

Under Sub-section (2) of Section 457, the liquidator has following powers without obtaining any sanction of the Court:

- (a) to do all acts and to execute in the name and on behalf of the company and to execute all deeds, receipts and other documents and for that purpose to use, when necessary the company's seal;
- (b) to inspect the records and returns of the company on the files of the Registrar without payment of any fee;
- (c) to prove, rank and claim in the insolvency of any contributory for any balance against his estate and to receive dividends in the insolvency in respect of that balance as a separate debt due from the insolvent, and rateably with other separate creditors;
- (d) to draw, accept, make and endorse any negotiable instruments in the name and on behalf of the company in the course of its business;
- (e) to take out, in his official name, letters of administration to any deceased

contributory and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate;

- (f) to appoint an agent to do any business which the liquidator is unable to do himself.

“(2A)¹ The liquidator shall —

- (a) appoint security guards to protect the property of the company taken into his custody and to make out an inventory of the assets in consultation with secured creditors after giving them notice;
- (b) appoint, as the case may be, valuer, chartered surveyors or chartered accountant to assess the value of the company's assets within fifteen days after taking into custody of property, assets referred to in sub-clause (a) and effects or actionable claims subject to such terms and conditions as may be specified by the Tribunal;
- (c) give an advertisement, inviting bids for sale of the assets of the company, within fifteen days from the date of receiving valuation report from the valuer, chartered surveyors or chartered accountants referred to in clause (b), as the case may be.

(2B) The liquidator shall, immediately after the order for winding up or appointing the liquidator as provisional liquidator is made, issue a notice requiring any of the persons mentioned in Sub-section (2) of Section 454, to submit and verify a statement of the affairs of the company and such notice shall be served by the liquidator.

(2C) The liquidator may apply to the Tribunal for an order directing any person who, in his opinion, is competent to furnish a statement of the affairs under Sections 439A and 454 and such person shall for the said purpose be served a notice by the liquidator in the manner as may be prescribed.

(2D) The liquidator may, from time to time, call any person for recording any statement for the purpose of investigating the affairs of the company which is being wound up and it shall be the duty of every such person to attend to the liquidator at such time and place as the liquidator may appoint and give the liquidator all information which he may require and answer all such questions relating to winding up of company as may be put to him by the liquidator.

(2E) Every bidder shall, in response to the advertisement referred to in clause (c) of Sub-section (2A), deposit, his offer in the manner as may be prescribed, with liquidator or provisional liquidator, as the case may be, within forty-five days from the date of the advertisement and the liquidator or provisional liquidator shall permit inspection of property and assets in respect of which bids were invited:

Provided that such bid may be withdrawn within three days before the last day of closing of the bid:

Provided further that the inspection of property shall be open for not more than five days before closing of the bid.

¹ Inserted by the Companies (Second Amendment) Act, 2002 w.e.f. a date yet to be notified.

- (2F) The advertisement inviting bids shall contain the following details, namely:—
- (a) name, address of registered office of the company and its branch offices factories and plants and the place where assets of the company are kept and available for sale;
 - (b) last date for submitting bids which shall not exceed ninety days from the date of advertisement;
 - (c) time during which the premises of the company shall remain open for inspection;
 - (d) the last date for withdrawing the bid;
 - (e) financial guarantee which shall not be less than one-half of the value of the bid;
 - (f) validity period of the bids;
 - (g) place and date of opening of the bids in public;
 - (h) reserve price and earnest money to be deposited along with the bid;
 - (i) any other terms and conditions of sale which may be prescribed.
- (2G) The liquidator appointed shall—
- (a) maintain a separate bank account for each company under his charge for depositing the sale proceeds of the assets and recovery of debts of each company;
 - (b) maintain proper books of account in respect of all receipts and payments made by him in respect of each company and submit half yearly return of receipts and payments to the Tribunal.”

Although the liquidator is not required to obtain sanction of the Court before exercising any of the foregoing powers yet he is subject to the control of the Court, and any contributory or creditor may apply to the Court with respect to any exercise of any such powers. He should have regard to any directions which may be given by resolutions of creditors or contributories in their respective meetings, called by the liquidator. The liquidator may summon general meetings of creditors and contributories, whenever he thinks fit, to ascertain their wishes. He is bound to call such meetings at such times as the creditors or contributories may by resolutions direct or whenever requested in writing to do so by not less than 1/10th in value of creditors or contributories (Sections 458 and 460).

The liquidator is required to present to the Court twice a year an account of his receipts and payments as liquidator. The Court gets the accounts audited; and the liquidator has to send a copy of the printed accounts to every creditor and contributory. A copy is also filed with the Registrar.

The Central Government is conferred with the power to take cognizance of the conduct of liquidators of companies which are being wound up by the Court. If it appears that a liquidator is not faithfully performing his duties or is not observing the requirements of the Act or if any complaint is made by a creditor or a contributory, the Central Government shall inquire into the matter and take necessary action (Section 463).

Powers of the Liquidator in Voluntary Winding Up of a Company

The powers of the liquidator in voluntary winding up are just the same as those of an Official Liquidator in a winding up by the Court. However, in cases where the Official Liquidator has to obtain the sanction of the Court before acting, the voluntary liquidator shall have to obtain the sanction of the company, and in case of creditors' voluntary winding up, he shall have to obtain the sanction of the Court, or of the Committee of Inspection or, in its absence, of the creditors. However, for the convenience of the students, the powers of a voluntary liquidator are detailed below. Thus, the voluntary liquidator may exercise the following powers, in the case of a members' voluntary winding up with the sanction of a special resolution of the company, and in the case of a creditors' voluntary winding up, with the sanction of the Court or the Committee of Inspection or, if there is no Committee of Inspection, with the sanction of the creditors:

- (a) to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name and on behalf of the company;
- (b) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;
- (c) to sell immovable or movable property and actionable claims of the company; and
- (d) to raise on the security of the assets of the company any money requisite.

The following powers can be exercised by voluntary liquidator without any sanction:

- (i) to do all acts and to execute, in the name and on behalf of the company all deeds, receipts and other documents, and for that purpose to use, when necessary, the company's seal.
- (ii) to inspect the records and returns of the company on the files of the Registrar without payment of any fee.
- (iii) to prove, rank and claim in the insolvency of any contributory.
- (iv) to draw, accept, make and endorse any bill of exchange, hundi or promissory note in the name and on behalf of the company.
- (v) to take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate.
- (vi) to appoint an agent to do any business which the liquidator is unable to do himself.
- (vii) to exercise the power of the Court of setting the list of contributories (which shall be prima facie evidence of the liability) of the persons named therein to be contributories.
- (viii) to exercise the power of the court of making calls.
- (ix) to call general meetings of the company for the purpose of obtaining the sanction of the company by ordinary resolution or special resolution, as the case may require, or for any other purpose he may think fit.
- (x) to pay the debts of the company and adjust the rights of the contributories among themselves.

Although the foregoing powers can be exercised by the voluntary liquidator without any sanction, they are, nevertheless, subject to the control of the Court inasmuch as any creditor or contributory may apply to the Court with respect to any exercise or proposed exercise of any of these powers. For example, a contributory, whose name has been settled on the list of contributories by the voluntary liquidator, may apply to the Court with the prayer that his name ought not to have been so settled on the list as he is not a member or had ceased to be a member more than 12 months before the commencement of winding up. Or a creditor may apply to the Court against the decision of the voluntary liquidator to admit his claim.

When more than one liquidators are appointed, the manner and extent of their powers are determined at the time of their appointment by the authority appointing them. If the powers of the liquidators are not so determined on their appointment, then any of the aforesaid powers is exercisable only jointly by all or by not less than 2 of them.

Duties and Functions of Voluntary Liquidator

The function and duties of a voluntary liquidator may be summarised as follows:

1. To satisfy himself that the resolution for voluntary winding up was validly passed and that a copy of the resolution was duly filed with the Registrar.
2. To file with the Registrar a notice of his appointment.
3. To advertise in the Official Gazette and in a local newspaper asking the creditors to meet at a certain specified place and time within 21 days of his appointment, and also to send notice to each creditor.
4. To take possession of the companies assets and see that they are intact.
5. To call by advertisement for the claims of creditors by a certain specified date, and to admit the claims.
6. To prepare a list of debts and claims and send notices to contributories for the settlement of list of contributories.
7. To settle the list of contributories on the date fixed for the purpose.
8. To look into payment made during six months immediately preceding the winding up and satisfy himself that there has been no fraudulent preference.
9. To avoid voluntary transfers.
10. To disclaim onerous property.
11. To dispose of the assets of the company to the best advantage and collect so far as practicable all outstanding debts due to the company.
12. To apply the proceeds of realisation in the prescribed manner.
13. To make calls on unpaid shares, if necessary.
14. To file returns at the end of the first year and then every six months during the continuation of the winding up.
15. To convene annual general meetings of the company and of creditors during liquidation and present the annual accounts thereat.
16. At the end of winding up, to call a general meeting and lay before it the

account of the winding up. For this to make publication in the Official Gazette and in newspapers.

17. To file within one week of this meeting a return with the Registrar and the Official Liquidator.
18. To give information, papers, books and documents to the Official Liquidator for his scrutiny and submission of report to the Court.

Status of Liquidator

The liquidator in a winding up by the Court or under the supervision of the Court, is an officer of the Court, and as such is required to exercise a high degree of honesty and fairness towards the creditors and the members of the company. He is also the agent of the company and incurs no personal liability when he enters into any contracts as a liquidator.

In a voluntary winding up, the liquidator is more rightly described as the agent of the company. He is not an officer of the Court. As a paid agent of the company he has statutory duties towards the creditors and contributories including the administration of the assets of the company.

Both in a compulsory winding up and voluntary winding up, a liquidator as an agent of the company, must exercise a high degree of care and diligence in discharging his statutory duties. He may be liable in damage to a creditor or contributory for injury caused to him as a result of his breach of statutory duties.

A liquidator is not a trustee. The property of the company is not vested in him. But he is in a fiduciary position in relation to any property of the company and is in the position of a trustee, or what is sometimes stated, he is a "statutory trustee". Accordingly, if he pays an invalid claim, even without willful default, he is liable to misfeasance proceedings. He is not a trustee for individual creditors or contributories.

Persons entitled to be Heard

The persons entitled to be heard by the Court in a winding up petition are the company, the creditors, the contributories, the Registrar and the Central Government. The Court may, however, in its discretion hear any other person who may be interested in the winding up. Rule 34 of the Companies (Court) Rules, 1959, provides that any person who intends to appear at the hearing of the petition must give notice in Form No. 9 to the petitioner indicating the grounds of opposition, if he wishes to oppose the petition.

Procedure after the Winding Up Order

(1) For the purpose of winding up of companies by the Court, an Official Liquidator may be appointed either from a panel of professional firms of chartered accountants, advocates, company secretaries, costs and works accountants or firms having a combination of these professionals, which the Central Government shall constitute for the Tribunal, or may be a body corporate consisting of such professionals as may be approved by the Central Government from time to time, or may be a whole-time or a part-time officers appointed by the Central Government. Before appointing the Official Liquidator, the Tribunal may give due regard to the views or opinion of the secured creditors and workmen.

Provided that before appointing the Official Liquidator, the Tribunal may give due regard to the views or Opinion of the secured creditors and workmen.

(2) The terms and conditions for the appointment of Official Liquidators appointed by Tribunal shall be approved by the Tribunal and remuneration shall be subject to a maximum remuneration of five per cent of the value of debt record and realization of sale of assets.

The terms and conditions of the Official Liquidator appointed from the Officers appointed by the Central Government shall be approved by the Central Government in accordance with the rules made by it in this behalf.

(3) Where the Official Liquidator is an officer appointed by the Central Government under clause (c) of Sub-section (1), the Central Government may also appoint, if considered necessary, one or more Deputy Official Liquidators or Assistant Official Liquidators to assist the Official Liquidator in the discharge of his functions, and the terms and conditions for the appointment of such Official Liquidators and the remuneration payable to them shall also be in accordance with the rules made by the Central Government.

(4) All references to the "Official Liquidator" in this Act shall be construed as reference to the Official Liquidator specified in Sub-section (1), or to the Deputy Official Liquidator or Assistant Official Liquidator referred to in Sub-section (3), as the case may be.

(5) The amount of the remuneration payable shall—

- (a) form part of the winding up order made by the Tribunal;
- (b) be treated as first charge on the realisation of the assets and be paid to the Official Liquidator or to the Central Government, as the case may be.

(6) The Official Liquidator shall conduct proceedings in the winding up of a company and perform such duties in reference thereto as the Tribunal may specify in this behalf:

Provided that the Tribunal may—

- (a) transfer the work assigned from one Official Liquidator to another Official Liquidator for the reasons to be recorded in writing;
- (b) remove the Official Liquidator on sufficient cause being shown;
- (c) proceed against the Official Liquidator for professional misconduct.

The Official Liquidator is required to conduct the proceedings in winding up of the company and perform such duties as the Court may impose.

Statement of Affairs by Directors

Section 454 provides that within twenty-one days of the date of winding up order a statement as to the affairs of the company has to be submitted to the Official Liquidator. This time may be extended up to three months either by the Official Liquidator or by the Court. The statement has to be submitted and verified by a director, manager, secretary or other chief officer of the company or such other

persons as the Official Liquidator may, subject to the direction of the Court, require. The statement should be verified by an affidavit by any of the aforementioned officers of the company and should contain the following particulars:

- (a) assets of the company, showing separately cash in hand and at the bank and negotiable securities if any held by the company;
- (b) its liabilities and debts;
- (c) names, residences and occupation of the company's creditors indicating the amount of secured or unsecured debts and in the case of secured debts, the particulars of the securities given, whether by the company or an officer thereof, their value and dates on which they were given;
- (d) the debts due to the company and the names, residences and occupation of the persons from whom they are due, and the amount likely to be realised on account thereof; and
- (e) such other information as may be required.

As per Sub-section (5) of said section, if any person, without reasonable excuse, makes default in complying with any of the requirements of this Section, he shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to one thousand rupees for every day during which the default continues or with both.

In *Official Liquidator v. P.R. Mehta* (2000) 36 CLA 210, it was held that the prosecution has to prove that the person has failed to submit the statement without reasonable cause. If a person was not director on relevant date or if there was reasonable cause for non-filing for statement, liability under this provision would not be there. In *Indla Satya Raju v. Sramika Agro Farm* (2002) 39 SCL 940, it was held that a person cannot be prosecuted and convicted under Section 454(5) merely for reason that he committed default in complying with any requirements of Section 454. In addition to establishing default, prosecution is also required to establish that the said person, without reasonable excuse, committed such fault.

Report by the Official Liquidator

Section 455 provides that, in case where a winding up order is made, the Official Liquidator shall, as soon as practicable after receipt of the above mentioned statement of affairs submitted to him under Section 454 but not later than 6 months of the date of winding up order or such time as extended by the Court submit a preliminary report to the Court showing:

- (a) the amount of issued, subscribed and paid-up share capital and the estimated amount of assets and liabilities;
- (b) if the company has failed, the causes of the failure; and
- (c) whether, in his opinion, further inquiry is desirable as to any matter relating to the promotion, formation or failure of the company or the conduct of its business.

If the Official Liquidator is of the view that there has been a fraud about formation of the company then he may submit a further report or reports. This can be the basis of public examination of the directors of the company under Section 478.

Committee of Inspection (Sections 464 and 465)

The Court may, at the time of making an order for the winding up or at any time thereafter, direct that there shall be appointed a Committee of Inspection to act with the liquidator. Where such a direction is given by the Court, the liquidator is required to convene, within two months from the date of direction, a meeting of the creditors for the purpose of determining who are to be members of the committee, the liquidator must call a meeting of the contributories within fourteen days from the date of creditor's meeting, to consider the creditors meetings' decision with respect to the membership of the Committee. Contributories may accept the decision of the creditors with or without modification or reject it. If the contributories at their meeting do not accept the creditors' decision in its entirety, the liquidator shall apply to the Court for directions as to what the composition of the committee shall be and who shall be its members (Section 464). The committee of inspection shall consist of not more than twelve members, being creditors and contributories of the company or persons holding general or special power of attorney from creditors or contributories, in such proportion as may be agreed upon by the meetings of the creditors and contributories and in case of difference of opinion between the meetings, as may be determined by the Court [Section 465(1)].

The committee of inspection may inspect the accounts of the liquidator at all reasonable times [Section 465(2)].

The committee of inspection will meet at such times as it may from time to time appoint and the liquidator or any member of the committee may also call a meeting of the committee as and when he thinks necessary. The quorum for a meeting of the committee shall be one-third of the total number of the members or two whichever is higher. The committee may act by a majority of its members present at a meeting but shall not act unless a quorum is present. A member of the committee may resign by notice in writing signed by him and delivered to the liquidator. If a member is adjudged an insolvent or compounds or arranges with his creditors or is absent from five consecutive meetings of the committee without leave of those members who, together with himself, represent the creditors or contributories, his office shall become vacant.

A member of the Committee of Inspection may be removed at a meeting of the creditors, if he represents creditors, or at a meeting of contributories if he represents contributories, by an ordinary resolution of which seven days notice has been given stating the object of the meeting. When any vacancy has occurred in the committee the liquidator shall call a meeting of the creditors or contributories, as the case may be, and the meeting may re-appoint the same person or appoint some other person to fill the vacancy. However, the liquidator may apply to the Court that in the circumstances of the case the vacancy need not be filled. The Court may make an order accordingly.

General Powers of the Court

The Court has the power to cause the assets of the company to be collected and applied in discharge of its liabilities. For this purpose, the Court will settle a list of contributories. The Court may, after ascertaining the adequacy of the company's assets, proceed to make calls on all or any of the contributories requiring them, within

the extent of their liability, to pay any money which the Court considers necessary to satisfy the debts and liabilities of the company, and the expenses of winding up and for the adjustment of the rights of the contributories.

Where the contributory owes money on calls on his shares and the company owes him some money, he cannot set off one against the other except:

- (1) in the case of unlimited company;
- (2) in the case of limited company with directors having un-limited liability in respect of such directors;
- (3) in the case of any company after the creditors are paid in full;

He must first pay what is due by him on the shares and then claim payment of his debt along with other creditors.

Where any contributory, trustee, receiver, banker, agent, officer or other employee of the company is in possession of any money, property, books or papers of the company, the Court may require him to deliver the same to the liquidator.

The Court can also summon before it any officer of the company or person known or suspected to have in his possession any such property of the company, or any person whom the Court deems capable of giving information concerning the promotion, formation, trade, property or other affairs of the company. Such person may be examined on oath which is called "private examination". The examination may be ordered by the Court ex-parte or on an application by the liquidator or any other person including a creditor or contributory. A person failing to respond to the order to appear before the Court may be caused to be apprehended and brought before the Court. The Court may require him to produce any books and papers in his custody relating to the company. It may be remembered that the auditor is also an officer of the company for this purpose.

Offences antecedent to or in course of winding up.

(i) Offences of Officers

Section 538 stipulates the offences for which officers of a company in winding up are made liable to be punished with imprisonment or with fine or with both. For this purpose, officers include any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

A past or present officer of the Company is liable to be punished with imprisonment up to five years or with fine or with both if within twelve months next before the winding up or any time thereafter, he:

- (i) obtains fraudulently or on false representation any property on credit for or on behalf of the company which the company does not subsequently pay for; or
- (ii) obtains on credit under false pretence that the company is carrying on its business, any property which the company does not subsequently pay for; or
- (iii) pawns, pledges or disposes of any property of the company which has been

obtained on credit and has not been paid for unless such pawning, pledging or disposing is in the ordinary course of business of the company.

The pawnee or pledgee or receiver of property who knows that the property pawned, pledged or disposed of was obtained on credit and has not been paid for is also punishable as per Section 538(2), with imprisonment up to three years or with fine or with both.

Similarly, a past or present officer of the company is punishable with imprisonment up to two years or with fine or with both, if he—

- (i) does not to the best of his knowledge and belief, fully or truly discover to the liquidator all property movable or immovable of the company and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary course of business of the company;
- (ii) does not deliver up to liquidator or in the manner he directs, all movable or immovable property, books and papers of the company that are in his custody or control;
- (iii) within twelve months next before the commencement of the winding up or any time thereafter:
 - (a) conceals or fraudulently removes any part of the company's property to the value of ₹ 100 or more;
 - (b) conceals any debt to or from the company;
 - (c) conceals, destroys, mutilates or falsifies any books or papers affecting or relating to the property of the company;
 - (d) makes or is privy to the making of any false entry in books or papers affecting or relating to the property or affairs of the company;
 - (e) fraudulently parts with, alters or makes any omission or is privy to the fraudulent parting with or altering or making of any omission in any books or papers affecting or relating to the property or affairs of the company;
- (iv) makes any material omission in any statement relating to the affairs of the company;
- (v) fails for a period of one month to inform the liquidator about any false debts having been proved within his knowledge;
- (vi) attempts to account for any part of the property of the company by fictitious losses or expenses within 12 months next before the commencement of the winding of the creditors of the company or any of them to an agreement with reference to the affairs of the company or to the winding up.

