LANDMARK JUDGEMENTS (Mergers & Amalgamations)

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JUDGEMENT WHICH SETS THE TONE OF MERGER

- **Justice DHANANJAY Y CHANDRACHUD** in the case of **Ion Exchange (India) Ltd. In re,** (2001) 105 Comp Cases 115 (Bom) has beautifully put forth the approach of the judiciary

- "Corporate restructuring is one of the means that can be employed to meet the challenges and problems which confront business. The law should be slow to retard or impede the discretion of corporate enterprise to adapt itself to the needs of changing times and to meet the demands of increasing competition. The law as evolved in the area of mergers, and amalgamation has recognised the importance of the Court not sitting as an appellate authority over the commercial wisdom of those who seek to restructures business."

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THE TORCHBEARER JUDGEMENT

Miheer H. Mafatlal vs. Mafatlal Industries Ltd. Supreme Court on 11.09.1996 JT 1996 (8) 205

1) Bonafides of the majority voters was questioned

Bona fides of the majority acting as a group has to be examined vis-a-vis the Scheme in question and not the bona fides of the **person whose personal interest might be different from the interests** of the voters as a class. Bona fide of person can only be relevant if it can be established with reasonable certainty that he represents majority or is controller of majority.

It is not possible to agree with the contention of learned senior counsel for the appellant that the majority had acted unfairly to the appellant and had not protected his interest of minority shareholders falling in the same class along with the majority.

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It is not possible to concur that the majority had acted with any oblique motive to fructify any adverse commercial interest qua him (the Appellant) and his group **when it consisted of outsiders like financial institutions or that there was any possibility of their surrendering their economic interest in the Scheme at the dictates of shareholder-director** Arvind Mafatlal and his group.

In this connection, the Supreme Court referred to a decision of English Court in the case of ***Hellenic and general Trust Limited*** **reported in 1976 (1) WLR 123**. In that case the court was concerned with a Scheme of Arrangement whereunder

- all the ordinary shares of the company were to be cancelled and new shares were to be issued to Hambros which would make the company as wholly owned subsidiary of Hambros.
- Holders of such cancelled shares were to be paid by Hambros at 48 pennies.

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In short it was an arrangement for taking over of the company by Hambros.

- 53% shares of the Hellenic Company were held by another company MIT.
- MIT itself was a wholly owned subsidiary company of Hambros.

This situation led the court to conclude that the subsidiary company of Hambros which was holding such large number of shares placed itself vis-à-vis Hambros in the position of vendor and **the lifted vail of transaction showed it to be one of acquisition than of amalgamation.**

The aforesaid decision is a pointer to the fact that **what was required to be considered while sanctioning the scheme was bona fides of the majority acting as a class and not of one single person.**

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2) Whether the Court has jurisdiction to minutely scrutinise the scheme when the majority of the creditors or members or their respective classes have approved the scheme.

On this question, the Supreme Court observed the following:

- It is the commercial wisdom of the parties to the scheme who have taken an informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court.

- The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the Scheme by the requisite majority. Consequently, the Company Court's jurisdiction to that extent is peripheral and supervisory and not appellate.

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- The Court acts like an umpire in a game of cricket who has to see that both the teams play their according to the rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not to the umpire.

- The supervisory jurisdiction of the Company Court can also be called out from the provisions of Section 392 of the Act [this section vests the Courts with power to supervise the carrying out of the scheme]

- the said provision itself clearly earmarks the field in which the sanction of the Court operates. It is obvious that the supervisor cannot ever be treated as the author or a policy maker.

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- The Court cannot, therefore, undertake the exercise of scrutinising the scheme placed for its sanction with a view to finding out whether a better scheme could have been adopted by the parties. This exercise remains only for the parties and is in the realm of commercial democracy permeating the activities of the concerned creditors and members of the company who in their best commercial economic interest by majority agree to give green signal to such a compromise or arrangement.

