STUDY MATERIAL

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING VALUATION AND INSOLVENCY

MODULE 1

PAPER 3

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, VALUATION AND INSOLVENCY

Corporate Restructuring is a non-recurring 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, better corporate governance etc. The 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.

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, Valuation as well as Insolvency, aims at 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 as well as recommended readings.

The subject of Corporate Restructuring, Valuation and Insolvency is inherently technical and is subjected to constant refinement through new legislations, rules and regulations made there under, court decisions on specific legal issues and corporate business dynamics. 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 law/professional journals like Company Law Journal, Corporate Law Advisor, SEBI and Corporate Laws, Company Cases etc.

This Study Material is based on the provisions which are notified under Companies Act, 2013. The amendments made upto 1st December, 2018 have been incorporated in this 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. The students are therefore, advised to refer to the e-bulletin ‘Student Company Secretary’, `Chartered Secretary’ and other publications for updation of the study material.

In the event of any doubt, students may write to the Directorate of Academic in the Institute for clarification at academics@icsi.edu.

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 e-bulletin ‘Student Company Secretary'.

PROFESSIONAL PROGRAMME

SYLLABUS
FOR

MODULE I - PAPER 3: CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY

Level of Knowledge: *Advance Knowledge*

Objective: *To acquire knowledge of the legal, procedural and practical aspects of Corporate Restructuring, Valuation and Insolvency.*

Detailed Contents:

PART A - Corporate Restructuring (50 Marks)

1. Introduction and Concepts

- Meaning of Corporate Restructuring
- Need, Scope and Modes of Restructuring
- Historical Background
- Emerging Trends
- Planning, Formulation and Execution of Various Corporate Restructuring Strategies - Mergers, Acquisitions, Takeovers, Disinvestments and Strategic Alliances, Demerger and Hiving off
- Expanding Role of Professionals

2. Merger and Amalgamation

- Introduction
- 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 Government Companies
- Cross Border Acquisition and Merger

3. Corporate Demerger and Reverse Merger

- 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

4. Takeover

- Meaning and Concept

- Types of Takeovers; Legal Aspects – SEBI Takeover Regulations
- Disclosure and Open Offer Requirements
- Bail Out Takeovers and Takeover of Sick Units
- Takeover Defences
- Cross Border Takeovers

5. Funding of Merger and Takeover

- Financial Alternatives; Merits and Demerits
- Funding through various Types of Financial Instruments including Equity and Preference Shares, Debentures, Securities with Differential Rights, Swaps, Stock Options; ECBs, Funding through Financial Institutions and Banks
- Rehabilitation Finance
- Management Buyouts/Leveraged Buyouts

6. Financial Restructuring

- Reduction of Capital
- Reorganization of Share Capital
- Buy-Back of Shares – Concept and Necessity
- Procedure for Buy-Back of Shares by Listed and Unlisted Companies

7. Post Merger Reorganization

- Factors involved in Post Merger Reorganization
- Integration of Businesses and Operations
- Assessing Accomplishment of Post Merger Objectives; Measuring Post Merger Efficiency

8. Case Studies

PART B – Valuation (30 Marks)

9. Introduction

- Meaning, Objective & Scope of Valuation
- Principles of Valuation
- Preliminary Work relating to Valuation
- Valuation Standards and Valuation Analysis

10. Valuation Techniques

- Historical Earnings Valuation
- Asset Based Valuation
- Market Based Valuation

11. Regulatory and Taxation Aspects

- Legal & Regulatory aspects related to Valuation such as SEBI Regulations/ RBI Regulations
- Income Tax Implications

12. Valuations for Different Strategies

- Merger & Acquisition, Demerger, Slump Sale
- Liquidation and Corporate Insolvency
- Internal & External Restructuring
- Valuation of Intangibles
- Valuation of Securities

PART C – Insolvency (20 Marks)

13. Introduction

- Concept of Insolvency, Historical Developments
- History of Bankruptcy Laws in USA, UK and India

14. Corporate Insolvency and Resolution Process

- Background
- Insolvency and Bankruptcy Code, 2016
- Corporate Insolvency Resolution
- Voluntary Liquidation

15. Securitization and Debt Recovery

- Overview of the Securitization 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)
- Overview of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Tribunal, Procedure; Compromises and Arrangements with Banks and Creditors

16. 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; Dealing with Contracts; Managing Estate
- Outsourcing Responsibilities to Professionals/Service providers such as Valuers, Security Agencies
- 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

17. Cross Border Insolvency

- UNCITRAL Model Law on Cross Border Insolvency
- UNCITRAL Legislative Guide to Insolvency Law
- World Bank Principles for Effective Insolvency and Creditor Rights
- Asian Development Bank Principles of Corporate Rescue and Rehabilitation
- Bankruptcy under chapter 11 of US Bankruptcy Code

LIST OF RECOMMENDED BOOKS

MODULE I

PAPER 3 : CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY

Recommended Readings and References:

1.	A. Ramaiya	:	Guide to Companies Act, LexisNexis Butterworths, Wadhwa, Nagpur
2.	M.C. Bhandari	:	Guide to Company Law Procedures, LexisNexis Butterworths Wadhwa Nagpur
3.	ICSI	:	Handbook on Mergers Amalgamations and takeovers.
4.	K. R. Sampath	:	Mergers/Amalgamations, Takeovers, Joint Ventures, LLPs and Corporate Restructure, Snow White Publications
5.	S. Ramanujam	:	Mergers et al, LexisNexis Butterworths Wadhwa Nagpur
6.	Ray	:	Mergers and Acquisitions Strategy, Valuation and Integration, PHI

Important Websites

(a) www.sebi.gov.in
(b) www.rbi.org.in
(c) www.finmin.nic.in
(d) www.dipp.nic.in
(e) www.mca.gov.in
(f) www.nclt.gov.in
(g) www.nclat.nic.in
(h) www.drt.gov.in
(i) www.ibbi.gov.in

Students are advised to read relevant Bare Acts and Rules and Regulations relating thereto. 'Student Company Secretary' e-bulletin and 'Chartered Secretary' should also be read regularly for updating the knowledge.

ARRANGEMENT OF STUDY LESSONS

MODULE I - PAPER 3: CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY

Lesson No. *Subject*

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY

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Lesson 1
Corporate Restructuring – Introduction & Concepts

LESSON OUTLINE

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

- Meaning of Corporate Restructuring
- Need & Scope of Corporate Restructuring
- Various Modes of Restructuring
- Historical Background
- Emerging Trends
- Planning, formulation and execution of various Restructuring Strategies
- Role of Professionals in Restructuring Process

LEARNING OBJECTIVES

The speed of business dynamics demands, the business organizations not only to revamp their internal business strategies like effective market expansion, increased customer base, product diversification and innovation etc., but also expects the corporates to devise inorganic business strategies like mergers, acquisitions, takeovers etc., that results in faster pace of growth, effective utilization of resources, fulfillment of increasing expectations of stakeholders. These restructuring strategies work positively for the business both during the time of business prosperity and recession.

This lesson would help you in understanding the concept of corporate restructuring, available tools, historical background & emerging trends in restructuring strategies etc., the role of professionals like company secretaries in the process of restructuring right from the strategy development and pre diligence stage till the post integration stage.

INTRODUCTION

There are primarily two ways of growth of business organization, i.e. organic and inorganic growth.

Organic growth is through internal strategies, which may relate to business or financial restructuring within the organization that results in enhanced customer base, higher sales, increased revenue, without resulting in change of corporate entity.

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 the growth is through the internal sources without change in the corporate entity. Organic growth can be through capital restructuring or business restructuring.

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 corporate restructuring strategies that may create a change in the corporate entity.

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".

As per Collins English dictionary, meaning of corporate restructuring is a change in the business strategy of an organization resulting in diversification, closing parts of the business, etc, to increase its long-term profitability.

Corporate Restructuring is defined as the process involved in changing the organization of a business. Corporate Restructuring can involve making dramatic changes to a business by cutting out or merging departments. It 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.

Corporate Restructuring as a Business Strategy

Corporate Restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Restructuring may involve major layoffs or bankruptcy, though restructuring is usually designed to minimize the impact on employees, if possible. Restructuring may involve the company's sale or a merger with another company. Companies use restructuring as a business strategy to ensure their long-term viability. Shareholders or creditors might force a restructuring if they observe the company's current business strategies as insufficient to prevent a loss on their investments. The nature of these threats can vary, but common catalysts for restructuring involve a loss

of market share, the reduction of profit margins or declines in the power of their corporate brand. Other motivators of restructuring include the inability to retain talented professionals and major changes to the marketplace that directly impact the corporation's business model.

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Corporate restructuring is an inorganic growth strategy.

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 it's contribution to corporate objectives. It also aims at exploiting the strategic assets accumulated by a business i.e. natural monopolies, goodwill, exclusivity through licensing etc. to enhance the competitive advantages. Thus restructuring would help in 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 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.

Corporate Restructuring …..an Example

ABC Limited has surplus funds but it is not able to consider any viable projects. Whereas XYZ Limited has identified viable projects but has no money to fund the cost of the project. The merger of ABC Limited and XYZ Limited is a mutually beneficial option and would result in positive synergies of both the Companies.

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.

Planning, formulation and execution of various restructuring strategies

Corporate restructuring strategies depends on the nature of business, type of diversification required and results in profit maximization through pooling of resources in effective manner, utilization of idle resources, effective management of competition etc.

Planning the type of restructuring requires detailed business study, expected business demand, available resources, utilized/idle portion of resources, competitor analysis, environmental impact etc., The bottom line is that the right restructuring strategy provides optimum synergy for the organizations involved in the restructuring process.

It involves examination of various aspects before and after the restructuring process.

Important aspects to be considered while planning or implementing corporate restructuring strategies

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

- Valuation & Funding
- Legal and procedural issues
- Taxation and Stamp duty aspects
- Accounting aspects
- Competition aspects etc.
- Human and Cultural synergies

Based on the analysis of various aspects, a right type of strategy is chosen.

Types of Corporate Restructuring Strategies

Various types of corporate restructuring strategies include:

1. Merger
2. Demerger
3. Reverse Mergers
4. Disinvestment
5. Takeovers
6. Joint venture
7. Strategic alliance
8. Franchising
9. Slump Sale

1. Merger

Merger is the combination of two or more companies which can be merged together either by way of amalgamation or absorption or by formation of a new company. The combining of two or more companies, is generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock.

Mergers may be

(i) Horizontal Merger: It is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor and hence expands as the firm's operations in the same industry. Horizontal mergers are designed to achieve economies of scale and result in reducing the number of competitors in the industry.

(ii) Vertical Merger: It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities. On the other hand, forward integration may result if a company decides to take over the retailer or Customer Company. Vertical merger provides a way for total integration to those firms which are striving for owning of all phases of the production schedule together with the marketing network

(iii) Congeneric Merger: It is the type of merger, where two companies are in the same or related industries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger. The potential benefit from these mergers is high because these transactions offer opportunities to diversify around a common case of strategic resources.

(iv) Conglomerate Merger: These mergers involve firms engaged in unrelated type of activities i.e. the business of two companies are not related to each other horizontally or vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. Conglomerate mergers are merger of different kinds of businesses under one flagship company. The purpose of merger remains utilization of financial resources enlarged debt capacity and also synergy of managerial functions. It does not have direct impact on acquisition of monopoly power and is thus favoured throughout the world as a means of diversification.

2. Demerger

It is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. A demerger is often done to help each of the segments operate more smoothly, as they can focus on a more specific task after demerger.

3. Reverse Merger

Reverse merger is the opportunity for the unlisted companies to become public listed company, without opting for Initial Public offer (IPO). In this process, the private company acquires majority shares of public company with its own name.

4. Disinvestment

Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".

5. Takeover/Acquisition

Takeover occurs when an acquirer takes over the control of the target company. It is also known as acquisition. Normally this type of acquisition is undertaken to achieve market supremacy. It may be friendly or hostile takeover.

Friendly takeover: In this type, one company takes over the management of the target company with the permission of the board.

Hostile takeover: In this type, one company takes over the management of the target company without its knowledge and against the wish of their management.

6. Joint Venture (JV)

A joint venture is an entity formed by two or more companies to undertake financial activity together. The parties agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. It may be Project based joint venture or Functional based joint venture.

Project based Joint venture: The joint venture entered into by the companies in order to achieve a specific task is known as project based JV.

Functional based Joint venture: The joint venture entered into by the companies in order to achieve mutual benefit is known as functional based JV.

7. Strategic Alliance

Any agreement between two or more parties to collaborate with each other, in order to achieve certain objectives while continuing to remain independent organizations is called strategic alliance.

8. Franchising

Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce and market goods or services according to certain specifications.

The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty and gains.

9. Slump sale

Slump sale means the transfer of one or more undertaking as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale.

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.

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 all over the world, 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.

Expanding role of professionals in corporate restructuring process

The restructuring process does not only involve strategic decision making based on the market study, competitor analysis, forecasting of synergies on various respects, mutual benefits, expected social impact etc, but also the technical and legal aspects such as valuation of organizations involved in restructuring process, swap ratio of shares if any, legal and procedural aspects with regulators such as Registrar of Companies, High Court etc., optimum tax benefits after merger, human and cultural integration, stamp duty cost involved etc.

It involves a team of professionals including business experts, Company Secretaries, Chartered

Accountants, HR professionals, etc., who have a role to play in various stages of restructuring process. The Company Secretaries being the vital link between the management and stakeholders are involved in the restructuring process through out as co-coordinator, in addition to their responsibility for legal and regulatory compliances.

The restructuring deals are increasing day by day to be in line with business dynamics and international demands. It necessitates the expanded role of professionals in terms of maximum quality in optimum time.

COMPANIES ACT, 2013

Companies Act, 2013 has brought many enabling provisions with regard to mergers, compromise or arrangements, especially with respect to cross border mergers, time bound and single window clearances, enhanced disclosures, disclosures to various regulators, simplified procedure for smaller companies etc. Some of Sections under the Companies Act, 2013 are as under:-

Section 66 – Reduction of Share Capital

Section 67 – Restriction on purchase by company of its own shares

Chapter XV- Compromises, Arrangements and Amalgamations

Section 230 - Power to Compromise or Make Arrangements with Creditors and Members

Section 231- Power of Tribunal to Enforce Compromise or Arrangement

Section 232 - Merger and Amalgamation of Companies

Section 233 - Merger or Amalgamation of Certain Companies

Section 234 - Merger or Amalgamation of Company with Foreign Company

Section 235 - Power to Acquire Shares of Shareholders Dissenting from Scheme or Contract Approved by Majority

Section 236 - Purchase of Minority Shareholding

Section 237- Power of Central Government to Provide for Amalgamation of Companies in Public Interest

Section 238 - Registration of Offer of Schemes Involving Transfer of Shares

Section 239 - Preservation of Books and Papers of Amalgamated Companies

Section 240 - Liability of Officers in Respect of Offences Committed Prior to Merger, Amalgamation, etc.

Salient Features of Companies Act, 2013 relating to Corporate Restructuring (Section 230-240)

Corporate Restructuring through Compromises, Arrangements and Amalgamations

- National Company Law Tribunal assumed jurisdiction of High Court.
- **Section 230(1)** provides that the Compromise or arrangement may be proposed between the company and its Creditors or the Company and its members.
- **Section 230(2)** – Application for compromise or arrangement shall be submitted before the NCLT accompanied by an affidavit, disclosing
    1. All material facts relating to the company.
    2. Reduction of capital if any included in the compromise or arrangement;

3. Any scheme of corporate debt restructuring consented to by not less than 75% of the secured creditors in value along with creditors responsibility statement, safeguard for the protection of other secured and unsecured creditors, report of the auditor as to the funds requirement after CDR and the conformity to liquidity test etc.

- **Section 230(3) –** Notice relating to compromise or arrangement and other documents shall be sent to all the members, creditors, debenture holders and also to be placed on the website of the company. The notice shall contain a statement disclosing the effect to corporate action on all the stakeholders separately.
- **Proviso to Section 230(4) –** Persons holding not less than 10% of the shareholdings or persons having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement, entitled to object the scheme of compromise or arrangement.
- **Section 230(5) –** Notice of meeting for approval of the scheme of compromise or arrangement be sent to various regulators including:

1. The Central Government;
2. Income-tax Authorities;
3. Reserve Bank of India (`RBI');
4. Securities and Exchange Board of India (`SEBI');
5. The Registrar;
6. Respective Stock Exchange;
8. The Competition Commission of India; if necessary; and
9. Other Sectoral regulators which could likely be affected by the scheme. Representation, if any, by the above authorities will have to be made within a period of 30 days from receipt of notice.

Section 230(6) – Approval of scheme by majority of persons representing three fourths in value of members or creditors. Such approved scheme, when sanctioned by tribunal shall be binding on company, all creditors, members or on liquidators (in case of a company being wound up)**.**

Section 232(1) deals with the scheme of compromise and arrangement wherein it has been proposed for the purpose of reconstruction of the company or the merger or amalgamation of two or more companies.

Section 233 – Fast track mergers introduced to enable fast track merger without the approval of NCLT, between:

1. Two or more small companies. Small company is defined under the Act.
2. Holding and its wholly owned subsidiary company.
3. Other class of companies as may be prescribed.

Section 233 (10) provides that the transferee company cannot hold any shares in its own name or in the name of any trust, or on behalf of any of its subsidiary or associate company. It is necessary that all such shares need to be cancelled and extinguished upon merger.

Winding Up

Section 2(94A) defines the term Winding up to means winding up under the Companies Act, 2013 or liquidation under the Insolvency and Bankruptcy Code, 2016.

MODES OF WINDING UP

The company may be wound up in any of the following modes:

1. By National Company Law Tribunal (Tribunal) under part 1 of the Chapter XX of the Companies Act, 2013
2. By Voluntary Liquidation under Chapter -V of the part II of the Insolvency and Bankruptcy Code, 2016.

Winding up by Tribunal:

Instances wherein the company can be wound up by Tribunal:

A company may, on a petition under section 272 of the Companies Act, 2013 be wound up by the Tribunal,-

(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) 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;

(c) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

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

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 Tribunal by any of the following persons

(a) the company;

(b) any contributory or contributories;

(c) all or any of the persons specified in clauses (a) and (b);

(d) the Registrar;

(e) any person authorised by the Central Government in that behalf; or

(f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.

Voluntary Winding up

The provisions relating to Voluntary Winding Up of Companies under the Companies Act, 2013 are omitted vide MCA Notification No. F.O. 3453(E) dated 15th November, 2016 and notified Section 255 of the Insolvency and Bankruptcy Code, 2016 which refers to the eleventh Schedule of the Insolvency and Bankruptcy Code, 2016.

Voluntary Liquidations

Part II of Chapter XX of the Companies Act, 2013 dealing with voluntary winding up has since been deleted by the Insolvency and Bankruptcy Code, 2016 and a separate provision of section 59 has been made in the Code for dealing with voluntary winding up of corporate persons including companies. This section provides for the initiation of voluntary liquidation proceedings by the corporate debtor which has not defaulted on any debt due to any person A corporate debtor, being a company may choose to be wound up voluntarily under several circumstances including winding up as a result of expiry of period of operation fixed in its constitutional documents or occurrence of an event provided in its constitutional documents for its dissolution.

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.
- The regulatory framework for corporate restructuring includes, the Companies Act, 2013, Insolvency and Bankruptcy Code, 2016 , SEBI(SAST) Regulations; 2011, SEBI (LODR) Regulations, 2015 , Indian Stamp Act, 1899, Companies(Court) Rules; etc.
- The restructuring process over the years has expanded the role of professionals in the restructuring process at various stages.
- The Companies Act; 2013 has provided several provisions for revamping the corporate restructuring process in India.

SELF TEST QUESTIONS

1. What are different types of growth strategies?
2. Briefly discuss the scope and mode of Corporate Restructuring.
3. Discuss about different restructuring strategies.
4. Write a brief note on the role of professionals in restructuring strategies.
5. Restructuring is just not a strategic plan. Discuss.

Lesson 2
Mergers and Amalgamations – Legal and Procedural Aspects

LESSON OUTLINE

- Regulatory Framework
- Provisions of the Companies Act, 2013 relating to mergers/amalgamation
- Companies (Compromise, Arrangements and Amalgamations) Rules, 2016
- National Company Law Tribunal Rules, 2016.
- National Company Law Appellate Tribunal Rules, 2016
- Approvals in the scheme of amalgamation
- Process/steps involved in mergers/ Amalgamation
- Filing of various forms in the process of mergers/amalgamation

LEARNING OBJECTIVES

While implementing the strategic decision of merger/amalgamation, the transferor/transferee company has to comply with a number of regulations viz., the Companies Act, 2013, National Company Law Tribunal Rules, 2016 (hereinafter called "the NCLT Rules"), Income Tax Act, 1961, The Indian Stamp Act 1899, The Competition Act, 2002 etc. It involves conducting of various meeting including board/general meetings, obtaining of various approvals from regulators like Stock Exchanges, National Company Law Tribunal (NCLT) , Ministry of Corporate Affairs (ROC/RD), drafting of documents such as preparation of scheme, notices/explanatory statements, filing of various documents including e-forms with ROC, filing of scheme of amalgamation with NCLT etc., After reading this lesson you will be able to understand the regulatory framework, interpretations of provisions in the Companies Act relating to merger/amalgamation, different approvals, steps involved, judicial pronouncements etc. The aspects as to stamp duty, valuation, competition law aspects are being dealt in separate chapters.

Note: Sections 230-240 of Companies Act, 2013 have been notified by Ministry of Corporate Affairs ("MCA") which are in effect from December 15, 2016 and are accordingly dealt with in this lesson.

REGULATORY FRAMEWORK FOR MERGER/AMALGAMATION

The Regulatory Framework of Mergers and Amalgamations covers

1. The Companies Act, 2013
2. National Company Law Tribunal Rules, 2016.
3. Companies (Compromise, Arrangements and Amalgamations) Rules, 2016
4. Income Tax Act, 1961
5. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
6. Competition Act, 2002

1. Companies Act, 2013

Chapter XV of Companies Act, 2013 comprising Sections 230 to 240 contains provisions on Compromises, Arrangements and Amalgamations'. The scheme of Chapter XV goes as follows.

1. Section 230-231 deals with compromise or arrangements with creditors and members and power of the Tribunal to enforce such a comprise or arrangement.
2. Section 232 deals with mergers and amalgamation including demergers.
3. Section 233 is relating to the merger or amalgamation of small companies or between the holding company and its wholly owned subsidiary (also called fast track mergers)
4. Section 234 deals with amalgamation with foreign company (also called cross border mergers).
5. Section 235 deals with acquisition of shares of dissenting shareholders.
6. Section 236 deals with purchase of minority shareholding
7. Section 237 contains provisions as to the power of the central government to provide for amalgamation of companies in public interest.
8. Section 238 deals with registration of offer of schemes involving transfer of shares.
9. Section 239 deals with preservation of books and papers of amalgamated companies.
10. Section 240 deals with liability of officers in respect of offences committed prior to merger, amalgamation etc.

2. Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (read with National Company Law Tribunal Rules, 2016)

Rules 3 to Rule 29 contain 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

The Income Tax Act, 1961 covers aspects such as tax reliefs to amalgamating/amalgamated companies, carry forward of losses, exemptions from capital gains tax etc. For example, 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.

4. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) on September 2, 2015. A time period of ninety days has been given for implementing the Regulations. However, two provisions of the regulations, which are facilitating in nature, are applicable with immediate effect. These pertain to:

(i) passing of ordinary resolution instead of special resolution in case of all material related party transactions subject to related parties abstaining from voting on such resolutions, in line with the provisions of the Companies Act, 2013, and

(ii) re-classification of promoters as public shareholders under various circumstances.

The relevant Regulations relating to Corporate Restructuring are as follows.

Scheme of Arrangement.

Regulation 11. The listed entity shall ensure that any scheme of arrangement /amalgamation/merger /reconstruction/reduction of capital etc. to be presented to any Tribunal does not in any way violate, override or limit the provisions of securities laws or requirements of the stock exchange(s):

Provided that this regulation shall not be applicable for the units issued by Mutual Fund which are listed on a recognised stock exchange(s).

Draft Scheme of Arrangement & Scheme of Arrangement.

Regulation 37. (1) Without prejudice to provisions of regulation 11, the listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before any Tribunal under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, with the stock exchange(s) for obtaining Observation Letter or No-objection letter, before filing such scheme with any Tribunal, in terms of requirements specified by the Board or stock exchange(s) from time to time.

(2) The listed entity shall not file any scheme of arrangement under sections 230-234 and Section 66 of Companies Act, 2013, with Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

(3) The listed entity shall place the Observation letter or No-objection letter of the stock exchange(s) before the Tribunal at the time of seeking approval of the scheme of arrangement:

Provided that the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Tribunal

(4) The listed entity shall ensure compliance with the other requirements as may be prescribed by the Board from time to time.

(5) Upon sanction of the Scheme by the Tribunal, the listed entity shall submit the documents, to the stock exchange(s), as prescribed by the Board and/or stock exchange(s) from time to time.

(6) Nothing contained in this regulation shall apply to draft schemes which solely provide for merger of a wholly owned subsidiary with its holding company:

Provided that such draft schemes shall be filed with the stock exchanges for the purpose of disclosures.