No Court shall take cognizance of any offence against the Act, (other than an offence with respect to which proceedings are instituted under Section 545), which is alleged to have been committed by any officer of the company, except on the complaint in writing of the Registrar, or of a shareholder of the company, or of a person authorised by the Central Government or of a person authorised by SEBI.

The burden of proof to establish the offence and bring the case within any one of

the aforesaid clauses is on the prosecution. It is good defence to the accused to show that he had no intent to defraud or that he had no intent to conceal the true state of affairs of the company.

(ii) Penalty for Falsification of Books

According to Section 539, if with intent to defraud or deceive any person, any officer or contributory of a company in liquidation destroys, mutilates, alters, falsifies or secretes or is privy to any of these acts any books, papers or securities, or makes any fraudulent entry in any register, books of account or document belonging to the company, he shall be punished with imprisonment up to seven years and fine.

(iii) Penalty for Frauds by Officers

Section 540 states that if any person, being at the time of the commission of the alleged offence, an officer of a company which is subsequently ordered to be wound up by the Court or which passes a resolution for voluntary winding up has:

- (a) by false pretences or by means of any fraud induced any person to give credit to the company, or
- (b) with intent to defraud creditors of the company, made or caused to be made any gift or transfer of or charge on, or has caused or connived at the levying any execution against, the property of the company, or
- (c) with intent to defraud creditors of the company concealed or removed any part of the property of the company, since the date of any unsatisfied judgment or order of payment of money obtained against the company or within two months before that date,

he shall be punishable with imprisonment up to two years and also with fine.

(iv) Liability where proper accounts are not kept

According to Section 541 where proper books of account were not kept by the company for a period of two years immediately preceding the commencement of the winding up or the period between the incorporation of the company and the commencement of winding up, whichever is shorter, every officer of the company, who is in default, is liable to punishment with imprisonment for a term which may extend to one year, unless he shows that he acted honestly and that in the circumstances in which the business of the company was carried on, the default was excusable.

In the following cases it shall be deemed that proper books of account have not been kept, if there have not been kept:

- (a) such books or account as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day-to-day in sufficient detail of cash received and cash paid; and
- (b) where the business of the company has involved dealing in goods, statements of the annual stock takings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient details to enable those goods and those buyers and sellers to be identified.

(v) Fraudulent conduct of business

Section 542 lays down that, if in the course of winding up of a company, it appears that any business of the company has been carried on, with intent to defraud creditors of the company, or any other person, or for any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company may, if it thinks proper, declare that any persons who were knowingly parties to the carrying on the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct. Moreover, every person who is knowingly a party to be carrying on of the business in such a manner is liable to imprisonment up to two years, or fine up to ₹ 50,000 or both. The above penalties are in addition to any criminal liabilities in respect of any of the above matters.

The Court is also empowered to give such further directions as it thinks proper for the purpose of giving effect to that declaration. In particular, the Court may make provision for making the liability of any such person under the declaration a charge of any debt or obligation due from the company to him, or of any mortgage or charge on any interest in any mortgage or charge on any assets of the company held by or vested in him, or any person on his behalf or any person claiming as assignee from or through the person liable or any person acting on his behalf. The Court is also empowered to make such further orders, from time to time, as may be necessary for the purpose of enforcing any charge.

The expression, "assignee", for the above purposes, includes any person to whom or in whose favour, by the directions of the person liable, the debt, obligation, mortgage or charge was created, issued or transferred or the interest was created, but does not include an assignee for valuable consideration (nor including consideration by way of marriage) given in good faith and without notice of any of the matters on the grounds on which the declaration is made.

(vi) Recovery of Damages from Delinquent Persons

Section 543 of the Act confers powers on the Court to examine the conduct of any person who has taken part in the promotion or formation of the company or any past or present director, manager, liquidator or officer of the company, if in the course of winding up proceedings, it appears that such a person:-

- (i) has misapplied or retained or become liable or accountable for any money or property of the company; or
- (ii) has been guilty of any misfeasance or breach of trust in relation to a company.

The enquiry into the aforesaid matters can be conducted by the Court on an application made by the Official Liquidator, liquidator or any contributory or creditor within a period of five years from the date of the order of the winding up or of the first appointment of liquidator or of the mis-application, retention, misfeasance or breach of trust, whichever is longer. If as a result of the enquiry mentioned above, the person concerned is found guilty, the Court may compel him to repay or restore the money or the property or any part thereof or to contribute such sums to be assets of the company by way of compensation in respect of the mis-application, retention, misfeasance or breach of trust as the Court thinks fit.

The aforesaid powers of the Court are available in all kinds of winding up including voluntary winding up. These powers can be exercised by the Court notwithstanding the fact that the matter is one for which the person concerned is criminally liable.

Where the person proceeded against under Section 543 dies, the misfeasance proceedings can be continued against his heirs and legal representatives for the purpose of determining and declaring the loss of damage caused to the company. [*Official Liquidator v. Parthasarathi Sinha*, (1983) 53 Comp. Cas. 163 (SC)].

Where a declaration or an order under Section 542 or Section 543, as the case may be, is made in respect of any firm or body corporate, the Court has also the power to make a declaration or an order in respect of any person who was at the relevant time a partner in that firm or a director of that body corporate.

In the matter of *Ajay G Podar v. Official Liquidator of JS & WM & Ors.* (2008) 85 CLA 398 (SC), Hon'ble SC has held that section 543(2) of the Companies Act, 1956 deals with the limitation of applications/claims including misfeasance proceedings and prescribes five (5) years period of limitation from the date of the winding up order for filing an application under section 543 (1). However, section 458A of the Companies Act, 1956 provides for the concept of computation of the limitation period. Section 458A being a non obstante clause exclude the period starting from commencement of winding up proceedings till the date on which winding up order is passed and a period of one (1) year thereafter. In view of the above, misfeasance proceedings filed by the OL are well within limitation period.

In *L.K. Prabhu v. S.M. Ameerul Millath* (2002) 40 SCL 385 (Ker HC), it was held that application under Section 543 (for damages for misapplication or misfeasance) is maintainable against Official Liquidator also, as 'liquidator' includes 'Official Liquidator'. Moreover he is 'Officer' of the company as defined in Section 2(30), even if not specifically mentioned in the definition. However there should be *prima facie* case against him and there is substance in the allegations. If Official Liquidator has acted in good faith, he is entitled to protection under Section 635A.

It has been held in *Official Liquidator v. Ashok Kumar*, (1976) 46 Comp. Cas. 575 (Pat), that a director who has not been duly elected and has taken his qualification shares shall be liable if he has acted as such. In other words, where a director continued to act de facto without being validly elected, he shall be liable for misfeasance.

Examples of misfeasance are:

- (i) improper payment of dividends, e.g. out of capital;
- (ii) ultra vires investment;
- (iii) director selling his own property to the company without disclosure;
- (iv) allotting shares in breach of Section 69;
- (v) knowingly allotting shares to a minor.

(vii) *Prosecution of delinquent officers and members*

According to Section 545, if it appears to the Court in the course of a winding up or winding up subject to supervision of the Court, that any past or present officer or member of the company has been guilty of any offence in relation to the company, it

may either on the application of any person interested in the winding up or of its own motion, direct the liquidator either himself to prosecute the offender or to refer the matter to the Registrar. In the course of voluntary winding up, if it appears to the liquidator that any officer, past or present, or any member of the company has been guilty of any offence in relation to the company, he shall forthwith report the matter to the Registrar. Where any such report is made to the Registrar, he may, if he thinks fit, refer the matter to the Central Government for further investigation. Where the Registrar finds that the case is not one in which the proceedings ought to be taken by him he shall inform the liquidator who may with the sanction of the Court, himself take proceedings against the offender. Where the liquidator does not make any report to the Registrar but an offence appears to the Court to have been committed, the Court may on the application of any person interested in the winding up or on its own motion direct the liquidator to make such report.

In the case of companies under voluntary winding up, if the liquidator finds that any past or present member or officer is guilty of an offence, he should make a reference to the Registrar and to furnish him such information as he may require. The Registrar has to be allowed access to all the books and papers in the custody and control of the liquidator which might be relevant to the matter in question. If the liquidator does not report, any person interested in the winding up may apply to the Court for an order or the Court may of its own motion direct the liquidator to make such a reference to the Registrar.

On receipt of the report, if the Registrar is of the view that the case does not merit prosecution of the offender he will inform the liquidator accordingly. The liquidator may, however, himself prosecute the offender with the sanction of the Court.

In cases where the Registrar considers that prosecution ought to be launched he shall refer the matter to the Central Government. Before making the reference he is required to give to the accused person an opportunity of being heard. The Central Government may after taking such legal advice, as it thinks fit, direct the Registrar to institute proceedings.

viii. Disposal of Books and Papers of the Company

Section 550 provides for the manner in which the books and papers of the company and those of the liquidator are to be disposed of when the affairs of the company have been wound up and is about to be dissolved. It is provided that the books and papers of the company should be disposed of in the following manner.

- (a) in the case of winding up by or subject to the supervision of the Court, in such manner as may be directed by the Court;
- (b) in the case of members' voluntary winding up in the manner as the company may, by special resolution, direct;
- (c) in the case of creditors' voluntary winding up, in such manner as the Committee of Inspection or, if there is no such Committee, as the creditors of the company may direct.

The company or liquidator or the person to whom custody of books and papers is entrusted is not responsible for producing the books and papers after the expiry of a period of five years from the date of dissolution.

The Central Government may frame rules to prevent the destruction of the books

and papers of the company which has been wound up and of its liquidator for such period as it may think proper but not exceeding five years.

Rule 15 of the Companies (Central Government's) General Rules and Forms, 1956 provides that these books and papers shall not be destroyed for a period of five years. Any contributory or creditor or liquidator of the company, may make a representation of destroying these books and papers at a period earlier than five years. After considering as may be concerned with the matter, the Central Government may decide to reduce the period as may be considered proper or keep the period unaltered. An appeal against the directions of the Central Government can be made to the Court.

Annual Statement, if winding up is not concluded within one year.

Section 551 provides that if the winding up of the company is not concluded within one year of the commencement, the liquidator shall file a statement in the prescribed form containing the prescribed particulars duly audited by the person qualified to act as auditor of the company with respect to proceedings and position of the liquidation. The statement is required to be filed in the Court where the company is being wound up by or subject to the supervision of the Court. A copy of the statement is required to be filed simultaneously with the Registrar. A copy is also required to be kept in the records of the company. Where the company is being wound up voluntarily, the statement is required to be filed with the Registrar.

In case of Government company in liquidation, the liquidator shall forward a copy of the statement to the Central Government or State Government or to both as the case may be depending upon which Government is a member of the company.

The filing of the statement is to be done within two months of the expiry of the period of one year and thereafter until the winding up is concluded at intervals of not more than one year or at such shorter intervals as may be prescribed. The statement to be filed with the Official Liquidator should be in Form No. 153 of the Companies (Court) Rules, 1959.

Court to ascertain the wishes of Creditors and Shareholders

Section 557 provides that in all matters relating to the winding up of the company, the Court may ascertain the wishes of the creditors or the contributories of the company. For this purpose, the Court may:

- (a) direct for calling, holding and conducting of the meeting of the creditors or contributories in such manner as it may think proper;
- (b) appoint a person to act as a Chairman of such meeting and to report the result thereof to the Court.

While ascertaining the wishes of the creditors the Court shall have regard to the value of each creditor's debt. In the case of contributories, the Court shall have regard to the number of votes which may be cast by each contributory.

WINDING UP OF UNREGISTERED COMPANIES

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.

In *Polaroid Industries v. Nav Nirman Co.* (2001) 105 Comp. Cas. 188, it was held 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.

An unregistered company, which includes any partnership or association, is liable to be wound up like any company if it is hit by conditions prescribed in Section 433, but the prerequisite for such winding up is that it should be established that the partnership or association has more than seven members. Otherwise, petition for winding up is not maintainable. [*Makhan Singh v. Raja Oil Mills* (2000) 38 CLA 74].

In *Smt. M.V. Parsvarthavardhana v. M.V. Ganesh Prasad* (1999) 35 CLA 318 it was held that a partnership firm can be wound up even if there is arbitration clause. It was also held that even if partnership firm is dissolved, the partnership subsists for the purpose of winding up its business and adjusting the rights of partners *inter-se*.

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 All. 555 that the Court cannot entertain a petition for winding up of a company formed in contravention of the provisions of Section 4 (now Section 11) of the Act.

An "unregistered company" not being "company" as defined in the Act cannot be wound up under Part VII of the Act which deals with winding up of companies. The legislature has, therefore, enacted special provisions in Part X to provide for the winding up of unregistered companies legitimately or lawfully formed. 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.

When unregistered company unable to pay its debts

An unregistered company shall be deemed to be unable to pay its debts:

- (i) if a creditor, to whom the company owes more than ₹ 500 has served on the company a demand under his hand requiring the company to pay the sum

so due, and the company has for three weeks after the service of demand, neglected to pay the sum or to secure or to compound for it to the satisfaction of the creditor; or

- (ii) if any other suit or other legal proceeding has been instituted against any member for any debt or demand due, or claimed to be due, from the company, or from him in his character as member, and notice in writing of the institution of the suit or other legal proceeding having been served on the company, the company has not, within ten days after service of the notice, paid, secured or compounded for the debt or demand or procured the suit or other legal proceeding to be stayed, or indemnified the defendant to his satisfaction against the suit or other legal proceeding; or
- (iii) if execution or other process issued on a decree of Court is returned unsatisfied; or
- (iv) if it is otherwise proved that the company is unable to pay its debts (Section 583).

An unregistered company cannot be wound up either voluntarily or subject to the supervision of the Court. It can only be wound up by the Court. For the purpose of determining the jurisdiction of the Court in the matter of winding up, the State where the company has its principal place of business is deemed to be the State in which the registered office of the company is situated. If the principal place of business is situated in more than one State then the State in which the winding up proceedings are instituted is deemed to be the State in which the registered office of the company is situated.

Winding up of Foreign Company as Unregistered Company

Section 584 provides that where a company incorporated outside India (i.e. a foreign company) has been carrying on business in India, ceases to carry on business in India, it may be ordered to be wound up as an unregistered company, even though the company has been dissolved or ceases to exist by virtue of the laws of the country under which it was incorporated.

Contributories in winding up of an unregistered company

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 (Section 585).

As regards legal proceedings and stay of proceedings the same provisions as are applicable to a "company" will apply in the case of an unregistered company.

If an unregistered company has no power to sue and be sued in a common name, or if the Court for any other reason considers it expedient, the Court may by winding up order or by any subsequent order, direct that all or any part of the property of all description shall vest in the Official liquidator by his official name. The liquidator may bring or defend in his official name, any suit or other legal proceedings relating to the property or necessary to be brought or defended for the purpose of effectually winding up the company and recovering its property (Section 588). All these provisions relating to the winding up of an unregistered company are in addition to other provisions/relating to winding up of companies by the Court.

Role of the Secretary in Winding Up

When an order for winding up of a company has been made or a provisional liquidator has been appointed or where a resolution for voluntary winding up has been passed, the secretary is required to make out and submit to the Official Liquidator or to provisional liquidator, or the liquidator, as the case may be, within 21 days from the date of appointment of the provisional liquidator or from the commencement of the winding up, a statement, verified by an affidavit, as to the affairs of the company. The statement is required to contain the following particulars, namely:

- (a) the assets of the company, stating separately:
 - (i) the cash balance in hand and at the bank, if any, and
 - (ii) the negotiable securities, if any, held by the company.
- (b) its debts and liabilities;
- (c) the names, residences and occupations of its creditors stating separately:
 - (i) the amount of secured and unsecured debts, and
 - (ii) in the case of secured debts, particulars of the securities given and whether they were given by the company or an officer thereof;
- (d) the debts due to the company, and
 - (i) the names, residences and occupations of the persons from whom they are due, and
 - (ii) the amount likely to be realised on account thereof;
- (e) such further statement as the Official Liquidator or liquidator may require [Section 454 read with Section 511A].

The secretary may make an application for dispensing with the requirements of law regarding the making of statement of affairs, showing the special circumstances which, in his opinion, render such a course desirable. The Court may, on such application, dispense with the requirement of making of statement of affairs.

The Official Liquidator shall, as soon as possible after his appointment as the provisional liquidator, or after the winding up order, or in the case of a voluntary winding up, after the commencement of the winding up, shall serve a notice on the

secretary or other persons who are officers or chief executive officers of the company calling upon them to submit and verify a statement of affairs within 21 days or within such extended time not exceeding three months [Sections 454(2) and 511(A)].

The Official Liquidator or the liquidator in a voluntary winding up may also require persons who had been secretaries of the company within one year before the commencement of the winding up order or before the date of appointment of the provisional liquidator to submit and verify a statement of affairs. The time limit of 21 days may be extended to three months by the Court, Official Liquidator or a liquidator, as the case may be. The statement of affairs is to be made in the prescribed form and the liquidator is required to give adequate facilities to the secretary to make the statement of affairs. The statement of affairs is to be verified by the secretary and the verified statement shall be submitted to the Official Liquidator or liquidator within twenty-one days of the extended time limit, as the case may be.

The secretary may submit a bill for his actual expenses for the preparation and making of the statement of affairs. Such costs and expenses shall not be paid until the statement of affairs, verified by an affidavit, has been submitted to the Official Liquidator or liquidator, as the case may be.

The secretary is required to attend on the Official Liquidator or the liquidator if required so to do at such time and place as may be appointed by him. He is further required to answer all such questions as may be put to him by the Official Liquidator or the liquidator. The Official Liquidator or liquidator is required to maintain minutes of such interviews or the memorandum containing the substances of such interviews.

Any default, without any reasonable excuse, in complying with the requirements of law of making a statement of affairs is a punishable offence and may be punished with imprisonment for a term which may extend to two years or a daily fine of rupees one hundred for every day during which the default continues, or with both. The offence is triable only by the winding up Court.

After the statement of affairs has been made, the Official Liquidator is required to make a preliminary report to the Court not later than six months from the date of the winding up order or within such extended period as the Court may allow. Where the making of statement of affairs is dispensed with, such preliminary report shall be submitted as soon as practicable after the commencement of the winding up.

A creditor or contributory has a right to inspect the statement of affairs and the preliminary report submitted by the Official Liquidator at all reasonable times and to obtain copies there of or extracts therefrom on payment of the prescribed charges.

The Official Liquidator may also submit further report or reports:

- (a) stating the manner in which the company was promoted or formed and whether, in his opinion, any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof; and
- (b) any other matter which in his opinion, it is desirable to bring to the notice of the Court.

Such report shall set out the names of the persons by whom the fraud, in the

opinion of the Official Liquidator or liquidator was committed and the facts on which such opinion is based.

On a consideration of the report made by the Official Liquidator, or liquidator, the Court may direct the public examination of the promoters, directors or officers of the company (which will include secretaries) with a view to discovering the facts. The object of the public examination is to get information to enable the Court to determine what course is to be followed with reference to the winding up. After the public examination, the Court may, if it is of opinion that a fraud has been committed.

(a) by any person in the promotion or formation of the company; or

(b) by any officer of the company in relation to the company since its formation,

direct the public examination of such person or officer.

Where an order has been made for public examination of any person, the examination shall be held before the judge. The liquidator is to take part in the public examination and employ such legal assistance as may be sanctioned by the Court. Any creditor or contributory may also take part in the public examination and may appear personally or through an advocate. The person who is examined publicly is to be examined on oath and is required to answer all such questions as the Court may allow to be put to him. A person who is ordered to be publicly examined is required to be furnished, at his own cost, with a copy of the liquidator's report. He may, at his own cost, with a copy of the liquidator's report. He may, at his own cost, engage a lawyer to defend his case. The notes of the public examination are to be taken down in writing and are required to be read over and signed by the person examined.

After the public examination, the Court may start misfeasance proceedings against any officer of the company who is found to have misappropriated or misapplied or retained any money or property of the company or who has become liable or accountable for any money or property of the company or has been guilty of wrongful exercise of lawful authority or breach of trust in relation to the company. The misfeasance proceedings may be started within 5 years from the commencement of the winding up, mis-application, retainer, misfeasance or breach of trust, whichever is longer.

As a result of the misfeasance proceedings any amount belonging to the company which is found to have been misappropriated, misapplied or retained or in respect of which any wrongful exercise of any lawful authority has been made or breach of trust has been committed, may be recovered from the concerned officer of the company.