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3) Contours of the jurisdiction of the Court were laid down

The following broad contours of such jurisdiction have emerged:

1. The sanctioning court has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meeting as contemplated by Section 391(1) (a) have been held.

2. That the scheme put up for sanction of the Court is backed up by the requisite majority vote as required by Section 391 sub-section (2).

3. 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 fair to the class as whole so as to legitimately blind even the dissenting members of that class.

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4. That all the necessary material indicated by Section 393(1)(a) is placed before the voters at the concerned meetings as contemplated by Section 391 sub-Section (1).

5. That all the requisite material contemplated by the provision 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.

6. 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 satisfy itself 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.

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7. 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.

8. 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.

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7. Once the aforesaid broad parameters about the requirements of a scheme 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 would be a better scheme for the company and its members or creditors for whom the scheme is framed.

8. 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.

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9. Once the aforesaid broad parameters about the requirements of a scheme 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 would be a better scheme for the company and its members or creditors for whom the scheme is framed.

The aforesaid parameters of the scope and ambit of the jurisdiction of the Company Court which is called upon to sanction a Scheme of Compromise and Arrangement are not exhaustive but only broadly illustrative of the contours of the Court's jurisdiction.

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4) Class of members/creditors – how to determine

The Supreme Court in the Mafatlal case gave the following observations:

- As per Section 86 the share capital of a company shall be of two kinds only, namely, equity share capital and preferences share capital. So far as the Articles of Association of respondent-company are concerned they also contemplate two classes of shareholders. No separate class of equity shareholders is contemplated either by the Act or by the Articles of Association of respondent-company. **Appellant is admittedly an equity shareholder. Therefore, he would fall within the same class of equity shareholders whose meeting was convened by the orders of the Company Court**.

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- Even though the Companies Act or the Articles of Association do not provide for such a class within the class of equity shareholders, **in a given contingency it may be contended by a group of shareholders that because of their separate and conflicting interests vis-a-vis other equity shareholders with whom they formed a wider class, a separate meeting of such separately interested shareholders should have been convened.** But such is not the case of the appellant.

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Palmer in the Treatise on Company Law (24th Edition) says:

- "What constitutes a class: The Court does not itself consider at this point what classes of creditors or members should be made parties to the scheme. This is for the company to scheme purports to achieve. The application for an order for meetings is a preliminary step the applicant taking the risk that the classes which are fixed by the judge, unusually on the applicant's request, are sufficient for the ultimate purpose of the section, the risk being that if in the result, and we emphasis the words 'in the result' they reveal inadequacies, the scheme will not be approved'. **If e.g. rights of ordinary shareholders are to be altered, but those of preference shares are not touched, a meeting of ordinary shareholders will be necessary but not of preference shareholders.**

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If there are different groups within a class the interests of which are different from the rest of the class, or which are to be treated differently under the Scheme, such groups must be treated as separate class for the purpose of the scheme. Moreover, when the Company has decided what classes are necessary parties to the scheme, it may happen that one class will consist of a small number of persons who will all be willing to bound by the scheme. In that case it is not the practice to hold a meeting of that class, but to make the class a party to the scheme and to obtain the consent of all its members to be bound. It is however, necessary for at least one class meeting to be held in order to give the Court jurisdiction under the Section."

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- It is, therefore, obvious that **unless a separate and different type of Scheme of Compromise is offered to a sub- class of a class of creditors or shareholders, no separate meeting of such sub-class of the main class of members or creditors is required** to be convened.

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Another judgement on "determination of Class"

Gujarat High Court

Maneck Chowk and Ahmedabad Mfg. Co. Ltd. In re.

(1970) 2 Comp LJ 300 (Guj)

It is always a moot question as to what constitutes a class. However, speaking broadly, when it is shown that a group of persons would constitute a "class" that they have conveyed all interests, and their claims are capable of being ascertained by a common system of valuation. **The group who are styled as "class" must have "commonality of interest" and ordinarily be homogeneous and they have been offered identical compromise.** This will provide a rationale for determination of the peripheral boundaries of classification.