Minimum Public Shareholding.

Regulation 38. The listed entity shall comply with the minimum public shareholding requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957 in the manner as specified by the Board from time to time:

Provided that provisions of this regulation shall not apply to entities listed on institutional trading platform without making a public issue.

6. 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.

7. 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 2013

Section 230 – Power to compromise or make arrangements with creditors and members.

Section 230 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.

Scope of Section 230

Section 230 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.

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.

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

Where a company or a creditor or a member of the 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, or where the company is being wound up, the liquidator may make an application to the Tribunal. On such application, the Tribunal 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 Tribunal may direct.

The key words and expressions under sub-section are ‘creditors’, ‘Tribunal’, ‘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 230 to the Tribunal 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) – Disclosures to the Tribunal by applicant under sub-section 1:

Sub-section (2) provides that the company or any other person, who makes an application as provided under sub-section (1) shall disclose by affidavit to the Tribunal:

(a) 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 and the pendency of any investigation or proceedings against the company;

(b) reduction of share capital of the company, if any, included in the compromise or arrangement;

(c) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent. of the secured creditors in value, including—

(i) a creditor's responsibility statement in the prescribed form;

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(v) a valuation report in respect of the shares and the property Corporate Restructuring & Insolvency 3 and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

What is the disclosure requirement under Section 230(2)?

Material facts including latest financial position of company, latest auditor's report and pending proceedings, if any

Reduction of share capital, if any

Any scheme of corporate debt restructuring, consent to by 3/4th majority of secured creditors

Sub-section (3) –Notice of the meeting.

Notice of the meeting called in pursuant to the order of the tribunal shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by

1. a statement disclosing the details of the compromise or arrangement,

2. a copy of the valuation report, if any, and

3. explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture holders and

4. the effect of the compromise or arrangement on any material interests of the directors of the

company or the debenture trustees, and

5. such other matters as may be prescribed:

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed: When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

Sub-section (4) – Notice to provide for voting by themselves or through proxy or through postal ballot

Subsection (4) states that a notice under sub-section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice:

Sub-section (5) – Notice to be sent to the regulators seeking their representations

Section 230(5) states that a notice under sub-section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals

Sub-section (6): Approval and sanction of the scheme

Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company

Sub-section (7): Order of the tribunal sanctioning the scheme to provide for the Certain matters

An order made by the Tribunal shall provide for all or any of the following matters, namely:

(a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

(b) the protection of any class of creditors;

(c) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;

(d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

(e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Sub-Section (8): Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

Sub-section (9): The Tribunal may dispense with calling of meeting of creditors

Section 230(9) states that the Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

Sub-section (10):

Compromise in respect of buy back is to be in compliance with section 68 As per Section 230(10), no compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

Sub-section (11):

Section 230(11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board. This sub-section is not yet notified.

Section 231 – Power of the tribunal to enforce compromise or arrangement

As per section 231(1) when the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

(a) shall have power to supervise the implementation of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

Sub-section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding up the company and such an order shall be deemed to be an order made under section 273.

Section 232 – Merger and amalgamation of companies

Sub-section (1): Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies

Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal— (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and (b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies, the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply mutatis mutandis

Sub-section (2) Circulation of documents for members/creditors meeting

Section 232(2) states that when an order has been made by the Tribunal under sub-section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:

(a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;

(b) confirmation that a copy of the draft scheme has been filed with the Registrar;

(c) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promotors and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

(d) the report of the expert with regard to valuation, if any;

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

Sub-section (3): Sanctioning of scheme by tribunal

Section 232(3) states that the Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

(a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;

(b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

No transferee company can hold shares in its own name or under any trust

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

(c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer;

(d) dissolution, without winding-up, of any transferor company;

(e) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;

(f) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;

(g) the transfer of the employees of the transferor company to the transferee company;

(h) when the transferor company is a listed company and the transferee company is an unlisted company,—

(A) the transferee company shall remain an unlisted company until it becomes a listed company;

(B) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal: The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

(i) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

(j) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out:

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Sub-section (4) Transfer of property or liabilities

Sub-section (4) stares that an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect

Sub-section (5): Certified copy of the order to be filed with the registrar

Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order

Sub Section (6): Effective date of the scheme.

Section 232(6) states that the scheme under this section shall clearly indicate an appointed date from

which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

Sub-section (7): Annual statement certified by CA/CS/CWA to be filed with registrar every year until the completion of the scheme.

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

Sub-section (8): Punishment

Section 232(8) states that if a transferor company or a transferee company contravenes the provisions of this section, the transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

In case of Government Company - Sections 230-232 for the word "Tribunal" the words "Central Government" shall be substituted.

Section 233 – Merger or amalgamation of certain companies

Section 233 prescribes simplified procedure for Merger or amalgamation of

- two or more small companies or
- between a holding company and its wholly-owned subsidiary company or
- such other class or classes of companies as may be prescribed;

Sub-section (1)

Accordingly sub-section (1) of Section 233 states that notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:—

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent. of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

Sub-section (2)

The sub-section states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

Sub-section (3): Central Government to issue confirmation order, where there are no objections or suggestions from registrar or official liquidator.

Section 233(3) states that on the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

Sub-section (4): Objections if any by the registrar or official liquidator to be communicated to the central government.

Section 233(4) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

Sub-section (5): Application by Central Government to the Tribunal.

Section 233(5) states that if the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

Sub-section (6): Tribunal's Action to Central Government's application

Section 233(6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit: If the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

Sub-section (7): Registrar having jurisdiction over transferee company has to be communicated

Section 233(7) states that a copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

Sub-section (8): Effect of Registration of the scheme

Sub-Section (8) states that the registration of the scheme under subsection (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding up.

Sub-section (9):

This sub-section states that the registration of the scheme shall have the following effects, namely:—

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

(d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

Sub-section (10): Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished

Section 233 (10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

Sub-section (11): Transferee Company to file an application with Registrar along with the scheme registered

Section 233(11) The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 contains the procedure for Merger or Amalgamation of certain companies envisaged under section 233.

Section 234: Merger or amalgamation of a Company with a foreign company

Section 234(1) states that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

Section 234(2) Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose. For the purposes of sub-section (2), the expression “foreign company” means any company or body corporate incorporated outside India whether having a place of business in India or not.

Rule 25A inserted in the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 provides the procedure for Merger or amalgamation of a foreign company with a company and vice versa.

25A. Merger or amalgamation of a foreign company with a Company and vice versa.—(1) A foreign company incorporated outside India may merge with an Indian company after obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and these rules.

(2) (a) A company may merge with a foreign company incorporated in any of the jurisdictions specified in Annexure B after obtaining prior approval of the Reserve Bank of India and after complying with provisions of sections 230 to 232 of the Act and these rules.

(b) The transferee company shall ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to Reserve Bank of India for obtaining its approval under clause (a) of this sub-rule.

(3) The concerned company shall file an application before the Tribunal as per provisions of section 230 to section 232 of the Act and these rules after obtaining approvals specified in sub-rule (1) and sub-rule (2), as the case may be.

Explanation 1.—For the purposes of this rule the term “company” means a company as defined in clause (20) of section 2 of the Act and the term “foreign company” means a company or body corporate incorporated outside India whether having a place of business in India or not:

Explanation 2.— For the purposes of this rule, it is clarified that no amendment shall be made in this rule without consultation of the Reserve Bank of India.”

Jurisdictions referred to in clause (a) of sub-rule (2) of rule 25A :

(i) whose securities market regulator is a signatory to International Organization of Securities Commission’s Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with SEBI, or

(ii) whose central bank is a member of Bank for International Settlements (BIS), and

(iii) a jurisdiction, which is not identified in the public statement of Financial Action Task Force (FATF) as:

(a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

(b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.”.

Foreign Exchange Management (Cross Border Merger) Regulations, 2018

RBI has issued the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 under the Foreign Exchange Management Act, 1999 on March 20, 2018 to make provisions for mergers, demergers, amalgamations and arrangements between Indian companies and foreign companies (the "Cross Border Regulations").

The Cross Border Regulations

In order to operationalize Section 234 of the Act, the RBI issued Cross Border Regulations in order to make provisions for the acquisition or transfer of any security or asset or debt by an Indian resident or non-resident in a cross border merger, demerger, amalgamation, or rearrangement. The Cross Border Regulations stipulate conditions that should be adhered to by companies involved in a scheme of merger, demerger, amalgamation, or rearrangement.

Valuation

The valuation of the Indian company and the foreign company shall be done in accordance with Rule 25A of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016. A valuer (who must be a member of a recognized professional body in the outbound jurisdiction) must conduct the valuation of the merged entity. Further, such valuation must be in accordance with internationally accepted principals on accounting and valuation and a declaration to this effect is required to be attached with the application made to the RBI seeking approval form the merger.

Prior Approval from the RBI

The National Company Law Tribunal will consider the merger application to give effect to the merger *only* after the company concerned has obtained an approval from the RBI and complied with the provisions of Sections 230 to 232 of the Act and the Rules.

Sections 230 to 232 of the Act sets out the procedural requirements which need to be complied with by the merged entity before a scheme of merger is sanctioned by the National Company Law Tribunal such as the manner of calling a meeting of the creditors, members or debenture holders of the merged entity to obtain their vote to the adoption of the scheme of merger, the details of the information needed to be made available to creditors, members and debenture holders of the merged entity and various governmental authorities such as the RBI, the Securities Exchange Board of India, the Competition Commission of India and such other regulators that may be applicable for making an informed decision in relation to the proposed scheme of merger.

Inbound Mergers

In the context of inbound mergers, the Cross Border Regulations stipulate the following:

(a) Any issue or transfer of security to a non-resident by the resultant Indian Company shall be in accordance with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.

(b) An office outside India of the foreign company, pursuant to the sanction of the Scheme of cross border merger shall be deemed to be the branch/office outside India of the resultant company in accordance with the Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015. Accordingly, the resultant company may undertake any transaction as permitted to a branch/office under the aforesaid Regulations.

(c) The guarantees or outstanding borrowings of the foreign company from overseas sources which become the borrowing of the resultant company or any borrowing from overseas sources entering into the books of resultant company shall conform, within a period of two years, to the External Commercial Borrowing norms or Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 or Foreign Exchange Management (Borrowing or Lending in Rupees) Regulations, 2000 or Foreign Exchange Management (Guarantee) Regulations, 2000, as applicable. Provided that no remittance for repayment of such liability is made from India within such period of two years;
Provided further that the conditions with respect to end use shall not apply.

(d) The resultant company may acquire and hold any asset outside India which an Indian company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

(e) Where the asset or security outside India is not permitted to be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.

(f) The resultant company may open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross border merger for a maximum period of two years from the date of sanction of the Scheme by NCLT.

Outbound mergers

In the context of outbound mergers, the Cross Border Regulations stipulate the following:

1) a person resident in India may acquire or hold securities of the resultant company in accordance with the Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2004.

(2) a resident individual may acquire securities outside India provided that the fair market value of such securities is within the limits prescribed under the Liberalized Remittance Scheme laid down in the Act or rules or regulations framed thereunder.

(3) An office in India of the Indian company, pursuant to sanction of the Scheme of cross border merger, may be deemed to be a branch office in India of the resultant company in accordance with the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. Accordingly, the resultant company may undertake any transaction as permitted to a branch office under the aforesaid Regulations.

(4) The guarantees or outstanding borrowings of the Indian company which become the liabilities of the resultant company shall be repaid as per the Scheme sanctioned by the NCLT in terms of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

Provided that the resultant company shall not acquire any liability payable towards a lender in India in Rupees which is not in conformity with the Act or rules or regulations framed thereunder.

Provided further that a no-objection certificate to this effect should be obtained from the lenders in India of the Indian company.

(5) The resultant company may acquire and hold any asset in India which a foreign company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

(6) Where the asset or security in India cannot be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated outside India immediately through banking channels. Repayment of Indian liabilities from sale proceeds of such assets or securities within the period of two years shall be permissible.

(7) The resultant company may open a Special Non-Resident Rupee Account (SNRR Account) in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 for the purpose of putting through transactions under these Regulations. The account shall run for a maximum period of two years from the date of sanction of the Scheme by NCLT.

Reporting requirements

Cross border merger transactions are required to be reported to the RBI in the same manner required under the Foreign Exchange Management Act, 1999, rules or regulations (including the filing of Form FC-TRS, Form FC-GPR and Form ECB). The Indian company and the foreign company involved in the cross border merger are also required to provide reports as may be prescribed by the RBI from time to time.

Deemed approval

Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.

A certificate from the Managing Director/Whole Time Director and Company Secretary, if available, of the company (ies) concerned ensuring compliance to these Regulations shall be furnished along with the application made to the NCLT under the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

Section 235: Power to acquire shares of shareholders dissenting from scheme or contract approved by majority

Section 235 of the Companies Act 2013 prescribes the manner of acquisition of shares of shareholders dissenting from the scheme or contract approved by the majority shareholders holding not less than nine tenth in value of the shares, whose transfer is involved. It includes notice to dissenting shareholders, application to dissenting shareholders to tribunal, deposit of consideration received by the transferor company in a separate bank account etc.,

Section 236: Purchase of minority shareholding

Section 236 prescribes the manner of notification by the acquirer (majority) to the company, offer to minority for burying their shares, deposit an amount equal to the value of shares to be acquired, valuation of shares by registered valuer, etc.,

Section 237: Power of Central Government to provide for amalgamation of companies in public interest

Sub-section (1): Power of Central Government to provide for amalgamation of Companies

Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

Continuation of legal proceedings.

Section 237 (2) states that the order under sub-section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

Interest or rights of members, creditors, debenture holders not to be affected.

As per Section 237(3), every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

Sub-section 4: Appeal to tribunal

As per Section 237 (4) Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

Sub-section 5: Conditions for order

As per Section 237 (5) No order shall be made under this section unless—

(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 (4) 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 it may deem fit in the light of 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.

Sub-section 6:

As per Section 237 (6) the copies of every order made under this section shall, as soon as may be after

it has been made, be laid before each House of Parliament.

Section 238: Registration of offer of schemes involving transfer of shares

Section 238(1) states that in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235,— (a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed; (b) every such 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; and (c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered: Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application. Section 238(2) states that an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under subsection (1). Section 238(3) states that the director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be liable to a penalty of one lakh rupees.

Section 239: Preservation of books and papers of amalgamated company

As per section 239, the books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

Section 240: Liability of officers in respect of offences committed prior to merger, amalgamation, etc.

As per Section 240, notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

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 Tribunal, 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 Tribunal's sanction. Without that the Tribunal cannot proceed. This approval is to be obtained at specially convened meetings held as per Tribunal's directions [Section 230(1)]. However, the Tribunal may dispense with meetings of members/creditors [Section 230(9)].

The scheme of compromise or arrangement has to be approved as directed by the Tribunal, 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 the Tribunal directions. An application seeking directions to call, hold and conduct meetings is made to the Tribunal, which has jurisdiction having regard to the location of the registered office of the company.

Following are some of the precedents under the relevant provisions of Companies Act, 1956. Since the 1956 Act has been replaced by the 2013 Act, the National Company Law Tribunal ("NCLT" or "Tribunal") is the relevant Authority under the 2013 Act, in place of the respective High Courts.

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 230(6), 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 230(6)]. 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.

Following are some of the precedents under the Companies Act, 1956. Since the *1956 Act has been replaced by the 2013 Act, section providing for such approval is different.*

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.

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 Karnatka 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:- Regulation 37 of the SEBI (LODR) Regulations, 2015

The listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before any Court or Tribunal under Sections 230- 234 and Section 66 of Companies Act, 2013, with the stock exchange(s) for obtaining Observation Letter or No-objection letter, before filing such scheme with the Tribunal,

(2)The listed entity shall not file any scheme of arrangement under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, with Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

(3)The listed entity shall place the Observation letter or No-objection letter of the stock exchange(s) before the Court or Tribunal at the time of seeking approval of the scheme of arrangement:

Provided that the validity of the Observation Letter‘ or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Tribunal.

(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 Tribunal

- 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 Tribunal for sanctioning the scheme.
- Every amalgamation, except those, which involve sick industrial companies, requires sanction of Tribunal 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 Tribunal has to be given to the Central Government (Regional Director, having jurisdiction of the State concerned).

— After the hearing is over, the Tribunal 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 230; Rule 5, Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.].

The court under Section 230-234 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.

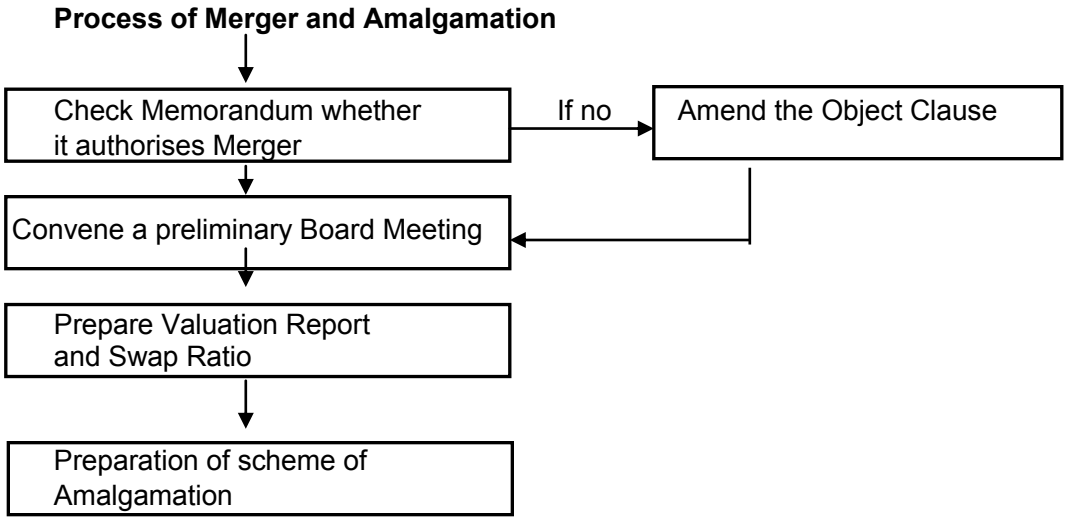
(vii) Approval of Reserve Bank of India

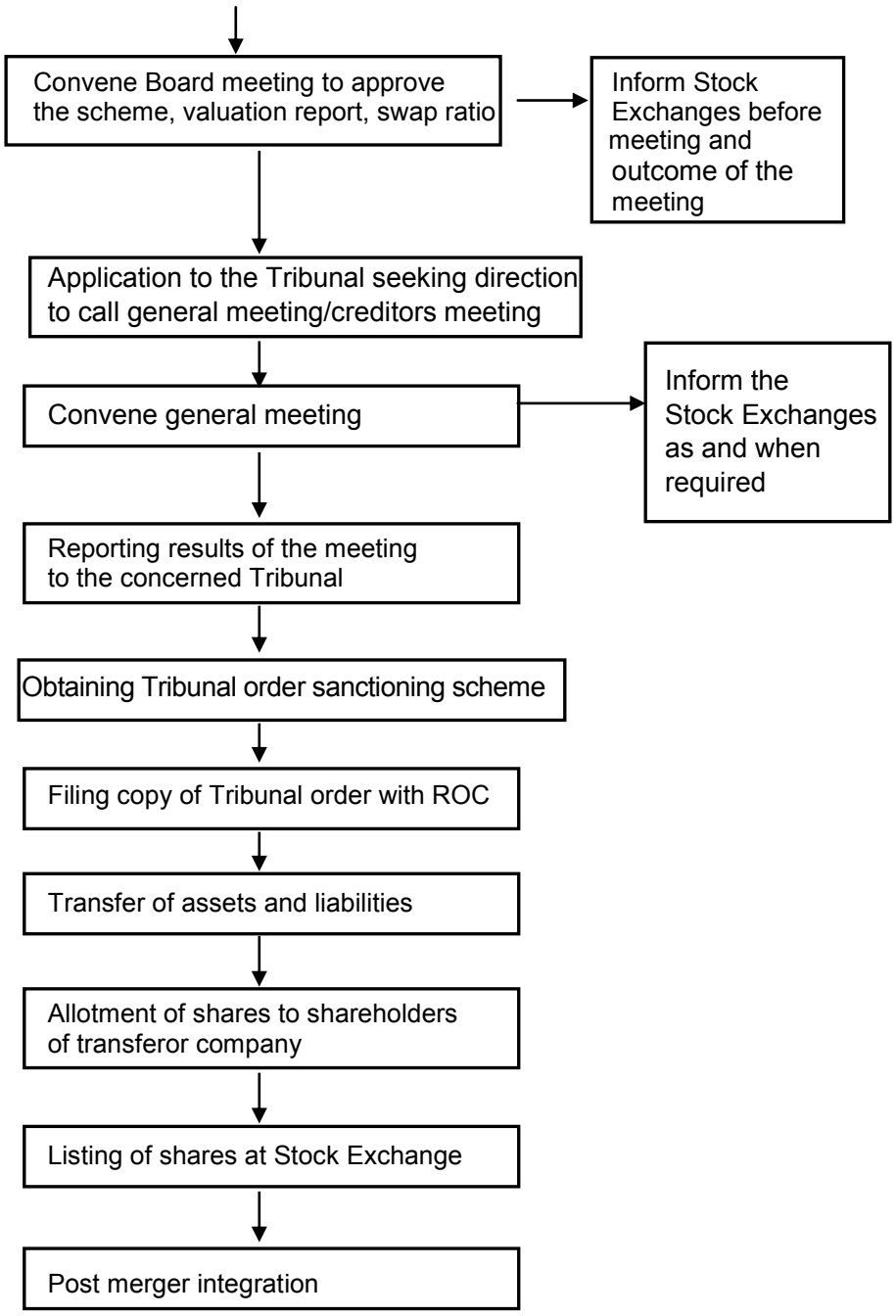
Where the scheme of amalgamation envisages issue of shares/cash option to Non-Resident Indians, the amalgamated company is required to obtain the permission of Reserve Bank of India subject to conditions prescribed under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident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

(viii) Approvals from Competition Commission of India (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 - 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 Tribunal's order sanctioning the scheme of compromise or arrangement is contained in Sections 230 to 240 of the Companies Act, 2013 and rules 3-29 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The Rules also prescribe Forms for various purposes relating to compromise or arrangement:

The following is 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 and file along with a certified copy of the special resolution along with copy of explanatory statement 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.

Following are some of the precedents under the Companies Act, 1956. Since the *1956 Act has been replaced by the 2013 Act, sections referred to in these precedents shall differ*.

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 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(2A) 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. [Section 11 of Companies Act, 2013 dealing with commencement of business is deleted vide Companies (Amendment) Act, 2015.]

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 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:

- *Appointed Date or 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, i.e., date of filing of High Court order with ROC.

- 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 230 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 Regulation 37 of LODR Regulation, all listed companies shall have to obtain NOC from the Stock Exchange before filing of any scheme/petition proposed to be filed before Tribunal under Sections 230, 232 and 66 of Companies Act, 2013.

Application to Tribunal seeking direction to hold meetings

Rule 3 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 lays down that an application under Section 230 of the Companies Act, 2013 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.

Jurisdiction of Tribunal

Following are the provisions under the Companies Act, 1956. Since the 1956 Act has been replaced by the 2013 Act, sections referred to herein shall differ. The NCLT/Tribunal is now the relevant authority (replacing the relevant High Court) constituted under Section 408 of the 2013 Act.

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 NCLT under Section 230 of the Companies Act, 2013 in accordance with the provisions of rule 3 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 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 230 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 230(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 may 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 3(3) lays down that where the company is not the applicant, a copy of the notice of admission 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 notice of admission.

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 232 of the Act for facilitating the reconstruction or amalgamation of the company or companies.

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

On receiving a petition, the Tribunal 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 Tribunal is bound to sanction the scheme.

The Tribunal 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 Tribunal may refuse to pass order for the convening of the meeting.

According to Rule 5 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016., upon hearing the application under sub-section (1) of section 230 of the Act, the Tribunal shall, 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.

Draft Notice, Explanatory statement under Section 230 of the Companies Act, 2013 and form of proxy are required to be filed and settled by the concerned Tribunal before they can be printed and dispatched to the shareholders.

After obtaining the Tribunal'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. CAA-2 of the said Rules and must be sent by the person authorised by the Tribunal in this behalf. The person authorised may be the person appointed by the court as chairman of the meeting, or if the Tribunal 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 Tribunal 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 230 setting forth the terms of the proposed compromise or arrangement explaining its effects and an explanatory statement in terms of the provision of 230(3)of the Companies Act.

Notice by advertisement

Generally, the Tribunal directs that the notice of meeting of the creditors and members or any class of them be given through newspapers advertisements also. Where the Tribunal 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 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 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. The Chairman appointed by the Tribunal has to file an affidavit at least 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 12 of the said Rules.

Information as to merger or amalgamation

Section 230(3) of the Companies Act, 2013 lays down that where a meeting of creditors or members or any class of them is called under Section 230(1):

a notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by a statement disclosing the details of the compromise or arrangement, a copy of the valuation report, if any, and explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and such other matters as may be prescribed:

Provided that such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed:

Provided further that where the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

Holding meeting(s) as per Tribunal's direction

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

Convening of General Meeting

— At the General Meeting convened by the Tribunal, 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, consequent change in Articles and issue of shares can be convened on the same day either before or after conclusion of the meeting convened by the Tribunal for the purpose of approving the amalgamation.