Every officer of the company who is found guilty is also liable to be prosecuted for negligence, default, breach of duty, misfeasance or breach of the trust. But every such offence is non-cognizable and no prosecution can be launched except when a complaint in writing has been made by the Registrar of Companies or a shareholder of the company or any person authorised by the Central Government.

OUTSOURCING RESPONSIBILITIES TO PROFESSIONALS

The absence of involvement and participation of professionals possessing appropriate knowledge and skills can impact the quality and efficiency of the entire

process. The National Company law tribunal has also been empowered to pass an order for winding up of a company by the Companies (Second Amendment) Act, 2002. Therefore, Practising Company Secretaries may represent the winding up case in the tribunal. Hitherto, only government officers could act as Official Liquidators. Now professionals like Practising Company Secretary can act as Liquidator in case of winding up by the tribunal as well as voluntary winding up.

Legal Position

At present Private Liquidator may be appointed only in case of Voluntary Winding Up either by Members or Creditors.

After the commencement of the Companies (Second Amendment) Act, 2002 Private Liquidator may be appointed by Tribunal in cases of Winding up other than Voluntary Winding Up and National Company Law Tribunal authorized to appoint liquidator who may also be called as deputy or assistant liquidator from the panel of professionals in the cases of winding up.

Responsibilities

General Duties

- (a) To act in good faith and for proper purpose.
- (b) Not allow a conflict of interest and duty.
- (c) Be impartial.
- (d) To exercise a degree of care and skill.

Specific Duties

To call meetings of the Members/Creditors as per provisions of the Act

Meetings are required to be held at specific intervals and happenings of certain events as provided in the Act.

To give notices of appointment to all concerned authorities

Notice of appointment shall be given to Income Tax, Sales Tax, Excise, Property Tax and other concerned authorities. It is expected that they shall expedite the assessment and crystallize the liability.

To keep proper books of accounts & other books

Maintenance of proper records is very important part of liquidator's duty. He is required to submit half yearly report to the ROC in Form 153 and give report on liquidation proceedings. Maintenance of other books does help him in preparing the same. This report covers areas such as receipt and payment statement for the period, statement of status of assets, status of creditors, estimation of outstanding to be realized, causes for delay, if any, probable date of completion of winding up, statement of pending legal cases etc.

To maintain all records of proceedings of liquidation

It is expected to maintain various books as provided in the court rules.

To secure control of the assets and papers

Control of assets includes insurance of property and providing security to protect the assets.

To realize assets and debts

It seems to be very simple duty to realize assets and debts but practically most difficult part, buyers do talk about only defects in the assets. They try to buy the same at scrap value. Also debtors do not respond at all or claim that they had paid the dues. Even after getting ex-parte decree difficulties are faced in tracing the debtors and execution of decree by attachment.

To ascertain liabilities and discharge them

Here also liabilities of creditors can be fixed faster but liability of Tax authorities and workmen are most difficult to be fixed in time. One has to face trade union and their abnormal demands.

To distribute surplus to the contributories

Problem can be there in finalizing list of contributories even though list is provided. As the company is in existence all types of transactions do continue like Demat facility, transfer and transmission cases etc.

To comply with all applicable laws and Court Rules for dissolution

To name few - Company Law, Labour Laws, Income Tax, Sales Tax, Pollution Control, National Statistics, Provident Fund, ESI, Banking, Municipal Law, Depository Act, Securities Contract Act, SEBI, Listing Agreement, Specific law applicable to that industry.

Authority

Private liquidator has authority:

- (a) To institute or defend any suit or prosecution.
- (b) To carry on business necessary for beneficial winding up.
- (c) To sell immovable and movable assets.
- (d) To raise security on assets.
- (e) To do all necessary things for winding up the affairs.

In case of voluntary winding up liquidator is entering the shoes of Board of Directors. Enjoying full authority to decide the matter but he has to discharge his responsibilities and comply with applicable provisions of various laws. Company remains live till the order of dissolution by the Tribunal and hence liquidator is required to submit all necessary returns in time. Consider the provisions of TDS, Capital Gain and finally sales tax set off. After the amendment Act in other cases of winding up liquidator will be under the supervision and control of Company Law Tribunal as at presently Official Liquidator is under the supervision and control of the court.

Remuneration

Most important aspect for any practitioner is reward for his efforts. One must be very cautious while fixing the remuneration because no one is having the authority to increase the same subsequently.

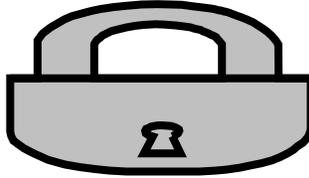
As the Company remains live till dissolution liquidator is expected to follow the procedure as given in tax laws i.e. preparation of balance sheet and filing the same with Income Tax. Accounts of liquidator can be of different period but the Balance sheet must be as of 31st March. TDS deduction and filing of return is must. Sales Tax returns are required to be filed till the cancellation of sales tax number even though they are nil returns. Demat facility continues. Listing continues with the exchange though they do not allow trading of scrip. Nothing is automatic in Voluntary winding up including retrenchment of workers.

Keeping in view the large role for professionals and experts in the insolvency process, the Irani Committee has recommended the recognition of the concept of insolvency Practitioners in its report. If the recommendations of the Irani Committee including those extracted above meet the favour of policy makers, the Indian insolvency system will undergo a revolutionary change bringing it at par with the international benchmark. The professionals will get the opportunity to participate and perform various roles in the insolvency process. The professionals would be able to get appointed as liquidators, administrators, valuers, turnaround advisors, and supervisors besides performing the services such as representing and advising creditor committees, individual creditors and other stakeholders, investigator, inspector, auctioneer, trustees, security advisors, etc.

LESSON ROUND UP



- A company cannot be adjudged as insolvent but can wind up
- There are fundamental differences between winding up and dissolution as regards the legal procedures are involved.
- A company may be wound up by the Court i.e. compulsory winding up; by voluntary winding up (members' voluntary winding up or creditors' voluntary winding up).
- Voluntary winding up is less cumbersome than compulsory winding up.
- Dissolution is possible without the process of winding up.
- The provisions related to winding up of companies is enumerated in Part VII of the Companies Act, 1956.

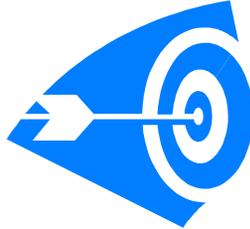
SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What are the various modes of winding up?
 2. What is compulsory winding up? Who are entitled to make a petition to the Court?
 3. Describe the duties and powers of liquidator appointed by the Court.
 4. Discuss the provisions of the Companies Act, 1956 regarding appointment and removal of a liquidator appointed by the Court.
 5. Write brief note on the liquidators' right of disclaimer.
 6. Define an unregistered company and point out how and when such a company can be wound up?
 7. Write short notes on the following:
 - (a) Committee of Inspection.
 - (b) Public examination.
 - (c) Dissolution of company.
 - (d) Commencement of winding up.
 8. 'A voluntary liquidator is more rightly described as an agent of the company'. Discuss.
 9. How is a 'Committee of Inspection' in a compulsory winding up appointed? What are its functions? How is any vacancy in the Committee filled up?
 10. What is a 'Statement of Affairs'? State the contents that must be included therein. By whom and within what time limit should it be made?
 11. Discuss in brief the role of a company secretary in winding up of a company.
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STUDY XVI
CROSS-BORDER INSOLVENCY

LEARNING OBJECTIVES



After going through this study, you will be able to learn:

- Corporate Insolvency Vs Individual insolvency
- Development of UNCITRAL Model law
- Salient features of Model law
- World Bank Principles
- Summary of World Bank Principles
- Reforms in Insolvency laws
- Legislative response to the reform process
- Role of professionals in Insolvency process.

Introduction

The law of Insolvency in India owes its origin to English law. Before the British came to India there was no indigenous law of Insolvency in the country.

The earliest rudiments of insolvency legislation can be traced to sections 23 and 24 of the Government of India Act, 1800, which conferred insolvency jurisdiction on the Supreme Court.

The passing of Statute 9 in 1828 (Geo. IV. c. 73) can be said to be the beginning of the special insolvency legislation in India. Under this Act, the first insolvency courts for relief of insolvent debtors were established in the Presidency-towns. A further step in the development of Insolvency Law was taken when the law in 1848 (11 and 12 Viet. c. 21) was passed. The Provisions of the Indian Insolvency Act, 1848, were, however, found to be inadequate to meet the changing conditions. However, the Act of 1848 was in force in the Presidency-towns until the enactment in 1909 of the present Presidency-towns Insolvency Act, 1909.

Individual Insolvency

In case of individuals there are two insolvency Act, one for the presidency towns and the other for the rest of the country. The Presidency –Towns Insolvency Act, 1909 and The Provincial Insolvency Act, 1920 respectively.

Corporate Insolvency

Indian insolvency law is contained in the Companies Act, 1956 (1956 Act) under which winding up of companies is carried out and Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) which deals with revival and rehabilitation of sick companies.

Companies Act, 1956

In India the Companies Act, 1956 provides for the law relating to corporate insolvency and *inter alia* contains the provisions for winding up of companies.

A company can be wound up in one of the following ways:

- Compulsory winding up by order of court
- Voluntary winding up
 - ▶ Members' voluntary winding up
 - ▶ Creditors' voluntary winding up
- Winding up subject to supervision of the court (Omitted by Companies (Amendment) Act, 2002 and yet to be notified).

In addition, the Registrars of Companies are empowered under section 560 to strike off the name of a defunct company from the register. An unregistered company or a foreign company can also be wound up under the provisions of the Companies Act.

Sick Industrial Companies (Special Provisions) Act, 1985

The process for rehabilitation, regulated by the Sick Industrial Companies (Special Provisions) Act 1985 is done through the institutional structure of Board of Industrial and Financial Restructuring (BIFR).

Securitisation & Reconstruction Of Financial Assets & Enforcement Of Security Interest Act, 2002

The Committees constituted by the Government to examine banking sector reforms had suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without the intervention of the court.

Based on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 was promulgated on 21st June, 2002. The ordinance was later replaced by the Securitisation Act, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The Act empowers the banks and financial institutions to realise long-term assets, manage problem of liquidity, asset liability mis-matches and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

In the year 1999, the Government of India set up a High Level Committee headed by Justice V.B.Eradi, to examine and make recommendations with regard to

the desirability of changes in existing law relating to winding up of companies so as to achieve more transparency and avoid delays in the final liquidation of the companies; The Committee recognized after considering international practices that the law of insolvency should not only provide for quick disposal of assets but in Indian economic scene, it should first look at the possibilities of rehabilitation and revival of companies. The Committee also recommended that the jurisdiction, power and authority relating to winding up of companies should be vested in a National Company Law Tribunal instead of the High Court as at present. The Committee strongly recommended appointing Insolvency Professionals who are members of Institute of Chartered Accountant of India (ICAI), Institute of Company Secretaries of India (ICSI), Institute of Cost and Work Accountants of India (ICWAI), Bar Councils or corporate managers who are well versed in Corporate management on lines of U.K. Insolvency Act.

Dr. J.J.Irani Expert Committee on Company Law was set up by the Government to recommend a new company law has proposed significant changes in the law to make the restructuring and liquidation process speedy, efficient and effective

DEVELOPMENT OF UNCITRAL MODEL LAW

The increasing incidence of cross-border insolvencies reflects the continuing global expansion of trade and investment. However, national insolvency laws have by and large not kept pace with the trend, and they are often ill-equipped to deal with cases of a cross-border nature. This frequently results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor against dissipation and hinder maximization of the value of those assets. Moreover, the absence of predictability in the handling of cross-border insolvency cases impedes capital flow and is a disincentive to cross-border investment. Fraud by insolvent debtors, in particular by concealing assets or transferring them to foreign jurisdictions, is an increasing problem, in terms of both its frequency and its magnitude. The modern, interconnected world makes such fraud easier to conceive and carry out. When the companies get into financial difficulties one of the challenges for the global economic community is how to make sure that the cross-border issues which arise in any resulting restructuring or liquidation can be dealt with in a coordinated and efficient manner.

With this in mind the United Nations Commission on International Trade Law approved the text of the UNCITRAL Model law on Cross-Border Insolvency (the Model Law) in May 1997. The Model Law is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency. The Model Law respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law. It offers solutions that help in several significant ways, including : foreign assistance for an insolvency proceeding taking place in the enacting State; foreign representative's access to courts of the enacting State; recognition of foreign proceedings; cross-border cooperation; and coordination of concurrent proceedings.

UNCITRAL had also came out with the Legislative Guide on Insolvency Law in

2004. The purpose of the Legislative Guide is to assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided in the Legislative Guide aims at achieving a balance between the need to address the debtor's financial difficulty as quickly and efficiently as possible and the interests of the various parties directly concerned with that financial difficulty, principally creditors and other parties with a stake in the debtor's business, as well as public policy concerns. The Legislative Guide addresses the issues central to an effective and efficient insolvency law and assists the reader to evaluate different approaches available and to choose the one most suitable in the national or local context. The Internet home page of UNCITRAL is <http://www.un.or.at/uncitral>.

UNCITRAL MODEL LAW

A model law is a legislative text that is recommended to countries for incorporation into their national law. Unlike an international convention, a model law does not require the country enacting it to notify the United Nations or other Nations that they have also enacted it.

Purpose of Model Law

The Preamble gives a succinct statement of the basic policy objectives of the Model Law. It is not intended to create substantive rights, but rather to give a general orientation for users of the Model Law and to assist in the interpretation of the Model Law. The purpose of the Model Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- (a) Cooperation between the courts and other competent authorities of a State and foreign States involved in cases of cross-border insolvency;
- (b) Greater legal certainty for trade and investment;
- (c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- (d) Protection and maximization of the value of the debtor's assets; and
- (e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

GENERAL PROVISIONS

Scope of application (Article 1)

According to Article 1 of the Model Law, it applies where:

- (a) Assistance is sought in the enacting State by a foreign court or a foreign representative in connection with a foreign proceeding; or
- (b) Assistance is sought in a foreign State in connection with a proceeding under the laws of the enacting State relating to insolvency; or
- (c) A foreign proceeding and a proceeding under the laws of the enacting State

relating to insolvency in respect of the same debtor are taking place concurrently; or

- (d) Creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under the laws of the enacting State relating to insolvency.

It further says that the Model Law does not apply to a proceeding concerning any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in a State and that State wishes to exclude from the Law (the type of entity to be excluded may be designated).

Banks or insurance companies are mentioned as examples of entities that the enacting State might decide to exclude from the scope of the Model Law. The reason for the exclusion would be that the insolvency of such entities gives rise to the particular need to protect vital interests of a large number of individuals, or that the insolvency of those entities usually requires particularly prompt and circumspect action (for instance to avoid massive withdrawals of deposits). For those reasons, the insolvency of such types of entities is in many States administered under a special regulatory regime. The enacting State might decide to exclude the insolvency of entities other than banks and insurance companies.

Definitions (Article 2)

For the purposes of this Law:

- (a) "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;
- (b) "Foreign main proceeding" means a foreign proceeding taking place in the State where the debtor has the centre of its main interests;
- (c) "Foreign non-main proceeding" means a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment within the meaning of subparagraph (f) of this Article;
- (d) "Foreign representative" means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding;
- (e) "Foreign court" means a judicial or other authority competent to control or supervise a foreign proceeding;
- (f) "Establishment" means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.

Meaning of 'State'

The word "State", as used in the preamble and throughout the Model Law, refers to the country that enacts the Law (the "enacting State"). The term should not be understood as referring, for example, to a state in a country with a federal system.

Types of foreign proceedings covered

To fall within the scope of the Model Law, a foreign insolvency proceeding 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, albeit 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.

Principle of supremacy of international obligations (Article 3)

Article 3 provides that to the extent that the Model Law conflicts with an obligation of the state enacting the model law arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail.

Competent court or authority (Article 4)

The functions under the Model Law relating to recognition of foreign proceedings and cooperation with foreign courts shall be performed by the court, courts, authority or authorities as specified in the Model Law who are competent to perform those functions in the enacting State.

ACCESS OF FOREIGN REPRESENTATIVES AND CREDITORS TO COURTS IN STATE ENACTING MODEL LAW**Right of direct access (Article 9)**

A foreign representative is entitled to apply directly to a court in the State enacting law. Article 9 is limited to expressing the principle of direct access by the foreign representative to courts of the enacting State, thus freeing the representative from having to meet formal requirements such as licences or consular action.

Application by a foreign representative to commence a proceeding (Article 11)

According to Article 11, a foreign representative is entitled to apply to commence a proceeding under the laws of the enacting State relating to insolvency, if the conditions for commencing such a proceeding are otherwise met.

A foreign representative has this right without prior recognition of the foreign proceeding because the commencement of an insolvency proceeding might be crucial in cases of urgent need for preserving the assets of the debtor.

The Model Law avoids the need to rely on cumbersome and time-consuming letters rogatory¹ or other forms of diplomatic or consular communications that might otherwise have to be used. This facilitates a coordinated, cooperative approach to cross-border insolvency and makes fast action possible.

1. Seeking information by one Court from another, especially foreign Court.

In addition to establishing the principle of direct court access for the foreign representative, the Model Law:

- (a) Establishes simplified proof requirements for seeking recognition and relief for foreign proceedings, which avoid time-consuming "legalization" requirements involving notarial or consular procedures (Article 15);
- (b) Provides that the foreign representative has procedural standing for commencing an insolvency proceeding in the enacting State (under the conditions applicable in the enacting State) and that the foreign representative may participate in an insolvency proceeding in the enacting State (Articles 11 and 12);
- (c) Confirms, subject to other requirements of the enacting State, access of foreign creditors to the courts of the enacting State for the purpose of commencing in the enacting State an insolvency proceeding or participating in such a proceeding (Article 13);
- (d) Gives the foreign representative the right to intervene in proceedings concerning individual actions in the enacting State affecting the debtor or its assets (Article 24);

Provides that the mere fact of a petition for recognition in the enacting State does not mean that the courts in that State have jurisdiction over all the assets and affairs of the debtor (Article 10).

Upon recognition of a foreign proceeding, the foreign representative is entitled to participate in a proceeding regarding the debtor under the laws of the enacting State relating to insolvency (Article 12).

Article 12 is limited to giving the foreign representative procedural standing (or "procedural legitimation") to make petitions, requests or submissions concerning issues such as protection, realization or distribution of assets of the debtor or cooperation with the foreign proceeding and does not vest the foreign representative with any specific powers or rights.

Protection of creditors and other interested persons

Foreign creditors have the same rights regarding the commencement of and participation in a proceeding under the laws of the enacting state relating to insolvency as creditors in the state.

The Model Law contains following provisions to protect the interests of the creditors (in particular local creditors), the debtor and other affected persons:

- availability of temporary relief upon application for recognition of a foreign proceeding or upon recognition is subject to the discretion of the court; it is expressly stated that in granting such relief the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected (Article 22, paragraph 1);
- the court may subject the relief it grants to conditions it considers appropriate; and
- the court may modify or terminate the relief granted, if so requested by a person affected thereby (Article 22, paragraphs 2 and 3).

In addition to those specific provisions, the Model Law in a general way provides that the court may refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting State (Article 6).

Notification to foreign creditors of a proceeding (Article 14)

Article 14 of the Model Law provides that whenever under laws of the enacting State relating to insolvency, a notification is to be given to creditors, such notification shall also be given to the known creditors that do not have addresses in the State. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known. The main purpose of notifying foreign creditors is to inform them of the commencement of the insolvency proceeding and of the time-limit to file their claims.

Such notification shall be made to the foreign creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No letters rogatory or other, similar formality is required. When a notification of commencement of a proceeding is to be given to foreign creditors, the notification shall:

- (a) Indicate a reasonable time period for filing claims and specify the place for their filing;
- (b) Indicate whether secured creditors need to file their secured claims; and
- (c) Contain any other information required to be included in such a notification to creditors pursuant to the law of this State and the orders of the court.

RECOGNITION OF A FOREIGN PROCEEDING AND RELIEF

Application for recognition of a foreign proceeding (Article 15)

Article 15 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.

The Model Law presumes that documents submitted in support of the application for recognition need not be authenticated in any special way, in particular by

legalization. According to Article 16, the court is entitled to presume that those documents are authentic whether or not they have been legalized. "Legalization" is a term often used for the formality by which a diplomatic or consular agent of the State in which the document is to be produced certifies the authenticity of the signature, the capacity in which the person signing the document has acted and, where appropriate, the identity of the seal or stamp on the document.

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. In order not to prevent recognition because of non-compliance with a mere technicality, the law allows evidence other than that specified; that provision, however, does not compromise the court's power to insist on the presentation of evidence acceptable to it.

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. That information is needed by the court not so much for the decision on recognition itself but for any decision granting relief in favour of the foreign proceeding. In order to tailor such relief appropriately and make sure that the relief is consistent with any other insolvency proceeding concerning the same debtor, the court needs to be aware of all foreign proceedings concerning the debtor that may be under way in third States.