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5) Whether scheme can be rejected on the ground that the Exchange Ratio was ex-facie unfair and unreasonable to the equity shareholders

- valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy.

- Reference was made to the decision of the Gujarat High Court decision of the Gujarat High Court in Kamala Sugar Mills Limited [55 Company Cases P.308] as below:

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"Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders 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 determined to their interest."

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PETITIONS IN DIFFERENT COURTS/STATES - CAN THEY PASS DIFFERENT ORDERS?

In cases of schemes where the companies are situated in different jurisdictions, there is always a chance of the different Courts passing opposing judgements.

While holding that different courts can pass different orders, the Courts have been vocal about this confusion and have even given advisory to the Ministry.

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…. PETITIONS IN DIFFERENT COURTS/STATES - CAN THEY PASS DIFFERENT ORDERS?

Bank of Baroda Ltd. v. Mahindra Ugine Steel Co. Ltd. (1976) 46 Com Cases 227 (Guj) wherein the learned Judge observed the following:

> "…..it is somewhat incongruous that provision be made for the same thing of matter by two different judicial orders passed by two different Courts presumably on two different dates. Could the legislature have really envisaged a situation of this nature?..... Is it a situation which can be remedied only by legislative intervention by way of an amendment?"

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…. PETITIONS IN DIFFERENT COURTS/STATES - CAN THEY PASS DIFFERENT ORDERS?

- ***Mafatlal Industries Limited*** (1995) 5 Comp LJ 38 (Guj) (Single Judge] The anomaly of a scheme being sanctioned by one High Court but not being sanctioned by another has to be avoided by appropriate amendment to the Companies Act.

- ***Consolidated Coffee Limited, In re,*** (1999) 97 Com Cases 1 (Kar) Merely because a petition for sanction is pending before another High Court it is not a ground on which the Court should be requested to defer the decision until that case was heard.

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…. PETITIONS IN DIFFERENT COURTS/STATES - CAN THEY PASS DIFFERENT ORDERS?

- ***Nokia Siemens Network India P Ltd.,*** *In re,* (2009) 150 Com Cases 728 (Kar) Where the scheme did not affect the rights of the members or creditors of the transferee company, it was **not necessary that the scheme be examined by the court within whose jurisdiction the transferee company was situated.**

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MERITS OF THE SCHEME CANNOT BE CONSIDERED AT THE APPLICATION STAGE

- NCLAT in Company Appeal (AT) No. 04 of 2019 vide Order dated 27.05.2019 arising out of the Order of Bengaluru Bench; **MEL Windmills Pvt. Ltd. vs. Mineral Enterprises Ltd & Anr.**

Brief Facts:

1. It was a scheme of demerger involving a company where in there were certain pending investigations in respect of its mining business.
2. The mining business was not being demerged
3. Company Application was made to the Bangalore Bench for dispensation of the meetings of the members/creditors

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…MERITS OF THE SCHEME CANNOT BE CONSIDERED AT THE APPLICATION STAGE

4. The NCLT went into the merits of the scheme and also considered the pending investigations and REJECTED the Application.

5. Appeal was made before the NCLAT against the Order.

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…MERITS OF THE SCHEME CANNOT BE CONSIDERED AT THE APPLICATION STAGE

The Appellate Tribunal set aside the Order observing that

- "It is manifestly clear that **at the stage of calling of meeting of creditors/members for consideration of the scheme of compromise or arrangement the Tribunal is not required to examine the merits of the scheme** qua the proposed compromise/ arrangement. Any such indulgence on the part of Tribunal would fall foul of the provision engrafted in Section 230 (1) of the Act and would be without jurisdiction"

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MERGER OF LLP WITH COMPANY

- The CA, 2013 provides for amalgamation of companies with other companies. On the other hand, the LLP Act, 2008 provides for amalgamation of LLPs with other LLPs.