— Following points of difference relating to the holding and conducting of the meeting convened by the Tribunal 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 13 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

In terms of Section 230(1), 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 Tribunal in Form No. CAA-4 of the said Rules within the time fixed by the Tribunal, or where no time has been fixed, within three days after the conclusion of the meeting. 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 Tribunal for confirmation of scheme

When the proposed scheme of compromise or arrangement is agreed to, with or without modifications, as provided in Section 230 of the Act, a petition must be made to the Tribunal 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. CAA-5 of the said rules. On hearing the petition the Tribunal 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 Tribunal may direct, not less than 10 days before the date fixed for hearing. (Rule 16) The Tribunal also directs that notices of petition be sent to the objectors or to their representatives under sub-section (4) of section 230 of the Act and to the Central Government and other authorities who have made

representation under rule 8 and have desired to be heard in their representation.

Obtaining order of the court sanctioning the scheme

An order of the Tribunal on summons for directions should be obtained which will be in Form No. CAA. 6 (Refer Rule 17).

Filing of copy of Court's order with ROC

According to the provisions of Section 230(8) 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 INC-28 as prescribed in the Companies Act, 2013.

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

The Tribunal 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 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 Tribunal 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 Tribunal 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. [High Court has been replaced by the Tribunal under the 2013 Act.]

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. [High Court has been replaced by the Tribunal under the 2013 Act.]

JUDICIAL PRONOUNCEMENTS

Following are some of the precedents under the relevant provisions of Companies Act, 1956. Since the 1956 Act has been replaced by the 2013 Act, the procedure under the 2013 Act shall apply. However, the reasoning and jurisprudence around mergers and amalgamations developed by the Courts over the years, shall broadly remain the same.

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, 1956 [*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)]*

— 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 on 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.

The scheme of amalgamation of the subsidiary company with the holding transferee company provided transfer of all assets and liabilities of the subsidiary transferor company to the holding transferee company and such transfer did not affect the rights of its members or creditors and also did not involve reorganization of the share capital of the transferee company. As the structure of the transferee company would remain unaltered. As such there was no requirement for the holding transferee company to initiate separate proceedings and make separate application under s. 391 or s.394. *Reliance Jamnagar Infrastructure Ltd., In re.,* [2012] 475:[2013] 176 Com Cases 217:[2013] 112 CLA 234 (Guj).

A scheme was proposed only with a view to dispose off the assets of the company and to relieve the promoters and ex-directors of the company from their personal liabilities. The court refused sanction. *Apurva J. Parekh v. Essen Computers Ltd.,* 2005 CLC 774 : (2006) 3 Comp LJ 321 : (2005) 61 SCL 254 : (2005) 68 CLA 29 (Guj).

In cases where the scheme of arrangement involves the company and one class of creditors, the wishes of the other classes of creditors, more particularly public sector/scheduled banks must be ascertained to ensure that their interest is not adverse affected. Neither any meetings were held nor was 'no objection' letters or consent letters sought. The scheme is but a ruse to avoid repayment of the

dues of the creditors of both the petitioner companies and was filed to obtain an order of stay from this court under s.391(6) and therefore against public policy. The court is not expected to put its seal of approval on the scheme merely because the majority of the shareholders have voted in favour of the scheme. *Model Financial Corporation Ltd. v. A.P. Mahesh Co-operative Urban Bank Ltd.* (2013) 176 Com Cases 264:[2013] 113 CLA 19 (AP).

A company was ordered to be wound up for having closed its business due to heavy financial losses. The petitioner was an ex-director of the company. He filed a petition seeking sanction of a scheme of compromise for its revival and repayment of a part of dues of creditors in a phased manner. The scheme was objected to by major creditors. The court said that it can refuse to put its seal of approval, where there is no *bona fide* purpose behind the scheme and is intended to cover up misdeeds of ex-directors or is otherwise inequitable. The scheme had unworkable and unacceptable ideas like zero per cent debentures and refund one per cent to some creditors and 20% to some others. *Apurva J. Parekh v. Essen Computers Ltd., (*2005) 61 SCL 254 : (2006) 129 Com Cases 121 (Guj).

A scheme of arrangement that envisages re-aligning of existing reserves of shareholders, being equity premium reserve accounts, to business reconstructions reserve account and to re-evaluate immovable property of company deserves to be sanctioned when all shareholders have consented to it, the revaluation is in the interest of shareholders, creditors, employees and all stakeholders and there is no objection to the scheme from the Regional Director. *DSM Anti Infectives India Ltd. In re:,* (2011) 100 CLA 228 (P&H).

INFRASTRUCTURE LEASING & FINANCIAL SERVICES LTD v. B.P.L. LTD [SC] (09/01/2015**)**

Facts:

The appellant is the one of the secured creditors of the respondent company. The respondent company had executed a hypothecation deed in favour of the appellant and had also registered the charge with the registrar of companies. During the course, an arbitration award was passed in favour of the appellant. Meanwhile, the Respondent Company proposed a scheme of arrangement where under the existing CTV business undertaking of the respondent would be transferred to a new joint venture company.

The scheme was approved by the shareholders and the creditors of the respondent company. The appellant herein opposed the scheme and contented that it is not a secured creditor of the respondent company as the passing of the arbitration award had robed the security created in its favour and rendered it a mere unsecured creditor. However, the company court rejected the contention and passed the scheme. On appeal the DB also concurred with the company court. Against this order of the DB, the appellant appealed to the Supreme Court.

Decision:

The appeal was dismissed. It is clear that two facts are beyond dispute. First, the appellant stands registered as a secured creditor of the respondent company on the record of the Registrar of Companies under the Act;

Second, the arbitral tribunal has passed an award on the basis of consent and it has the status of a decree which is executable in law.

The purpose of the classification of creditors has its significance. It is with this object that when a class has to be restricted, the principle has to be founded on homogeneity and commonality of interest

The contention of the appellant is that it does not fall into the class of secured creditors, for it had

initiated the arbitration proceeding and an award has been passed on consent which is a simple money decree and, therefore, the deed of hypothecation, even if assumed to be executed at one point of time, has become irrelevant. To elaborate, the status of the appellant had changed from a secured creditor to that of an unsecured creditor. The principles of Order II, Rule 2, C.P.C. would be applicable as the appellant would be debarred to issue on the basis of the charge of hypothecation.

Emphasis has been laid on the factum that there having been a change of status, the appellant company cannot be clubbed with the secured creditors as a class and even if it is kept in homogenous category of secured creditors, it should still fall under a separate class, regard being had to the fact it has obtained an award from the arbitral tribunal. In this context, it is to be seen that whether the arbitration award has the effect of obliterating or nullifying the status of the appellant and making him an unsecured creditor as a consequence of which it would not be able to sue on the basis of a charge created in its favour.

The issue that the appellant shall remain as a secured creditor, for it was registered as such under the Registrar of Companies: The formalities for creating the charge having duly followed, the Division Bench has referred to the Form No. 8 and 13 and also adverted to the power of Registrar to make entries of satisfaction and release, as provided under Sections 138 and 139 of the Companies Act, 1956. It has also expressed the view that in the absence of any proceeding, the status of the company as a secured creditor continues. After registration of the deed of hypothecation, if a condition subsequent is not satisfied, that would be in a different realm altogether. In any case, the finding has been recorded that the respondent was not at fault and, in any case, that would not change the status of the appellant as a secured creditor.

Thus, the appellant cannot be treated as an unsecured creditor and it is not permissible for him to put forth a stand that it would not be bound by the Scheme that has been approved by the learned Company Judge.

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 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 for alteration of its articles is passed;

   (c) a special resolution 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 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. 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. 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. 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.
3. 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.
4. The transferee company is required to file with the Registrar of Companies, **INC-28** along with a certified copy of the Tribunal's order on summons directing the convening and holding of meetings of equity shareholders/creditors including debentures holders etc. as required under Section 230 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 while filing **INC-28**, failing which the filing will not be considered and legal action will be taken.
5. 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.
6. 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.
7. To file with ROC within thirty days of passing of the special resolution, 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. 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.
8. The transferee company is required to file with the Central Government notice of every application made to the Tribunal under Section 230 to 240 of the Companies Act, 2013. No notice need be given to the Central Government once again when the Court proceeds to pass final order to dissolve the transferor company.
9. 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, the return of allotment along with the prescribed filing fee as per

requirements 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.

Changes to the regime of mergers and amalgamations under the Companies Act, 2013 and Rules thereunder:

Process of Making application: An application under section 230 (1) of the Act for compromise, arrangements or amalgamation may be made before the Tribunal in Form NCLT-1 as provided in the NCLT Rules, 2016.

The same shall be accompanied by the following:

a. A notice of admission in Form No. NCLT-2;
b. An affidavit in Form No. NCLT-6;
c. A copy of scheme of compromise or arrangement; and
d. Such fees as prescribed in the Schedule of fees.

Mode of sending notice: The notice shall be sent by the Chairperson appointed for the meeting, or, if the Tribunal so directs, by the company (or its liquidator), or any other person as the Tribunal may direct, by registered post or speed post or by courier or by email or by hand delivery or any other mode as directed by the Tribunal to their last known address at least one month before the date fixed for the meeting.

Dispensation from the meeting: If 90% by value of creditors/members agree by way of affidavit then meeting of creditors/members can be dispensed with by the NCLT

Manner of voting: Voting in person or by proxy or by postal ballot or by voting through electronic means are permitted.

Notice to statutory authorities: Notice of the meeting shall also be served to the CG, IT authority, RBI, Stock exchanges, CCI, SEBI as may be applicable and to such other regulators as may be directed by the Tribunal. Further, such statutory authorities can also make their representation by sending notice to the Tribunal and to the company within 30 days of receiving the notice.

Time limit within which order sanctioning petition to be filed: Order of NCLT to be filed with RoC within 30 days of receipt of the order. However, that the order shall have no effect until filed, is not provided.

Brief Pointers on changes in provisions relating to merger and amalgamation under Companies Act, 2013:

1. Dispensation from holding shareholders meeting.
2. Notification to be sent to multiple Authorities.
3. Approval of the Scheme through postal ballot.
4. Valuation Report must be annexed to the notice for meetings under section 232(2) of the Companies Act, 2013.
5. Accounting Standards prior certification from an auditor mandatory for both listed and unlisted companies stating that accounting treatment is in accordance with Accounting Standards.

6. Merger of a listed company into an unlisted one under Section 232(3)(h) of the Companies Act, 2013.
7. Merger or Amalgamation of Company with Foreign Company (Cross-border mergers) under section 234 of the Companies Act, 2013.
8. Penalties have been made more severe under 232 (8) of the Companies Act, 2013.
9. Fast Track Merger and Merger of "small companies" and holding with wholly-owned subsidiaries under Section 233 of the Companies Act, 2013.
10. Restriction on the maintenance of the treasury stock under Section 233(10) of the Companies Act, 2013.
11. For compromise or arrangement in respect of buy back of securities to be valid, buy-back of securities must be in accordance with section 68 of the Companies Act, 2013.
12. Compromise or arrangement can include takeover offer provided takeover offer is as per SEBI Regulations made in this behalf.
13. Objections can be made by shareholders holding a minimum of ten per cent of the shareholding or creditors having outstanding debt amounting to five per cent or more of the total outstanding debt, as per the latest audited financial statement as per the proviso to section 230(4) of the Companies Act, 2013.
14. Compliance with order of Tribunal till the completion of the scheme under Section 232(7).

LESSON ROUND UP

- 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.
- While implementing the strategic decision of merger/amalgamation, the transferor/transferee company has to comply with a number of regulations viz., the Companies Act, 2013, Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. , Income Tax Act, 1961, The Indian Stamp Act, 1899, The Competition Act, 2002 etc.,
- Section 230 is relating to the power of the company to compromise or to make arrangement with its creditors and members.
- Section 230(2) deals with regard to information as to compromises and arrangements with creditors and members.
- Section 232 deals with facilitation of merger and amalgamation of companies.
- Section 230(5) deals with a notice to be given to the Central Government in respect of applications under Section 391 and 394.
- Sections 235-236 deal with provisions regarding the power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority shareholders.
- Section 237 contains provisions as to the power of the central government to provide for amalgamation of companies in national interest.

- Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 contains provisions dealing with the procedure for carrying out a scheme of compromise or arrangement including amalgamation or reconstruction.
- Mergers involves approvals from Board of Directors, Shareholders, Court, Stock Exchanges etc.,
- Mergers involves filing of various forms with different regulators.

SELF TEST QUESTIONS

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

1. Briefly describe the legal framework for mergers?
2. What are the approvals required in merger?
3. What are the procedural steps involved in a merger?
4. Discuss the role of Tribunal in approving a scheme of reconstruction or restructuring under Sections 230-240 of the Companies Act, based on decided cases from the standpoint of shareholders and employees.
5. 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, 2013 and the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 whether such a joint-petition can be filed.
6. 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.

Lesson 3
Economic and Competition Law Aspects of Mergers and Amalgamations

LESSON OUTLINE

- Reason for mergers and amalgamations
- Underlying economic objectives in mergers
- Competition aspects of combinations
- Combination thresholds
- Regulation of combinations
- Compulsory wait period
- Exemptions
- Inquiry into combination by the Commission

LEARNING OBJECTIVES

As the countries are getting integrated into one global platform, the businesses across the jurisdictions are also competing on the flat platform, providing multiple choices to consumers and calling for highest quality of output supported by innovation and technology. The paradigm requires the corporates to possess multiple expertise, through business restructuring. Mergers, acquisitions and takeovers are widely accepted business strategies in the global platform. The economic reasons behind such strategies may be increased market share, cost reduction, managing competition, financial/tax benefits, increased economies of scale etc.,

Further the competition law being an economic legislation regulates merger (called combinations) deals with threshold limits (domestic/cross border), notice to Competition Commission of India etc.

After reading this lesson, you will be able to understand, the economic aspects of merger and the important regulatory aspects of combinations as specified in the Competition Act, 2002.

ECONOMIC ASPECTS

Reasons for Merger and Amalgamation

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

Mergers and amalgamations are usually intended to achieve any 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 later 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 position.

(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 reasons for merger is to improve the economies of scale. Economies of scale may be obtained 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 resources and planning, budgeting, reporting and control. A combined business 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 companies may result in reduction of costs due to operating economies. A combined company may avoid overlapping of functions and facilities. Various functions may be consolidated and duplicate channels may be eliminated by implementing an integrated planning and control system.

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 company may borrow at a lower rate of interest. Apart from this, a merged company 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 company 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 receive encouraging response from customers or consumers. In such a situation 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 on 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. However, in 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.

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 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 entity 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 enables the amalgamated entity to achieve substantial savings on costs and 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 on 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. One of the most important reasons for mergers and amalgamations is to realize synergy; either through cost effective production bases or by cost savings and pooling of resources in R&D marketing and distribution.

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 later.

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 later.

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:

Category		*Motives*
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. In mergers business enterprises achieve what could be termed as a buy out of the competitor'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.

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. However, there has been 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 were established members of the Global Fortune 500 index. They were the 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. The study has identified seven key factors to have 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. The study identified that companies also made acquisitions to access new markets, products, technologies, customers and talent at an accelerated pace.

COMPETITION ASPECTS OF COMBINATIONS

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

Based on the recommendations of the Raghavan Committee, the Competition Bill, 2000 was introduced in Parliament which was later enacted as the Competition Act, 2002.

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 interest of consumers and to ensure freedom of trade carried on by other participants in market, 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 business, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds 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.

Combinations – Thresholds

On March 4, 2016, the Central Government issued notifications pertaining to the statutory thresholds for the purposes of "combinations" under Section 5 of the Competition Act, 2002 ("Act").

1. ***Increase in thresholds:*** Pursuant to Notification No.S.O.675(E) dated March 4, 2016, the value of assets and the value of turnover has been enhanced by 100% for the purposes of Section 5 of the Act. Accordingly, the revised thresholds for notification to the Competition Commission of India ("Commission") are:

THRESHOLDS FOR FILING NOTICE				
		Assets		**Turnover**
Enterprise Level	**India**	> INR 2000 crore	**OR**	> INR 6000 crore
	Worldwide with India leg	>USD 1 bn With at least INR 1000 crore in India		>USD 3 bn With at least INR 3000 crore in India

OR				
Group Level	**India**	> INR 8000 crore	**OR**	> INR 24000 crore
	Worldwide with India leg	>USD 4 bn With at least INR 1000 crore in India		>USD 12 bn With at least INR 3000 crore in India

2. ***Thresholds of De Minimis Exemption:*** The Central Government, vide notification S.O. 988(E) dated 27th March, 2017, in public interest, exempts the enterprises being parties to —

(a) any acquisition referred to in clause (a) of section 5 of the Competition Act;

(b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, referred to in clause (b) of section 5 of the Competition Act; and

(c) any merger or amalgamation, referred to in clause (c) of section 5 of the Competition Act,

where the value of assets being acquired, taken control of, merged or amalgamated is not more than rupees three hundred and fifty crores in India or turnover of not more than rupees one thousand crores in India, from the provisions of section 5 of the said Act for a period of five years from the date of publication of this notification in the official gazette.

Notification No.S.O.674(E) dated March 4, 2016 stands rescind vide notification S.O. 989(E) dated 27th March, 2017 except as respects things done or omitted to be done before such rescission.

THRESHOLDS FOR AVAILING OF DE MINIMIS EXEMPTION FOR ACQUISITIONS				
		Assets		**Turnover**
Target Enterprise	**In India**	≤ INR 350 crore	**OR**	≤ INR 1000 crore

3. ***Definition of Group:*** As per Notification No.S.O.673(E) dated March 4, 2016, the exemption to the "group" exercising less than fifty per cent of voting rights in other enterprise from the provisions of Section 5 of the Act under Notification No.S.O.481(E) dated March 4, 2011, has been continued for a further period of 5 years.

The value of assets and turnover provided in the De Minimis exemption apply to the 'enterprise' whose control, shares, voting rights or assets are being acquired; and not to the value of the target assets/division/business being acquired

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).

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.

Central Government, vide notification no. S.O. 2039(E), in public interest, exempted every person or enterprise who is a party to a combination as referred to in section 5 of the said Act from giving notice within thirty days mentioned in sub-section (2) of section 6 of the said Act, subject to the provisions of sub-section (2A) of section 6 and section 43A of the said Act, for a period of five years from the date of publication of this notification in the Official Gazette.

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 or 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 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 (23FB) 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.

EXEMPTION NOTIFICATIONS UNDER COMPETITION ACT, 2002

1. The Central Government through notification dated 22 November, 2017 exempted all cases of combinations under section 5 of the Act involving the Central Public Sector Enterprises (CPSEs) operating in the Oil and Gas Sectors under the Petroleum Act, 1934 and the rules

made thereunder or under the Oilfields (Regulation and Development) Act, 1948 and the rules made thereunder, along with their wholly or partly owned subsidiaries operating in the Oil and Gas Sectors, from the application of the provisions of sections 5 and 6 of the Act, for a period of five years.

2. The Central Government through notification dated 30 August, 2017 exempted, all cases of reconstitution, transfer of the whole or any part thereof and amalgamation of nationalized banks, under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, from the application of provisions of Sections 5 and 6 of the Competition Act, 2002 for a period of ten years.

3. The Central Government through notification dated 10th August, 2017, exempted the Regional Rural Banks in respect of which the Central Government has issued a notification under sub-section (1) of section 23A of the Regional Rural Banks Act, 1976, from the application of provisions of sections 5 and 6 of the Competition Act, 2002 for a period of five years.

4. The Central Government through notification dated 29th June, 2017, exempted every person or enterprise who is a party to a combination as referred to in section 5 of the Act from giving notice within thirty days mentioned in sub-section (2) of section 6 of the Act, subject to the provisions of sub-section (2A) of section 6 and section 43A of the Act, for a period of five years.

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 moto*) 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 moto* 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 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 competition 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 yardsticks are to be taken into account irrespective of the fact whether an inquiry is instituted, on receipt of notice under section 6(2) or 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 working days from the date of receipt of the response of the parties to the combinations or the receipt of the report from Director General under section 29 (1A) whichever is later, direct the parties to the combination to publish within ten working days, the details of the combination, in such 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 45 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 provides 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 to the Commission to ensure prompt and timely conduct of the investigation. It further imposes on Commission a time limit of 45 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 working 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).

The section 6(2A) envisages that no combination shall come into effect until 210 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 is 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 section 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 not likely to, have an appreciable adverse effect on the Competition in relevant market in India, it may, approve that Combination.

(i) Where the Commission is of the opinion that the combination has, or is 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 modification shall carry out such modification within the period specified by the Commission.

(iv) Where the parties have accepted the modification, but fail to carry out 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) Where the parties to the Combination do not accept the proposed modification such parties may within 30 days of modification proposed by the Commission, submit amendment to the modification proposed by the Commission.

(vi) Where the Commission agrees with the amendment submitted by the parties, it shall, by an order approve the combination.

(vii) Where the Commission does not accept the amendment, parties shall be allowed a further period of 30 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 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(c) shall not be given effect to by the parities.

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 210 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 210 days, the period of thirty 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 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.

Extra Territorial Jurisdiction of Commission

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 demonstrate that 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 of 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.

CCI (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2018

The Competition Commission of India (CCI) notified the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2018 on 9th October 2018

Mechanism for computation of 210-day period

Under the Competition Act, 2002 (Competition Act), a notified transaction cannot be completed until the CCI gives its approval or until the expiry of 210 calendar days from the date of notification, whichever is earlier. Prior to this amendment, there was ambiguity in the manner of computation of the 210-day period, particularly whether the clock-stops during the review process are required to be excluded while counting the period of 210 days, given that there is no categorical mention of such exclusion in the Competition Act and/or the Combination Regulations. The Amendment Regulations now clarify that the period of 210 days is extendable based on the number of times a request for information is issued by the CCI. This means a longer waiting period for a "deemed approval" and could result in significant uncertainty in approval timelines.

Withdrawal and refiling of notice (Regulation 16A)

Previously, in cases where changes made to a notice (post filing) were likely to substantially affect the factors for determining appreciable adverse effect on competition, the CCI had the liberty to invalidate

the notice. Now, in case a proposed transaction undergoes a significant change, the parties can withdraw the previous notice, and refile a fresh notice. The introduction of this provision provides flexibility to the parties to decide whether to "withdraw and refile" or to simply notify the CCI of any change to the notice. However, the final decision on whether to allow the refiling vests with the CCI.

While an invalidation of the notice by the CCI does not carry any penal consequences, it is an outcome most parties wish to avoid. The CCI has been following this practice of allowing the parties to "withdraw and refile" and the Amendment Regulations seek to formalize the same.

Introduction of provision for Phase I voluntary modifications [Regulation 19(2)]

Previously, Regulation 19(2) of the Combination Regulations provided that if the CCI considers it necessary, it may ask for additional information and accept voluntary modifications, if made by the parties. However, after the substitution of Regulation 19(2) by the Amendment Regulations, the CCI may accept voluntary modifications, even when it does not deem such modifications to be necessary. Further, the previous Regulation 19(2) only provided that the CCI may accept modifications if offered by the parties but did not provide for the approval of the combination based on such modifications. However, in practice, the CCI approved the transaction after the parties proposed a modification. The substitution, therefore, is a welcome step as it has embodied the decisional practice of the CCI.

Introduction of provision for voluntary modifications before Phase II review [Regulation 25]

The introduction of the new provision allows the parties to offer modifications (prior to a formal Phase II process) immediately after the CCI has formed its *prima facie* opinion under Section 29(1) of the Competition Act, in response to the show-cause notice issued by the CCI just before initiating a Phase II investigation.

Now, the parties will not have to wait for the CCI to order modification after a long-drawn Phase II review process. As such, this would result in speedier resolution of the CCI's concerns and consequently will also result in quicker approvals. This insertion is a win-win situation for both the parties and the CCI and is consistent with the approach taken by other leading international merger authorities.

Introduction of agencies to oversee such implementation [Regulation 27]

In regulation 27, for sub-regulation (1), the following sub-regulation shall be substituted, namely:-

“(1) Where the Commission is of the opinion that the implementation of the modifications to the proposed combination needs supervision, it may appoint agencies to oversee such implementation, on such terms and conditions as may be determined by the Commission.”.

The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Amendment Regulation, 2015

The Competition Commission of India (“CCI”) vide a Notification (published in the Gazette of India) on July 01, 2015, (“the amendment”) published the “The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Amendment Regulation, 2015” , amending the existing Competition Commission of India (Procedure in regard to the transaction of business relating to combinations)Regulations, 2011(“Combination Regulations”).

To bring in more firmness, scope of the term “other document” has now been limited to a communication conveying the intention to make an acquisition to a Statutory Authority.

- Any person duly authorised by the board of directors can sign the notice. The number of copies to be filed with the commission has also been reduced.

- CCI has also revised Form I required to be filed for notifying combination to the effect that notes of the forms will be provided for guidance to the notifying parties regarding the information to be filed in the notice.
- Furthermore, to provide more transparency regarding review process, amendment provides that summary of the combination under review will be published on the CCI website. With this the stakeholders will get an opportunity to submit their comments to CCI regarding the proposed combination.
- CCI has also modified the timelines for *prima facie* opinion on appreciable adverse effects from 30 Calendar Days to 30 Working days.