Decision to recognize a foreign proceeding (Article 17)

Subject to Article 6, 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 foreign proceeding shall be recognized as a foreign main proceeding if it is taking place in the State where the debtor has the centre of its main interests; or as a foreign non-main proceeding if the debtor has an establishment within the meaning of subparagraph (f) of Article 2 in the foreign State.

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 the abovesaid 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.

Subsequent information (Article 18)

The foreign representative shall inform the court immediately if from the time of filing the application for recognition of the foreign proceeding, there is:

- (a) Any substantial change in the status of the recognized foreign proceeding or the status of the foreign representative's appointment; and

- (b) Any other foreign proceeding regarding the same debtor that becomes known to the foreign representative.

It is possible that, after the application for recognition or after recognition, changes may occur in the foreign proceeding that would have affected the decision on recognition or the relief granted on the basis of recognition. For example, the foreign proceeding may be terminated or transformed from a liquidation proceeding into a reorganization proceeding, or the terms of the appointment of the foreign representative may be modified or the appointment itself terminated. The technical modifications in the status of the proceedings or the terms of the appointment are frequent, but that only some of those modifications are such that they would affect the decision granting relief or the decision recognizing the proceeding; therefore, the provision only calls for information of "substantial" changes.

Relief that may be granted upon application for recognition of a foreign proceeding (Article 19)

According to Article 19, from the time of filing an application for recognition until the application is decided upon, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including:

- (a) Staying execution against the debtor's assets;
- (b) Entrusting the administration or realization of all or part of the debtor's assets located in a State to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy;
- (c) Any relief mentioned in Article 21.

Relief available under Article 19 is provisional in the sense that, the relief terminates when the application for recognition is decided upon; however, the court is given the opportunity to extend the measure, as provided in Article 21. The court may refuse to grant relief under this Article if such relief would interfere with the administration of a foreign main proceeding.

Effects of recognition of a foreign main proceeding (Article 20)

Once foreign proceeding is recognized which is a foreign main proceeding, the following are the effects:

- (a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;
- (b) Execution against the debtor's assets is stayed; and
- (c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

The effects provided by Article 20 are not discretionary in nature. These flow

automatically from recognition of the foreign main proceeding. The automatic effects under Article 21 apply only to main proceedings.

Relief that may be granted upon recognition of a foreign proceeding (Article 21)

Upon recognition of a foreign proceeding, whether main or non-main, where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including:

- (a) Staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities, to the extent they have not been stayed under Article 20;
- (b) Staying execution against the debtor's assets to the extent it has not been stayed under Article 20;
- (c) Suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under Article 20;
- (d) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;
- (e) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court;
- (f) Extending relief granted under Article 19;
- (g) Granting any additional relief that may be available to a person or body administering a reorganization or liquidation under the law of the enacting State under the laws of that State.

Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in the State enacting the Model Law to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors are adequately protected.

In granting relief under this Article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of the enacting State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

Protection of creditors and other interested persons (Article 22)

The court may under Article 22, at the request of the foreign representative or a person affected by relief granted, or at its own motion, modify or terminate such relief. In granting or denying relief under Article 19 or 21, or in modifying or terminating relief, the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected.

The idea underlying Article 22 is that there should be a balance between relief

that may be granted to the foreign representative and the interests of the persons that may be affected by such relief.

Actions to avoid acts detrimental to creditors (Article 23)

Under many national laws both individual creditors and insolvency administrators have a right to bring actions to avoid or otherwise render ineffective acts detrimental to creditors. Such a right, insofar as it pertains to individual creditors, is often not governed by insolvency law but by general provisions of law (such as the civil code); the right is not necessarily tied to the existence of an insolvency proceeding against the debtor so that the action may be instituted prior to the commencement of such a proceeding. The person having such a right is typically only an affected creditor and not another person such as the insolvency administrator. Furthermore, the conditions for these individual-creditor actions are different from the conditions applicable to similar actions that might be initiated by an insolvency administrator.

The procedural standing conferred by Article 23 extends only to actions that are available to the local insolvency administrator in the context of an insolvency proceeding, and the Article does not equate the foreign representative with individual creditors who may have similar rights under a different set of conditions. Such actions of individual creditors fall outside the scope of Article 23.

The Model Law expressly provides that a foreign representative has "standing" to initiate actions to avoid or otherwise render ineffective legal acts detrimental to creditors. The provision is drafted narrowly in that it does not create any substantive right regarding such actions and also does not provide any solution involving conflict of laws. The effect of the provision is that a foreign representative is not prevented from initiating such actions by the sole fact that the foreign representative is not the insolvency administrator appointed in the enacting State.

Intervention by a foreign representative in proceedings (Article 24)

Upon recognition of a foreign proceeding, the foreign representative may, provided the requirements of the law of the State are met, intervene in any proceedings in which the debtor is a party. The purpose of Article 24 is to avoid the denial of standing to the foreign representative to intervene in proceedings merely because the procedural legislation may not have contemplated the foreign representative among those having such standing. The Article applies to foreign representatives of both main and non-main proceedings.

Cooperation with Foreign Courts and Foreign Representatives

Chapter IV (Articles 25-27), on cross-border cooperation, is a core element of the Model Law. Its objective is to enable courts and insolvency administrators from two or more countries to be efficient and achieve optimal results. Cooperation as described in the chapter is often the only realistic way, for example, to prevent dissipation of assets, to maximize the value of assets.

Articles 25 and 26 not only authorize cross-border cooperation, they also mandate it by providing that the court and the insolvency administrator "shall cooperate to the maximum extent possible". The Articles are designed to overcome the widespread problem of national laws lacking rules providing a legal basis for

cooperation by local courts with foreign courts in dealing with cross-border insolvencies.

Enactment of such a legal basis would be particularly helpful in legal systems in which the discretion given to judges to operate outside areas of express statutory authorization is limited. However, even in jurisdictions in which there is a tradition of wider judicial latitude, enactment of a legislative framework for cooperation has proved to be useful. To the extent that cross-border judicial cooperation in the enacting State is based on the principle of comity among nations, the enactment of Articles 25-27 offers an opportunity for making that principle more concrete and adapted to the particular circumstances of cross-border insolvencies.

The Articles in chapter IV leave certain decisions, in particular when and how to cooperate, to the courts and, subject to the supervision of the courts, to the insolvency administrators. For a court to cooperate with a foreign court or a foreign representative regarding a foreign proceeding, the Model Law does not require a previous formal decision to recognize that foreign proceeding.

Cooperation and direct communication between courts or foreign representatives (Article 25)

The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives. The ability of courts, with appropriate involvement of the parties, to communicate "directly" and to request information and assistance "directly" from foreign courts or foreign representatives is intended to avoid the use of time-consuming procedures traditionally in use, such as letters rogatory.

Cooperation and direct communication between a person or body administering a reorganization or liquidation under the law of the enacting State and foreign courts or foreign representatives (Article 26)

Article 26 on international cooperation between persons who are appointed to administer assets of insolvent debtors reflects the important role that such persons can play in devising and implementing cooperative arrangements, within the parameters of their authority. The provision makes it clear that an insolvency administrator acts under the overall supervision of the competent court. The Model Law does not modify the rules already existing in the insolvency law of the enacting State on the supervisory functions of the court over the activities of the insolvency administrator.

According to Article 27, Cooperation may be implemented by any appropriate means, including:

- (a) Appointment of a person or body to act at the direction of the court;
- (b) Communication of information by any means considered appropriate by the court;
- (c) Coordination of the administration and supervision of the debtor's assets and affairs;
- (d) Approval or implementation by courts of agreements concerning the coordination of proceedings;

- (e) Coordination of concurrent proceedings regarding the same debtor;
- (f) The enacting State may wish to list additional forms or examples of cooperation.

CONCURRENT PROCEEDINGS

Commencement of a proceeding after recognition of a foreign main proceeding (Article 28)

After recognition of a foreign main proceeding, a proceeding under the laws of the enacting State relating to insolvency may be commenced only if the debtor has assets in the state enacting the Model Law. The effects of that proceeding shall be restricted to the assets of the debtor that are located in such State and to the extent necessary to implement cooperation and coordination under Articles 25, 26 and 27 to other assets of the debtor that, under the law of such State, should be administered in that proceeding.

Article 28, in conjunction with Article 29, provides that recognition of a foreign main proceeding will not prevent the commencement of a local insolvency proceeding concerning the same debtor as long as the debtor has assets in the State.

Coordination of a proceeding (Article 29)

Article 29 gives guidance to the court that deals with cases where the debtor is subject to a foreign proceeding and a local proceeding at the same time. Where a foreign proceeding and a proceeding under the laws of the enacting State relating to insolvency are taking place concurrently regarding the same debtor, the court shall seek cooperation and coordination under Articles 25, 26 and 27, and the following shall apply:

- (a) When the proceeding in the State (which has enacted model law) is taking place at the time the application for recognition of the foreign proceeding is filed,
 - (i) Any relief granted under Article 19 or 21 must be consistent with the proceeding in such State; and
 - (ii) If the foreign proceeding is recognized in such State as a foreign main proceeding, Article 20 does not apply;
- (b) When the proceeding in such State commences after recognition, or after the filing of the application for recognition, of the foreign proceeding,
 - (i) Any relief in effect under Article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the proceeding in this State; and
 - (ii) If the foreign proceeding is a foreign main proceeding, the stay and suspension referred to in Article 20 shall be modified or terminated, if inconsistent with the proceeding in such State;
- (c) In granting, extending or modifying relief granted to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets which, according to the law of the enacting State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

The salient principle embodied in Article 29 is that the commencement of a local proceeding does not prevent or terminate the recognition of a foreign proceeding. This principle is essential for achieving the objectives of the Model Law in that it allows the court in the enacting State in all circumstances to provide relief in favour of the foreign proceeding.

Coordination of more than one foreign proceeding (Article 30)

Article 30 deals with cases where the debtor is subject to insolvency proceedings in more than one foreign State and foreign representatives of more than one foreign proceeding seek recognition or relief in the enacting State. The provision applies whether or not an insolvency proceeding is pending in the enacting State. If, in addition to two or more foreign proceedings, there is a proceeding in the enacting State, the court will have to act pursuant to both Article 29 and Article 30.

In respect of more than one foreign proceeding regarding the same debtor, the court shall seek cooperation and coordination under Articles 25, 26 and 27, and the following shall apply:

- (a) Any relief granted under Article 19 or 21 to a representative of a foreign non-main proceeding after recognition of a foreign main proceeding must be consistent with the foreign main proceeding;
- (b) If a foreign main proceeding is recognized after recognition, or after the filing of an application for recognition, of a foreign non-main proceeding, any relief in effect under Article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the foreign main proceeding;
- (c) If, after recognition of a foreign non-main proceeding, another foreign non-main proceeding is recognized, the court shall grant, modify or terminate relief for the purpose of facilitating coordination of the proceedings.

The objective of Article 30 is similar to that of Article 29 in that the key issue in the case of concurrent proceedings is to promote cooperation, coordination and consistency of relief granted to different proceedings. Such consistency will be achieved by appropriate tailoring of relief to be granted or by modifying or terminating relief already granted. Unlike Article 29, which, as a matter of principle, gives primacy to the local proceeding, Article 30 gives preference to the foreign main proceeding if there is one.

Rule of payment in concurrent proceedings (Article 32)

Without prejudice to secured claims or rights in rem, a creditor who has received part payment in respect of its claim in a proceeding, pursuant to a law relating to insolvency, in a foreign State, may not receive a payment for the same claim in a proceeding under the laws of the enacting State relating to insolvency regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.

The rule set forth in Article 32, also referred to as the hotchpotch rule, is a useful safeguard in a legal regime for coordination and cooperation in the administration of cross-border insolvency proceedings. It is intended to avoid situations in which a creditor might obtain more favourable treatment than the other creditors of the same

class by obtaining payment of the same claim in insolvency proceedings in different jurisdictions.

EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS - WORLD BANK PRINCIPLES

The World Bank Principles were originally developed in 2001 in response to a request from the international community in the wake of the financial crises in emerging markets in the late 90s. At the time, there were no internationally recognized benchmarks or standards to evaluate the effectiveness of domestic creditor rights and insolvency systems. The World Bank's initiative began in 1999, with the constitution of an ad hoc committee of partner organizations, and with the assistance of leading international experts who participated in the World Bank's Task Force and Working Groups. The Principles were vetted in a series of five regional conferences, involving officials and experts from some 75 countries, and drafts were placed on the World Bank's website for public comment. The Bank's Board of Directors approved the Principles in 2001 for use in connection with the joint IMF-World Bank program to develop Reports on the Observance of Standards and Codes (ROSC), subject to reviewing the experience and updating the Principles as needed.

From 2001 to 2004, the Principles were used to assess country systems under the ROSC and Financial Sector Assessment Program (FSAP) in some 24 countries in all regions of the world. Assessments using the Principles have been instrumental to the Bank's developmental and operational work, and in providing assistance to member countries. This has yielded a wealth of experience and enabled the Bank to test the sufficiency of the Principles as a flexible benchmark in a wide range of diverse country systems. In taking stock of that experience, the Bank has consulted a wide range of interested parties at the national and international level, including officials, civil society, business and financial sectors, investors, professional groups, and others.

In 2003, the World Bank convened the Global Forum on Insolvency Risk Management (FIRM) to discuss the experience and lessons from the application of the Principles in the assessment program. The forum consisted of over 200 experts from 31 countries to discuss the lessons from the principles and to discuss further refinements to them. During 2003 and 2004, the Bank also convened three working group sessions of the Global Judges Forum, involving judges from approximately 70 countries, who have assisted the Bank in its review of the institutional framework principles and in developing more detailed recommendations for strengthening court practices for commercial enforcement and insolvency proceedings. Other regional fora have also provided a means for sharing experience and obtaining feedback in areas of the Principles, including the Forum on Asian Insolvency Reform (FAIR) from 2002-2004 (organized by OECD and co-sponsored with the Bank and the Asian Development Bank), and Forum on Insolvency in Latin America (FILA) in 2004 organised by the Bank.

In the area of the insolvency law framework and creditor rights systems, staffs of the Bank maintained participation in the UNCITRAL working groups on insolvency law and security interests and liaised with UNCITRAL staff and experts to ensure consistency between the Bank's Principles and the UNCITRAL Legislative Guide on

Insolvency Law. The Bank has also benefited from an ongoing collaboration with the International Association of Insolvency Regulators (IAIR) to survey regulatory practices of IAIR member countries and develop recommendations for strengthening regulatory capacity and frameworks for insolvency systems. A similar collaboration with INSOL International has provided feedback and input in the area of director and officer liability and informal workout systems.

Based on the experience gained from the use of the Principles, and following extensive consultations, the Principles have been thoroughly reviewed and updated. The revised Principles have benefited from wide consultation and, more importantly, from the practical experience of using them in the context of the Bank's assessment and operational work.

The World Bank Principles have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems that are fundamental to a sound investment climate, and to promote commerce and economic growth. Efficient, reliable and transparent creditor rights and insolvency systems are of key importance for reallocation of productive resources in the corporate sector, for investor confidence and forward looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales.

The Principles emphasize contextual, integrated solutions and the policy choices involved in developing those solutions. The Principles highlight the relationship between the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements (Part A). The Principles also outline key features and policy choices relating to the legal framework for risk management and informal corporate workout systems (Part B), formal commercial insolvency law frameworks (Part C) and the implementation of these systems through sound institutional and regulatory frameworks (Part D).

The principles have broader application beyond corporate insolvency regimes and creditor rights. The Principles are designed to be flexible in their application, and do not offer detailed prescriptions for national systems. The Principles embrace practices that have been widely recognized and accepted as good practices internationally. As legal systems and business and commerce are evolutionary in nature, so too are the Principles, and it is anticipated that these will continue to be reviewed going forward to take account of significant changes and developments.

THE WORLD BANK PRINCIPLES – A SUMMARY

A brief summary of the key elements of the World Bank Principles for effective insolvency and creditor rights systems is given below -:

1. Credit Environment

Compatible credit and enforcement systems. A regularized system of credit should be supported by mechanisms that provide efficient, transparent and reliable methods for recovering debt, including seizure and sale of immovable and movable assets and sale or collection of intangible assets, such as debt owed to the debtor by third parties. An efficient system for enforcing debt claims is crucial to a functioning

credit system, especially for unsecured credit. A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is the simplest, most effective means of ensuring prompt payment. It is far more effective than the threat of an insolvency proceeding, which often requires a level of proof and a prospect of procedural delay that in all but extreme cases make it not credible to debtors as leverage for payment.

Collateral systems. One of the pillars of a modern credit economy is the ability to own and freely transfer ownership interests in property, and to grant a security interest to credit providers with respect to such interests and rights as a means of gaining access to credit at more affordable prices. Secured transactions play an enormously important role in a well functioning market economy. Laws on secured credit mitigate lenders' risks of default and thereby increase the flow of capital and facilitate low cost financing. Discrepancies and uncertainties in the legal framework governing security interests are the main reasons for high costs and unavailability of credit, especially in developing countries.

The legal framework for secured lending addresses the fundamental features and elements for the creation, recognition and enforcement of security interests in all types of assets—movable and immovable, tangible and intangible, including inventories, receivables, proceeds and future property, and on a global basis, including both possessory and non-possessory interests. The law should encompass any or all of a debtor's obligations to a creditor, present or future and between all types of persons. In addition, it should provide for effective notice and registration rules to be adapted to all types of property, and clear rules of priority on competing claims or interests in the same assets. For security rights and notice to third parties to be effective, they must be capable of being publicized at reasonable costs and easily accessible to stakeholders. A reliable, affordable, public registry system is therefore essential to promote optimal conditions for asset based lending. Where several registries exist, the registration system should be integrated to the maximum extent possible so that all notices recorded under the secured transactions legislation can be easily retrieved.

Enforcement systems. A modern, credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony. Commerce is a system of commercial relationships predicated on express or implied contractual agreements between an enterprise and a wide range of creditors and constituencies. Although commercial transactions have become increasingly complex as more sophisticated techniques are developed for pricing and managing risks, the basic rights governing these relationships and the procedures for enforcing these rights have not changed much. These rights enable parties to rely on contractual agreements, fostering confidence that fuels investment, lending and commerce. Conversely, uncertainty about the enforceability of contractual rights increases the cost of credit to compensate for the increased risk of nonperformance or, in severe cases, leads to credit tightening.

Credit information systems. A modern credit-based economy requires access to complete, accurate and reliable information concerning borrowers' payment histories. This process should take place in a legal environment that provides the

framework for the creation and operation of effective credit information systems. Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Legal controls on the type of information collected and distributed by credit information systems may often be used to advance public policies, including anti-discrimination laws.

Privacy concerns should be addressed through notice of the existence of such systems, notice of when information from such systems is used to make adverse decisions, and access by data subjects to stored credit information with the ability to dispute and have corrected inaccurate or incomplete information. An effective enforcement and supervision mechanism should be in place that provides efficient, inexpensive, transparent and predictable methods for resolving disputes concerning the operation of credit information systems along with proportionate sanctions which encourage compliance but that are not so stringent as to discourage operations of such systems.

Informal corporate workouts. Corporate workouts should be supported by an environment that encourages participants to restore an enterprise to financial viability. Informal workouts are negotiated in the “shadow of the law.” Accordingly, the enabling environment must include clear laws and procedures that require disclosure of or access to timely and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable distressed enterprises; support a broad range of restructuring activities, such as debt write-offs, reschedulings, restructurings and debt-equity conversions; and provide favorable or neutral tax treatment for restructurings. A country’s financial sector should promote an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure— especially in markets where enterprise insolvency is systemic.

2. Insolvency Law Systems

Commercial insolvency. Though approaches vary, effective insolvency systems have a number of aims and objectives. Systems should aspire to:

- (i) integrate with a country’s broader legal and commercial systems;
- (ii) maximize the value of a firm’s assets and recoveries by creditors;
- (iii) provide for both efficient liquidation of nonviable businesses and those where liquidation is likely to produce a greater return to creditors and reorganization of viable businesses;
- (iv) strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one proceeding to another;
- (v) provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;
- (vi) provide for timely, efficient and impartial resolution of insolvencies;
- (vii) prevent the improper use of the insolvency system;
- (viii) prevent the premature dismemberment of a debtor’s assets by individual creditors seeking quick judgments;
- (ix) provide a transparent procedure that contains, and consistently applies,

clear risk allocation rules and incentives for gathering and dispensing information;

- (x) recognize existing creditor rights and respect the priority of claims with a predictable and established process; and
- (xi) establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

Where an enterprise is not viable, the main thrust of the law should be swift and efficient liquidation to maximize recoveries for the benefit of creditors. Liquidations can include the preservation and sale of the business, as distinct from the legal entity. On the other hand, where an enterprise is viable, meaning it can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if sold in a liquidation. The rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise.