- The cross-merger between an LLP and a company is neither specifically permitted nor is specifically prohibited, whereas merger of foreign body corporate (hence, foreign LLP/LLC) with Indian company is specifically permitted.

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…MERGER OF LLP WITH COMPANY

- Two significant judgements in this regard where the NCLT approved the merger of LLP into a company:

  - merger of *Vertis Microsystems LLP with Forgeahead Solutions Private Limited* (filed under section 394 of Companies Act, 1956) by **NCLT Mumbai**.

  - Merger of *Real Image LLP with Qube Cinema Technologies P Ltd* by **NCLT Chennai**

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…MERGER OF LLP WITH COMPANY

- The rationale of the NCLT, Chennai was that under the Companies Act, 1956, there was an express provision wherein 'transferor company' included any body-corporate. However, there is no similar provision under the Companies Act, 2013. Since, merger of a body corporate (including LLP) with an Indian Company was categorically covered under the Companies Act, 1956 and there being no specific provision under the Companies Act, 2013 to provide for the same, it was reckoned to be case of 'casus omissus' i.e. a case which was omitted to be included but which would otherwise have been included given that the same was specifically provided for in the erstwhile law.

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…MERGER OF LLP WITH COMPANY

- A similar scheme for amalgamation of a registered Indian partnership firm, with an Indian company was placed before the Ahmedabad Bench of the NCLT for its approval. The Ahmedabad Bench of the NCLT held that since a registered partnership firm did not fall within the ambit of the term 'company' as per the 2013 Act, it should not be permitted to be merged with a company.

- *However, the NCLAT has reversed the order of NCLT, Chennai for merger of LLP into a company.*

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…MERGER OF LLP WITH COMPANY

- Therefore, it is now settled that an LLP cannot be merged with Company. The only way to do this, is to convert the LLP into a company and then propose a scheme for merger.

  My View: Merger of LLP with company may be allowed if the LLP is a member of the company. The eligibility criteria for making application u/s 230 permits any member to make an application. Therefore, all is not lost

  ➔ only water needs to be tested !!

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APPOINTED DATE

- Sec 232(6) provides that the scheme shall clearly indicate an appointed date

- In **Marshall Sons & Co. India Ltd v. ITO** [223ITR 809], Supreme Court held that the Appointed Date may precede the date of sanctioning of Scheme, the date of filing of certified copy of the Order, date of allotment of shares, etc.

- In the matter of amalgamation of **Equitas Housing Finance Ltd and Equitas Micro Finance Ltd with Equitas Finance Ltd** in CP Nos. 119 to 121 of 2016, the Madras High Court held that "the appointed date" need not necessarily be a specific calendar date.

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…APPOINTED DATE

- General Circular No. 9/2019 dated 21.08.2019 clarified that

  - Section 232(6) enables to choose and state an appointed date in the scheme.

  - This date may be a specific calendar date

  - Appointed date may be tied to an event such as grant of licence by a competent authority or fulfilment of any preconditions agreed upon by parties.

  - Where appointed date chosen is a specific calendar date, it may precede the date of filing the Application, but not beyond a year unless justification brought out in the scheme.

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RECALL OF MERGER ORDER

There have been a few applications with prayers to rescind the Order of merger. But, the Courts have been very cautious in allowing such prayers. In one of the instances some relief has been allowed by the Madras High Court in the Scheme of Amalgamation involving Anand Electronics and Industries Ltd. (Transferee Co) and Dharmapuri Paper Mills P Ltd. (Transferor Co) [CP 144 and 145/95 respectively; Unreported].

- After the Merger Order, two applications CA 282 and 283/96 were filed in CP 144 and 145/95 to rescind the order sanctioning the scheme
- Citing business reasons and that the same had also been approved by the board of directors of the company (the company had not even filed the Order with ROC).