LESSON ROUND UP

- The economic aspects of merger include market leadership, acquiring new product/brand name, imposing economies of scale, rationalization in production etc.
- The preamble of the Competition Act, 2002 states that this is an Act to establish a Commission to prevent anti-competitive practices, promote and sustain competition, protect the interests of the consumers and ensure freedom of trade in markets in India.
- Combination means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses, mergers and amalgamations between or amongst enterprises.
- 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 approval of the proposal relating to merger or amalgamation by the board of directors of the enterprise concerned with such merger or amalgamation, as the case may be, or execution of any agreement or other.
- Section 32 of the Competition Act, 2002 extends the extra territorial jurisdiction of the Competition Commission of India to enquiry and pass orders in accordance with the provisions of the Act in to an agreement, dominant position and regulates combinations i.e. mergers and acquisitions with a view to ensure that there is no adverse effect on competition in India.

SELF TEST QUESTIONS

1. What are the reasons for mergers?
2. Enumerate the preamble of the Competition Act, 2002.
3. Discuss about the thresholds limits of Combination.
4. Explain abut Competition Commission of India extra territorial jurisdiction.

Lesson 4
Accounting Aspects of Amalgamations

LESSON OUTLINE

- Applicability
- Types of amalgamation under AS 14
    - i. Amalgamation in the nature of merger
    - ii. Amalgamation in the nature of purchase
- Methods of accounting for amalgamations
    - i. Pooling of interest method and
    - ii. Purchase method.
- Consideration for amalgamation
- Treatment of Reserves on Amalgamation
- Goodwill on amalgamation
- Balance of profit & Loss account
- Disclosure Requirements
- Amalgamation after the Balance Sheet date

LEARNING OBJECTIVES

Accounting Standard 14 (AS 14) deals with Accounting for amalgamations. According to AS 14 amalgamation may be either in the nature of merger or in the nature of purchase. It prescribes certain conditions to be fulfilled for consideration of amalgamation in the nature of merger. It includes aspects relating to transfer of assets and liabilities, shareholders of transferor companies becoming shareholders of transferee company, consideration for amalgamation continuity of business of transferor Company(ies) etc.,

AS 14 further prescribes that amalgamation in the nature of merger should be accounted for under pooling of interest method and amalgamation in the nature of purchase should be accounted for under the purchase method. It also covers aspects such as treatment of reserves/goodwill in a scheme of amalgamation, amalgamation after the balance-sheet etc. After reading this lesson you will be able to understand the applicability of AS 14 to various strategic decisions, accounting methods, disclosure requirements etc. and the applicability and phases of implementation of the Companies (Indian Accounting Standards) Rules, 2015 notified by MCA, with special reference to INDAS 103 dealing with Business combinations.

APPLICABILITY

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.

Is AS-14 Applicable to Demerger?

Case 1 – Scheme of arrangement between Sony India Private Limited (Sony India) and Sony Software Centre Private Limited (Sony Software) with reference to transfer of software undertaking of Sony India to Sony Software

The Delhi High Court (the High Court), while approving scheme of arrangement between Sony India and Sony Software in 2012 has clarified that AS-14 (i.e., accounting standards issued by the Institute of Chartered Accountants) is applicable only to amalgamations and not to demerger. As per the scheme of arrangement, 'Software Undertaking' of Sony India is proposed to be transferred to Sony Software under Sections 391 to 394 of the Companies Act, 1956. One of the conditions of the scheme was that any excess in the value of net assets of software undertaking transferred to the resulting company shall be applicable for distribution to the shareholders of the resulting company

Regional Director of Northern Region, Ministry of Corporate has raised objection in his affidavit filed with the High Court stating that excess if any, in the value of the net assets of the software undertaking should be adjusted to the capital reserve as prescribed in AS-14 and not to the general reserve as proposed in the scheme of arrangements.

The petitioners contended that **AS-14** is applicable only to amalgamations and not to demerger. It was clarified that ***AS-14 is applicable only to amalgamations and not to demerger.*** On a plain reading of the accounting standard under reference, it is clear that the same is applicable only in case of an amalgamation and not in case of demergers. This has also been held by the Gujarat High Court in the case of *2010 1 CLJ 351 tiled Gallops Realty (P) Ltd.* Copy of the order has been placed on record.

Case 2 - Gujarat, Gallops Realty (P.) Ltd

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. 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 ought to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve. It was held that the 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.***

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.

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 Interests 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 have 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 reversed.

Let us recapitulate

There are two types of amalgamation and two methods of accounting for amalgamations under AS 14. The types of amalgamation are, amalgamation in the nature of merger and amalgamation in the nature of purchase. There are two main methods of accounting for amalgamations viz. the pooling of interests method; and 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.

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 net 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.

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.

Companies (Indian Accounting Standards) Rules, 2015

The Ministry of Corporate Affairs (MCA) has notified on February 16, 2015 the Companies (Indian Accounting Standards) Rules, 2015. The applicability and the phases of implementation of the standards has been given below:

Applicability	*Timelines*	*Class of companies*
On voluntary basis	For accounting periods beginning on or after 1st April, 2015	Any company

On mandatory basis	For the accounting periods beginning on or after 1st April, 2016	a) companies having net worth of `500 crore or more whether their equity and/or debt securities are listed or otherwise b) holding, subsidiary, joint venture or associate companies of the class of companies covered in (a) above.
On mandatory basis	For the accounting periods beginning on or after 1st April, 2017	a) companies whose equity and/or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than `500 crore b) unlisted companies having net worth of `250 crore or more but less than `500 crore c) holding, subsidiary, joint venture or associate companies of the above class of companies.

Indian Accounting Standard 103 – for Business Combinations- A bird's eye view

Ind AS 103 defines business combination which has a wider scope whereas the existing AS 14 deals only with amalgamation. Under the existing AS 14 there are two methods of accounting for amalgamation. The pooling of interest method and the purchase method. Ind AS 103 prescribes only the acquisition method for each business combination

IND-AS 103 provides definition of a business. It defines business as "An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants" Further a Business Combinations is a transaction or other event in which anacquirerobtains control of one or morebusinesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are alsobusiness combinationsas that term is used in this Indian Accounting Standard.

Under Ind AS 103, all business combinations are accounted for using the purchase method that considers the acquisition date fair values of all assets, liabilities and contingent liabilities of the acquiree. The limited exception to this principle relates to acquisitions between entities under common control.

Ind AS-103, Business Combinations and AS-14, Accounting for Amalgamations

(i) Ind AS 103 defines business combination which has a wider scope whereas the existing AS 14 deals only with amalgamation.

(ii) Under the existing AS 14 there are two methods of accounting for amalgamation. The pooling of interest method and the purchase method. Ind AS 103 prescribes only the acquisition method for each business combination.

(iii) Under the existing AS 14, the acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method. Ind AS 103 requires the acquired identifiable assets liabilities and non-controlling interest to be recognised at fair value under acquisition method.

(iv) Ind AS 103 requires that for each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's

proportionate share of the acquiree's identifiable net assets. On other hand, the existing AS 14 states that the minority interest is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made and it is shown outside shareholders' equity.

(v) Under Ind AS 103, the goodwill is not amortised but tested for impairment on annual basis in accordance with Ind AS 36.The existing AS 14 requires that the goodwill arising on amalgamation

in the nature of purchase is amortised over a period not exceeding five years.

(vi) Ind AS 103 deals with reverse acquisitions whereas the existing AS 14 does not deal with the same.

(vii) Under Ind AS 103, the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The existing AS 14 does not provide specific guidance on this aspect.

(viii) Ind AS 103 requires bargain purchase gain arising on business combination to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. Under existing AS 14 the excess amount is treated as capital reserve

(ix) Appendix C of Ind AS 103, deals with accounting for common control transactions, which prescribes a method of accounting different from Ind AS 103. Existing AS 14 does not prescribe accounting for such transactions different from other amalgamations.

LESSON ROUND UP

- 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.
- AS 14 is not applicable to demergers.
- AS 14 provides for two types of amalgamations viz amalgamation in the nature of merger and amalgamation in the nature of purchase.
- There are two main methods of accounting for amalgamations viz the pooling of interests method; andthe 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 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.
- 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.
- 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 specified.
- 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.
- AS 14 also prescribes certain disclosure requirements.
- 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 the financial statements.

- 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.

SELF TEST QUESTIONS

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

1. Does AS 14 apply to Demerger? Explain.
2. What are the types of amalgamation provided under AS 14?
3. What are the methods of accounting provided under AS 14?
4. How the balance in Profit and Loss Account of transferor is treated in case of amalgamation in the nature of merger?

Lesson 5
Financial, Stamp Duty and Taxation Aspects of Amalgamation

LESSON OUTLINE

- Financial aspects of mergers and amalgamations
- Constitutional background on levy of stamp duty
- Stamp duty payable on high court order sanctioning amalgamation
- Amalgamation of holding and subsidiary companies – exemption from payment of stamp duty
- Taxation aspects of mergers and amalgamation
- Taxation aspects of slump sale

LEARNING OBJECTIVES

Financial aspects of merger denotes financial benefits. Stamp duty and taxation aspects are closely linked to the financial aspects. Similarly, 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. Taxation aspects of merger includes aspects such as carry forward of losses after merger.

After reading this lesson you will be able to understand the regulatory aspects and court decisions as to the stamp duty aspects of mergers, tax advantage on mergers, etc.

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 relating to the valuation of shares is 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 are 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,1899 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.

Under the provisions of the Companies Act, 1956 it has been decided that 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 Tribunal Order Sanctioning Amalgamation

As section 232 of the Companies Act, 2013 is the corresponding section to the Section 394 of the Companies Act, 1956 and for understanding the payment of Stamp duty on Tribunal Order Sanctioning Amalgamation, it is necessary to take reference of the judicial pronouncement under the Companies Act, 1956, which is as under:

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 affect 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 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. Therefore, it 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 class 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 to 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.

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 includes 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:

As per Section 2(g) of the Bombay Stamp Act, 1958 "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.

The Calcutta High Court in the case of Emami Biotech Ltd (2012) held that a Court order sanctioning a scheme of amalgamation or demerger under section 391 to 394 of the Companies Act, 1956 is an instrument and conveyance within the meaning of the Stamp Act applicable to the State of West Bengal and is accordingly, subject to stamp duty.

This case is related to a scheme sanctioned by the Calcutta High Court in West Bengal.

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 having 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.

W.e.f 15.12.2016, Section 232 of Companies Act, 2013 has been notified and the now the power to sanction amalgamation shall vest with the Tribunal.

TAXATION ASPECTS OF MERGERS AND AMALGAMATIONS

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 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 of Income Tax Act, 1961, 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 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

fourth 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.

The following sub-section (6A) was 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 (xiiib) 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 installments. The amalgamated company gets the right to claim the unexpired installments 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 180(1) of the Companies Act, 2013 empowers the Board of Directors of a company, after obtaining the consent of the company by a special resolution to sell, lease or otherwise dispose off the whole or substantially the whole of the undertaking(s) of a company.

Explanation-

(i) "undertaking" shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent of the total income of the company during the previous financial year;

(ii) the expression "substantially the whole of the undertaking" in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year

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).

LESSON ROUND UP

- Financial aspects of mergers denotes financial benefits, i.e., increase in productivity, improved profitability and enhanced paying capacity.
- 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.
- 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.
- 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.
- Capital gains tax is leviable if there arises capital gain due to transfer of capital assets.

SELF TEST QUESTIONS

1. Describe the financial benefits that would arise out of merger.
2. Explain the constitutional background of Indian Stamp Act, 1899 with respect to merger.
3. Is the order of Tribunal an instrument? Is stamp duty compulsory on the Tribunal order?
4. What are the tax advantages of mergers?

Lesson 6
Interest of the Small Investors in Mergers

LESSON OUTLINE

- Minority interest and substantive law
- Right of minority shareholders during Mergers/Amalgamation
- Fair valuation as a means of safeguarding minority interests
- Provisions of the Companies Act, 2013
- Judicial pronouncements
- SEBI circular to protect the interest of minority in Mergers.

LEARNING OBJECTIVES

Shareholders have important rights which they can exercise democratically at the general meeting. They have the power to control and supervise management of the company. The term shareholder democracy relates to the different ways in which shareholders can influence or even determine a company's course of life. As regards mergers, the minority shareholders' interest may be protected through rational valuation, proper disclosure etc., After reading this lesson you will be able to understand the regulatory aspects, case laws, recent SEBI initiatives for the protection of minority shareholders in mergers.

INTRODUCTION

The fundamental principle defining operation of shareholders democracy is that the rule of majority shall prevail. However, it is also necessary to ensure that this power of the majority is placed within reasonable bounds and does not result in oppression of the minority and mis-management of the company. The minority interests, therefore, have to be given a voice to make their opinions known at the decision making levels. The law should provide for such a mechanism. If necessary, in cases where minority has been unfairly treated in violation of the law, the avenue to approach an appropriate body for protecting their interests and those of the company should be provided for. The law must balance the need for effective decision making on corporate matters on the basis of consensus without permitting persons in control of the company, i.e., the majority, to stifle action for redressal arising out of their own wrong doing.

Minority and 'Minority Interest' under Companies Act

The term "minority" and "minority interest" are not clearly defined in the Companies Act, 2013 or Rules made thereunder. However, in various provisions of the Act, members are given various collective statutory rights which can be exercised even if they are not in majority (i.e. holding more than 50% of the numbers/shares/voting rights). In another way, minority can be identified as those members who are not in the control or management of the affairs of the company.

The following are some of the provisions where minority interest is recognised in the Act:

1. At present as per Section 244 of the Companies Act, 2013, in case of a company having share capital, not less than 100 members or not less than 1/10th of total number of members, whichever is less or any member or members holding not less than 1/10th of issued share capital have the right to apply to NCLT in case of oppression and mismanagement. In case of companies not having share capital, not less than 1/5th of total number of members have the right to apply.

2. To reflect the interest of the "Minority", a 10% criteria in case of companies having share capital and a 20% criteria in the case of other companies is provided for in the Act. To help the Minority shareholders, proviso to Section 244(1) of the Companies Act, 2013 empowers NCLT to allow application by shareholders who are not otherwise eligible (i.e. holding less than 10%-20% as aforesaid). This really opens up possibility of minority actions in deserving cases of oppression and mismanagement.

3. In Section 235 of the Act, the dissenting shareholders have been put at the limit of 10% of the value of the shares.

4. Remedy against oppression is available in section 241 (a) of the Act. Oppression can be defined as conducting the company's affairs in a manner prejudicial to public interest or in a manner oppressive to any member or members. Remedy against Mis-management is available in Section 241(b) of the Act. Mis-management can be defined as conducting the affairs of the company in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company.

5. In section 245 of the Act, provisions of Class action are laid down. Under these provisions, minority members or depositors may apply to NCLT on behalf of the members or depositors, if they are of the opinion that the management or conduct of the affairs of the Company are in a manner prejudicial to the interest of the company or its members or depositors. In this provision also the threshold of minority action is in line with Section 244 of the Act as noted above. Section 245 of the Act has broadened the scope for minority actions in India in line with international practices.

Rights of minority shareholders during mergers/amalgamations/ takeovers

1. As per existing provisions of the Act, approval of High Court (prior to 15th December, 2016) /Tribunal (w.e.f. 15th December, 2016) 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 NCLT. The scheme is circulated to all shareholders along with statutory notice (Form No. CAA-2) of the Tribunal convened meetings and the explanatory statement u/s 230(3) of the Act read with Rule 6 of Companies (Compromise, Arrangement and Amalgamation) Rules, 2016 for approving the scheme by shareholders.

2. As per proviso to Section 230(4) of the Act, it is provided that any objection to the compromise or arrangement shall be made by persons holding 10% or more of the shareholding or having 5% or more of the total outstanding debt as per latest audited financial statement. Thus, shareholders holding less than 10% or more of the shareholding are not entitled to object to the scheme as matter of statutory right.

There are other built in safeguards in the matter of approval of the scheme of compromise and arrangements. The notice convening the meetings and also the notice of hearing of the petition (in Form CAA-2) is required to be published in the newspaper as per the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The notice is also required to be given to various statutory authorities, sectoral regulators etc.

Though there may not be any express protection to any dissenting minority shareholders to file their objections as a matter of right on this issue, the Tribunal, while approving the scheme, may follow judicious approach more particularly in view of the publication of the public notices about the proposed scheme in the newspapers. Any interested person (including a minority shareholder) may appear before the NCLT. 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. In view of this, proviso to Section 230(4) of the Act has put some limit for the objectors.

3. In case of Takeovers, as per SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011, SEBI has powers to appoint investigating officer to undertake investigation, in case complaints are received from the investors, intermediaries or any other person on any matter having a bearing on the allegations of substantial acquisition of shares and takeovers. SEBI may also carry out such investigation *suo moto* upon its own knowledge or information about any breach of these regulations. Under section 235 of the Act, a transferee company, which has acquired 90% shares of a transferor company through a scheme or contract, is entitled to acquire shares of remaining 10% shareholders. Dissenting shareholders have been provided with an opportunity to approach Tribunal. For this purpose, there is no threshold applicable i.e. even a single dissentient shareholding holding one share may also approach Tribunal. In such case, further acquisition of shares by the transferee company will be subject to the outcome of the decision of the NCLT.

Legal provisions of Companies Act, 2013 with respect to 'Minority interest in Mergers/ Amalgamation etc'.

Sections 230 to 240 of the Companies Act, 2013 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 guide the legal procedure for corporate strategies, including mergers, amalgamations and reconstructions.

Sections 230 to 232 *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 235 gives the right to acquire the shares of dissenting shareholders from the scheme or contract, which has been approved by the majority (i.e. members holding 90% or more of the value of shares whose transfer is involved).

As per Section 236(1) of the Act, any person who acquires 90% or more of the issued equity shares of the company shall notify to the company of their intention to buy the remaining equity shares. The acquirer as described under sub section (1) shall offer minority shareholders of the company for buying equity shares held by them at a price determined on basis of valuation by registered valuer thus providing compulsory exit opportunity to the minority shareholders.

Section 237 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 230 to 232 and Rules made thereunder and submit the details of all the formalities for consideration of the Tribunal.

Protection of minority Interest

Section 232(3)(e) authorises the Tribunal to make provision for any person who dissent from the scheme. Thus, the Tribunal has 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 Tribunal considers Minority interest while approving the scheme of merger

As per existing provisions of the Act, approval of 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 Tribunal. The scheme is circulated to all shareholders along with statutory notice of the court convened meeting and the explanatory statement u/s 230(3) read with Rule 6 of The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 of the Act for approving the scheme by shareholders

The notice of hearing of petition (in form CAA-2) is also required to be published in the newspaper. As per proviso to Section 230(4) of the Act, members holding 10% or more of the shareholding are entitled to file their objection before NCLT as a matter of right.

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.

Majority approval cannot deprive minority from raising objections.

Approval of majority of shareholders is not an automatic rejection of objections of minority shareholders. The court has to apply its mind to dissent or objections raised by minority shareholders. The majority view will prevail if there is nothing cogent or valid In the objections (In case of Consolidated Coffee Limited(1999))

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 reading of Section 230 makes it clear at once that the Tribunal 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 Tribunal 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 tribunal 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 right to say that once the scheme gets sanctioned by the Tribunal, 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 Tribunal 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)]*

LESSON ROUNDUP

- At present, in case of a company having share capital, not less than 100 members or not less than 1/10th of total number of members, whichever is less or any member or members holding not less than 1/10th of issued share capital have the right to apply to CLB/NCLT in case of oppression and mismanagement.
- Section 232 (3)(e) authorises the tribunal to make provision for those who dissent from the scheme.
- As per proviso to Section 230(4) of the Act, objection to compromise or arrangement shall be made only by person holding 10% or more of the shareholding or having 5% or more of the total outstanding debt as per the latest audited financial statement.
- There have been occasions when the minority shareholders have raised objections and have succeeded in preventing the implementation of a scheme of arrangement.

SELF TEST QUESTIONS

1. Write a brief regulatory background about protection of minority interest?
2. Describe the success of minority shareholders in merger decision with case laws.

* *ipse dixit* means an unsupported statement.

Lesson 7
Amalgamation of Banking and Government Companies

LESSON OUTLINE

- Amalgamation of Banking Companies- Introduction
- Directions issued by Reserve Bank of India for amalgamation of Private sector banks
- Amalgamation of Non-Banking Financial Company (NBFC) with Banking Company
- Change in control of Non-Banking Financial Companies by transfer of shares and acquisition
- Procedure for amalgamation of Government Companies.

LEARNING OBJECTIVES

Mergers and Acquisitions (M&As) are the commonly resorted to mode of business consolidation used by corporates to maintain their market share and keep themselves afloat in a competing environment. Mergers and Acquisitions as well as Demergers in the normal corporate sector amidst listed companies and unlisted companies are quite frequent and no study of corporate restructuring process could be complete without understanding of the complex process involved in them. Banking sector is also a vibrant part of the economy. As of now, the Reserve Bank of India has proposed that licences for commercial banks would be made available on tap. We are also seeing new types of institutions like payment banks, small commercial banks and local area banks. During the year 2015-16 new licences for small commercial banks and payment banks were issued. When the different types of financial intermediaries would be in play, the natural course of restructuring of such institutions would also be happening. Procedures for merger and amalgamation of banks are subject to the guidelines made by the sectoral regulator, viz, Reserve Bank of India. The Reserve Bank of India is empowered to approve amalgamation of banks under section 44A of the Banking Regulation Act, 1949. The master direction issued by the Reserve Banks covers the procedure for amalgamation of Banks inter-se and also for merger of non-banking financial companies with a banking company.

Section 237 of the Companies Act, 2013 deals with the Power of Central Government to provide for amalgamation of companies in public interest. This section corresponds to the section 396 of the Companies Act, 1956. This section has been used sparingly in the past and it is subject to the satisfaction of the Central Government that in public interest two or more companies should amalgamate into a single entity. During the year 2011, by a circular the Ministry of Corporate Affairs informed that in appropriate cases, the simpler route available under section 396 (now corresponding to new section 237) shall be utilised for amalgamation of Government Companies.

A study of the chapter will enable a clear understanding of the relevant provisions covering the above topics.

AMALGAMATION OF BANKING COMPANIES

Background

The Banking Regulation Act, 1949 is the important legislation with regard to licensing of commercial banks, their operation, supervision and restructuring and winding up. As per this Act, the provisions of applicable company legislation would apply to the commercial banks which are incorporated as companies to the extent the same not superseded in the Banking Regulation Act, 1949 and the rules and regulations framed thereunder.

Section 5(c) of the Banking Regulation Act, 1949 defines a "banking company" as any company which transacts the business of banking in India. The term "banking" too has been given the definition in the said Act vide section 5(i)(b) which states that "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.

In the Companies Act, 2013, vide sub-section (9) of Section 2, the term "Banking Company" has been defined. It states that the terms "banking company" means a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

Mergers implemented since the year 2000

Year	Transferee Bank	Transferor Bank
2001	Bank of Madura	ICICI Bank Limited
2002	Benares State Bank Limited	Bank of Baroda
2003	Bank of Muscat	Centurion Bank of Punjab Ltd
2004	Global Trust Bank Limited	Oriental Bank of Commerce
2004	Nedungadi Bank Limited	Punjab National Bank
2005	Bank of Punjab Limited	Centurion Bank of Punjab Ltd
2006	Lord Krishna Bank Ltd.	Centurion Bank of Punjab Ltd.
2006	United Western Bank Limited	IDBI Bank Limited
2007	The Sangli Bank Limited	ICICI Bank Limited
2008	State Bank of Saurashtra	State Bank of India
2009	Centurion Bank of Punjab	HDFC Bank Limited
2010	Bank of Rajasthan	ICICI Bank Limited
2015	ING Vysya Bank Limited	Kotak Mahindra Bank Limited
2017	State Bank of India	5 Associate Banks of SBI
2017	State Bank of India	Bharatiya Mahila Bank

Recently merger of the associate banks of State Bank of India (viz. State Bank of Bikaner and Jaipur (SBBJ), State Bank of Mysore (SBM), State Bank of Travancore (SBT), State Bank of Hyderabad (SBH) and State Bank of Patiala (SBP)) and the Bharatiya Mahila Bank Ltd. with the State Bank of India took place w.e.f. April 1, 2017. It would be noted that merger/amalgamation of banks and also mergers of Non Banking financial companies with banking companies is a matter of commercial expediency. In the past, when the banking sector was predominantly controlled by state ownership, mergers were not witnessed except for the orders of moratorium upon some small and unhealthy private sector commercial banks. There was hardly any restructuring of banks. Now with different categories of banks coming up like payment banks, small commercial banks and local area banks, one would see frequent restructuring of banks.