The rescue of a business should be promoted through formal and informal procedures. Rehabilitation should permit quick and easy access to the process, protect all those involved, permit the negotiation of a commercial plan, enable a majority of creditors in favor of a plan or other course of action to bind all other creditors (subject to appropriate protections) and provide for supervision to ensure that the process is not subject to abuse.

3. Implementation: Institutional and Regulatory Frameworks

Strong institutions and regulations are crucial to an effective insolvency system. The institutional framework has three main elements: the institutions responsible for insolvency proceedings, the operational system through which cases and decisions are processed and the requirements needed to preserve the integrity of those institutions—recognizing that the integrity of the insolvency system is the linchpin for its success.

4. Overarching considerations of sound investment climates

Transparency, accountability and corporate governance. Minimum standards of transparency and corporate governance should be established to foster communication and cooperation. Disclosure of basic information—including financial statements, operating statistics and detailed cash flows—is recommended for sound risk assessment. Accounting and auditing standards should be compatible with international best practices so that creditors can assess credit risk and monitor a debtor's financial viability. A predictable, reliable legal framework and judicial process are needed to implement reforms, ensure fair treatment of all parties and deter unacceptable practices.

Corporate law and regulation should guide the conduct of the borrower's shareholders. A corporation's board of directors should be responsible, accountable and independent of management, subject to best practices on corporate governance. The law should be imposed impartially and consistently. Creditor rights and insolvency systems interact with and are affected by these additional systems, and are most effective when good practices are adopted in other relevant parts of the legal system, especially the commercial law.

Transparency and Corporate Governance. Transparency and good corporate governance are the cornerstones of a strong lending system and corporate sector. Transparency exists when information is assembled and made readily available to other parties and, when combined with the good behavior of “corporate citizens,” creates an informed and communicative environment conducive to greater cooperation among all parties. Transparency and corporate governance are especially important in emerging markets, which are more sensitive to volatility from external factors. Without transparency, there is a greater likelihood that loan pricing will not reflect underlying risks, leading to higher interest rates and other charges. Transparency and strong corporate governance are needed in both domestic and cross-border transactions and at all phases of investment—at the inception when making a loan, when managing exposure while the loan is outstanding, and especially once a borrower’s financial difficulties become apparent and the lender is seeking to exit the loan.

Transparency increases confidence in decision making and so encourages the use of out-of-court restructuring options. Such options are preferable because they often provide higher returns to lenders than straight liquidation through the legal process—and because they avoid the costs, complexities and uncertainties of the legal process.

Predictability. Investment in emerging markets is discouraged by the lack of well defined and predictable risk allocation rules and by the inconsistent application of written laws. Moreover, during systemic crises investors often demand uncertainty risk premiums too onerous to permit markets to clear. Some investors may avoid emerging markets entirely despite expected returns that far outweigh known risks. Rational lenders will demand risk premiums to compensate for systemic uncertainty in making, managing and collecting investments in emerging markets. The likelihood that creditors will have to rely on risk allocation rules increases as fundamental factors supporting investment deteriorate. That is because risk allocation rules set minimum standards that have considerable application in limiting downside uncertainty, but that usually do not enhance returns in non-distressed markets. During actual or perceived systemic crises, lenders tend to concentrate on reducing risk, and risk premiums soar. At these times the inability to predict downside risk can cripple markets. The effect can impinge on other risks in the country, causing lender reluctance even toward untroubled borrowers.

6. REFORMS IN INSOLVENCY LAWS

World over, insolvency procedures help entrepreneurs close down unviable businesses and start up new ones. This ensures that the human and economic resources of a country are continuously rechannelised to efficient use thereby increasing the overall productivity of the economy. It is in this context, free entry and exit are sine qua non for attaining efficiency.

Indian insolvency law is contained in the Companies Act, 1956 (1956 Act) under which winding up of companies is carried out and Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) which deals with revival and rehabilitation of sick companies. The two laws were enacted to cater to meet the expectations of industries thriving in a protectionist environment unexposed to competition in a closed economy. As India swiftly moves to the centre stage of world economy there has been a consistent effort by the policy makers to undertake comprehensive

reforms in the laws and systems to bring them at par with international standards and incentivise the foreign investors to invest in the Indian economy.

Justice Eradi Committee

In the year 1999, the Government of India set up a High Level Committee headed by Justice V.B.Eradi, to examine and make recommendations with regard to the desirability of changes in existing law relating to winding up of companies so as to achieve more transparency and avoid delays in the final liquidation of the companies; the mechanism through which the management of companies will be conducted after the winding up order is issued and the authority which will supervise timely completion of proceedings; the rules of winding up and adjudication of insolvency of companies; the manner in which the assets of the companies are brought to sale and the proceeds are distributed efficiently; and a self-contained law on winding up of companies having regard to SICA, and the Securities Contracts (Regulation) Act, 1956, with a view to creating confidence in the minds of investors, creditors, labour and shareholders. The committee submitted its report to the Central Government in the year 2000.

The Committee addressed and recommended the following key points:

- The Committee recognized after considering international practices that the law of insolvency should not only provide for quick disposal of assets but in Indian economic scene, it should first look at the possibilities of rehabilitation and revival of companies.
- The Committee noted that there are three different agencies namely,
 - (i) the High Courts, which have powers to order winding up of companies under the provisions of the Companies Act, 1956;
 - (ii) the Company Law Board to exercise powers conferred on it by the Act or the powers of the Central Government delegated to it and
 - (iii) Board for Industrial and Financial Reconstruction (BIFR) which deals with the references relating to rehabilitation and revival of companies.
- The committee revealed data of time taken to wind up a company – it may run on an average upto 25 years; Eastern region being the worst.
- Position as on 31.3.1999 as indicated by Eradi Committee was as under:

	<i>0-5 years</i>	<i>5-10 Years</i>	<i>10-15 Years</i>	<i>15-20 Years</i>	<i>20-25 Years</i>	<i>25 Years and Above</i>	<i>Total</i>
Northern Region	259	130	86	56	47	66	644
Eastern Region	126	77	83	73	71	293	723
Southern region	325	212	89	68	51	78	823
Western Region	355	184	224	124	82	36	1005
Total	1065	603	482	321	251	473	3195

- Committee further noted that the High Courts are not able to devote exclusive attention to winding up cases which is essential to conclude the winding up of companies quickly. The experiment with BIFR for speedy revival of companies has also not been encouraging. Committee recognized that there is a need for establishing a National Tribunal as a specialized agency to deal with matters relating to rehabilitation, revival and winding up of companies. With a view to avoiding multiplicity of fora, the National Tribunal should be conferred with jurisdiction and powers to deal with matters under Companies Act, 1956 presently exercised by the Company Law Board; jurisdiction, power and authority relating to winding up of companies vested with High Courts and power to consider rehabilitation and revival of companies presently vested in the BIFR.

The Committee also recommended that the jurisdiction, power and authority relating to winding up of companies should be vested in a National Company Law Tribunal instead of the High Court as at present. The National Company Law Tribunal—

- (a) should have the jurisdiction and power presently exercised by Company Law Board under the Companies Act, 1956;
 - (b) should have the power to consider rehabilitation and revival of companies – a mandate presently entrusted to BIFR/AAFIR under SICA;
 - (c) should have the jurisdiction and power relating to winding up of companies presently vested in the High Courts. In view of above recommendations Article 323B of the Constitution should be amended to set up National Tribunal. SICA should be repealed and the Companies Act, 1956 be amended accordingly.
 - (d) should be headed by a sitting judge or a former judge of a High Court and each of its Benches should consist of a judicial member and a technical member.
 - (e) shall have such number of member as may be prescribed by the Central Government. The principal Bench of the Tribunal should be located at New Delhi and its Benches should be located at the principal seats of each High Court. The Central Government may set up more such Benches if so required. While passing the order for winding up of a company, the Tribunal shall have power to prescribe time limit for each step to be taken by the Liquidator in the course of winding up process. The Tribunal shall also have power to prescribe the time limits for compliance of each step by parties while considering the reference for revival of sick companies.
 - (f) should be vested with the power to transfer all proceedings from one Private Liquidator to another "Private liquidator" or to the "Official Liquidator", as the circumstances of case may require. The Tribunal shall have the power to direct the sale of business of the company as a going concern or at its discretion to sell its asset in a piece-meal manner.
- Tribunal may continue to have jurisdiction for winding up the companies on grounds stated in section 433 but following further grounds may be added

therein, namely:

- a company has failed to file balance sheet and profit and loss accounts and/or annual returns for last three years on due dates; or
- any action of the company has or is likely to threaten the security or integrity of India. Share holder or the Central Government will be entitled to file the petition under on aforesaid grounds.
- There should be two distinct aspects of the liquidation:
 - (i) sale of assets (ii) distribution of sale proceeds

An all-out effort should be made by the Liquidator for sale of assets of the company promptly as in absence of the receipt of sale proceeds, timely distribution among the creditors. The pending references before BIFR/AAIFR under SICA should abate in view of repeal of SICA recommendations by the Committee. However, the winding up proceedings pending in High Courts under Companies Act, 1956 shall stand transferred to National Tribunal for expeditious disposal of those cases.
- There is a need to encourage voluntary winding up of companies. To achieve this object, a provision may be made in the Companies Act, 1956 to provide a company having paid-up capital of ₹ 10 lac or more may submit a petition for its winding up in the process Tribunal and companies with paid-up capital below that amount must resort to voluntary winding up. Creditors may approach the Tribunal for winding up only if a company defaults in payment of undisputed debts exceeding ₹ 1,00,000 and in other cases of default, creditors voluntary Winding up should be resorted. The provisions regarding winding up subject for supervision of court may be deleted as such cases will be taken care of by procedure of compulsory winding up by Court.
- It should be obligatory for a company filing a winding up petition to submit the Statement of Affairs along with the petition for winding up. In cases where the company opposes winding up petition, it should file Statement of Affairs along with its counter affidavit/reply statement. The Statement of Affairs should be accompanied by latest addresses of directors/company secretary of company, a details of location of assets and their value and debtors and creditors list with complete addresses. This will ensure speedy winding up of the company.
- "A Fund for Revival and Rehabilitation" preservation and protection of companies may be created under the supervision and control of the Government. The Fund shall be maintained and operated by an officer authorised in that behalf of such Government.
- The winding up order passed by the Tribunal should be made available to the liquidator within a period not exceeding two weeks from the date of passing of the order.
- The directors and officers of the company should be responsible for ensuring that books of account are completed and got audited up to the date of winding up order and submitted to the Tribunal at the cost of company failing which such directors and officers should be subjected to monetary penalty as well as imprisonment.

- The present system of liquidator required to seek the court's directions, even for small matters relating to routine administrative decisions not only causes delay in winding up but also takes valuable time of the court. Therefore, the liquidator should not seek the sanction of the court except for important matters such as confirmation of sale of assets and distribution of proceeds realised.
- Appropriate legislative action must be taken to ensure that the claims of all employees of a company and its secured creditors are ranked "pari-passu".
- Specific provisions may be made in the Companies Act, 1956 that the liquidator may distribute interim dividend.
- There should be a two point criteria for determining the maintainability of the reference for revival and rehabilitation to the of a company to the Tribunal, namely, that the company has suffered 50% of erosion of its net worth or there is a debt default involving a sum of not less than ₹1 lakh in respect of undisputed debts.
- The reference to the Tribunal for revival by a company should be voluntary. As already stated the jurisdiction of hearing references of revival and rehabilitation of companies will vest in the Tribunal and not BIFR as at present.
- An explicit provision need be made in the Companies Act giving a right to the secured creditors to file proof of debt with the liquidator without surrendering his status as a secured creditor and get the dividend in accordance with the priority to which he is entitled.
- The committee further favoured the appointment of professionals as the Liquidators from a panel to be prepared by the Government.
- The repeal of SICA and the ameliorative, revival and reconstructionist procedures obtaining under it to be reintegrated in a suitably amended form in the structure of the Companies Act 1956.
- The committee considered the adoption of the UNCITRAL Model Law in the Companies Act itself to deal with all cases of "Cross-Border Insolvency".
- The Committee also considered that the principles enunciated under legal frame work of "Orderly and Effective Procedure" recommended by IMF be incorporated in the Companies Act.
- The Committee strongly recommended appointing Insolvency Professionals who are members of Institute of Chartered Accountant of India (ICAI), Institute of Company Secretaries of India (ICSI), Institute of Cost and Work Accountants of India (ICWAI), Bar Councils or corporate managers who are well versed in Corporate management on lines of U.K. Insolvency Act. For this purpose Central Government may maintain a panel of persons who may act as professional Insolvency practitioners subject to their fulfilling of the qualification and experience as may be specified by rules.

DR. J.J. IRANI EXPERT COMMITTEE ON COMPANY LAW

Dr. J.J. Irani Expert Committee on Company Law was set up by the Government to recommend a new company law as a part of the on-going legal and financial sector reform process in the country. Committee submitted its report to the Government of India on 31 May, 2005.

The Committee proposed significant changes in the law to make the restructuring and liquidation process speedy, efficient and effective. Recommendations are directed at restoring the eroded confidence of key stakeholders in the insolvency system while balancing their interest.

The Committee noted that a beginning towards reform was made with the enactment of Companies (Second Amendment) Act, 2002, which in addition to significant changes in the restructuring and liquidation provisions provided for the setting up of a new institutional structure in the form of the National Company Law Tribunal (NCLT)/Tribunal and its Appellate Body, the National Company Law Appellate Tribunal (NCLAT). The highlights of the report of the Committee regarding Restructuring and Liquidation are given below:

- Corporate insolvency to be addressed in company law. No need for a separate insolvency law.
- Law to strike a balance between rehabilitation and liquidation process.
- Rehabilitation and liquidation processes to be time bound.
- Setting up of institutional structure in the form of NCLT/NCLAT for overseeing such processes.
- Winding up to be resorted to only when revival is not feasible.
- Reasonable opportunity for rehabilitation of business before it is decided to be liquidated.
- Period of one year to be adequate for rehabilitation from commencement of process to sanction of plan.
- Time bound procedures which limit the possibility of appeals and thereby delays.
- Two years to be feasible for completion of liquidation.
- Insolvency process to apply to all corporate entities except banks, financial institutions and insurance companies.
- Insolvent company to replace the concept of sick industrial company
- Debtors and creditors to have fair access to insolvency system.
- Rather than net worth erosion principle, test for insolvency should be default in payment of matured debt on demand within a prescribed time [liquidity test].
- Debtors seeking rehabilitation to approach the Tribunal only with a draft scheme. Creditors being at least 3/4th in value may also file rehabilitation scheme.
- If tribunal deems fit, liquidation proceedings may be converted into restructuring proceedings.
- Law to impose certain duties and prohibitions to apply to debtors and creditors on admission of rehabilitation application. Automatic prohibition on Debtors' rights to transfer, sale or dispose off assets or parts of the business except to the extent necessary to operate the business, with the approval of the Tribunal.
- There should be a duty cast on companies to convene creditors and shareholders meeting in case of default in payments to creditors to consider

suitable steps to protect interest of stakeholders, preserve assets and adopt necessary steps to contain insolvency.

- Tribunal be vested with the power to summarily dismiss the proceedings for not meeting commencement standards with cost/ sanction.
- Law to impose a prohibition on the unauthorized disposition of the Debtors' assets and suspension of actions by creditors.
- Law to provide for treatment of unperformed contracts.
- Provisions to interfere with the contractual obligations, which are not fulfilled completely.
- Meeting of the secured creditors be convened by the debtors to consider a rehabilitation plan when the Company has failed to repay its due debt without waiting for creditors to act on default or filing of application for rehabilitation.
- Companies to convene a General Meeting without delay where losses in financial year are equal to 25% or more of its average net worth during last two financial years and there is a default in making payments to the creditors.
- Role of operating agency envisaged under the existing law should be performed by independent Administrator or other qualified professionals.
- Qualified Administrator appointed by the Tribunal in consultation with the secured creditors with board authority to administer the estate in the interest of all stakeholders should replace management of the going concern.
- Creditors to actively participate and monitor the insolvency process.
- Appointment of professional experts and specialists by Creditor Committee to advise them on technical and legal issues.
- Separate Committee to represent other categories of creditors and unsecured creditors and stakeholders be formed with separate rules thereof.
- Provisions to Coordinate meetings of unsecured and secured creditors to be made.
- Mechanism to recognize and record claims of unsecured creditors in preparation of the rehabilitation plan.
- Panel of Administrators and Liquidators to be prepared and maintained by an independent body of professionals with appropriate experience and knowledge of insolvency practice.
- Tribunal to appoint Administrator and Liquidators out of the panel maintained by the independent body and Official Liquidators from panel of officials made available by the Government.
- Identification of the assets that constitute the insolvency estate including assets of debtor and third party owned assets wherever located and collection of assets forming part of insolvency estate by Administrator/ Liquidator be facilitated.
- Avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions. A flexible but transparent system for disposal of assets efficiently to be provided for.

- Sales free and clear of security interests, charges or other encumbrances be allowed subject to priority of interests in the proceeds from assets disposal.
- Provision for monitoring and effective implementation of the scheme/ plan to be made.
- Provision should also be made to
 - amend the plan in the interest of rehabilitation
 - terminate the plan and to liquidate the company.
 - Discharge or for alternation of debts and claims that have been discharged or otherwise altered under the plan.
- National Company Law Tribunal (NCLT) envisaged as the forum to address Insolvency issues to be constituted speedily.
- Provisions to be made for ready access to court records, court hearings, debtors, financial data and other public information.
- Tribunal should have clear authority and effective methods of enforcing its judgments.
- Encourage and recognize the concept of Insolvency Practitioners (Administrators, Liquidators, Turnaround Specialists, Valuers etc). CA, CS and Cost Accountancy disciplines can offer high quality professional for this purpose.
- Insolvency Fund may be set up to meet the costs of the insolvency process.
- Company under restructuring and liquidation to draw out of the Fund only in proportion of the contribution made by it to the Fund in the pre-restructuring and pre-liquidation period. Application of the Fund to the insolvency/ rehabilitation process be subject to the orders of the Tribunal.
- International considerations
- Insolvency law to provide for rules of jurisdiction, recognition of foreign judgments and co-operation amongst courts in different countries.
- Provisions to deal with issues concerning treaties and arrangements entered into with different countries be framed.

7. LEGISLATIVE RESPONSE TO THE REFORM PROCESS

Companies (Second Amendment) Act, 2002

Companies (Second Amendment) Act, 2002, the objective of which provides to expedite the winding-up process of the companies, facilitating rehabilitation of sick companies and protection of workers interest, is a sound attempt towards creating a balance between reorganization and liquidation. The Second Amendment has introduced some significant improvements in the law. Some of major provisions made under the Companies (Second Amendment) Act, 2002 are briefly discussed below:

National Company Law Tribunal

The Companies (Second Amendment) Act, 2002 provides for setting up of a National Company Law Tribunal (NCLT) and its Appellate Tribunal. The purpose of creation of the Tribunal is to avoid multiplicity of litigation before various courts or quasi-judicial bodies or forums regarding revival or rehabilitation or merger and

amalgamation, and winding up of companies. NCLT will have-

- The power to consider revival and rehabilitation of companies² – a mandate presently entrusted to BIFR under SICA.
- The jurisdiction and power relating to winding up of companies presently vested in the High Court. The winding up proceeding pending in High Courts shall stand transferred to the Tribunal.
- The jurisdiction and power exercised by the Company Law Board under the 1956 Act. The Company Law Board will stand abolished.

Revival and rehabilitation of sick industrial companies

The Amendment Act has inserted a new Part VI-A in the Principal Act to provide for the revival and rehabilitation of sick industrial companies.

Management of insolvency proceedings

The Second Amendment provides for appointment of court appointed professionals as Liquidators who will be capable and competent of handling insolvency proceedings much more efficiently.

Sick Industrial Companies (Special Provisions) Repeal Act, 2003

Sick Industrial Companies (Special Provisions) Repeal Act, 2003 proposed to repeal the said Act, SICA, 1985 and dissolution of BIFR. The establishment of National Company Law Tribunal under the Companies (Second Amendment) Act, 2002 and providing it with powers for expediting the winding up procedure is in a way transfer of power and functions of BIFR to the Tribunal.

CORPORATE INSOLVENCY AND PROCESS IN UNITED KINGDOM AND UNITED STATES OF AMERICA

International insolvency has over the years gained a prominence, excited much interest, aroused speculation in the fields of both academia and practice, that seems amply justified in the light of the often spectacular insolvencies on an international scale, particularly those which have affected institutions in the financial sector. Apart from this, the increasing cross border business ventures have made it necessary to be aware of the legislative framework with regard to corporate insolvency and latest developments in other countries. A brief discussion on law relating to corporate insolvency in United Kingdom and United States of America, is given hereunder:

United Kingdom

In United Kingdom the insolvency legislation is consolidated in the Insolvency Act, 1986. The insolvency proceedings governed by this Act falls under two categories namely:

- (i) Insolvency proceedings in respect of companies registered under the Companies Act, 1985 and unregistered companies;
- (ii) Insolvency proceedings in respect of individuals known as bankruptcy.