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…RECALL OF MERGER ORDER

- The learned single Judge refused to rescind stating that (i) it is a suo moto reconsideration by the Boards of the companies (ii) it is not open to company to seek sanction and annulment of such sanction at the whim and pleasure of the Boards of the companies.

It was Appealed to Division Bench in O.S.A. 152 and 153/96. In the Appeal an alternative was also prayed that instead of recall of the Order for merger, an Order may be passed for not implementing the scheme.

- The Division Bench had certain reservations as to whether any objection could arise if either the rescinding or non-implementation prayers are allowed.

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…RECALL OF MERGER ORDER

- Therefore, it directed advertisements in newspapers calling for objections.

- The Court allowed the alternative prayer i.e. non-implementation of the scheme reading sections 391(3) and 394(3) together in regard to the order not having come into effect.

- Annoyed with the slackness on the part of the appellant in seeking the merger order and not implementing it, the Court levied cost of Rs. 5,000/- to the Madras High Courts Advocates Association.

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STAMP DUTY

- This is the most contentious part of any merger. Though the overwhelming view of the Courts is in favour of levying Stamp duty, there is no absolute unanimity amongst various High Courts. This is also because, stamp duty is State-subject and therefore the leviability depends on the respective Stamp Acts of the States.

- **Four issues** due to which confusion arises – **(i)** rate of stamp duty may not have been prescribed in the respective Stamp Act or **(ii)** whether an order for amalgamation is a "conveyance" or "instrument" or not **(iii)** when there are two Orders for merger passed by two different High Courts in respect of companies subject to merger reside in two different States **(iv)** When the property lies in two different States though there is only one Merger Order.

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…STAMP DUTY

- States of Maharashtra and Gujarat have specifically amended the Stamp Act and included the order of amalgamation in the definition of “conveyance”.

- Hence, clearly there is no escape from Stamp Duty in these two States.

- State of Tamilnadu has also amended its Stamp Act and levied a stamp duty of 2% on the total value of consideration under the Order.

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…STAMP DUTY

- The Bombay Stamp Act was amended w.e.f. 10.12.1985 by bringing the term "conveyance", "a decree or final order of any Civil Court". Further w.e.f. 1.5.1993, the definition of the "conveyance" includes "every order made by the High Court u/s 394 of CA 1956 in respect of amalgamation of companies". The validity of this amendment was upheld by Bombay High Court in the case of ***Li Taka Pharmaceutical Ltd. v. State of Maharashtra*** [AIR 1997 Bom 7] by holding that an order sanctioning an amalgamation is an instrument within the meaning of the amended Stamp Act and is therefore liable to pay stamp duty as prescribed by the Act on conveyance of property.

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…STAMP DUTY

- The Supreme Court also decided on the same lines in the case of **Hindustan Lever Limited v. State of Maharashtra** [(2003) 117 Com Cases 758].

- Rate of Stamp duty in Maharashtra is currently 10% of the market value of shares allotted and any other amount paid - subject to cap of 5% of market value of immovable property or 0.7% of market value of shares allotted together with other any consideration paid, whichever is higher.

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…STAMP DUTY

- Regarding levy of stamp duty on the Order in case of two different states, the judgement of the Bombay High Court dated 31.03.2016 in the case of ***Chief Controlling Revenue Authority v. Reliance Industries Limited***, AIR 2016 Bom 108 sparked a controversy. It was held that both the Orders will be subject to levy of stamp duty depending on the applicable rates in the two States.

- This matter has been appealed in the Supreme Court. Pending final judgement, the Supreme Court has stayed the Bombay High Court Order vide its Order dated 21.11.2016.

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…STAMP DUTY

- In this case there were two orders – one from the Bombay High Court (dated 7.6.2002) and another from the Gujarat High Court (dated 13.9.2002).

- Before the Supreme Court, it was argued that *".....on amalgamation, without the order of the High Court of Gujarat which is later in point of time, the document does not become as instrument so as to attract the stamp duty"*

- Stay on the Bombay High Court Order granted, final judgement still pending.

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Thank you

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