Master Direction issued by the Reserve Bank of India for amalgamation of Banking company inter se and also for amalgamation of Non Banking Financial Company with a Banking company

The Reserve Bank of India issues master circulars and directions every year with a view to consolidate their instructions from time to time. The Reserve Bank of India announces various policy decisions by circulars and also wherever legal prescription is required, the same is issued by way of directions and notifications. Since there are frequent amendments to such directions and notifications, the Reserve Bank issues master circulars once a year on various topics and also has now started issuing master directions consolidating various instructions with regard to the topics so that anyone interested in them may access the latest master circulars/directions and only check if any further circular have been issued subsequent to the date of such circulars/directions. One need not go back to search older records though the same are all available in the website of the Reserve Bank of India. One such master direction bearing no. RBI/DBR/2015-16/22 dated the 21st April, 2016 is the latest one with regard to amalgamation of private sector banks and the salient features of the same are given in the next paragraph. This direction repeals the earlier guidelines contained in DBOD.No.PSBS.BC.89/16.13.100/2004-05 dated the 11th May, 2005 on guidelines for merger/amalgamation of Private sector banks. This master direction would apply to amalgamation between two banking Companies and also for amalgamation of a Non Banking Financial Company (NBFC) with a Banking Company. The principles contained in this direction would also be applicable for public sector banks. For amalgamation of two banking companies, the authority solely vests with the Reserve Bank of India in terms of section 44A of the Banking Regulation Act, 1949. In case a NBFC is to be merged with a banking Company, the provisions applicable under Companies Act, 2013 sections 232-234 would apply. The scheme of amalgamation would have to be approved by the National Company Law Tribunal. Wherever NCLT is involved, the normal provisions under Companies Act, 2013 and the rules thereunder would apply.

AMALGAMATION BETWEEN TWO BANKING COMPANIES

In terms of paragraph 6 of the said master direction, the decision of amalgamation is required to be approved by the Board of the Bank concerned with a two thirds majority and not just those present and voting. This means that if the Board has say 12 directors, then 8 directors must be present and vote in favour of the amalgamation. The Banks shall also have to bear in mind the deed of covenants as recommended by the Ganguly Working Group on Corporate Governance. The draft scheme of amalgamation is also required to be approved by the Board of Directors with the same majority.

As stated in paragraph 7, in terms of section 44A of the Banking Regulation Act, 1949, the draft scheme of amalgamation shall 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. The ceiling on voting rights under section 12(2) i.e. ten per cent of maximum vote irrespective of holding by the shareholder would apply in the context of section 44A when there is a poll to determine whether the resolution has been passed by requisite majority.

As per paragraph 9, the Boards should give particular attention to the following:

- 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 company and whether such incorporation will result in a revaluation of assets upwards or credit being taken for unrealized gains.
- Whether due diligence exercise has been undertaken in respect of the amalgamated company.
- The nature of the consideration, which, the amalgamating company will pay to the shareholders of the amalgamated company.
- 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.
- 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 company will be violative of the Reserve Bank guidelines or require its prior approval.
- The impact of the amalgamation on the profitability and the capital adequacy ratio of the amalgamating company.
- 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.

As per paragraph 11, while submitting the application the companies should submit to the Reserve Bank the information and documents as contained in the Schedule to the Directions. The information/documents to be submitted are as under:

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. All relevant information for the consideration of the scheme of amalgamation including the following particulars:

   (a) annual reports of each of the banking companies for each of the three completed financial years immediately preceding the Appointed date for amalgamation;

   (b) financial results, if any, published by each of the banking companies for any period subsequent to the financial statements prepared for the financial year immediately preceding the Appointed Date;

   (c) pro-forma combined balance sheet of the amalgamating company as it will appear as of the Appointed Date consequent on the amalgamation;

   (d) computation based on such proforma balance sheet of the following:

      (i) Tier I Capital

      (ii) Tier II Capital

      (iii) Risk-weighted assets

      (iv) Gross and Net NPAs

      (v) Ratio of Tier I Capital to Risk Weighted Assets

      (vi) Ratio of Tier II Capital to Risk Weighted Assets

      (vii) Ratio of Total Capital to Risk Weighted Assets

      (viii) Tier I Capital to Total Assets

      (ix) Ratio of Gross and Net NPAs to Advances

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.

Entitlement of dissenting Shareholders

In terms of paragraph 12 of the Directions, a dissenting shareholder is entitled in the event of the scheme being sanctioned by the Reserve Bank, to claim within 3 months from the date of sanction, from the banking company concerned, in respect of the shares held by him in that company their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares to be paid to the dissenting shareholders shall be final for all purposes.

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.

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. The borrower accounts in the transferor banking company would be in tact transferred to the transferee banking 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)]. The depositors of the transferor bank shall be entitled to get the balances lying in their account from the transferee bank branches.

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 and such direction shall take effect notwithstanding anything to the contrary contained in any other law [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)]

In terms of section 44A(7), provisions of section 44A would not affect the power of the Central Government to provide for amalgamation of two or more banking companies under section 396 of the Companies Act, 1956. In the Companies Act, 2013, the corresponding section is section 237. We have yet to see the use of section 237 of the new Act or section 396 of the previous act for merger of banking companies.

AMALGAMATION OF A NON BANKING FINANCIAL COMPANY WITH A BANKING COMPANY

In the past, some of the Non-Banking Financial Companies have been merged with the commercial banks with the approval of Reserve Bank of India and further approval of the High Courts. The erstwhile Industrial Credit and Investment Corporation of India Limited which was one of the Development Financial Institutions merged with ICICI Bank Limited. Now since as per the Companies Act, 2013, the jurisdiction has shifted from High Courts to the National Company Law Tribunal, the consequent approval of the merger of NBFC with a Banking Company would be obtained from the National Company Law Tribunal in terms of Companies (Compromises, Arrangements and Amalgamation) Rules, 2016.

As per paragraphs 15 and 16 of the master direction, while according approval to the scheme, the Board of the Banking Company shall give consideration to the matters listed in paragraph 9 referred to above. In addition, the Board of the Banking Company shall examine whether –

(a) the NBFC has violated/is likely to violate any of the RBI/SEBI norms and if so, shall ensure that these norms are complied with before the scheme of amalgamation is approved;

(b) The NBFC has complied with KYC (Know your customer) norms for all the accounts, which will become accounts of the banking company after amalgamation;

(c) If the NBFC has availed of credit facilities from banks/FIs, whether the loan agreements mandate the NBFC to seek consent of the bank/FI concerned for the proposed merger/amalgamation.

As per paragraph 17 of the master direction, to enable the Reserve Bank of India to consider the application for approval, the banking company shall furnish to the Reserve Bank of India, information as specified in the schedule to the direction (except certificate in respect of names of shareholders who gave notice in writing at or prior to the meeting to the NBFC that they dissented from the scheme of amalgamation) and also the information and documents relating to the valuation along with its computation and the quoted price details.

The aforesaid direction and its terms will also apply in respect of amalgamation of a banking company with a Non-Banking Financial Company.

PRIOR APPROVAL OF RBI IN CASES OF ACQUISITION OR TRANSFER OF CONTROL OF DEPOSIT TAKING NBFC's

As per, Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009 (As amended by Notification No. DNBS.(PD) 275/GM(AM)-2014 dated May 26, 2014), 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. It is also clarified that approval shall be taken before approaching the Court or the National Company Law Tribunal (after Companies Act, 2013) in the following situations:

(i) any takeover or acquisition of control of an NBFC, whether by acquisition of shares or otherwise;

(ii) any merger/amalgamation of an NBFC with another entity or any merger/amalgamation of an entity with an NBFC that would give the acquirer / another entity control of the NBFC;

(iii) any merger/amalgamation of an NBFC with another entity or any merger/amalgamation of an entity with an NBFC which would result in acquisition/transfer of shareholding in excess of 10 percent of the paid up capital of the NBFC.

PRIOR APPROVAL OF THE RESERVE BANK OF INDIA FOR ACQUISITION AND CHANGE IN CONTROL OF MANAGEMENT OF NON BANKING FINANCIAL COMPANY

Whenever, there is a change in management of any Non Banking Financial Company (Core Investment Company, Deposit Accepting Non Banking Financial Company, Non Deposit Accepting Financial Company) by transfer of shares or change in control of management of Non Banking Financial Company, the prior approval for change in management shall be obtained from the Reserve Bank of India. In other words, any restructuring proposal of Non Banking Financial Companies requires the clearance of the Reserve Bank of India in terms of the directions/guidelines/circulars issued by the Reserve Bank of India. Change in control can arise by a change in the shareholding of the companies which hold shares in the Non Banking Financial Companies. Whenever there is change in the shareholding pattern of ultimate holding company, in effect the

control of Non Banking Financial Company would also change and thus the approval of the Reserve Bank of India is necessary.

In cases of Systemically Important Core Investment Companies, directions/guidelines to the above effect could be found in chapter VI of Section III of the Master direction dated the 25th August, 2016. The following are the instances provided in the said master direction:

(a) any takeover or acquisition of control of CIC, which may or may not result in change of management;

(b) any change in the shareholding of CIC, including progressive increases over time, which results in acquisition / transfer of shareholding of 26 per cent or more of the paid up equity capital of the CIC.

Provided that, prior approval shall not be required in case of any shareholding going beyond 26 per cent due to buyback of shares / reduction in capital where it has approval of a competent Court. The same is to be reported to the Bank not later than one month from its occurrence;

(c) any change in the management of the CIC which results in change in more than 30 per cent of the directors, excluding independent directors.

Provided that, prior approval shall not be required in case of directors who get re-elected on retirement by rotation.

Similar guidelines are also provided in the master direction dated the 1st September, 2016 in chapter IX, Section III, paragraph 59 applicable to the non systemically important non deposit taking Non Banking Financial Companies also. In cases of systemically important non deposit taking Non Banking Financial Companies, instructions to similar effect are contained in Chapter X, Section III vide paragraph 64 in the master direction dated the 1st September, 2016.

PROCEDURE FOR MERGER AND AMALGAMATION RELATED TO GOVERNMENT COMPANIES (vide MCA circular dated 20.04.2011 in the context of Section 233 of the Companies Act, 2013)

The Ministry of Corporate Affairs (MCA) has 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. The Government announced vide circular dated the 20th April 2011. Without prejudice to the generality of the circular that it has 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. However, in the new Companies Act of 2013, the same provisions are contained in section 233. This section has been implemented with effect from 15.12.2016 and the relevant rules are found in Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The Government has not announced any fresh policy with regard to following the procedure of simplified merger utilizing the provision of section 237 of the Companies Act, 2013. However, it is expected that the Government will follow the same procedure for merger / amalgamation of Government Companies as announced earlier as per circular dated 20.4.2011 and the salient features and conditions of the scheme for amalgamation of Government Companies are 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 prescribed procedure, 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 shall then be submitted to the Central Government which shall, if it is satisfied that all the requirements of Section 396 and the circular issued by MCA on this behalf 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.

Further developments in regard to this topic may be watched and as and when any new notification under section 237 is issued for merger of two or more Government companies, the same may be compared with the past circular of 20th April, 2011.

LESSON ROUND UP

- 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, 2013 are not applicable in this case. Restructuring of Banks has been seen in the last one and a half decade and even the state owned banks to have been merged for reasons of commercial expediency.
- 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-third in value of the shareholders, present in person or by proxy at a meeting called for the purpose. Further the approval of the Reserve Bank of India is needed. Such companies do not need to go to the National Company Law Tribunal (NCLT).
- 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 National Company Law Board (earlier it was the jurisdictional High Court) for approval.
- 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.
- In the case of non banking financial companies, whenever there is any kind of change of control by acquisition or transfer of shares or change in ultimate holding company, the same would need the approval of the Reserve Bank of India.
- Without prejudice to the generality of Section 396, it has now been notified by the Ministry of Corporate Affairs that, in appropriate cases, simpler procedures shall be adopted for the amalgamation of Government Companies under section 396 of the Companies Act, 1956.

SELF TEST QUESTIONS

1. Describe the procedure for amalgamation of private sector banks.
2. Explain the procedural aspects with respect to amalgamation of NBFC with a banking company.
3. What is the requirement to be complied whenever there is change in control or management of Non Banking Financial Companies due to transfer of shareholding?
4. Amalgamation of government companies follow a simplified procedure to be complied with. Explain this statement.

Lesson 8
Corporate Demergers and Reverse Mergers

LESSON OUTLINE

- 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

LEARNING OBJECTIVES

Companies have to downsize 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. This may also be necessary to undo a previous merger or acquisition which proved unsuccessful. Such downsizing of corporate restructuring is carried out through strategies such as demerger or spin off, split off, etc.

In a reverse merger, a healthy company merges with a financially weak company. The main reason for this type of reverse merger is to avail tax benefits under the Income-Tax Act, 1961.

After reading this lesson you will be able to understand the concepts of demerger, its methods, procedural compliances as to demerger, taxation aspects relating to demerger or reverse merger etc.

Section 230-240 of Companies Act, 2013 have been notified on 7th December, 2016 and came into force w.e.f. 15th December, 2016. Section 234 notified on 13th April, 2017.

Further, In exercise of the powers conferred by sub-sections (1) and (2) of sections 469 read with sections 230 to 233 and sections 235 to 240 of Companies Act, 2013, the Central Government have notified on 14th December, 2016, the rules, namely, the Companies (Compromises, Arrangements and Amalgamations) Rule, 2016 and these rules came into force with effect from 15th December, 2016.

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, 2013

A demerger is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. It is the converse of a merger or acquisition. A demerger can take place through a spin-off by distributed or transferring the shares in a subsidiary holding the business to company shareholders carrying out the demerger. The demerger can also occur by transferring the relevant business to a new company or business to which then that company's shareholders are issued shares of. In contrast, divestment can also "undo" a merger or acquisition, but the assets are sold off rather than retained under a renamed corporate entity.

The expression 'demerger' is not expressly defined in the Companies Act, 2013 (the Act). However Explanation to Section 230(1) gives a clue about the word demerger.

Section 230(1) of the Act states that where a compromise or arrangement is 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, the Tribunal may, on the application of the company or of any creditor or member of the company, or in the case of a company which is being wound up, of the liquidator,appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

Explanation: For the purposes of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods.

The Explanation to Section 230(1), thus provides an inclusive definition of arrangement i.e. consolidation or by the division of shares into shares of difference classes or by both the methods and the literary meaning of demerger is somewhat explained.

DEMERGER UNDER INCOME TAX ACT, 1961

The word demerger has been defined in Section 2(19AA) of the Income-tax Act, 1961 as follows:

Section 2(*19AA*) "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 relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

(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.

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 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 or 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 fulfils such conditions as may be notified in the Official Gazette, by the Central Government;

Following *Explanation 5* shall be inserted after *Explanation 4* in clause (*19AA*) of section 2 by the Taxation Laws (Amendment) Act, 2016, w.e.f. 1-4-2017:

Explanation 5.—*For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette.*

Meaning of Demerged Company

According to section 2(19AAA) of Income Tax Act '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) of Income Tax Act '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.

Compromise, Arrangments and Amalgamation under Chapter XV of the Companies Act, 2013

Chapter XV (Section 230 to 240)[1] of the Act, which deals with the Compromises, Arrangements and Amalgamation. The rules framed under Chapter XV is known as Companies (Compromises, Arrangements and Amalgamations) Rule, 2016 and it came into force w.e.f 15th December, 2016.

The scheme of Chapter XV goes as follows:

Section 230: Power to compromise or make arrangements with creditors and members.

Section 231: Power of Tribunal to enforce compromise or arrangement

Section 232: Merger and amalgamation of companies

Section 233: Merger or amalgamation of certain companies

Section 234: Merger or amalgamation of company with foreign company

Section 235: Power to acquire shares of shareholders dissenting from scheme or contract approved by majority

Section 236: Purchase of Minority shareholding

Section 237: Power of central government to provide for amalgamation of companies in public interest.

Section 238: Registration of offer of schemes involving transfer of shares.

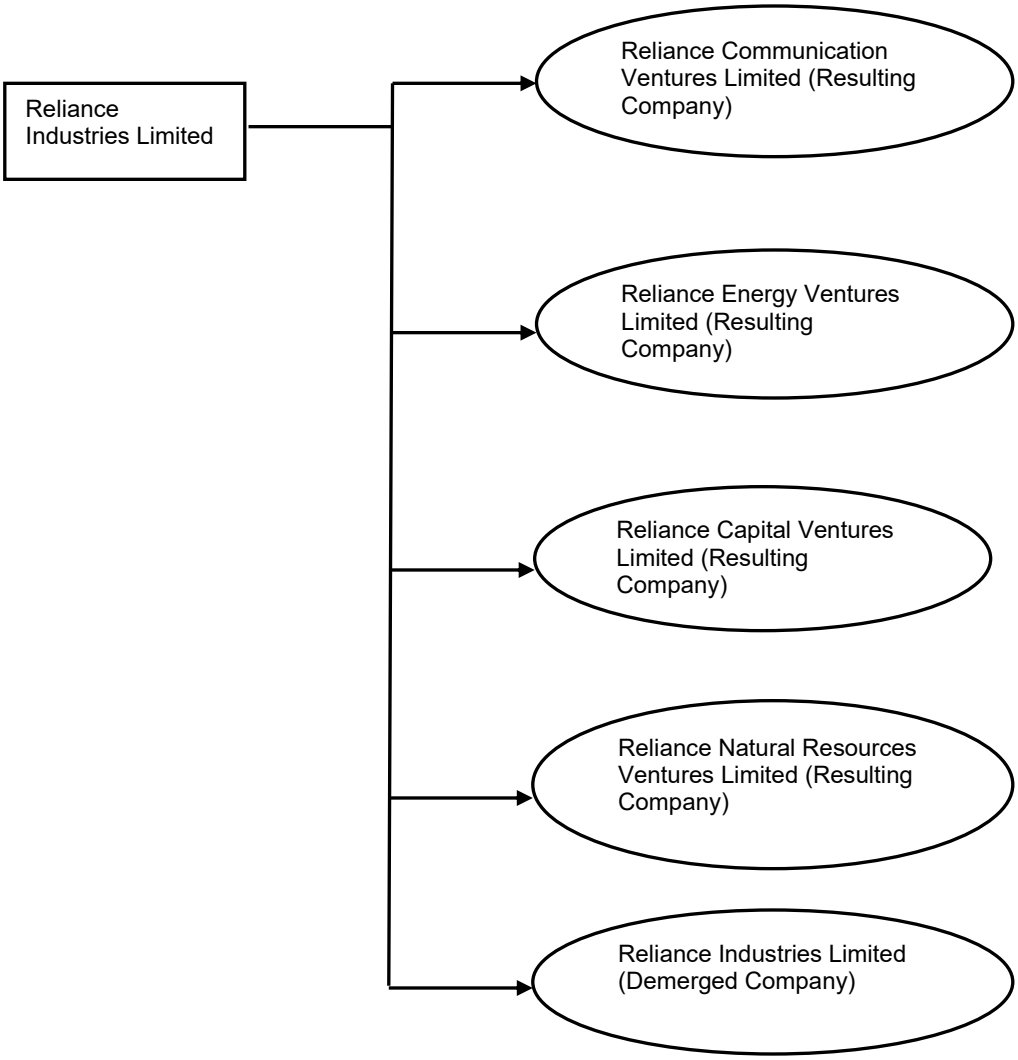
Section 239: Preservation of books and papers of amalgamated companies.

Section 240: Liability of officers in respect of offences committed prior to merger, amalgamation etc.

[1] Section 230 to 240 (Section 234 notified on 13th April, 2017) have been notified and came into force w.e.f. 15th December, 2016.

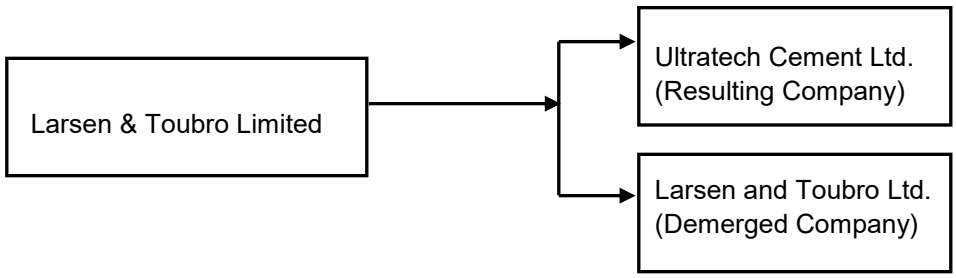
Some Examples –Demerger

Reliance Industries Limited – Demerger of Four Units



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&Ts grand strategies to concentrate more on infrastructure, engineering, energy and turnkey businesses.



Let us understand the recent Wipro Demerger which was approved by Karnataka High Court in March 2013

The scheme

The demerger of the

Wipro Consumer Care & Lighting (including Furniture business),

Wipro Infrastructure Engineering (Hydraulics & Water businesses), and

Medical Diagnostic Product & Services business (through its strategic joint venture),

into a separate company to be named Wipro Enterprises Limited(Resulting Company). Wipro Limited (Demerged Company) will remain a publicly listed company that will focus exclusively on information technology. Wipro Enterprises Limited will be an unlisted company.

Background

In fiscal year 2011-12, the IT Business contributed to 86% of revenue and 94% of operating profit of Wipro Limited. The demerger is anticipated to provide fresh impetus for both Wipro Limited and Wipro Enterprises Limited to pursue their individual growth strategies. The demerger is also expected to improve the competitiveness in their respective markets.

According to the restructuring scheme as currently proposed, resident Indian shareholders of Wipro Limited on the record date can choose from multiple options as per their investment objectives. They may opt to:

(i) receive one equity share with face value of Rs.10 in Wipro Enterprises Limited for every five equity shares with face value of Rs.2 each in Wipro Limited that they hold; or

(ii) receive one 7% Redeemable Preference Share in Wipro Enterprises Limited, with face value of Rs.50, for every five equity shares of Wipro Limited that they hold; or

(iii) exchange the equity shares of Wipro Enterprises Limited and receive as consideration equity shares of Wipro Limited held by the Promoter. The exchange ratio will be 1 equity share in Wipro Limited for every 1.65 equity shares in Wipro Enterprises Limited.

Non-resident shareholders (excluding ADR holders) and the ADR holders on the record date would be entitled to receive equity shares of Wipro Enterprises Limited in the aforesaid ratio. The Non-resident shareholders (excluding ADR holders) shall further have the option to exchange the Wipro Enterprises Limited equity shares that they are entitled to and receive equity shares of Wipro Limited held by the Promoter in the aforesaid ratio.

The meeting pursuant to court order approving Demerger.

Pursuant to the Order dated the 26th day of November, 2012, passed by the High Court of Karnataka, Bangalore, the meeting of the equity shareholders of Wipro Limited held on the 28th day of December, 2012.

The Court Order Approving Demerger

Wipro Limited has informed the Exchange on March 21, 2013 that Hon'ble High Court of Karnataka has approved the Scheme of Arrangement for demerger of 'Diversified Business' of the Company as provided in the Scheme.

DIFFERENCE BETWEEN DEMERGER AND RECONSTRUCTION

As discussed above “demerger” means transfer, pursuant to a scheme of arrangement under Chapter XV of the Companies Act, 2013 comprising of sections 230 to 240, 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 relatable 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 as the transferee company) is formed, the existing company (hereinafter referred to as 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.

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.

Section 231: Power of Tribunal to Enforce Compromise or Arrangement:

Procedure in respect of approval of Scheme of Demerger

The procedure for convening, holding and conducting class meetings for affecting demerger, is laid down in

rules titled as The Companies (Compromises, Arrangements and Amalgamations) Rule, 2016. The relevant rules are as under:

Rule 3. Application for order of a meeting

(1) An application under sub-section (1) of section 230 of the Act may be submitted in Form no. NCLT-1 (appended in the National Company Law Tribunal Rules, 2016) along with:-

(i) a notice of admission in Form No. NCLT-2 (appended in the National Company Law Tribunal Rules, 2016);

(ii) an affidavit in Form No. NCLT-6 (appended in the National Company Law Tribunal Rules, 2016);

(iii) a copy of scheme of compromise or arrangement, which should include disclosures as per sub-section (2) of section 230 of the Act; and

(iv) fee as prescribed in the Schedule of Fees.

(2) Where more than one company is involved in a scheme in relation to which an application under sub-rule (1) is being filed, such application may, at the discretion of such companies, be filed as a joint-application.

(3) Where the company is not the applicant, a copy of the notice of admission and of the affidavit shall be served on the company, or, where the company is being wound up, on its liquidator, not less than fourteen days before the date fixed for the hearing of the notice of admission.

(4) The applicant shall also disclose to the Tribunal in the application under sub-rule (1), the basis on which each class of members or creditors has been identified for the purposes of approval of the scheme.

Rule 4. Disclosures in application made to the Tribunal for compromise or arrangement.—Creditors Responsibility Statement

For the purposes of sub-clause (i) of clause (c) of sub-section (2) of section 230 of the Act, the creditor's responsibility statement in Form No. CAA. 1 shall be included in the scheme of corporate debt restructuring.

Explanation:- For the purpose of this rule, it is clarified that a scheme of corporate debt restructuring as referred to in clause (c) of sub-section (2) of section 230 of the Act shall mean a scheme that restructures or varies the debt obligations of a company towards its creditors.