2. A new Part VIA (Section 424A to 424L) has been incorporated by the Companies (Second Amendment) Act, 2002.

The law relating to corporate insolvency encompasses receivership, administrative receivership, administration, liquidation. Receivership is a limited process where a person is appointed to administer specific property owned by a debtor company, on behalf of the person holding a fixed charge or mortgage over the property. Administrative receivership is a process similar to receivership but usually extending to all the assets owned by a debtor company and covered by a floating charge. A floating charge is said to hover over a debtor company's assets until some default is made in the terms, at which time it becomes fixed on the assets then in existence. Administration is a process to enable a company to reorganize its business under the control of an administrator and with the sanction of the court.

Liquidation (also known as 'winding-up') is a process whereby an insolvency practitioner (the liquidator) is appointed for the purpose of collecting in and realising the assets of a company and distributing the amounts realised in order to satisfy, to the extent possible, its liabilities, and to distribute any surplus to its shareholders. Liquidation is governed by Part IV of the Insolvency Act, 1986. A company can be wound up compulsorily by the court or voluntarily by shareholders' resolution.

Compulsory Liquidation is governed by Sections 117-162 of the Insolvency Act. The court may make an order that a company be wound up on the presentation of a petition by the company, its directors or a creditor or shareholder on various grounds, including that the company is unable to pay its debts which includes a failure to meet a demand (in a prescribed form) for a debt of £750 or more.

On the making of the order, the Official Receiver acts as liquidator but, where there are sufficient assets to meet the expense, meetings of creditors and shareholders may be called to appoint a licensed insolvency practitioner as liquidator. In the event that the meetings nominate different liquidators, the choice of the creditors prevails. The Official Receiver may also ask the Secretary of State to appoint a practitioner as liquidator.

Voluntary liquidations fall into two categories and are governed by Sections 84-116 of the Insolvency Act. Both are commenced by a resolution of the shareholders that the company be wound up and that a named licensed insolvency practitioner be appointed the liquidator. If the directors make a statutory declaration of solvency in accordance with Section 89 of the Insolvency Act within five weeks prior to the resolution, the liquidation will proceed as a members' voluntary liquidation. Otherwise the process will be a creditors' voluntary liquidation and a meeting of creditors must be held within 14 days of the members' resolution. If the meeting of creditors nominates a practitioner other than the one nominated by the members as liquidator, the creditors' choice will prevail.

On the appointment of a liquidator in a creditors' voluntary winding-up, all powers of the directors cease except so far as are preserved by the creditors' committee or the creditors. If the shareholders do not appoint a liquidator, the powers of the directors are not exercisable except so far as are necessary to secure compliance to convene a meeting of creditors, the production of a statement of affairs and to protect the assets or dispose of perishable assets.

In a voluntary liquidation, the company must cease to carry on its business except so far as is necessary for its beneficial winding-up. In a compulsory liquidation, the liquidator has no power to carry on the business, even to that extent,

without the sanction of the court or (if appointed at the creditors' meeting) the committee of creditors.

In all liquidations, the claims of creditors cease to be enforceable against the company and the creditors' financial entitlement is only to receive dividends by reference to claims admitted to proof, in accordance with the statutory order of payments. In a compulsory liquidation, disposals of the company's property between the petition and the order are avoided unless validated by the court and, in all liquidations, creditors cannot generally retain the benefit of incomplete attachments and executions or maintain or commence actions or proceedings against the company or its property.

The main powers of a liquidator are set out in Sections 165-168 of the Insolvency Act and Schedule IV. These must be exercised solely for the purpose of the beneficial realisation of the company's assets and distribution of the proceeds. The powers are wide-ranging and sufficient for the purpose of a complete liquidation of the company's assets, although certain powers are exercisable only with the sanction of the court or the committee of creditors, the detail depending upon the type of liquidation. The liquidator also has powers of administrative nature allowing him to administer the procedure relating to proof of debt and to distribute dividends to creditors after meeting the expenses of the liquidation. In carrying out his functions, the liquidator has power to seek to enlarge the estate by taking action to avoid certain pre-liquidation transactions and, as office-holder, has certain duties and inquisitorial powers.

White Paper on Competition and Insolvency

The UK Government has published a White Paper on Insolvency, part of a package of wide-ranging reforms to competition and insolvency rules. The White Paper considers insolvency reform from two angles, the corporate and the personal. However, we are focusing on the Corporate Insolvency portion only.

In respect of matters of corporate insolvency, the Government aims to create a fairer system for insolvency matters, one in which there is a duty of care to all creditors, who are all able to participate.

The White Paper's main proposals regarding corporate insolvency are as follows:

- To remove the right of the holder of a floating charge to appoint an administrative receiver; this will apply to all except recognised investment exchanges or clearing houses.
- To streamline the administration procedure so that it becomes a fully effective procedure under all circumstances.
- To abolish the issue of Crown preference in all cases of insolvency i.e., removing the right of the VAT and the taxman to take priority over ordinary creditors. However, this will not affect the rights of employees to be treated preferentially in respect to wages and holiday pay.

As regards the streamlining of administration orders, the aims of this proposal are:

- to make the procedure more effective and accessible
- to give ordinary creditors a greater say in the insolvency process and its outcome, and

- not to make secured creditors who presently have the right of veto, feel at risk.

These changes would be effected by enabling a floating charge holder – i.e. a bank with a debenture – to present a petition for administration in the event that the borrower had defaulted and that the debt owing was due.

In cases of urgency a new interim procedure would allow petition without notice. The Court would be able to make an interim administration order with an interim administrator, who would then have to report back to the Court within 14 days. On receipt of the administrator's report, the Court would be able to make either an administration or winding up order, or such other order as it deems appropriate.

The paper has also added a new 'statutory purpose' for which the order may be made: to enable to realisation of the security of a floating charge holder while taking into account the prospect of preserving all or part of the insolvent business.

There are a number of significant changes being proposed to the present procedure:

- Secured creditors would lose their power of veto, although would still have to be given notice of such a petition.
- The present three-month period referred in Section 23 of the Insolvency Act, 1986 would be reduced to 28 days, subject to any leave of the Court to extend it.
- Consideration would be given to extending the criteria of eligibility, so that foreign companies would also be able to apply for protection by way of an administration order.

Therefore, there are a number of changes currently afoot in insolvency practice and procedure. There is also a possibility of the Government altering the balance between limited company protection and personal liability of directors in order to encourage entrepreneurship.

United States of America

The 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. Since the enactment of the Bankruptcy Code, it is safe to observe that a majority of the insolvency cases, which are conducted under court supervision, take place under the Bankruptcy Code. In part, this is due to the few restrictions placed upon who may be a debtor. The Bankruptcy Code prohibits only 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. The purpose of these committees is to more efficiently represent creditors holding similar claims or shareholders holding similar equity interest and, in turn, to facilitate the negotiation and confirmation of a plan of reorganisation. 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.

LESSON ROUND-UP



- A company is said to be insolvent when its liabilities exceed its assets which results in its liability to pay off the debts. Cross border insolvency issues arise when a non-resident is either a debtor or contributory or creditor.
- Since National insolvency laws have by and large not kept pace with the trend, they are often ill equipped to deal with cases of cross border nature. It hampers the rescue of financially troubled business. It hampers the administration of cross border insolvencies. This gave the path for evolution of UNCITRAL Model law on Cross-Border Insolvency in 1997.
- UNICITRAL had also came out with the legislative guide on Insolvency Law in 2004.

- The study deals with each article of the UNCITRAL Model law covering its purpose, scope, the process, reliefs foreign courts, foreign proceedings etc. in a summarized and easy language.
- The study further discusses about World Bank Principles which have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems that are fundamental to a sound investment climate and to promote commerce and economic growth.
- These principles emphasize contextual, integrated solutions and the policy choices involved in developing the solutions. The principles *inter alia* outline key features and policy choices relating to legal framework for risk management and informal corporate work out systems, formal commercial insolvency law frame works etc.
- The study discusses various suggestions by various committees on reforms in Insolvency law in India.
- Engagement and participation of experts possessing appropriate knowledge and skills in insolvency process becomes necessary for the quality and efficiency of the insolvency system. The suggestions as highlighted under J.J. Irani Committee report on role of professionals in Insolvency process is discussed in the study.

SELF-TEST QUESTIONS



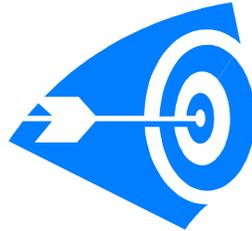
(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. Distinguish between Corporate Insolvency and Individual Insolvency.
 2. Write short note on:
 - (i) UNCITRAL Model Law
 - (ii) Foreign proceedings
 - (iii) State
 3. Under UNCITRAL Model Law, what are the reliefs that may be granted upon recognition of a foreign proceeding under Article 21.
 4. What are the world Bank Principles? Why and how these are designed?
-

STUDY XVII

ROLE OF INSOLVENCY PRACTITIONERS

LEARNING OBJECTIVES



This study lesson would enable you to understand

- Role of Insolvency professionals in liquidation and revival process
- Emerging legal developments about the role of insolvency professionals
- Insolvency professionals in other countries
- Code of ethics for Insolvency Practitioners

ROLE OF PROFESSIONALS IN INSOLVENCY PROCESS

Role Of Professionals In Corporate Insolvency & Restructuring

Currently, the Indian law does not support effective participation of professionals and experts in the insolvency process. While government officials are appointed as liquidators under the Companies Act, 1956, banks and financial institutions act as operating agency under the Sick Industrial Companies (Special Provisions) Act, 1985 to prepare revival and rehabilitation schemes. In fact, the Indian law does not provide the framework that recognizes the various services that can be provided through the professionals. There is no privatization of any part of insolvency process. Outsourcing is limited and disorganized. This has contributed to the inefficiency of the rehabilitation and liquidation process. Some progress was made with the passing of the Companies (Second Amendment) Act, 2002 (Second Amendment) which provides for appointment of liquidators from a panel of firms of Chartered Accountants, Cost & Work Accountants, Advocates, Company Secretaries or others, as may be prescribed.

Dr. J J Irani Committee in its report recommended a larger role and participation of experts and professionals at various stages in the insolvency process. The selected extracts of the report are given below -

“16.3 The Law should enable appointment of professional experts and specialists by Creditor Committee to advise them on various technical and legal issues.”

“18.1 A panel of Administrators and Liquidators should be prepared and maintained by an independent body out of professionals with appropriate experience and knowledge of insolvency practice. The panel should be of individual advocates, accountants, company secretaries, costs and works accountants and other experts

rather than the firms so that the independence and accountability of individuals may be determined. The panel should be prepared in a fair and transparent manner. This would also ensure that appropriate professionals who are appointed on the strength of their knowledge and experience provide the service rather than the other partners or colleagues in their firms. The law should however provide power to the Tribunal to make exceptions to the rule and appoint firms.”

20.2 Independent experts may be appointed as valuers for valuation of assets of a business concern under liquidation.”

Insolvency Practitioners

Keeping in view the large role for professionals and experts in the insolvency process, the Dr. J J Irani Committee recommended the recognition of the concept of Insolvency Practitioners in paragraph 25 of its report which reads as under:

“There is no shortage of quality professionals in India. Disciplines of chartered accountancy, company secretaryship, cost and works accountancy, law etc can act as feeder streams, providing high quality professionals for this new activity. In fact, private professionals can play a meaningful role in all aspects of process. Insolvency practice can also open up a new field of activity for service professionals while improving the quality of intervention at all levels during rehabilitation/winding up/liquidation proceedings. Law should encourage and recognize the concept of Insolvency Practitioners (Administrators, Liquidators, Turnaround Specialists, Valuers etc). Greater responsibility and authority should be given to Insolvency Practitioners under the supervision of the Tribunal to maximize resource use and application of skills.”

Incorporating the abovementioned recommendations will lead to a revolutionary change in the Indian insolvency system by bringing it at par with the international standards and provide opportunities to professionals. The professionals will get opportunities to participate and perform various roles in the insolvency process. Besides performing the services such as representing and advising creditor committees, individual creditors and other stakeholders, investigator, inspector, auctioneer, trustees, security advisors, etc., the professionals would be able to get appointed as Liquidators; Administrators; Valuers; Turnaround Advisors; and Supervisors.

The Companies Bill, 2011

The Companies Bill, 2011 provides a larger role for Company Secretaries in the area of restructuring and liquidation. Brief highlights of the provisions of the Companies Bill, 2011 are given below :

Interim Administrator/Company Administrator

The entire rehabilitation and liquidation process has been made time bound.

- The Tribunal may appoint an interim administrator or a company administrator from the panel of COMPANY SECRETARIES, Advocates, CAs, CWAs, etc. maintained by the Central Government.

- The Company Administrator shall prepare a scheme of revival and rehabilitation.
- If revival scheme is not approved by the creditors, the Tribunal shall order for winding up of the company.
- No civil court shall have jurisdiction in respect of any matter on which Tribunal or Appellate Tribunal is empowered.

Company Liquidators

The Tribunal may appoint Provisional Liquidator or the Company Liquidator from a panel maintained by the Central Government consisting of Company Secretaries, Chartered Accountants, Advocates and Cost and Works Accountants.

Professional Assistance to Company Liquidator

The Company Liquidator may, with the sanction of the Tribunal, appoint one or more professionals including Company Secretaries to assist him in the performance of his duties and functions under the Act.

Insolvency Practitioners – Role, Responsibility and Accountability

It is recognized that varying interests of different stakeholders are involved at the time of Liquidation and therefore, it becomes important to see that the affairs of the Company are wound-up in an equitable manner. Private professionals in their capacity of Company Liquidators under the regime of Companies Bill, 2009 will be dealing with huge sum of other people's (creditors) money. In case of an insolvent company, the responsibility of the Company Liquidator would be to collect the company's assets, determine and satisfy outstanding claims against the company and to ascertain any misconduct by those in control of the company which has caused prejudice to the general body of creditors. Therefore, the Company Liquidator has a very responsible role to play in the entire winding-up of the company and any error on his part may result in illegal benefit to some stakeholder at the cost of others.

An Insolvency practitioner has various roles and responsibilities to perform with utmost care. An Insolvency practitioner might be acting as a Company Administrator in case of Revival and Rehabilitation of a Sick Company; or as a Company Liquidator in case of winding up of Company; or as a valuer. At the same time, he might have to act as a negotiator and arbitrator between different stakeholders as well. The capacity building of the Insolvency Professionals should aim at a deep understanding and proper perspective of his roles and respective duties on part of the professional.

Code of Professional Conduct

The level of responsibilities attached to the Insolvency Practitioners requires certain set of control and supervision over their actions during the course of fulfilling their duty as an Insolvency Practitioner. Essential requirements are prescribed in the laws and rules. However, the responsibilities of Insolvency Practitioners are much more complex and therefore, there is a need for Code of Professional Conduct to guide their actions at each and every step of the process. The Code of Professional Conduct should be such that the stakeholder is able to judge the performance of the Insolvency Practitioner with reference to the Code of Professional Conduct.

INSOLVENCY PRACTITIONERS IN OTHER COUNTRIES

UNITED KINGDOM

Authorising/Licensing Body

In UK, the Secretary of State (SoS) for the Department of Business, Enterprises and Regulatory Reforms regulates the Insolvency Practitioners. The SoS recognizes independent professional bodies for the purpose of authorizing, licensing and regulating appropriately qualified individuals to act as Insolvency Practitioners. These bodies are called Recognized Professional Bodies or RPBs). The SoS and each RPBs regulate the Insolvency Practitioners whom they authorize and licence by monitoring their compliance with legislation and accepted standards.

Qualifications for Insolvency Practitioners

Insolvency is a regulated profession under the Insolvency Act, 1986 and anyone who wishes to practice as an Insolvency Practitioners needs to pass the three examination papers (paper on Liquidations; Administrations, Company Voluntary arrangements and receiverships; and Personal Insolvency) set by the Joint Insolvency Examination Board (JIEB) and meet the authorizing body's insolvency experience requirements.

AUSTRALIA

Authorising/Licensing Body

All insolvency procedures applying to corporate entities are provided for in Chapter 5 of the Corporations Act and Regulations and Australian Securities and Investment Commission (ASIC) is the authority which regulates the Private Insolvency Practitioners in Australia.

Qualifications of Private Practitioners as Liquidators

A person applying for registering himself/herself as a Liquidator has to fulfill:

- ▶ Holds a degree, diploma or certificate from a prescribed university or another prescribed institution in Australia and has passed examinations in such subjects, under whatever name, as the appropriate authority of the university or other institution certifies to ASIC to represent a course of study in accountancy of not less than 3 years duration and in Commercial Law (including Company Law) of not less than 2 years duration; or has other qualifications and experience that, in the opinion of ASIC, are equivalent to the qualifications mentioned above.
- ▶ Has experience in winding up bodies corporate
- ▶ Is capable of performing the duties of a registered liquidator and is otherwise a fit and proper person to be a registered liquidator.
- ▶ Is not a person disqualified from managing corporations.
- ▶ Is (generally) resident in Australia and
- ▶ If the application is granted, will comply with out policy on the security required under Section 1284).

UNITED STATES OF AMERICA

Once the order of Relief is made in case of liquidation proceedings under Chapter 7 of the Bankruptcy Code, the United States Trustee shall appoint one disinterested person that is a member of the panel of private trustees.

Qualifications of Private Trustees

The qualifications for membership on the panel for a Private Trustee are as follows:

The qualifications for membership on the panel for a Private Trustee are as follows:

- (1) The person who can be appointed as a trustee must be :
 - (i) Be a member in good standing of the bar of the highest court of a state or of the District of Columbia; or
 - (ii) Be a certified public accountant; or
 - (iii) Hold a bachelor's degree from a full four-year course of study (or the equivalent) of an accredited college or university with a major in a business-related field of study or at least 20 semester-hours of business-related courses; or hold a master's or doctoral degree in a business-related field of study from a college or university of the type described above; or
 - (iv) Be a senior law student or candidate for a master's degree in business administration recommended by relevant law school or business school dean and working under the direct supervision of : (A) A member of law school faculty; or (B) A member of the panel of private trustees; or (C) A member if a program established by the local bar association to private clinical experience to students; or
 - (v) Have equivalent experience as deemed acceptable by the U.S. Trustee.
- (2) Possesses integrity and good moral character.
- (3) Be physically and mentally able to satisfactorily perform a trustee's duties.
- (4) Be courteous and accessible to all parties with reasonable inquiries or comments about a case for which such individual is serving as private trustee.
- (5) Be free of prejudices against any individual, entity, or group of individuals or entities which would interfere with unbiased performance of a trustee's duties.

Four Main Selection Processes identified by UNCITRAL

Engagement of experts (Insolvency Practitioners) in the insolvency process enhances the efficiency of the insolvency system. Insolvency laws adopt a number of different approaches to selection and appointment of an insolvency Practitioner. The UNCITRAL Guide identified four main selection processes in different country systems.

- The insolvency Practitioners can be selected from a number of different backgrounds such as from the ranks of the business community, from the employees of a specialized governmental agency or from a private panel of qualified persons like lawyers, accountants or other professionals. In some jurisdictions, the insolvency law provides that a particular public official titled the Official Trustee, the Official Receiver, the Official Assignee or in some other name automatically will be appointed to all insolvency cases or to certain types of insolvency cases. India follows this process under the Companies Act, 1956. In many countries, the insolvency Practitioners (IP) must be a natural person, but some countries do provide that a legal person may also be eligible for appointment, subject to certain requirements such as that the individuals to undertake the work on behalf of the legal person are appropriately qualified and that the legal person itself is subject to regulation.
- In many jurisdictions, it is the court that selects, appoints and supervises the insolvency Practitioners. The selection may be made from a list of appropriately qualified professionals at the discretion of the court. This is what is proposed by Second Amendment. In some jurisdictions it may be made by reference to a roster or rotation system or by some other means, such as the recommendation of the creditors or the debtor. While ensuring fair and impartial distribution of cases, one possible disadvantage of a roster system is that it may not ensure the appointment of the person most qualified to conduct the particular case.
- In some jurisdictions, a separate office or institution which is charged with the general regulation of all insolvency Practitioners selects the insolvency Practitioners after the court directs it to do so. This approach may have the advantage of allowing the independent appointing authority to draw upon professionals that will have the expertise and knowledge to deal with the circumstances of a particular case, including the nature of the debtor's business or other activities; the type of assets; the market in which the debtor operates or has operated; the special knowledge required to understand the debtor's affairs; or some other special circumstance. The use of an independent appointing authority will depend upon the existence of an appropriate body or institution that has both the resources and infrastructure necessary to perform the required functions; otherwise it will require the establishment of an appropriate body or institution.
- Another approach allows creditors to play a role in recommending and selecting the insolvency Practitioners to be appointed, provided that the person meets the qualifications for serving in the specific case. The approaches that rely upon the independent appointing authority and the creditor committee may serve to avoid perceptions of bias and assist in reducing the supervisory burden placed upon the courts. A different approach permits the debtor to appoint the insolvency Practitioners in those cases where reorganization proceedings are commenced by the debtor. This approach allows discussions to take place between the debtor and other parties, such as secured creditors, before commencement of the proceedings to familiarise the prospective representative with the business and allows the debtor to select an insolvency Practitioner that it considers

will best be able to conduct the reorganization. Concerns may be raised, however, as to the independence of the insolvency Practitioners. These may be addressed by permitting creditors, in appropriate circumstances, to replace an insolvency Practitioner appointed by the debtor.

The Irani Committee proposes a process wherein empanelment will be done by an independent body and appointment to be made out of them by NCLT.

It is therefore clear that it is essential to filter the feeder streams so that professionals possessing appropriate skills and knowledge can be appointed to provide the various services in the insolvency process. These professionals will be termed as insolvency Practitioners.

Remuneration

In addition to the reimbursement of the proper expenses incurred in the course of administration of the estate, the IP will be entitled to receive remuneration for its services. One of the main concerns that arise therefore is that of determination of remuneration of insolvency Practitioners. It is necessary that the remuneration is commensurate with the qualifications of the IP and the tasks it is required to perform, and achieve a balance between risk and reward in order to attract appropriately qualified professionals.

UNCITRAL Guide examines the several methods adopted for calculating that remuneration. It notes that remuneration may be fixed by reference to an approved scale of fees set by a government agency or professional association; determined by the general body of creditors, the court or some other administrative body or tribunal in a particular case; based upon the time properly spent by the IP (and the various categories of person who are likely to work on the insolvency administration from office staff through to the principal appointee) on administration of the estate; or it could be based upon a percentage of the quantum of the assets of the estate which are realized or distributed or a combination of both (calculated at the end of the procedure when the assets have been sold and the value determined).

A time-based method operates in some cases as an incentive to maximise the time spent on administration without necessarily achieving a proportional return of value to the estate. An advantage of the commission system, at least from the creditors' perspective, is that at least some, if not a substantial proportion, of the assets recovered will be distributed to them. From the insolvency Practitioner's point of view, however, it may be an uncertain method of calculation because the amount of work involved in an administration is not necessarily proportional to the value of assets available for distribution. It may also encourage an approach of "maximum return for minimum cost" and provides little incentive for undertaking functions which are not directly related to increasing returns to creditors, such as obligations to report to both the court and to creditors, and to assist regulatory authorities with investigations into the debtor's affairs and possible misconduct. This method of calculation may also lead, in very large cases, to significantly large fees being paid out of the estate, which can deter both creditor and debtor applications.

In some countries, the creditors play a role in fixing or approving the remuneration, having regard to factors such as the complexity of the case, the nature

and degree of the responsibilities of the insolvency Practitioners and the effectiveness with which these have been discharged, as well as the value and nature of the assets of the estate.

Unattractive fees face the risk of disincentivising the best talent from offering their services. The experts and best of the professionals expect appropriate fees for their services. High fees paid to insolvency Practitioners have been subject of criticism and debate. Clearly, there will be need to establish guidelines for remuneration.

The United Kingdom took an initiative in this direction by issuing a Policy Statement in the year 2004 – The Fixing and Approval of the Remuneration of Appointees (2004) setting out the court's approach to, and basis for, determining applications for remuneration. The Statement identifies eight guiding principles by which applications are to be considered by the court and should be considered by applicants in the preparation and presentation of their applications. These guiding principles are:

- Justification
- Benefit of the doubt (against the appointee)
- Professional integrity
- Value of service rendered
- Fairness and reasonableness
- Proportionality
- Professional guidance
- Impracticality

Inspiration and guidance can be drawn from the 2004 principles.

Liability

The standard of care to be employed by the insolvency Practitioners and its personal liability are important to the conduct of insolvency proceedings. Establishing a measure for the care, diligence and skill with which the insolvency Practitioner is to carry out its duties and functions requires that the difficult circumstances in which the insolvency Practitioners finds itself when fulfilling its duties are taken into account and balanced against payment of an appropriate level of remuneration and the need to attract qualified persons to act as insolvency Practitioners. A balance is also desirable between a standard that will ensure competent performance of the duties of the insolvency Practitioners and one that is so stringent it invites law suits against the insolvency Practitioners and raises the costs of its services.

The insolvency law will also need to take into consideration the fact that the liability of the insolvency Practitioners may often involve the application of law outside of insolvency, or where the insolvency Practitioner is a member of a professional organization, the relevant professional standards of the organization. Under many legal systems, the insolvency Practitioner will be liable in a civil action for damages arising from its misfeasance or malfeasance, although different approaches are taken to setting the standard required. To some extent, the measure adopted will depend upon how the insolvency Practitioner is appointed and the

nature of the appointment (e.g. a private practitioner as opposed to a government employee). One approach may be to require the insolvency Practitioner to observe a standard no more stringent than would be expected to apply to the debtor in undertaking its normal business activities in a state of solvency, that of a prudent person in that position. Some countries, however, may require a higher standard of prudence in such a case because the insolvency Practitioner is dealing with assets belonging to another person, not its own assets. A different formulation is one based upon an expectation that the insolvency Practitioner acts in good faith for proper purposes. A further approach may be based upon the standard of care required to determine negligence.

One means of addressing the issue of liability for damages may be to require the insolvency Practitioner to post a bond or take out insurance to cover loss of assets of the estate or possible damages payable as a result of a breach of its duties. A number of insolvency laws require both payment of a bond and insurance where the bond will cover one kind of damage and the insurance another, while others require only insurance. In some cases the level of the bond required relates to the book value of the assets of the insolvency estate, in others both the value of the bond and the amount of insurance cover required are established in the rules of the relevant professional association or regulatory body, or even in the insolvency law. A further distinction between the two approaches may relate to the procedure for making a claim for damages and whether it is different for claiming against a bond or against insurance. Paying a bond or obtaining personal indemnity insurance however, may not be possible in all countries and other solutions will be needed. In designing the solution to this issue, a balance may be desirable between controlling the costs of the service provided by insolvency Practitioners and distributing the risks of the insolvency process among the participants, rather than placing it entirely upon the insolvency Practitioners on the basis of availability of personal indemnity insurance.

Another issue may be the personal liability of the insolvency Practitioners for obligations incurred in the ordinary course of insolvency proceedings, particularly in reorganization, such as those relating to the ongoing operation of the business. The advantages of adopting an approach that makes the insolvency Practitioners personally liable would be that it creates certainty for suppliers to the debtor and may operate as a check to the incurring of debt. At the same time, however, it may also operate as a disincentive if the risk of personal liability far exceeds the fees that may be earned. One solution is to make only the assets of the estate liable, rather than the personal assets of the insolvency Practitioners. A further issue of liability relates to liability of the insolvency Practitioners for wrongful acts of the debtor depending upon the level of control the insolvency Practitioner exercises over the debtor's activities. Under some laws the insolvency Practitioner may be made liable for the wrongful acts of the debtor during the period of its control, but it is not desirable that the insolvency Practitioner be liable for acts of the debtor, such as environmental damage, occurring prior to its appointment as insolvency Practitioner.

CODE OF ETHICS & REGULATION OF INSOLVENCY PRACTITIONERS

The level of responsibilities attached to the Insolvency Practitioners requires certain set of control and supervision over their actions during the course of fulfilling their duty as an Insolvency Practitioner. Essential requirements are prescribed in the

laws and rules. However, the responsibilities of Insolvency Practitioners are much more complex and therefore, there is a need for Code of Professional Conduct to guide their actions at each and every step of the process. The Code of Professional Conduct should be such that the stakeholder is able to judge the performance of the Insolvency Practitioner with reference to the Code of Professional Conduct.

1. PRACTICE IN UNITED KINGDOM

Regulation of the Insolvency Practitioners

- (1) IPs are regulated by Government monitored self regulation i.e. Insolvency Practitioners Regulation 2005
- (2) The Secretary of State and each RPB regulate the Insolvency Practitioners whom they authorize and give licence.
- (3) Insolvency Practitioner Unit of the SoS is responsible for all the functions/regulations in relation to IPs authorized by the SoS
- (4) IPs are required to comply with the statements of Insolvency Practice set out by RPBs and in case of default by the IPs, the concerned RPBs and in case of default by the IPs, the concerned RPBs could take disciplinary action.
- (5) All IPs are subject to monitoring, visit from their authorizing bodies, the SoS and the RPBs. Monitors seek to establish that IPs are adhering to legislations namely Insolvency Act, 1986 and Insolvency Regulation 1986.
- (6) In the Institute of Chartered Accountants of England and Wales, which is one of the biggest RPBs, the Insolvency Licensing Committee undertakes monitoring visit.
- (7) IPs are required to comply with Insolvency Licensing Regulations of respective RPBs
- (8) IPs are required to follow the Professional Standards and the Code of Ethics framed by respective RPBs

Code of Ethics

In addition to the above regulations, the Insolvency Practitioners are also required to adhere to Joint Insolvency Committee's code of Ethics issued by the Joint Insolvency Committee and adopted by all Recognized Professional Bodies (RPBs). This Code is intended to assist Insolvency Practitioners meet the obligations expected of them by providing professional and ethical guidance. This Code applies to all Insolvency Practitioners should take steps to ensure that the code is applied in all professional work relating to an insolvency appointment, and to any professional work that may lead to such an insolvency appointment. Failure to observe the Code may not, of itself, constitute professional misconduct, but is taken into account in assessing the conduct of an Insolvency Practitioner.

2. PRACTICE IN AUSTRALIA

Australian Securities and Investment Commission ("ASIC") is the regulatory body that governs and regulates the private Liquidators involved in the liquidation of

Companies in Australia. ASIC in order to supervise the Liquidation of Companies by private Liquidators has made it mandatory for every private Liquidator to report matters and lodge documents with ASIC on regular basis. The reporting by the private Liquidators has to be done online and Liquidators compliance section of ASIC also specifically highlights the responsibilities, duties and obligations of a private Liquidator in a Liquidation proceedings. This online portal also helps the Liquidators to obtain books, records and other data that might be required in order to fulfil his/her obligations as a Liquidator. In case of failure to fulfil the duties/obligations or failure to comply with Liquidator compliance including the failure to lodge and maintain security, as required under section 1284 of the Act and the failure to comply with the arrangement for liquidators under ASIC Policy Statement 33, the ASIC can apply before the Companies Auditors and Liquidators Disciplinary Board (CALDB) for disciplinary action to be taken against liquidator as it deems fit.

Insolvency Practitioners Association of Australia ("IPAA") is an independent, self-governing Association of Insolvency Specialists, the majority of who are Chartered Accountants. The IPPA has issued a Code of professional practice to be adhered and followed by the Insolvency Practitioners so as to establish and promote high standards of professional service and conduct. Though IPAA is a self-governing body but the non-adherence to the code issued by it may attract disciplinary action against the members.

3 PRACTICE IN UNITED STATES OF AMERICA

Bankruptcy Trustees in US

The US Government created the U.S. Trustee Program in 1978 as part of the Bankruptcy

Reform Act and Bankruptcy trustees are overseen by the U.S. Trustee Program. United States Trustees appoint and supervise private trustees who are assigned to judicial districts in their respective states. Bankruptcy trustees (Private Trustees) in chapter 7 cases are not government employees, according to the National Association of Bankruptcy Trustees. Chapter 7 bankruptcy trustees are private citizens, usually attorneys or accountants, appointed by the U.S. Trustee Program to administer bankruptcy cases. The bankruptcy trustee's primary role in a Chapter 7 case is to liquidate those assets for the greatest benefit to creditors.

Under 586(a)(3)(F), the trustee is to report to the U.S. Attorney any action which may constitute a crime. Most of the crimes for which the U.S. Trustees watch are listed in Title 11, section 152 of the U.S. Code, and described more thoroughly in Volume 5 of the United States Trustee Manual. These crimes include concealment of property, fraudulent destruction of documents, extortion, bribery and embezzlement. If the trustee detects the elements of these crimes as described in the manual, he is obliged to make a report to the U.S. Attorney. The standing trustee, as a representative of the Department of Justice, reviews the actions of private trustees in individual bankruptcy cases and can remove trustees from the panel of eligible trustees for actions that violate the appropriate ethical standard.

Chapter 7 of the US Bankruptcy code deals with the liquidation of the Companies and under that the United States Trustee appoints and supervises administration of

Bankruptcy cases by the Bankruptcy Trustees. The responsibilities and duties of a Bankruptcy Trustee are provided under the Chapter itself.

In US there is a US Manual which specifically outlines the duties and responsibilities of Bankruptcy Trustee under different chapters of the Bankruptcy Code. Volume 2 of the US Trustee Manual deals with Chapter 7 case administration (liquidation of companies) Which deals with appointment of Bankruptcy Trustee, their remuneration, duties and responsibilities and supervision its administration of the Bankruptcy of the case. The failure by the Bankruptcy Trustee to properly file the Report with the US Trustee and the Court may attract any remedial action (damage can be recovered from the Security Bond given by the Bankruptcy Trustee before taking up the assignment), penalty or removing his name from the panel of the Bankruptcy Trustee depending upon the facts and circumstance of the case.

SALIENT FEATURES OF A DESIRED CODE OF ETHICS FOR INSOLVENCY

PRACTITIONERS

1. Fundamental Principles

- (a) **Integrity:** - An Insolvency Practitioner should be straightforward and honest in all professional and business relationships.
- (b) **Objectivity:** An Insolvency Practitioner should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.
- (c) **Professional competence and due care:** It is the Duty of an Insolvency Practitioners to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service.
- (d) **Confidentiality:** An Insolvency Practitioner should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the Insolvency Practitioner or third parties.
- (e) **Professional behaviour:** An Insolvency Practitioner should comply with relevant laws and regulations and should avoid any action that discredits the profession. Insolvency Practitioners should conduct themselves with courtesy and consideration towards all with whom they come into contract when performing their work.

2. Conflict of Interest: - An Insolvency Practitioner should take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may give rise to threats to compliance with the fundamental principles.

3. Professional and personal relationships: - The principle of objectivity may be threatened if any individual within the practice, the close or immediate family of an individual within the practice or the practice itself, has or has had a professional or

personal relationship which relates to the insolvency appointment being considered. Where a professional or personal relationship has been identified the Insolvency Practitioner should evaluate the impact of the relationship in the context of the insolvency appointment being sought or considered.

4. Transparency: - An Insolvency Practitioner in the role as office holder has a professional duty to report openly to those with an interest in the outcome of the insolvency. An Insolvency Practitioner should always report on his acts and dealings as fully as possible given the circumstances of the case, in a way that is transparent and understandable.

5. Dealing with the assets of the Company: - actual or perceived threats (for example self interest threats) to the fundamental principles may arise when during an insolvency appointment, an Insolvency Practitioner realizes assets. Save in circumstances which clearly do not impair the Insolvency Practitioner's objectivity, Insolvency Practitioners appointed to any insolvency appointment in relation to an entity, should not themselves acquire, directly or indirectly, any of the assets of an entity, nor knowingly permit any individual within the practice, or any close or immediate family member of the Insolvency Practitioner or of an individual within the practice, directly or indirectly, to do so.

6. Gifts and hospitality: - An Insolvency Practitioner, or a close or immediate family member, may be offered gifts and hospitality. In relation to an insolvency appointment, such an offer will give rise to threats to compliance with the fundamental principles. The significance of such threats will depend on the nature, value and intent behind the offer. In deciding whether to accept any offer of a gift or hospitality the Insolvency Practitioner should have regard to what a reasonable and informed third party having knowledge of all relevant information would consider to be appropriate.

7. Record keeping: - It will be always for the Insolvency Practitioner to justify his actions. An Insolvency Practitioner will be able to demonstrate the steps that he took and the conclusions that he reached in identifying, evaluating and responding to any threats, both leading up to and during an insolvency appointment, by reference to written contemporaneous records. The records an Insolvency Practitioner maintains, in relation to the steps that he took and the conclusions that he reached, should be sufficient to enable a reasonable and informed third party to reach a view on the appropriateness of his actions.

Lesson Round up



- Engagement and participation of experts possessing appropriate knowledge and skills in insolvency process becomes necessary for the quality and efficiency of the insolvency system.

- Currently, the Indian law does not support effective participation of professionals and experts in the insolvency process.
 - Some progress was made with the passing of the Companies (Second Amendment) Act, 2002 (Second Amendment) which provides for appointment of liquidators from a panel of firms of Chartered Accountants, Cost & Work Accountants, Advocates, Company Secretaries or others, as may be prescribed.
 - An Insolvency practitioner might be acting as a Company Administrator in case of Revival and Rehabilitation of a Sick Company; or as a Company Liquidator in case of winding up of Company; or as a valuer
 - the responsibilities of Insolvency Practitioners are much more complex and therefore, there is a need for Code of Professional Conduct to guide their actions at each and every step of the process
 - Code of ethics has been prescribed in countries like United Kingdom, Australia, America etc., covering aspects like integrity, confidentiality, conflict of interest etc.
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PROFESSIONAL PROGRAMME
CORPORATE RESTRUCTURING AND INSOLVENCY

PP-CRI/2011

TEST PAPERS

This Test Paper set contains five test papers. Test Paper 1/2011, 2/2011, 3/2011, 4/2011 and 5/2011. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt atleast **one Test Paper from Test Papers 3/2011, 4/2011 and 5/2011 i.e. either Test Paper 3/2011 or Test Paper 4/2011 or Test Paper 5/2011** and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate. However, students may, if they so desire, are encouraged to send more response sheets including Test Paper 1/2011 and 2/2011 for evaluation.

While writing answers, students should take care not to copy from the study material, text books or other publications. Instances of deliberate copying from any source, will be viewed very seriously.

WHILE WRITING THE RESPONSE SHEETS TO THE TEST PAPERS GIVEN AT END OF THIS STUDY MATERIAL, THE STUDENTS SHOULD KEEP IN VIEW THE FOLLOWING WARNING AND DESIST FROM COPYING.

W A R N I N G

Time and again, it is brought to our notice by the examiners evaluating response sheets that some students use unfair means in completing postal coaching by way of copying the answers of students who have successfully completed the postal coaching or from the suggested answers/study material supplied by the Institute. A few cases of impersonation by handwriting while answering the response sheets have also been brought to the Institute's notice. The Training and Educational Facilities Committee has viewed seriously such instances of using unfair means to complete postal coaching. The students are, therefore, strongly advised to write response sheets personally in their own handwriting without copying from any original source. It is also brought to the notice of all students that use of any malpractice in undergoing postal or oral coaching is a misconduct as provided in the explanation to Regulation 27 and accordingly the studentship registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information :

“27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may *suo motu* or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

PROFESSIONAL PROGRAMME
CORPORATE RESTRUCTURING AND INSOLVENCY

TEST PAPER 1/2011

(Based on entire study lessons)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer All Questions.

1. (a) State with reasons whether the following statements are true or false:
 - (i) There is bar to a company amalgamating with a fifteen-day old company having no assets and business.
 - (ii) Encumbered shares need not be disclosed under SEBI (SAST) Regulations, 2011.
 - (iii) Up stream merger means the amalgamation of two companies by which the disappearing company is merged into subsidiary of surviving company and shareholders of the disappearing company receive shares of the surviving company.
 - (iv) Shareholder of company can buyback its share by passing ordinary resolution.
 - (v) "Non-performing asset" 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. *(2 marks each)*

(b) List out the reasons for buy back of share by a company. *(10 marks)*
2. (a) "On-going corporate restructuring is a must for survival due to globalization, liberalization and economic reforms." Discuss.

(b) How does strategic planning help in strengthening business environment in a company? *(8 marks each)*
3. (a) What do you mean by 'valuation of shares'? Briefly explain the need of valuation.

(b) Distinguish between Corporate Insolvency and Cross Border Insolvency. *(8 marks each)*
4. Write short note on:
 - (i) Preamble of UNCITRAL Model Law
 - (ii) Foreign proceedings
 - (iii) Slump Sale
 - (iv) Lok adalat *(4 marks each)*
5. (a) Discuss in brief the procedure for acquiring the shares of dissenting shareholders in a scheme of amalgamation as laid down in Section 395 of the Companies Act, 1956.

- (b) Discuss the process involved in securitization? *(8 marks each)*
6. (a) What is the relevance of Price Earning Ratio in the valuation of a firm?
- (b) Describe briefly about role of professionals in corporate insolvency.
(8 marks each)
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TEST PAPER 2/2011

(Based on entire study lessons)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer All Questions.