Rule 5. Directions at hearing of the application:

Upon hearing the application under sub-section (1) of section 230 of the Act, the Tribunal shall, unless it thinks fit for any reason to dismiss the application, give such directions as it may think necessary in respect of the following matters:-

(a) determining the class or classes of creditors or of members whose meeting or meetings have to be held for considering the proposed compromise or arrangement; or dispensing with the meeting or meetings for any class or classes of creditors in terms of sub-section (9) of section 230;

(b) fixing the time and place of the meeting or meetings;

(c) appointing a Chairperson and scrutinizer for the meeting or meetings to be held, as the case may be and fixing the terms of his appointment including remuneration;

(d) fixing the quorum and the procedure to be followed at the meeting or meetings, including voting in person or by proxy or by postal ballot or by voting through electronic means;

Explanation.— For the purposes of these rules, "voting through electronic means" shall take place,

mutatis mutandis, in accordance with the procedure as specified in rule 20 of Companies (Management and Administration) Rules, 2014.

(e) determining the values of the creditors or the members, or the creditors or members of any class, as the case may be, whose meetings have to be held;

(f) notice to be given of the meeting or meetings and the advertisement of such notice;

(g) notice to be given to sectoral regulators or authorities as required under sub-section (5) of section 230;

(h) the time within which the chairperson of the meeting is required to report the result of the meeting to the Tribunal; and

(i) such other matters as the Tribunal may deem necessary.

Rule 6. Notice of meeting:

(1) Where a meeting of any class or classes of creditors or members has been directed to be convened, the notice of the meeting pursuant to the order of the Tribunal to be given in the manner provided in subsection (3) of section 230 of the Act shall be in Form No. CAA.2 and shall be sent individually to each of the creditors or members.

(2) The notice shall be sent by the Chairperson appointed for the meeting, or, if the Tribunal so directs, by the company (or its liquidator), or any other person as the Tribunal may direct, by registered post or speed post or by courier or by email or by hand delivery or any other mode as directed by the Tribunal to their last known address at least one month before the date fixed for the meeting. Explanation: - It is hereby clarified that the service of notice of meeting shall be deemed to have been effected in case of delivery by post, at the expiration of forty eight hours after the letter containing the same is posted.

(3) The notice of the meeting to the creditors and members shall be accompanied by a copy of the scheme of compromise or arrangement and a statement disclosing the following details of the compromise or arrangement, if such details are not already included in the said scheme:-

(i) details of the order of the Tribunal directing the calling, convening and conducting of the meeting:-
  - (a) date of the Order;
  - (b) date, time and venue of the meeting

(ii) details of the company including:
  - (a) Corporate Identification Number (CIN) or Global Location Number (GLN) of the company;
  - (b) Permanent Account Number (PAN);
  - (c) name of the company;
  - (d) date of incorporation;
  - (e) type of the company (whether public or private or one-person company);
  - (f) registered office address and e-mail address;
  - (g) summary of main object as per the memorandum of association; and main business carried on by the company;
  - (h) details of change of name, registered office and objects of the company during the last five years;
  - (i) name of the stock exchange (s) where securities of the company are listed, if applicable;
  - (j) details of the capital structure of the company including authorised, issued, subscribed and paid

up share capital; and

(k) names of the promoters and directors along with their addresses.

(iii) if the scheme of compromise or arrangement relates to more than one company, the fact and details of any relationship subsisting between such companies who are parties to such scheme of compromise or arrangement, including holding, subsidiary or of associate companies;

(iv) the date of the board meeting at which the scheme was approved by the board of directors including the name of the directors who voted in favour of the resolution, who voted against the resolution and who did not vote or participate on such resolution;

(v) explanatory statement disclosing details of the scheme of compromise or arrangement including:-

(a) parties involved in such compromise or arrangement;

(b) in case of amalgamation or merger, appointed date, effective date, share exchange ratio (if applicable) and other considerations, if any;

(c) summary of valuation report (if applicable) including basis of valuation and fairness opinion of the registered valuer, if any, and the declaration that the valuation report is available for inspection at the registered office of the company;

(d) details of capital or debt restructuring, if any;

(e) rationale for the compromise or arrangement;

(f) benefits of the compromise or arrangement as perceived by the Board of directors to the company, members, creditors and others (as applicable);

(g) amount due to unsecured creditors.

(vi) disclosure about the effect of the compromise or arrangement on:

(a) key managerial personnel;

(b) directors;

(c) promoters;

(d) non-promoter members;

(e) depositors;

(f) creditors;

(g) debenture holders;

(h) deposit trustee and debenture trustee;

(i) employees of the company:

(vii) Disclosure about effect of compromise or arrangement on material interests of directors, Key Managerial Personnel (KMP) and debenture trustee.

Explanation – For the purposes of these rules it is clarified that- (a) the term ‘interest’ extends beyond an interest in the shares of the company, and is with reference to the proposed scheme of compromise or arrangement. (b) the valuation report shall be made by a registered valuer, and till the registration of persons as valuers is prescribed under section 247 of the Act, the valuation report shall be made by an independent merchant banker who is registered with the Securities and Exchange Board or an independent chartered accountant in practice having a minimum experience of ten years.

(viii) investigation or proceedings, if any, pending against the company under the Act.

(ix) details of the availability of the following documents for obtaining extract from or for making or

obtaining copies of or for inspection by the members and creditors, namely:

(a) latest audited financial statements of the company including consolidated financial statements;

(b) copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with;

(c) copy of scheme of compromise or arrangement;

(d) contracts or agreements material to the compromise or arrangement;

(e) the certificate issued by Auditor of the company to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the Accounting Standards prescribed under Section 133 of the Companies Act, 2013; and

(f) such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;

(x) details of approvals, sanctions or no-objection(s), if any, from regulatory or any other governmental authorities required, received or pending for the proposed scheme of compromise or arrangement. (xi) a statement to the effect that the persons to whom the notice is sent may vote in the meeting either in person or by proxies, or where applicable, by voting through electronic means.

Explanation- For the purposes of this rule, disclosure required to be made by a company shall be made in respect of all the companies, which are part of the compromise or arrangement.

Rule 7. Advertisement of the notice of the meeting:

The notice of the meeting under sub-section (3) of Section 230 of the Act shall be advertised in Form No. CAA.2 in at least one English newspaper and in at least one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated, or such newspapers as may be directed by the Tribunal and shall also be placed, not less than thirty days before the date fixed for the meeting, on the website of the company (if any) and in case of listed companies also on the website of the SEBI and the recognized stock exchange where the securities of the company are listed: Provided that where separate meetings of classes of creditors or members are to be held, a joint advertisement for such meetings may be given.

Rule 8. Notice to statutory authorities:

(1) For the purposes of sub-section (5) of section 230 of the Act, the notice shall be in Form No. CAA.3, and shall be accompanied with a copy of the scheme of compromise or arrangement, the explanatory statement and the disclosures mentioned under rule 6, and shall be sent to.-

(i) the Central Government, the Registrar of Companies, the Income-tax authorities, in all cases;

(ii) the Reserve Bank of India, the Securities and Exchange Board of India, the Competition Commission of India, and the stock exchanges, as may be applicable;

(iii) other sectoral regulators or authorities, as required by Tribunal.

(2) The notice to the authorities mentioned in sub-rule (1) shall be sent forthwith, after the notice is sent to the members or creditors of the company, by registered post or by speed post or by courier or by hand delivery at the office of the authority.

(3) If the authorities referred to under sub-rule (1) desire to make any representation under sub-section (5) of section 230, the same shall be sent to the Tribunal within a period of thirty days from the date of receipt of such notice and copy of such representation shall simultaneously be sent to the concerned companies and in case no representation is received within the stated period of thirty days by the Tribunal, it shall be presumed

that the authorities have no representation to make on the proposed scheme of compromise or arrangement.

Rule 9. Voting:

The person who receives the notice may within one month from the date of receipt of the notice vote in the meeting either in person or through proxy or through postal ballot or through electronic means to the adoption of the scheme of compromise and arrangement. Explanation. For the purposes of voting by persons who receive the notice as shareholder or creditor under this rule–

(a) "shareholding" shall mean the shareholding of the members of the class who are entitled to vote on the proposal; and

(b) "outstanding debt" shall mean all debt owed by the company to the respective class or classes of creditors that remains outstanding as per the latest audited financial statement, or if such statement is more than six months old, as per provisional financial statement not preceding the date of application by more than six months.

Rule 10. Proxies:

(1) Voting by proxy 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.

(2) Where a body corporate which is a member or creditor (including holder of debentures) of a company authorises any person to act as its representative at the meeting, of the members or creditors of the company, or of any class of them, as the case may be, a copy of the resolution of the Board of Directors or other governing body of such body corporate authorising such person to act as its representative at the meeting, and certified to be a true copy by a director, the manager, the secretary, or other authorised officer of such body corporate shall be lodged with the company at its registered office not later than 48 hours before the meeting.

(3) No person shall be appointed as a proxy who is a minor.

(4) The proxy of a member or creditor blind or incapable of writing may be accepted if such member or creditor has attached his signature or mark thereto in the presence of a witness who shall add to his signature his description and address : provided that all insertions in the proxy are in the handwriting of the witness and such witness shall have certified at the foot of the proxy that all such insertions have been made by him at the request and in the presence of the member or creditor before he attached his signature or mark.

(5) The proxy of a member or creditor who does not know English may be accepted if it is executed in the manner prescribed in the preceding sub-rule and the witness certifies that it was explained to the member or creditor in the language known to him, and gives the member's or creditor's name in English below the signature.

Rule 11. Copy of compromise or arrangement to be furnished by the company

Every creditor or member entitled to attend the meeting shall be furnished by the company, free of charge, within one day on a requisition being made for the same, with a copy of the scheme of the proposed compromise or arrangement together with a copy of the statement required to be furnished under section 230 of Act.

Rule 12. Affidavit of service:

(1) The Chairperson appointed for the meeting of the company or other person directed to issue the advertisement and the notices of the meeting shall file an affidavit before the Tribunal not less than seven

days before the date fixed for the meeting or the date of the first of the meetings, as the case may be, stating that the directions regarding the issue of notices and the advertisement have been duly complied with.

(2) In case of default under sub-rule (1), the application along with copy of the last order issued shall be posted before the Tribunal for such orders as it may think fit to make.

Rule 13. Result of the meeting to be decided by voting:

(1) The voting at the meeting or meetings held in pursuance of the directions of the Tribunal under Rule 5 on all resolutions shall take place by poll or by voting through electronic means.

(2) The report of the result of the meeting under sub - rule (1) shall be in Form No. CAA. 4 and 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, and where applicable, who voted through electronic means, their individual values and the way they voted.

Rule 14. Report of the result of the meeting by Chairperson:

The Chairperson of the meeting (or where there are separate meetings, the Chairperson of each meeting) shall, within the time fixed by the Tribunal, or where no time has been fixed, within three days after the conclusion of the meeting, submit a report to the Tribunal on the result of the meeting in Form No. CAA.4.

Rule 15. Petition for confirming compromise or arrangement:

(1) Where the proposed compromise or arrangement is agreed to by the members or creditors or both as the case may be, with or without modification, the company (or its liquidator), shall, within seven days of the filing of the report by the Chairperson, present a petition to the Tribunal in Form No. CAA.5 for sanction of the scheme of compromise or arrangement.

(2) Where a compromise or arrangement is proposed for the purposes of or in connection with scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition shall pray for appropriate orders and directions under section 230 read with section 232 of the Act.

(3) Where the company fails to present the petition for confirmation of the compromise or arrangement as aforesaid, it shall be open to any creditor or member as the case may be, with the leave of the Tribunal, to present the petition and the company shall be liable for the cost thereof.

Rule 16. Date and notice of hearing:

(1) The Tribunal shall fix a date for the hearing of the petition, and notice of the hearing shall be advertised in the same newspaper in which the notice of the meeting was advertised, or in such other newspaper as the Tribunal may direct, not less than ten days before the date fixed for the hearing.

(2) The notice of the hearing of the petition shall also be served by the Tribunal to the objectors or to their representatives under sub-section (4) of section 230 of the Act and to the Central Government and other authorities who have made representation under rule 8 and have desired to be heard in their representation.

Rule 17. Order on petition:

(1) Where the Tribunal sanctions the compromise or arrangement, the order shall include such directions in regard to any matter or such modifications in the compromise or arrangement as the Tribunal may think fit to make for the proper working of the compromise or arrangement.

(2) The order shall direct that a certified copy of the same shall be filed with the Registrar of Companies

within thirty days from the date of the receipt of copy of the order, or such other time as may be fixed by the Tribunal.

(3) The order shall be in Form No. CAA. 6, with such variations as may be necessary.

Rule 18. Application for directions under section 232 of the Act:

(1) Where the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and the matters involved cannot be dealt with or dealt with adequately on the petition for sanction of the compromise or arrangement, an application shall be made to the Tribunal under section 232 of the Act, by a notice of admission supported by an affidavit for directions of the Tribunal as to the proceedings to be taken.

(2) Notice of admission in such cases shall be given in such manner and to such persons as the Tribunal may direct.

Rule 19. Directions at hearing of application: Upon the hearing of the notice of admission given under rule 18 or upon any adjourned hearing thereof, the Tribunal may make such order or give such directions as it may think fit, as to the proceedings to be taken for the purpose of reconstruction or amalgamation, as the case may be, including, where necessary, an inquiry as to the creditors of the transferor company and the securing of the debts and claims of any of the dissenting creditors in such manner as the Tribunal may think just and appropriate.

Rule 20. Order under section 232 of the Act:

An order made under section 232 read with section 230 of the Act shall be in Form No.CAA.7 with such variation as the circumstances may require

Rule 21. Statement of compliance in mergers and amalgamations:

For the purpose of sub-section (7) of section 232 of the Act, every company in relation to which an order is made under sub-section (3) of section 232 of the Act shall until the scheme is fully implemented, file with the Registrar of Companies, the statement in Form No. CAA.8 along with such fee as specified in the Companies (Registration Offices and Fees) Rules, 2014 within two hundred and ten days from the end of each financial year.

Rule 22. Report on working of compromise or arrangement

At any time after issuing an order sanctioning the compromise or arrangement, the Tribunal may, either on its own motion or on the application of any interested person, make an order directing the company or where the company is being wound-up, its liquidator, to submit to the Tribunal within such time as the Tribunal may fix, a report on the working of the said compromise or arrangement and on consideration of the report, the Tribunal may pass such orders or give such directions as it may think fit.

Rule 23. Liberty to apply

(1) The company, or any creditor or member thereof, or in case of a company which is being wound-up, its liquidator, may, at any time after the passing of the order sanctioning the compromise or arrangement, apply to the Tribunal for the determination of any question relating to the working of the compromise or arrangement.

(2) The application shall in the first instance be posted before the Tribunal for directions as to the notices and

the advertisement, if any, to be issued, as the Tribunal may direct.

(3) The Tribunal may, on such application, pass such orders and give such directions as it may think fit in regard to the matter, and may make such modifications in the compromise or arrangement as it may consider necessary for the proper working thereof, or pass such orders as it may think fit in the circumstances of the case.

Rule 24. Liberty of the Tribunal

(1) At any time during the proceedings, if the Tribunal hearing a petition or application under these Rules is of the opinion that the petition or application or evidence or information or statement is required to be filed in the form of affidavit, the same may be ordered by the Tribunal in the manner as the Tribunal may think fit.

(2) The Tribunal may pass any direction(s) or order or dispense with any procedure prescribed by these rules in pursuance of the object of the provisions for implementation of the scheme of arrangement or compromise or restructuring or otherwise practicable except on those matters specifically provided in the Act.

Rule 25. Merger or Amalgamation of certain companies

(1) The notice of the proposed scheme, under clause (a) of subsection (1) of section 233 of the Act, to invite objections or suggestions from the Registrar and Official Liquidator or persons affected by the scheme shall be in Form No. CAA.9.

(2) For the purposes of clause (c) of sub-section (1) of section 233 of the Act the declaration of solvency shall be filed by each of the companies involved in the scheme of merger or amalgamation in Form No. CAA.10 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, before convening the meeting of members and creditors for approval of the scheme.

(3) For the purposes of clause (b) and (d) of sub-section (1) of section 233 of the Act, the notice of the meeting to the members and creditors shall be accompanied by –

(a) a statement, as far as applicable, referred to in sub-section (3) of section 230 of the Act read with sub-rule (3) of rule 6 hereof;

(b) the declaration of solvency made in pursuance of clause (c) of sub-section (1) of section 233 of the Act in Form No. CAA.10;

(c) a copy of the scheme.

(4)(a) For the purposes of sub-section (2) of section 233 of the Act, the transferee company shall, within seven days after the conclusion of the meeting of members or class of members or creditors or class of creditors, file a copy of the scheme as agreed to by the members and creditors, along with a report of the result of each of the meetings in Form No. CAA.11 with the Central Government, along with the fees as provided under the Companies (Registration Offices and Fees) Rules, 2014.

(b) Copy of the scheme shall also be filed, along with Form No. CAA. 11 with –

(i) the Registrar of Companies in Form No. GNL-1 along with fees provided under the Companies (Registration Offices and Fees) Rules, 2014; and

(ii) the Official Liquidator through hand delivery or by registered post or speed post.

(5) Where no objection or suggestion is received to the scheme from the Registrar of Companies and Official Liquidator or where the objection or suggestion of Registrar and Official Liquidator is deemed to be not sustainable and the Central Government is of the opinion that the scheme is in the public interest or in the

interest of creditors, the Central Government shall issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12.

(6) Where objections or suggestions are received from the Registrar of Companies or Official Liquidator and the Central Government is of the opinion, whether on the basis of such objections or otherwise, that the scheme is not in the public interest or in the interest of creditors, it may file an application before the Tribunal in Form No. CAA.13 within sixty days of the receipt of the scheme stating its objections or opinion and requesting that Tribunal may consider the scheme under section 232 of the Act.

(7) The confirmation order of the scheme issued by the Central Government or Tribunal under sub-section (7) of section 233 of the Act, shall be filed, within thirty days of the receipt of the order of confirmation, in Form INC-28 along with the fees as provided under Companies (Registration Offices and Fees) Rules, 2014 with the Registrar of Companies having jurisdiction over the transferee and transferor companies respectively.

(8) For the purpose of this rule, it is clarified that with respect to schemes of arrangement or compromise falling within the purview of section 233 of the Act, the concerned companies may, at their discretion, opt to undertake such schemes under sections 230 to 232 of the Act, including where the condition prescribed in clause (d) of sub-section (1) of section 233 of the Act has not been met.

Rule 26. Notice to dissenting shareholders for acquiring the shares

For the purposes of sub-section (1) of section 235 of the Act, the transferee company shall send a notice to the dissenting shareholder(s) of the transferor company, in Form No. CAA.14 at the last intimated address of such shareholder, for acquiring the shares of such dissenting shareholders.

Rule 27. Determination of price for purchase of minority shareholding

For the purposes of sub-section (2) of section 236 of the Act, the registered valuer shall determine the price (hereinafter called as offer price) to be paid by the acquirer, person or group of persons referred to in sub-section (1) of section 236 of the Act for purchase of equity shares of the minority shareholders of the company, in accordance with the following rules:-

(1) In the case of a listed company,-

(i) the offer price shall be determined in the manner as may be specified by the Securities and Exchange Board of India under the relevant regulations framed by it, as may be applicable; and

(ii) the registered valuer shall also provide a valuation report on the basis of valuation addressed to the Board of directors of the company giving justification for such valuation.

(2) In the case of an unlisted company and a private company, (i) the offer price shall be determined after taking into account the following factors:-

(a) the highest price paid by the acquirer, person or group of persons for acquisition during last twelve months;

(b) the fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple vis-à-vis the industry average, and such other parameters as are customary for valuation of shares of such companies; and (ii) the registered valuer shall also provide a valuation report on the basis of valuation addressed to the board of directors of the company giving justification for such valuation.

Rule 28. Circular containing scheme of amalgamation or merger

(1) For the purposes of clause (a) of sub-section (1) of section 238 of the Act, every circular containing the

offer of scheme or contract involving transfer of shares or any class of shares and recommendation to the members of the transferor company by its directors to accept such offer, shall be accompanied by such information as set out in Form No. CAA.15.

(2) The circular shall be presented to the Registrar for registration.

Rule 29. Appeal under sub-section (2) of section 238 of the Act: Any aggrieved party may file an appeal against the order of the Registrar of Companies refusing to register any circular under sub-section (2) of section 238 of the Act and the said appeal shall be in the Form No. NCLT.9 (appended in the National Company Law Tribunal Rules, 2016) supported with an affidavit in the Form No. NCLT.6 (appended in the National Company Law Tribunal Rules, 2016).

The Rules also set out the following forms for various purposes:

Form No.	***Relevent Rule***	***Section***	***Particulars***
CAA 1	4	230(2)(c) (i)	Creditor's Responsibility Statement
CAA 2	6 & 7	230(3)	Notice and Advertisement of notice of the meeting of creditors or members
CAA 3	8	230(5)	Notice to central government, regulatory authorities
CAA 4	13(2) & 14		Report of result of meeting by Chairperson
CAA 5	15(1)	230	Petition to sanction compromise or arrangement
CAA 6	17(3)	230(7)	Order on petition
CAA 7	20	232	Heading as in form NCLT. 4
CAA 8	21	232(7)	Statement to be filed with Registrar of Companies
CAA 9	25(1)	233(1)(a)	Notice of the scheme inviting objections or suggestions
CAA 10	25(2)	233(1)(C)	Declaration of solvency
CAA 11	25(4)	233(2)	Notice of approval of the scheme of merger
CAA 12	25(5)	233	Confirmation order of scheme of merger or amalgamation between
CAA 13	25(6)	233(5)	Application by the Central Government to the Tribunal
CAA 14	26	235(1)	Notice to dissenting shareholders
CAA 15	28	238(1)(a)	Information to be furnished along with circular in relation to any scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company.

TAX ASPECTS OF DEMERGER

Tax concession/incentives in case of demerger

If any demerger takes places within the meaning of section 2(19AA) of the Income-tax Act, 1961 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) the shareholders holding not less than three-fourths in value of the shares] 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 :

Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

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)]:

The cost of acquisition of the shares in the resulting company 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 sub-section (2C).]

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]

35A. (1) In respect of any expenditure of a capital nature incurred after the 28th day of February, 1966 [but before the 1st day of April, 1998], on the acquisition of patent rights or copyrights (hereafter, in this section, referred to as rights) used for the purposes of the business, there shall, subject to and in accordance with the provisions of this section, be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

Explanation.—For the purposes of this section,—

(i) "relevant previous years" means the fourteen previous years beginning with the previous year in which such expenditure is incurred or, where such expenditure is incurred before the commencement of the business, the fourteen previous years beginning with the previous year in which the business commenced :

Provided that where the rights commenced, that is to say, became effective, in any year prior to the previous year in which expenditure on the acquisition thereof was incurred by the assessee, this clause shall have effect with the substitution for the reference to fourteen years of a reference to fourteen years less the number of complete years which, when the rights are acquired by the assessee, have elapsed since the commencement thereof, and if fourteen years have elapsed as aforesaid, of a reference to one year;

(ii) "appropriate fraction" means the fraction the numerator of which is one and the denominator of which is the number of the relevant previous years.

(2) Where the rights come to an end without being subsequently revived or where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) are not less than the cost of acquisition thereof remaining unallowed, no deduction under sub-section (1) shall be allowed in respect of the previous year in which the rights come to an end or, as the case may be, the whole or any part

of the rights is sold or in respect of any subsequent previous year.

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

(4) Where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) exceed the amount of the cost of acquisition thereof remaining unallowed, so much of the excess as does not exceed the difference between the cost of acquisition of the rights and the amount of such cost remaining unallowed shall be chargeable to income-tax as income of the business of the previous year in which the whole or any part of the rights is sold.

Explanation.—Where the whole or any part of the rights is sold in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(5) Where a part of the rights is sold and sub-section (4) does not apply, the amount of the deduction to be allowed under sub-section (1) shall be arrived at by—

(a) subtracting the proceeds of the sale (so far as they consist of capital sums) from the amount of the cost of acquisition of the rights remaining unallowed; and

(b) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the rights are sold.]

(6) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the rights to the amalgamated company (being an Indian company),—

(i) the provisions of sub-sections (3) and (4) shall not apply in the case of the amalgamating company; and

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

(7) Where in a scheme of demerger, the demerged company sells or otherwise transfers the rights to the resulting company (being an Indian company),—

(i) the provisions of sub-sections (3) and (4) shall not apply in the case of the demerged company; and

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

(b) Expenditure on know-how [Section 35AB]

35AB. (1) Subject to the provisions of sub-section (2), where the assessee has paid in any previous year relevant to the assessment year commencing on or before the 1st day of April, 1998 any lump sum consideration for acquiring any know-how for use for the purposes of his business, one-sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years.

(2) Where the know-how referred to in sub-section (1) is developed in a laboratory, university or institution

referred to in sub-section (2B) of section 32A, one-third of the said lump sum consideration paid in the previous year by the assessee shall be deducted in computing the profits and gains of the business for that year, and the balance amount shall be deducted in equal instalments for each of the two immediately succeeding previous years.

(3) 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 company 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.

Explanation.—For the purposes of this section, "know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).

(c) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]

35ABB. (1) In respect of any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year and for which payment has actually been made to obtain a licence, there shall, subject to and in accordance with the provisions of this section, be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

Explanation.—For the purposes of this section,—

(*i*) "relevant previous years" means,—

(*A*) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;

(*B*) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid,

and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force;

(*ii*) "appropriate fraction" means the fraction the numerator of which is one and the denominator of which is the total number of the relevant previous years;

(*iii*) "payment has actually been made" means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

(2) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(3) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the

amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Explanation.—Where the licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed under sub-section (1) in respect of the previous year in which the licence is transferred or in respect of any subsequent previous year or years.