1. (a) State with reasons whether the following statements are true or false:
 - (i) Horizontal mergers occur between firms which are complementary to each other.
 - (ii) Where amalgamation involves reorganisation of capital by reduction thereof, the provisions of Sections 100 to 102 of Companies Act need not be complied with.
 - (iii) Court ordered winding up of the company under 'just and equitable' clause on the ground that the substratum of the company has gone.
 - (iv) Takeover of a financially sick company by a profit earning company to bail out the former is known as hostile out takeover.
 - (v) Crown Jewel strategy refers to the "separation" clauses of an employment contract that compensate managers who lose their jobs under a change-of-management scenario. *(2 marks each)*
- (b) SKD (P) Ltd. and SS (P) Ltd. have finalized a scheme of arrangement. The registered offices of both the companies are located in Delhi. A joint-petition is proposed to be filed before the High Court for sanction of the scheme. Give your brief opinion in the light of the provisions of the Companies Act, 1956 and the Companies (Court) Rules, 1959 whether such a joint-petition can be filed. *(10 marks)*
2. (a) Can private and unlisted public companies, buy-back their securities and if so, how?
- (b) Comment on Constitutional validity of SRFAESI Act, 2002 and refer to Supreme Court judgement. *(8 marks each)*
3. (a) Enumerate the human aspects of a amalgamation?
- (b) How can post merger efficiency be measured? Enumerate the main parameters involved. *(8 marks each)*
4. (a) Discuss about payment of stamp duty in case of amalgamation, merger, acquisition of company including sick industrial company and Section 25 company.
- (b) Briefly explain the salient features of Section 16 of SICA regarding inquiry into working of sick industrial companies. *(8 marks each)*
5. (a) Discuss the grounds on which the scheme of amalgamation would be binding on minority shareholders of the company under Section 395 of the Companies Act, 1956.
- (b) What are the procedural steps involved in amalgamation? *(8 marks each)*

6. Write short note on:

- (i) Reverse merger
- (ii) Poison pill strategy
- (iii) Person Acting in Concert
- (iv) Split off

(4 marks each)

TEST PAPER 3/2011

(Based on entire study lessons)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer All Questions.

1. (a) State with reasons whether the following statements are true or false:
 - (i) Accounting Standard does not recognize Amalgamation or merger.
 - (ii) Diminution of share capital and surrender of share capital are same.
 - (iii) All Asset Reconstruction Companies are Public Financial Institution.
 - (iv) Under takeover offer escrow account is opened by promoters of the acquirer company.
 - (v) A company shall be deemed to be unable to pay its debts if an execution or other process has not been satisfied by the company.
(2 marks each)
- (b) A Company can be wound up under just and equitable reason. Discuss with decided case laws.
(10 marks)
2. Write short notes on the following:
 - (a) Committee of Inspection.
 - (b) Operating Agency
 - (c) Dissolution of company
 - (d) Demerger
(4 marks each)
3. (a) State the object behind "Recovery of debts due to Banks and Financial Institutions Act, 1993".
- (b) Describe about discretion of the court in sanctioning an amalgamation scheme?
(8 marks each)
4. (a) 'A strategic plan is the foundation on which all business activities can be connected.' Explain.
- (b) Enumerate the economic aspects of a takeover.
(8 marks each)
5. (a) Discuss in brief the role of a company secretary in winding up of a company.
- (b) Distinguish between "Appointed date" and "Effective date" in Amalgamation.
(8 marks each)
6. (a) In a scheme of arrangement made under section 391, a company proposes to transfer one of its undertakings to its subsidiary and also to reduce its share capital. Is the scheme valid? Explain with relevant provisions of law and relevant cases.
- (b) Discuss the factors involved in post merger reorganization.
(8 marks each)

TEST PAPER 4/2011

(Based on entire study lessons)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer All Questions.

1. (a) State with reasons whether the following statements are true or false:
 - (i) The order made by the Court under section 391(2) not required to filed with the Registrar of Company.
 - (ii) The Court can modify transfer date proposed in a scheme of amalgamation.
 - (iii) Under SEBI (SAST) Regulations, 2011, "offer period" and "tendering period" are the same.
 - (iv) Court would insist on prior approval of stock exchanges while sanctioning a scheme of arrangement of listed company.
 - (v) The word "amalgamation" or "merger" is not defined anywhere in Companies Act, 1956. *(2 marks each)*

(b) Discuss briefly corporate restructuring. *(10 marks)*
2. (a) Holy Cow Ltd. has approached your professional advice about the rights available for enforcing the securities interest under the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002. Highlight the right and advantages to the bank by resorting to that mode of recovery citing the relevant provisions of the said Act.

(b) Draft notice of the meeting of equity shareholders in a scheme of amalgamation under Section 391 of the Companies Act, 1956? *(8 marks each)*
3. Write short notes on the following:
 - (a) Strategic Planning
 - (b) Corporate Planning
 - (c) Spin-off
 - (d) Mandatory Bid *(4 marks each)*
4. (a) What do you mean by 'demerged company' and 'resulting company'?

(b) What do you mean by "voluntary offer" and "conditional offer" under SEBI (SAST) Regulations 2011. *(8 marks each)*
5. (a) Discuss briefly the role of "Asset Reconstruction Company".

(b) Enumerate the major causes of Sickness of Industrial Company. *(8 marks each)*
6. (a) Prepare a brief note for your Managing Director on Reduction of Share Capital of your company.

(b) Discuss the provisions of Income Tax Act, 1961 relating to demerged company? *(8 marks each)*

TEST PAPER 5/2011

(Based on entire study lessons)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer All Questions.

1. (a) State with reasons whether the following statements are true or false:
 - (i) Every notice of meeting called as per orders of the court under section 391 need not include explanatory statement.
 - (ii) Board of Directors of company can buy back share up to 10% of company's paid up share capital and free reserve in 365 days.
 - (iii) Court can modify the scheme of arrangement filed before it on its own.
 - (iv) Amalgamation of Banking Company governed solely by the Companies Act, 1956.
 - (v) Provisions of the Specific Relief Act, 1963 override the provisions of Section 391 and 392. *(2 marks each)*
- (b) Immunity from certain litigations to sick industrial company is the purpose of the Sick Industrial (Special Provision) Act, 1985. Discuss with reference to the legal provisions of the Act. *(10 marks)*
2. (a) Companies go in for international acquisitions for a number of strategic or tactical reasons. Comment.
- (b) Draft Board Resolution with respect to takeover for
 - (i) Offer by Offeror Company.
 - (ii) Appointment of Merchant Banker. *(8 marks each)*
3. (a) Discuss the grounds on which a company may be wound up by the Court.
- (b) Draft a notice to dissenting shareholders pursuant to section 395 of the Companies Act, 1956. *(8 marks each)*
4. (a) Distinguish between "Contributory petition" and "petition by creditors".
- (b) What are the various kind of Restructuring? *(8 marks each)*
5. (a) List out the major activities in amalgamation and merger.
- (b) Discuss the procedure for merger and amalgamation related to Government companies. *(8 marks each)*
6. (a) Briefly explain the compliance of Competition Act, 2002 with respect to merger, amalgamation or acquisition.
- (b) In India accounting for amalgamations is governed by Accounting Standard (AS-14). *(8 marks each)*

PROFESSIONAL PROGRAMME
CORPORATE RESTRUCTURING AND INSOLVENCY

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Corporate Restructuring and Insolvency paper are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

DECEMBER 2010

Time allowed: 3 hours

Maximum marks: 100

NOTE: All references to sections relate to the Companies Act, 1956 unless stated otherwise.

PART A

(Answer Question No.1 which is compulsory and any three of the rest from this part)

1. (a) It is widely believed that there are several reasons for business growth and expansion for a merged company. Explain at least three such reasons for business growth and expansion which may be achieved by a merged company. *(9 marks)*
- (b) A company is over-capitalised due to rights issue, bonus issue and allotment of shares to the shareholders of transferor companies. Its share prices have plunged due to floating shares and do not represent its fair value in the market. The management is now thinking to take some corrective measures. The company has sufficient liquid cash at its disposal. State briefly the corrective measures. *(6 marks)*
- (c) In a scheme of reconstruction, a company may, if its memorandum of association permits, carry out reconstruction following the procedure laid down under section 494, by incorporating a new company specifically for that purpose.

In the given case, the new company bears features which are substantially the same as of the earlier company.

But the shareholders of a transferor company objected to the scheme of reconstruction that the directors were actuated by sinister motive by doing so.

Is the objection sustainable if the objecting shareholders fulfil the formalities of minimum percentage for doing so? State your answer with case law. *(5 marks)*

- (d) What is 'strategic planning'? State its salient features. *(5 marks)*
2. (a) Can a lending bank file an appeal/revision application for modification of sanctioned scheme of amalgamation on the basis of the fact that there is a provision in the loan agreement executed between the company and the bank requiring prior approval of the bank before undertaking any steps for amalgamation or reconstruction? Explain. *(4 marks)*
- (b) Acquirer, target company and merchant banker are duty bound to comply with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 both in letter and spirit. Explain, with relevant provisions of law, consequences in case of violation of provisions of the SEBI regulations. *(4 marks)*
- (c) State, with reasons in brief, whether the following statements are true or false:
- (i) Provisions of the Specific Relief Act, 1963 override the provisions of sections 391 and 392.
 - (ii) A scheme, apparently made to merge the profit making company with a loss making company and to take tax advantage, is a valid scheme.
 - (iii) Amalgamation between two banking companies is governed solely by the Companies Act, 1956.
 - (iv) The transferee company after effecting merger is able to charge to profit and loss account the expenditure incurred wholly and exclusively for the purposes of amalgamation.
 - (v) Persons acting in concert (PAC) are individuals/company(ies)/any other legal entities who are acting together for an uncommon objective.
 - (vi) Under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, it is a voluntary requirement to appoint a merchant banker for acquisition of shares.
 - (vii) The shares of a target company are deemed as 'frequently traded' for pricing purpose if the annualised trading turnover in those shares is more than 5% (by number of shares). *(1 mark each)*
3. (a) By analysing a balance sheet of Aadarsh Ltd., it was found that there are plethora of reserves in the balance sheet for the year ended 31st March, 2009, and the reserves are summarised below:
- (i) Investment fluctuation reserve
 - (ii) Statutory reserve
 - (iii) Securities premium account
 - (iv) General reserve
 - (v) Foreign currency fluctuation reserve

- (vi) Dividend equalisation reserve
- (vii) Dividend redemption reserve (preference shares)
- (viii) Capital, redemption reserve.

Now, the Chairman of Aadarsh Ltd. asks you as a Company Secretary to know which of the above reserves can be utilised for the proposed buy-back of shares of the company. Advise.

(4 marks)

- (b) A company wants to demerge its unrelated business to a newly formed company with a purpose of selling the demerged company. However, the company presented a scheme of arrangement/demerger before the court and fixed an 'appointed date' before incorporation of the new company to which unrelated business will go. The Central Government raised objection that the 'appointed date' (i.e., on which date all assets and liabilities will transfer to the demerged company) cannot be transferred before the incorporation of the resulting company. Is the objection of the Central Government sustainable? State your answer with case law.
(4 marks)
 - (c) Regulation 22 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 puts certain obligations upon the acquirer. At the same time, the duty of SEBI is to issue directions only. An aggrieved person applied to the court for writ of mandamus to SEBI to conduct enquiry for irregularities committed by the acquirer. Will the petitioner succeed? State with relevant case law.
(4 marks)
 - (d) State government has power to impose stamp duty on transfer of properties under the order of amalgamation. Briefly comment with case law.
(3 marks)
4. (a) What are the safeguards incorporated in the takeover process so as to ensure that shareholders get their payments under the offer/receive back their share certificates?
(4 marks)
- (b) Can the Central Government amalgamate two companies in the public interest? Explain with the relevant provisions of law and process.
(4 marks)
- (c) What should be the minimum price for creeping acquisition? Explain with relevant provisions of law.
(4 marks)
- (d) Can an acquirer withdraw the offer once made? Give reasons. *(3 marks)*
5. (a) Describe any three of the following:
- (i) Cross border takeover
 - (ii) Demerger by agreement
 - (iii) Non-performing assets
 - (iv) Accounting Standard-14. *(3 marks each)*
- (b) Distinguish between any two of the following: .
- (i) 'Reduction of capital' and 'diminution of capital'.

- (ii) 'Split-off and 'split-up',
- (iii) 'Mandatory bid' and 'competitive bid'. *(3 marks each)*

PART B

(Answer ANY TWO questions from this part)

6. (a) "A company is also a person in the eye of law and can be adjudged as insolvent." Comment. *(5 marks)*
 - (b) Is the Registrar of Companies capable of making a petition for winding-up of a company? If so, on what grounds? *(5 marks)*
 - (c) Explain the immunities provided to a sick industrial company under the Sick Industrial Companies (Special Provisions) Act, 1985. *(5 marks)*
 7. (a) Briefly explain the mechanism for the enforcement of security interest by a secured creditor under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. *(7 marks)*
 - (b) Briefly describe the role of professionals in the insolvency process. *(4 marks)*
 - (c) Briefly describe the insolvency or bankruptcy laws as applicable in United States of America. *(4 marks)*
 8. (a) Though UNCITRAL Model Law is not a substantive law, yet it recommends protection to creditors and other interested persons. Briefly describe the protections provided under the UNCITRAL Model Law. *(4 marks)*
 - (b) Main object of asset reconstruction company' (ARC) is to act as an agent for banks and financial institutions. Briefly explain with relevant provisions of law. *(4 marks)*
 - (c) Can a company make winding-up petition? If so, what is the procedure of making petition for winding-up? *(4 marks)*
 - (d) Define `securitisation' and explain its motives. *(3 marks)*
-

JUNE 2011*Time allowed : 3 hours**Maximum marks : 100***NOTE :***All references to sections relate to the Companies Act, 1956 unless stated otherwise.***PART A***(Answer Question No.1 which is COMPULSORY and ANY THREE of the rest from this part.)*

1. (a) Big Ltd. prepared a scheme of amalgamation and arrangement with Small Ltd. and Little Ltd. and the scheme has gone through the required formalities and court approved the scheme, in which the swap ratio was provided as under :
- (i) The transferor Company No.1 — Small Ltd. : The shareholders of Small Ltd. will get one equity share of ₹10 each of Big Ltd. for every 2 shares fully paid-up of Small Ltd.
 - (ii) The transferor Company No.2 — Little Ltd. : The shareholders of Little Ltd. will get one equity share of ₹10 each fully paid-up for every 5 equity shares fully paid-up of Little Ltd.

There were no other types of shares in the companies on the record date fixed for swap ratio.

The capital structure of the transferee company (amalgamated company) and the transferor companies (amalgamating companies) was as under on appointed date, and there was no change in this regard upto date as aforesaid :

<i>Particulars</i>	<i>Big Ltd.</i>	<i>Small Ltd.</i>	<i>Little Ltd.</i>
Equity share capital (Nos.)	10,00,000	8,00,000	7,00,000
Fully paid-up equity share @ ₹10 each (₹)	1,00,00,000	80,00,000	70,00,000
Reserves and surplus (₹)	<u>50,00,000</u>	<u>70,00,000</u>	<u>50,00,000</u>
Total (₹)	<u>1,50,00,000</u>	<u>1,50,00,000</u>	<u>1,20,00,000</u>

Investments of Big Ltd. :

Equity shares of Small Ltd. of ₹10 each fully paid-up in Small Ltd. —

Equity shares (Nos.)	3,00,000
Nominal value (₹)	30,00,000
Paid-up value (₹)	30,00,000

Equity shares of Little Ltd. of ₹10 each fully paid-up in Little Ltd. —

Equity shares (Nos.)	2,00,000
Nominal value (₹)	20,00,000
Paid-up value (₹)	20,00,000

As a Company Secretary and CFO of Big Ltd. (the transferee company), how would you deal with —

- (i) the issues for effecting the allotment of equity shares of Big Ltd. for which shareholders' approval was received under section 81(1A).
(3 marks)
- (ii) the number of equity shares of Big Ltd. of ₹10 each fully paid-up to be issued to the shareholders of Small Ltd. and Little Ltd.
(6 marks)

And also state that the total number of issued equity shares of Big Ltd. after such allotment.
(1 mark)

(b) State whether the following statements are true or false citing briefly relevant provisions of the law :

- (i) A company seeking amalgamation with another company, passed a resolution under section 391(2), as per direction of the court and did not file the same with the Registrar of Companies under section 192, on the plea that it is neither an ordinary nor a special resolution but an extra-ordinary resolution.
- (ii) A company called a meeting of members of the company under direction of the court for amalgamation with another company and excluded the proxies for the purpose of counting quorum.
- (iii) The date of agreement made by the merchant banker with the acquirer is treated as 'deemed date of offer' for the purpose of acquisition of shares and/or control in the target company.
- (iv) The order sanctioning the scheme of amalgamation made by the court should be filed with the Registrar of Companies. If the order is not filed with the Registrar of Companies, it will not have any effect.
- (v) Every notice of any meeting called as per orders of court under section 391 shall not include explanatory statement.

(2 marks each)

(c) Explain the circumstances where reduction of share capital is done without confirmation by the court.
(5 marks)

- 2. (a) What is the difference between 'compromise' and 'arrangement' ?
(5 marks)
- (b) Explain briefly the procedure for making application to court under section 391 for directions to hold meetings of shareholders/creditors.
(5 marks)
- (c) What factors will you consider for valuation of shares in merger/ amalgamation?
(5 marks)

3. (a) Sharad who is a promoter of Grow Good Ltd. holds 20% of paid-up share capital of the company. The shares of the company are listed on National Stock Exchange Ltd., Mumbai. Sharad would like to pledge his shares for obtaining loan. State the requirements for disclosure of pledged shares

under the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009. (8 marks)

- (b) Explain the provisions relating to 'escrow account' under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (7 marks)

4. (a) Explain funding through swaps or stock to stock merger. (5 marks)

- (b) Draft a suitable Board resolution with respect to takeover for the following:

- (i) offer by offeror company; and
(ii) authorisation to invest in the shares of investee company.

(4 marks each)

- (c) Sanction to the scheme of amalgamation can be refused by the court on the ground that the transferee company does not have sufficient authorised share capital on the appointed date. Do you agree? Give reasons. (2 marks)

5. (a) A company has passed a special resolution for 'reduction of capital' and effected the same and applied before the Registrar of Companies (ROC) for issuance of certificate confirming the reduction.

The ROC issued certificate confirming the reduction. Subsequently, it was found that :

- (i) the company had no authority under its articles to reduce capital; and
(ii) the special resolution was invalid one.

State with brief reasons separately in both the above circumstances, whether the reduction of capital would be allowed. (4 marks)

- (b) It is a well known fact that to maximise the shareholders value, a company having surplus funds often induced to buy-back its own shares. What are common reasons which usually induce a company to resort to buy-back? (5 marks)

- (c) A listed company had drafted a special resolution to be passed through postal ballot to buy-back 25% of its paid-up equity share capital. As a Company Secretary, you are required to draft the explanatory statement to the proposed resolution. What factors will you consider to prepare the explanatory statement? (3 marks)

- (d) A company whether listed or not is required to make a 'declaration of solvency' and has to submit to the appropriate authorities before making a buy-back of shares. In view of the statement, you are required to answer where the declaration of solvency is to be submitted in case of —

- (i) A listed company.
(ii) An unlisted company.
(iii) A private limited company.

(1 mark each)

PART B

(Answer ANY TWO questions from this part.)

6. (a) Immunity from certain litigations to 'sick company' is the purpose of the Sick Industrial Companies (Special Provisions) Act, 1985. Discuss with reference to the legal provisions of the Act. *(7 marks)*
- (b) Explain the composition of debt recovery tribunals and explain the procedure for appeal to Appellate Tribunal. *(8 marks)*
7. (a) In a voluntary winding-up, all is left to the company, the contributories and the creditors to settle their affairs 'without intervention of the court as far as possible'. Can the court pierce the process, and what is its vested power to pierce the process, and when and where it is being exercised? Briefly discuss all relevant aspects. *(5 marks)*
- (b) In consequence of winding-up of a limited company, a person becomes both contributory and a creditor almost for the same amount. The person made an application to the liquidator that the amount to be payable as 'contributory' may be set-off against his 'receivable' amount from the company. Shall the person get such relief? If not, why and on what grounds? *(5 marks)*
- (c) What is 'non performing asset' (NPA) under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002? *(5 marks)*
8. (a) What is the procedural requirement for recognition of 'foreign proceedings' under the UNCITRAL Model Law? *(9 marks)*
- (b) Write short notes on the following:
- (i) Lok Adalat
 - (ii) Committee of inspection
 - (iii) Corporate insolvency. *(2 marks each)*
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