(5) Where a part of the licence is transferred in a previous year and sub-section (3) does not apply, the deduction to be allowed under sub-section (1) for expenditure incurred remaining unallowed shall be arrived at by—

(a) subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed; and

(b) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(6) Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the licence to the amalgamated company (being an Indian company),—

(i) the provisions of sub-sections (2), (3) and (4) shall not apply in the case of the amalgamating company; and

(ii) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalga-mating company if the latter had not transferred the licence.]

(7) Where, in a scheme of demerger, the demerged company sells or otherwise transfers the licence to the resulting company (being an Indian company),—

(i) the provisions of sub-sections (2), (3) and (4) shall not apply in the case of the demerged company; and

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

(8) Where a deduction for any previous year under sub-section (1) is claimed and allowed in respect of any expenditure referred to in that sub-section, no deduction shall be allowed under sub-section (1) of section 32 for the same previous year or any subsequent previous year.

(d) Amortisation of certain preliminary expenses [Section 35D]

35D. (1) Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2),—

(i) before the commencement of his business, or

(ii) after the commencement of his business, in connection with the extension of his undertaking or in connection with his setting up a new unit,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning

with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation:

Provided that where an assessee incurs after the 31st day of March, 1998, any expenditure specified in sub-section (2), the provisions of this sub-section shall have effect as if for the words "an amount equal to one-tenth of such expenditure for each of the ten successive previous years", the words "an amount equal to one-fifth of such expenditure for each of the five successive previous years" had been substituted.

(2) The expenditure referred to in sub-section (1) shall be the expenditure specified in any one or more of the following clauses, namely :—

(a) expenditure in connection with—

(i) preparation of feasibility report;

(ii) preparation of project report;

(iii) conducting market survey or any other survey necessary for the business of the assessee;

(iv) engineering services relating to the business of the assessee :

Provided that the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or of any other survey or the engineering services referred to in this clause is carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board;

(b) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;

(c) where the assessee is a company, also expenditure—

(i) by way of legal charges for drafting the Memorandum and Articles of Association of the company;

(ii) on printing of the Memorandum and Articles of Association;

(iii) by way of fees for registering the company under the provisions of the Companies Act, 1956;

(iv) in connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus;

(d) such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of this Act) as may be prescribed.

(3) Where the aggregate amount of the expenditure referred to in sub-section (2) exceeds an amount calculated at two and one-half per cent—

(a) of the cost of the project, or

(b) where the assessee is an Indian company, at the option of the company, of the capital employed in the business of the company,

the excess shall be ignored for the purpose of computing the deduction allowable under sub-section (1):

Provided that where the aggregate amount of expenditure referred to in sub-section (2) is incurred after the 31st day of March, 1998, the provisions of this sub-section shall have effect as if for the words "two and one-half per cent", the words "five per cent" had been substituted.

Explanation.—In this sub-section—

(*a*) "cost of the project" means—

(*i*) in a case referred to in clause (*i*) of sub-section (1), the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(*ii*) in a case referred to in clause (*ii*) of sub-section (1), the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee;

(*b*) "capital employed in the business of the company" means—

(*i*) in a case referred to in clause (*i*) of sub-section (1), the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(*ii*) in a case referred to in clause (*ii*) of sub-section (1), the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new unit of the company;

(*c*) "long-term borrowings" means—

(*i*) any moneys borrowed by the company from Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution which is eligible for deduction under clause (*viii*) of sub-section (1) of section 36 or any banking institution (not being a financial institution referred to above), or

(*ii*) any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of capital plant and machinery, where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

(4) Where the assessee is a person other than a company or a co-operative society, no deduction shall be admissible under sub-section (1) unless the accounts of the assessee for the year or years in which the expenditure specified in sub-section (2) is incurred have been audited by an accountant as defined in the *Explanation* below sub-section (2) of section 288, and the assessee furnishes, along with his return of income for the first year in which the deduction under this section is claimed, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

(5) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is

transferred, before the expiry of the period of ten years specified in sub-section (1), to another Indian company in a scheme of amalgamation,—

(*i*) no deduction shall be admissible under sub-section (1) in the case of the amalgamating company for the previous year in which the amalgamation takes place; and

(*ii*) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalga-mating company if the amalgamation had not taken place.

(5A) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is transferred, before the expiry of the period specified in sub-section (1), to another company in a scheme of demerger,—

(*i*) no deduction shall be admissible under sub-section (1) in the case of the demerged company for the previous year in which the demerger takes place; and

(*ii*) the provisions of this section shall, as far as may be, apply to the resulting company, as they would have applied to the demerged company, if the demerger had not taken place.

(6) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure specified in sub-section (2), the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of this Act for the same or any other assessment year.

(e) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E (7A)]

35E. (1) Where an assessee, being an Indian company or a person (other than a company) who is resident in India, is engaged in any operations relating to prospecting for, or extraction or production of, any mineral and incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2), the assessee shall, in accordance with and subject to the provisions of this section, be allowed for each one of the relevant previous years a deduction of an amount equal to one-tenth of the amount of such expenditure.

(2) The expenditure referred to in sub-section (1) is that incurred by the assessee after the date specified in that sub-section at any time during the year of commercial production and any one or more of the four years immediately preceding that year, wholly and exclusively on any operations relating to prospecting for any mineral or group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule or on the development of a mine or other natural deposit of any such mineral or group of associated minerals:

Provided that there shall be excluded from such expenditure any portion thereof which is met directly or indirectly by any other person or authority and any sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure.

(3) Any expenditure—

(*i*) on the acquisition of the site of the source of any mineral or group of associated minerals referred to in sub-section (2) or of any rights in or over such site;

(*ii*) on the acquisition of the deposits of such mineral or group of associated minerals or of any rights in or over such deposits; or

(*iii*) of a capital nature in respect of any building, machinery, plant or furniture for which allowance by way of depreciation is admissible under section 32,

shall not be deemed to be expenditure incurred by the assessee for any of the purposes specified in sub-

section (2).

(4) The deduction to be allowed under sub-section (1) for any relevant previous year shall be—

(*a*) an amount equal to one-tenth of the expenditure specified in sub-section (2) (such one-tenth being hereafter in this sub-section referred to as the instalment); or

(*b*) such amount as is sufficient to reduce to *nil* the income (as computed before making the deduction under this section) of that previous year arising from the commercial exploitation [whether or not such commercial exploitation is as a result of the operations or development referred to in sub-section (2)] of any mine or other natural deposit of the mineral or any one or more of the minerals in a group of associated minerals as aforesaid in respect of which the expenditure was incurred,

whichever amount is less:

Provided that the amount of the instalment relating to any relevant previous year, to the extent to which it remains unallowed, shall be carried forward and added to the instalment relating to the previous year next following and deemed to be part of that instalment, and so on, for succeeding previous years, so, however, that no part of any instalment shall be carried forward beyond the tenth previous year as reckoned from the year of commercial production.

(5) For the purposes of this section,—

(*a*) "operation relating to prospecting" means any operation undertaken for the purposes of exploring, locating or proving deposits of any mineral, and includes any such operation which proves to be infructuous or abortive;

(*b*) "year of commercial production" means the previous year in which as a result of any operation relating to prospecting, commercial production of any mineral or any one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule, commences;

(*c*) "relevant previous years" means the ten previous years beginning with the year of commercial production.

(6) Where the assessee is a person other than a company or a co-operative society, no deduction shall be admissible under sub-section (1) unless the accounts of the assessee for the year or years in which the expenditure specified in sub-section (2) is incurred have been audited by an accountant as defined in the Explanation below sub-section (2) of section 288, and the assessee furnishes, along with his return of income for the first year in which the deduction under this section is claimed, the report of such audit in the prescribed form[23] duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

(7) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is transferred, before the expiry of the period of ten years specified in sub-section (1), to another Indian company in a scheme of amalgamation—

(*i*) no deduction shall be admissible under sub-section (1) in the case of the amalgamating company for the previous year in which the amalgamation takes place; and

(*ii*) the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalga-mating company if the amalgamation had not taken place.

(7A) Where the undertaking of an Indian company which is entitled to the deduction under sub-section (1) is transferred, before the expiry of the period of ten years specified in sub-section (1), to another Indian

company in a scheme of demerger,—

(*i*) no deduction shall be admissible under sub-section (1) in the case of the demerged company for the previous year in which the demerger takes place; and

(*ii*) the provisions of this section shall, as far as may be, apply to the resulting company as they would have applied to the demerged company, if the demerger had not taken place.

(8) Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure specified in sub-section (2), the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of this Act for the same or any other assessment year.

(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.

Section 36. (1) (vii) provides that the deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

> Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:
>
> **Provided** that in the case of an assessee to which clause (*viia*) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:
>
> **Provided further** *that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.*
>
> *Explanation 1.*—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee;
>
> *Explanation 2.*—For the removal of doubts, it is hereby clarified that for the purposes of the proviso to clause (*vii*)of this sub-section and clause (*v*)of sub-section (2), the account referred to therein shall be only one account in respect of provision for bad and doubtful debts under clause (*viia*) and such account shall relate to all types of advances, including advances made by rural branches;

(g) Amortisation of expenditure in case of amalgamation or demerger [Section 35DD].

35DD. (1) 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.

(2) 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)]

Section 72A (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.

Section 72A(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.

(i) Deduction available under section 80-1A (12) or 80-1B(12)

Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.:

Section 80-IA (12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

(*a*) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and

(*b*) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings:

Section 80-IB(12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

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. The observation of Regional Director about the scheme not in consonance with Accounting Standard-14 and not tenable, as Accounting Standard-14 is applicable only in case of amalgamation and not in case of demerger. 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, 2013 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.

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. (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 reorganisation 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 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 (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.

(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 (xiiib) 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.

(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 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.

(*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 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;

(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)

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 partners 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 of 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.

Repeal of SICA Act, 1985

NOTIFICATION No. SO 3568(E) [F.No.3/2/2011-IF-II], dated 25-11-2016.—In exercise of powers conferred by sub-section (2) of section 1 of the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 (1 of 2004), the Central Government hereby notifies the 1st day of December, 2016, as the date on which provisions of the said Act shall come into force.

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.

Lesson 9
Takeovers

LESSON OUTLINE

- 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

LEARNING OBJECTIVES

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. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 prescribes disclosure requirements, open offer thresholds and other procedural aspects to takeover. After reading this lesson you will be able to understand the meaning, concept, objectives of takeover, procedural requirements as to takeover of listed/unlisted companies, takeover defenses etc.

MEANING AND CONCEPT OF TAKEOVERS

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, and product category or broadening its product and/or client base.

Takeover is 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 Sections 235 and 236 of the Companies Act, 2013. 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, 2011.

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 an important role to play in the takeover process especially with regard to compliances under the Companies Act, SEBI (SAST) Regulations 2011, Competition Law aspects, FEMA 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.

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, who are not the promoters of the company or the sellers of the shares under an agreement, 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 made by way of a a public announcement issued to the stock exchanges, followed by a Detailed Public Statement in the 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 beginning April 01, 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.

LEGAL ASPECTS OF TAKEOVER

The legislations/regulations that mainly govern takeover are as under:

1. SEBI (SAST) Regulations, 2011 (The Regulations)
2. Companies Act, 2013
3. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

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 186 apply to the acquisition of shares through a Company. Section 235 and 236 of the Companies Act lays down legal requirements for purpose of take-over of an unlisted company through transfer of undertaking to another company.

As per Regulation 31A (8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 If any public shareholder seeks to re-classify itself as a promoter, such a public shareholder shall be required to make an open offer in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Exception from the applicability

The regulations shall not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue, on the institutional trading platform of a recognised stock exchange.

Takeover of Unlisted and Closely Held Companies

Section 236 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 Tribunal 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 235 of the Companies 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 a period of 4 months after making an offer as envisaged under Section 235 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 235 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 cannot even call an extra-ordinary general meeting under Section 100 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 241 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 235 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 235 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 Tribunal's discretion to prevent compulsory acquisition.

The following are the important ingredients of the Section 235 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 235 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. The circular shall be sent to the dissenting shareholders in Form No: CAA 14 to the last known address of the dissenting shareholder
- 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.
- 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 take over 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 235 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.
3. Offer received from the transferee company along with other documents, particulars etc. should have been circulated to the members of the company in Form CAA 14.
4. 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.
5. 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.
6. 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. Form CAA 14 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. Register of Members.
8. Notice sent by the transferee company to dissenting shareholders for acquiring their shares.
9. Duly filled in and executed instrument(s) of transfer of shares held by the dissenting shareholders.
10. 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.

11. 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 Form CAA 14 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 235 of the Companies Act, 2013 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. Form No: CAA 14 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. Register of Investments.
9. Duly filled in and executed instrument(s) of transfer for shares held by the dissenting shareholders.
10. 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 Securities and Exchange Board of India (Substantial Acquisition of Shares and

Takeovers) Regulations, 2011 (the Regulations).

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 SEBI (LODR) Regulations, and the Companies Act. There could also be some compliance requirements under the Foreign Exchange Management Act if the acquirer were a person resident outside India.

As per Regulation 38, the listed entity shall comply with the minimum public shareholding requirements as specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957 in the manner as specified by the Board from time to time. In other words, the listed entity shall ensure that the public shareholding shall be maintained at 25% of the total paid up share capital of the company failing which the company shall take steps to increase the public shareholding to 25% of the total paid up share capital by the methods as specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957

This provisions shall not apply to entities listed on institutional trading platform without making a public issue.

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 stands 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, or which is being taken over 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 a position;

Shares

Shares means shares in the equity share capital of a target company carrying voting rights, and includes any security which entitles the holder thereof to exercise voting rights. Shares shall also include all depository receipts carrying an entitlement to exercise voting rights in the target company.

Disclosures related provisions (Regulations, 29, 30 and 31)

It may be noted that the word "shares" for disclosure purposes include convertible securities also.

Event based Disclosures (Regulation 29)

(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 encumbrance as a disposal.

Continual Disclosures (Regulation 30)

Continual disclosures of aggregate shareholding shall be made within 7 working days from the end of the 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 (Regulation 31)

The promoter of the target company shall disclose details of shares encumbered by them or by their PACs within 7 working days of such creation to the target company at its registered office and to the stock exchange where the shares of the company are listed. Further the promoter of the company shall intimate the target company at its registered office and to the stock exchange where the shares of the company are listed details of any invocation or release of such encumbrance of shares held by them within 7 working days of the occurrence of such an 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 a public announcement of making an open offer to acquire the shares 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 beginning April 01, only after making a public announcement of making an open offer to acquire the shares.

Provided that acquisition pursuant to a resolution plan approved under section31 of the Insolvency and Bankruptcy Code, 2016 shall be exempt from the obligation under the proviso to the sub-regulation (2) of regulation 3.

Indirect acquisition of shares or control (Regulation 5)

(1) For the purposes of regulation 3 and regulation 4, acquisition of shares or voting rights in, or control over, any company or other entity, that would enable any person and persons acting in concert with him to exercise or direct the exercise of such percentage of voting rights in, or control over, a target company, the acquisition of which would otherwise attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, shall be considered as an indirect acquisition of shares or voting rights in, or control over the target company.

(2) Notwithstanding anything contained in these regulations, in the case of an indirect acquisition attracting the provisions of sub-regulation (1) where,—

(a) the proportionate net asset value of the target company as a percentage of the consolidated

net asset value of the entity or business being acquired;

(b) the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or

(c) the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired; is in excess of eighty per cent, on the basis of the most recent audited annual financial statements, such indirect acquisition shall be regarded as a direct acquisition of the target company for all purposes of these regulations including without limitation, the obligations relating to timing, pricing and other compliance requirements for the open offer.

Explanation.— For the purposes of computing the percentage referred to in clause (c) of this sub-regulation, the market capitalisation of the target company shall be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

Delisting offer (Regulation 5A)

(1) Notwithstanding anything contained in these regulations, in the event the acquirer makes a public announcement of an open offer for acquiring shares of a target company in terms of regulations 3, 4 or 5, he may delist the company in accordance with provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009:

Provided that the acquirer shall have declared upfront his intention to so delist at the time of making the Detailed Public Statement and a subsequent declaration of delisting for the purpose of the offer proposed to be made under sub regulation (1) will not suffice.

(2) Where an offer made under sub-regulation (1) is not successful,-

(i) on account of non–receipt of prior approval of shareholders in terms of clause (b) of sub-regulation (1) of regulation 8 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; or

(ii) in terms of regulation 17 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; or

(iii) on account of the acquirer rejecting the discovered price determined by the book building process in terms of sub-regulation (1) of regulation 16 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009,

the acquirer shall make an announcement within two working days in respect of such failure in all the newspapers in which the detailed public statement was made and shall comply with all applicable provisions of these regulations.

(3) In the event of failure of the delisting offer made under sub-regulation (1), the open offer obligations shall be fulfilled by the acquirer in the following manner:

(i) the acquirer, through the manager to the open offer, shall within five working days from the date of the announcement under sub-regulation (2), file with the Board, a draft of the letter of offer as specified

in sub-regulation (1) of regulation 16; and

(ii) shall comply with all other applicable provisions of these regulations.

Provided that the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the scheduled date of payment of consideration to the shareholders and the actual date of payment of consideration to the shareholders.

Explanation: For the purpose of this sub-regulation, scheduled date shall be the date on which the payment of consideration ought to have been made to the shareholders in terms of the timelines in these regulations.

(4) Where a competing offer is made in terms of sub-regulation (1) of regulation 20,-

(a) the acquirer shall not be entitled to delist the company;

(b) the acquirer shall not be liable to pay interest to the shareholders on account of delay due to competing offer;

(c) the acquirer shall comply with all the applicable provisions of these regulations and make an announcement in this regard, within two working days from the date of public announcement made in terms of sub-regulation (1) of regulation 20, in all the newspapers in which the detailed public statement was made.

(5) Shareholders who have tendered shares in acceptance of the offer made under sub-regulation (1), shall be entitled to withdraw such shares tendered, within 10 working days from the date of the announcement under sub regulation (2) .

(6) Shareholders who have not tendered their shares in acceptance of the offer made under sub-regulation (1) shall be entitled to tender their shares in acceptance of the offer made under these regulations.

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 shareholding r may be 75% and in case of Public Sector companies it shall be 90%.

Voluntary Offer (Regulation 6)

A voluntary open offer under Regulation 6, is an offer made by a person who himself or through or along with Persons acting in concert with him if any, holds 25% or more shares or voting rights in the target company, but less than the maximum permissible non-public shareholding limit, for such number of shares such that the aggregate of the shareholding of the acquirer after the offer shall not exceed the maximum permissible non-public shareholding.

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 without attracting the provisions of the regulations, to make a public announcement. The acquirer is prohibited from acquiring any shares during the offer

period other than through the acquisitions 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;

Explanation: For the purpose of this sub-clause, the company shall include a body corporate, whether Indian or foreign.

(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 of the SEBI (SAST) Regulations.

(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; This Act has been repealed and all applications have to be made to the NCLT under the Companies Act, 2013, however no corresponding changes have been made in the SEBI Regulations.

(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.

(da) acquisition pursuant to a resolution plan approved under section 31 of the Insolvency and Bankruptcy Code, 2016.

(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 section 47 of the Companies Act, 2013.

(i) acquisition of shares by the lenders pursuant to conversion of their debt as part of a debt restructuring scheme implemented in accordance with the guidelines specified by the Reserve Bank of India**:**

Provided that the conditions specified under sub-regulation (5) of regulation 70 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 are complied with.

(ia) Acquisition of shares by the person(s), by way of allotment by the target company or purchase from the lenders at the time of lenders selling their shareholding or enforcing change in ownership in favour of such person(s), pursuant to a debt restructuring scheme implemented in accordance with the guidelines specified by the Reserve Bank of India:

Provided that in respect of acquisition by persons by way of allotment by the target company, the conditions specified under sub-regulation (6) of regulation 70 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 are complied with:

Provided further that in respect of acquisition by way of purchase of shares from the lenders, the acquisition shall be exempted subject to the compliance with the following conditions:

(a) the guidelines for determining the purchase price have been specified by the Reserve Bank of India and that the purchase price has been determined in accordance with such guidelines;

(b) the purchase price shall be certified by two independent qualified valuers, and for this purpose ‘valuer’ shall be a person who is registered under section 247 of the Companies Act, 2013 and the relevant Rules framed thereunder:

Provided that till such date on which section 247 of the Companies Act, 2013 and the relevant Rules come into force, valuer shall mean an independent merchant banker registered with the Board or an independent chartered accountant in practice having a minimum experience of ten years;

(c) the specified securities so purchased shall be locked-in for a period of at least three years from the date of purchase;

(d) the lock-in of equity shares acquired pursuant to conversion of convertible securities purchased

from the lenders shall be reduced to the extent the convertible securities have already been locked-in;

(e) a special resolution has been passed by shareholders of the issuer before the purchase;

(f) the issuer shall, in addition to the disclosures required under the Companies Act, 2013 or any other applicable law, disclose the following information pertaining to the proposed acquirer(s) in the explanatory statement to the notice for the general meeting proposed for passing special resolution as stipulated at clause (e) of this sub-regulation:

a. the identity including of the natural persons who are the ultimate beneficial owners of the shares proposed to be purchased and/ or who ultimately control the proposed acquirer(s);

b. the business model;

c. a statement on growth of business over the period of time;

d. summary of audited financials of previous three financial years;

e. track record in turning around companies, if any;

f. the proposed roadmap for effecting turnaround of the issuer.

(g) applicable provisions of the Companies Act, 2013 are complied with.

(j) increase in voting rights arising out of the operation of sub-section (1) of section 106 of the Companies Act, 2013 or pursuant to a forfeiture of shares by the target company, undertaken in compliance with the provisions of the Companies Act, 2013 and its articles of association.

(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 by the target company 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 of closure of the said buy-back offer.

(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 68 of the Companies Act, 2013;

(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 68 of the Companies Act, 2013; 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 of closure of the buy-back offer by the target company, 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 category I Alternate Investment 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 category I Alternate Investment 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 one lakh fifty thousand by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by RBI or 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 three lakh, 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 SEBI, 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 a Detailed Public Statement (DPS). The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement. The details of time line can be referred at Lesson 7 of 'Secretarial Audit, Compliance Management and Due Diligence'.

Filing Draft Letter of offer (Regulation 16)

Within 5 working days of publication of the 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.

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 an open 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 publication 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 such 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 *at least two working days* prior to the date of Detailed Public Statement.

II. Amount to be deposited in Escrow Account: [Regulation 17(1)]

Sl. No.	*Consideration payable under the Open Offer*	*Escrow Amount*
a.	On the first ` 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

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:

Applicable Regulation	***Details***	
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 bankers' 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	Manager to the Open Offer shall be empowered to realize the value of escrow account by way of sale or otherwise of the shares so deposited. Further in case of any shortfall in the amount in the escrow account, such shortfall shall be made good by the Manager.

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 deposited in the escrow account.
3. The balance 10% in the escrow account is to be released to the acquirer on the expiry of thirty days from the completion of all obligations under the open 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 shareholders [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:

Explanation:

(i) Letter of offer may also be dispatched through electronic mode in accordance with the provisions of Companies Act, 2013.

(ii) On receipt of a request from any shareholder to receive a copy of the letter of offer in physical format, the same shall be provided.

(iii) The aforesaid shall be disclosed in the letter of offer.

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 one working day 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 paid up capital of the target company existing as at the end of ten working days from the closure of the bidding period. This will have to account for all the outstanding securities which are likely to be converted till that period of time. The size of the voluntary open offer under Regulation 6 must be for at least such number of shares as would entitle the holder to exercise an additional 10% of the total shares of the target company and shall not exceed such number of shares as would result in the post-acquisition holding of the acquirer and persons acting in concert with him exceeding the maximum permissible non-public shareholding applicable to such a target company.

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.

The acquirer shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism as specified by the Board. [Regulation 18(6A)]

Advertisement before the tendering period [Regulation 18(7)]

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 SEBI, 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 been 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 Public Announcement.

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 one working day 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.

Completion of acquisition (Regulation 22)

The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period:

Provided that in case of an offer made under sub-regulation (1) of regulation 20, pursuant to a preferential allotment, the offer shall be completed within the period as provided under sub-regulation (1) of regulation 74 of Securities and Exchange Board of India (Issue of Capital and Disclosure) Regulations, 2009.

Provided further that in case of a delisting offer made under regulation 5A, the acquirer shall complete the acquisition of shares attracting the obligation to make an offer for acquiring shares in terms of regulations 3, 4 or 5, only after making the public announcement regarding the success of the delisting proposal made in terms of sub-regulation (1) regulation 18 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009.

(2) Notwithstanding anything contained in sub-regulation (1), subject to the acquirer depositing in the

escrow account under regulation 17, cash of an amount equal to entire consideration payable under the open offer assuming full acceptance of the open offer, the parties to such agreement may after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.

(3) The acquirer shall complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period:

Provided that in the event of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period, the Board may for reasons to be published, may grant an extension of time by such period as it may deem fit in the interests of investors in securities and the securities market.

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 Share Purchase Agreement 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,—

(a) 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;

(b) effect any material borrowings outside the ordinary course of business;

(c) 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, and 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-takover 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. The provision of the Companies Act 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. Thus the acquirer would have to wait for at least three annual general meetings before he gains control of the board. But this is subject to such conditions which provide 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 any time 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 raise 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 lookout 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.

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 strategic

acquisitions. Tata Motors acquisition of Daewoo Commercial Vehicle Company, Tata Steel's acquisition of Singapore's NatSteel, Reliance's acquisition of Flag is the culmination of Indian Company's efforts to establish a presence outside India.

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) Regulations, 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' under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?
6. What does the terms 'offer price' and 'persons acting in concert' mean under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?

Lesson 10
Funding of Mergers and Takeovers

LESSON OUTLINE

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

LEARNING OBJECTIVES

Financing of mergers and takeovers involve payment of consideration money to 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 acquiree company to the acquirer 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. After reading this lesson you will be able to understand the various funding alternatives available for mergers.

FINANCIAL ALTERNATIVES

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) 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.

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 uses 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. The provisions of preferential allotment are laid down in Section 62(1)(c) of the Companies Act, 2013 read with Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014. Further, listed companies have to comply with provisions of Chapter VII of the SEBI (Issue of Capital and Disclosure requirements) Regulations, 2009 for preferential allotment. As preferential allotment of equity shares also amounts to private placement, necessary provisions of Section 42 of the Act read with Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 is also required to be followed by the company.

Listed companies may also raise funds by way of qualified institutional placement under Chapter VIII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. Qualified institutional placement is a special type of preferential allotment made only to qualified institutional buyers.

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 EXTERNAL COMMERCIAL BORROWINGS (ECBs)

External Commercial Borrowings (ECB): ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalong basis. The framework for raising loans through ECB comprises the following three tracks.

Track 1: Medium term foreign currency denominated ECB with Minimum average maturity of 3/5 years.

Track 2: Long term foreign currency denominated ECB with minimum average maturity of 10 years

Track 3: Indian Rupees denominated ECB with minimum average maturity of 3/5 years.

Form of ECBs: The ECB Framework enables permitted resident entities to borrow from recognised non-resident entities in the following forms.

1. Loans including bank loans
2. Securitised instruments (floating rate notes and fixed rate bonds, non-convertible, optionally convertible preference shares/debentures)
3. Buyers' credit
4. Suppliers' credit

5. Foreign Currency Convertible Bonds (FCCBs)
6. Financial Lease and
7. Foreign Currency Exchangeable Bonds (FCEBs)

However, ECB framework is not applicable in respect to the investment in non-convertible debentures in India by Registered Foreign Portfolio Investors.

While the first six forms of borrowing, mentioned above, can be raised both under the automatic and approval routes, FCEBs can be issued only under the approval route.

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

ECB for investment in real sector-industrial sector, infrastructure sector and specified service sectors in India as indicated under para I (A) (i) (a) are under the Automatic Route, i.e. do not require Reserve Bank/Government of India approval. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route. It is clarified that eligibility for an ECB in respect of eligible borrowers, recognised lenders, end-uses, etc. have to be read in conjunction and not in isolation.

The master Direction on External Commercial Borrowings and Trade Credits was issued and updated upto June 9, 2017 which is available at www.rbi.org.

G. 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.

H. 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.

I. FUNDING THROUGH REHABILITATION FINANCE

Sick industries get merged 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.

Merger or takeover may be provided for as a part of insolvency resolution plan under the Insolvency and Bankruptcy Code, 2016.

The Insolvency and Bankruptcy Code, 2016 provides for reference to the NCLT in case of default by any Corporate debtor. Once a reference is made, NCLT will cause an enquiry, appoint an insolvency professional and provide moratorium. Thereafter, with certain further formalities, insolvency resolution plan may be approved by the NCLT. There is no provision in the Code guiding as to what such insolvency resolution plan may contain. However, in case corporate default is due to lack of sufficient

funds in respect of profitable and viable business, necessary provisions may be made for rehabilitation finance, takeover, corporate restructuring etc. in the insolvency resolution plan.

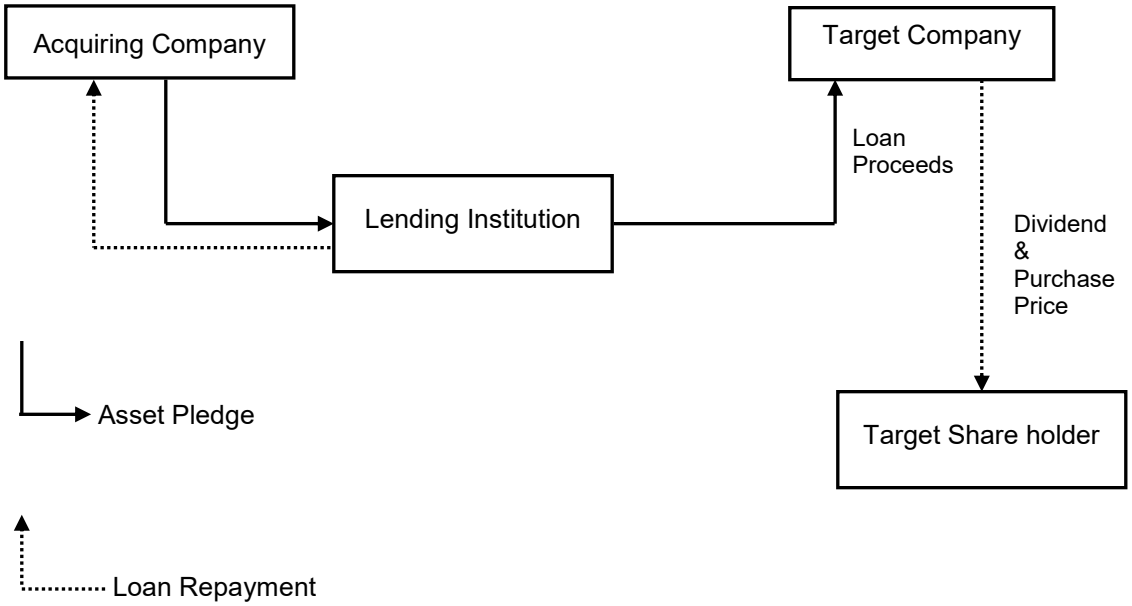
The insolvency resolution plan is prepared by the insolvency resolution applicant and submitted to the insolvency professionals who seeks the consent of the committee of creditors. Thereafter, the same is placed for approval of the NCLT. The insolvency resolution plan after the same is sanctioned by NCLT becomes operative and binding on all the concerned parties including the company, its employees, shareholders, creditors and other stakeholders who are party to such insolvency resolution process.

J. 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.

If the LBO is a direct merger, the seller receives cash for stock and the lender will make loan to the buyer against securities.

A Diagramic Representation of Leveraged Buy-out



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 their 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 buyout' for the funding.
4. Describe Depository Receipts as a funding options for merger.

Lesson 11
Financial Restructuring

LESSON OUTLINE

- Need for Financial Restructuring
- Reorganisation of capital
- Reduction of share capital
- Buyback of shares – Concept and objects
- Provisions of Buy Back under Companies Act, 2013 read with Companies (Share Capital and Debentures) Rules, 2014.
- SEBI (Buy-back of Securities) Regulations, 2018

LEARNING OBJECTIVES

Financial restructuring of a company involves rearrangement of its financial structure so as to make the company's finances more balanced, i.e., the company should be neither overcapitalized nor undercapitalized. Reduction of capital, reorganization of capital through consolidation, sub-division, buy back of shares, further issue of shares etc., are various forms of financial restructuring.

The Provisions relating to alteration of share capital, buy-back of shares, reduction of share capital has already been notified under Companies Act, 2013. The lesson covers provisions of Companies Act, 2013 relating to buy-back of shares and reduction of capital.

After reading this lesson you will be able to understand the legal and procedural aspects relating to reduction and re-organization of capital, buy-back of shares by listed and unlisted companies including aspects as to quantum, sources, restrictions etc.

Note: The Provisions relating to alteration of share capital and buy-back of shares have been notified under Companies Act, 2013 w.e.f. 01-04-2014. However, the provisions relating to reduction of capital are notified w.e.f. 15-12-2016 as it involves approval of National Company Law Tribunal. The lesson covers all the provisions of Companies Act 2013 along with relevant rules relating to buy-back of shares and reduction of capital.

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.

Let us understand the meaning of over capitalization and under capitalization

A company is said to be over-capitalized, if its earnings are not sufficient to justify a fair return on the amount of share capital and debentures that have been issued. Otherwise, it is said to be over capitalized when total of owned and borrowed capital exceeds its fixed and current assets i.e. when it shows accumulated losses on the assets side of the balance sheet.

If the owned capital of the business is much less than the total borrowed capital than it is said to be under capitalization. We may say that the owned capital of the company is disproportionate to the scale of its operation and the business is dependent more upon borrowed capital.

Let us remember

Under capitalization may be the result of excess volume of trading and over capitalization may be due to insufficient volume of trading.

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.

State whether the following statement is true or false.

A over capitalized company can resort to buy- back of shares.

Ans: True

ALTERATION OF CAPITAL

Power of limited company to alter its share capital (Section 61)

According to section 61 of the Companies Act, 2013 a limited company having a share capital derives its power to alter its share capital through its articles of association. As per the section the company may alter its memorandum in its general meeting to—

(a) increase its authorised share capital by such amount as it thinks expedient;

(b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.

The proviso to Section 61(1)(b) clarifies that No consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner. **(This Proviso notified w.e.f. 01-06-2016)**

(c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled. The cancellation of shares shall not be deemed to be a reduction of share capital.

REORGANISATION OF CAPITAL

In accordance with Section 390(b) of the Companies Act 1956, 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

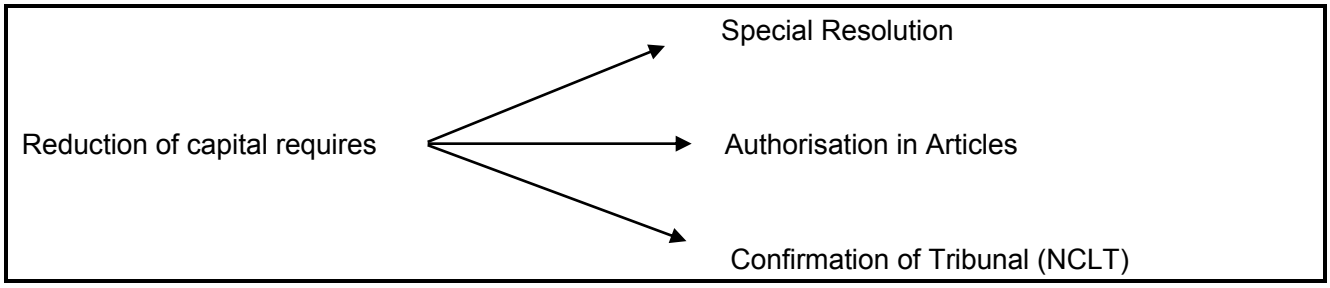
(2) by the division of shares of one class into shares of different classes, or

(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 etc.,

REDUCTION OF SHARE CAPITAL

Reduction of capital means reduction of issued, subscribed and paid-up capital of the company.



The need for reduction of capital may arise in various circumstances such as

- 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)].

Do you know?

Section 66 of the Companies Act, 2013 is applicable to a company limited by shares or a company limited by guarantee and having share capital. An unlimited company can reduce the share capital in the manner specified in the Articles and Memorandum of the company, as Section 66 of the Companies Act, 2013 is not applicable.

MODES OF REDUCTION

The mode of reduction 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 tribunal on petition, reduce its share capital in any way and in particular:

(a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or

(b) either with or without extinguishing or reducing liability on any of its shares,—

(i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

(ii) pay off any paid-up share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

Case Laws on Reduction of Capital

1. Can appeal against order of Single Judge allowing reduction, by a sole public shareholder, be allowed, when there is no fault in reasoning of Single Judge?

Where a company, reducing its share capital by cancelling and extinguishing some equity shares held by its subsidiary and some shares held by the public, passes the requisite resolution approving the reduction by a special majority in an extraordinary general meeting called for in this regard, and there is no fault in the reasoning given by the Single Judge approving the same, and also the valuation of shares, the appeal by a sole shareholder objecting to the said reduction is liable to be dismissed.

(Chander Bhan Gandhi v. Reckitt Benckiser (India) Ltd. [2012] 107 CLA 511 (Del.))

2. Whether the role of the court, while approving scheme of reduction of capital is limited to the extent of ensuring that the scheme is not unconscionable or illegal or unfair or unjust?

The role of the court, while approving scheme of reduction of capital, is limited to the extent of ensuring that the scheme is not unconscionable or illegal or unfair or unjust. Merely because the determination of the share exchange ratio or the valuation of shares is done by a different method which might result in a different conclusion would not justify interference of the court, unless found to be unfair. The court does not have the expertise nor the jurisdiction to delve into the deep commercial wisdom exercised by the creditors and members of the company who have approved the scheme by the requisite majority. Thus, where the valuer has used widely accepted methodologies, i.e., the discounted cash flow methodology and the comparable companies methodology which inter alia include the P/E multiple analysis for valuation of shares, there is no reason why the valuation report of the valuer, which is fair, reasonable and based on cogent reasoning, and which has also been accepted by a majority of the non-promoter shareholders of the company, should not be accepted by the court.

Rejecting the objections of the interveners/objectors that the fair value of shares arrived at by the valuer is not in the interest of the promoter shareholders, the High Court approved the valuation of shares and allowed the petition confirming reduction of share capital.

Wartsila India Ltd.v. Janak Mathuradas and Others [2010] 99 CLA 463 (Bom.)

3. Can the share premium account be utilized for reducing share capital?

The capital was proposed to be reduced by utilization of the Securities Premium Account and General Reserve. There was to be no diminution of liabilities or repayment of paid up capital. No reduction of issued, subscribed or paid up capital was involved. The Court said that the proposed reduction not being prejudicial in any manner was, therefore to be allowed.

(Alembic Ltd., Re (2008) 144 Com Cases 105 : (2009) 89 SCL 19 (Guj)

4. Can the reduction result in extinguishment of class of shares?

A scheme of amalgamation and arrangement involved reduction of share capital by extinguishment of shares of a particular class. The reduction was approved by majority of shareholders and creditors of transferee company. The court approved the reduction and extinguishment of portion of shares was held to be permissible as no one was prejudicially affected.

Siel Ltd., Re (2008) 144 Com Cases 469 :(2009)89 SCL 434(Del)

Reduction of share capital without sanction of the Tribunal

The following are cases which amount to reduction of share capital but where no confirmation by the Tribunal 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.

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

(d) Redemption of redeemable preference shares.

(e) Buy-back of its own shares.

Does buy back of shares requires Tribunal's confirmation as prescribed under Section 66?

Ans : No

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)].

Restructuring of Debts and reduction of capital-

The petitioner-company was referred to the corporate debt restructuring ('CDR') forum for re-scheduling and restructuring its debt. As per restructuring package, as approved by CDR forum, for every 10 equity shares the company would cancel 4 equity shares and in lieu of such cancellation, 4 non-cumulative preference shares would be allotted and the existing equity shareholders would continue to hold remaining 6 shares without any alteration of rights. When the petitioner-company moved to the High Court for confirmation of its restricting package, the objector opposed the scheme on the ground that it would suffer financial loss. Taking an overall view and considering the proposed scheme of reduction of share capital in larger perspective, the High Court found no reason not to confirm the proposed action of the company to reduce its share capital. The High Court observed that the proposal is likely to improve the financial resources of the company, and to increase the share of profit available for expansion and growth of the company. Moreover, the proposal does not involve diminution of any liability in respect of unpaid capital or the payment to any shareholder of any paid-up capital.

Essar Steel Ltd Re(2005)59SCL 457:(2006) 130 Com cases 123(Guj)

Creditors' Right to Object to Reduction

After passing the special resolution for the reduction of capital, the company is required to apply to the Tribunal by way of petition for the confirmation of the resolution under Section 66 Companies Act 2013. 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 tribunal 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 tribunal 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 Tribunal, in deciding whether or not to confirm the reduction will take into consideration the minority shareholders and creditors.

The Tribunal shall give notice of every application made to it under sub-section (1) to the Central Government, Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice:

Provided that where no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

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.

Confirmation and Registration

Section 66(3) of the Companies Act , 2013 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 of share capital on such terms and conditions as it deems fit.

Section 66(4) of the Companies Act, 2013 states that the order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be published by the company in such manner as the Tribunal may direct.

Section 66(5) of the Companies Act, 2013 states that the Tribunal order confirming the reduction together with the minutes giving the details of the company's

(a) the amount of share capital;

(b) the number of shares into which it is to be divided;

(c) the amount of each share; and

(d) the amount, if any, at the date of registration deemed to be paid-up on each share,

should be delivered to the Registrar within 30 days of receipt of the order of tribunal 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].

Let us remember!!!!

The effective date of reduction of capital is the date on which the Registrar of Companies registers the order of the court and the minutes approved by the court.

Liability of Members in respect of Reduced Share Capital

On the reduction of share capital, A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

If, however the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim—

(a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and

(b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

If any officer of the company—

(a) knowingly conceals the name of any creditor entitled to object to the reduction;

(b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

(c) abets or is privy to any such concealment or misrepresentation as aforesaid,

he shall be liable under section 447.

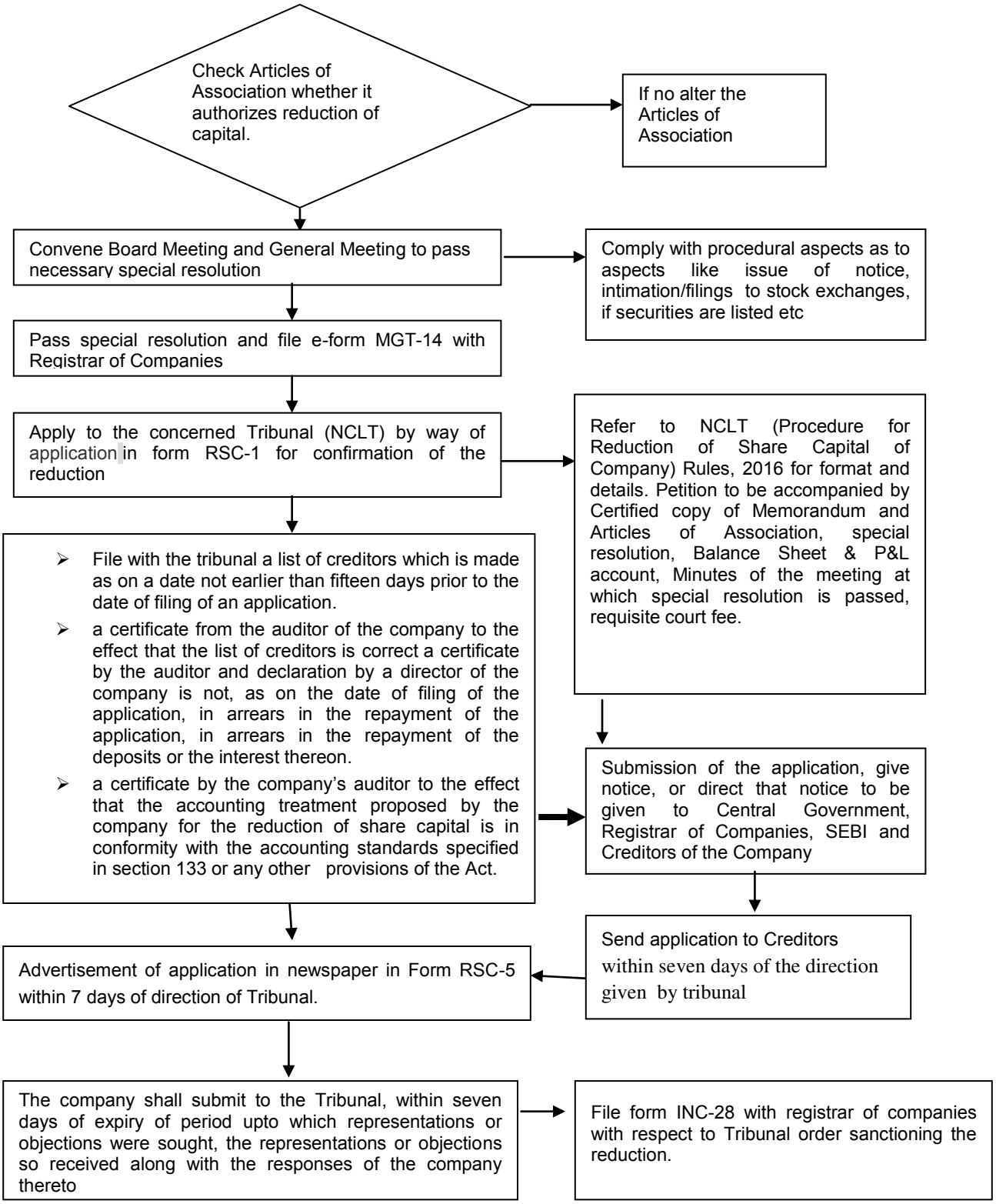
Reduction of Share Capital and Scheme of Compromise Or Arrangement

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)]. 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.

Procedure for reduction of capital – a Flow Chart



BUY-BACK OF SHARES

According to Section 68(1) of the Companies Act, 2013 a company whether public or private, 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.

"Specified securities" as referred to in the explanation to the section includes employees' stock option or other securities as may be notified by the Central Government from time to time.

"Free reserves" as referred to in the explanation includes securities premium account.

Authorisation

The primary requirement is that the articles of association of the company should authorise buyback. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buy-back. Buy-back can be made with the approval of the Board of directors at a meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

Quantum of Buy-back

(a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buy back has to be authorized by the board by means of a resolution passed at the meeting.

(b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution upto 25% of total equity capital in that year.

Post buy-back debt-equity ratio

The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back should not be more than twice the paid-up capital and its free reserves i.e the ratio shall not exceed 2:1. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

All the shares or other specified securities for buy-back are to be fully paid-up.

Buy-back by listed/unlisted companies

- The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

- The buy-back in respect of shares or other specified securities other than listed securities in is in accordance with such rules made under Chapter IV of the Companies Act, 2013.

Time gap

No offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

Explanatory statement

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of shares or securities intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back; and

(e) the time-limit for completion of buy-back.

Rule 17 of Companies (Share Capital and Debentures) Rules 2014 (hereinafter called the rules)

Additionally the Rules provide for following disclosures in explanatory statement with respect to private companies and unlisted public companies:

(a) the date of the board meeting at which the proposal for buyback was approved by the board of directors of the company;

(b) the objective of the buy-back;

(c) the class of shares or other securities intended to be purchased under the buy-back;

(d) the number of securities that the company proposes to buyback;

(e) the method to be adopted for the buy-back;

(f) the price at which the buy-back of shares or other securities shall be made;

(g) the basis of arriving at the buy-back price;

(h) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;

(i) the time-limit for the completion of buy-back;

(j) (i) the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;

(ii) the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;

(iii) the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;

(k) if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back –

(i) the quantum of shares proposed to be tendered;

(ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

(l) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

(m) a confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(i) that immediately following the date on which the general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;

(ii) 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 will in their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from that date; and

(iii) the directors have taken into account the liabilities (including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013

(n) a report addressed to the Board of directors 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;

(iii) that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and

(iv) the Board of directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Procedure

According to Rule 17(2) the company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in Form No.SH-8, along with the fee as prescribed. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

Filing Declaration of Solvency with SEBI/ROC [Rule 17(3)]

When a company proposes to buy-back its own shares or other specified securities under this section in

pursuance of a special resolution or board resolution as the case may be , it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board (in case of listed companies), a declaration of solvency in Form No. SH-9 signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit as specified in said form.

Dispatch of letter of Offer [Rule 17(4)]

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

The letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document; [Rule 17(10)]

Validity [Rule 17(5)]

The offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

Acceptance on proportional basis [Rule 17(6)]

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

Time limit for verification [Rule 17(7)]

The company shall complete the verifications of the offers received within 15 days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from the date of closure of the offer.

Payment of consideration/returning of share certificates

The company shall within seven days of the time limit of verification:

(a) make payment of consideration in cash to those shareholders or security holders whose securities have been accepted, or

(b) return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance .

Separate Account [Rule 17(8)]

The company shall immediately after the date of closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy-back.

The company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration only by way of cash. [Rule 17(10)]

Other conditions [Rule 17(10)]

The rules further provide that the company shall ensure that—

(a) the company shall not withdraw the offer once it has announced the offer to the shareholders;

(b) the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying back its shares; and

(c) the company shall not utilize the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities for the buy-back.

Time limit for completion of buy-back [Section 68(4)]

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

Methods of buy-back [Section 68(5)]

The buy-back may be—

(a) from the existing shareholders or security holders on a proportionate basis;

(b) from the open market;

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Extinguishment of securities bought back [Section 68(7)]

When a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

Prohibition of further issue of shares or securities [Section 68(8)]

When a company completes a buy-back of its shares or other specified securities it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a 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.

Register of buy-back [Section 68(9)]

When a company buys back its shares or other specified securities , it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

According to the rules the register of shares or securities bought back shall be maintained in Form SH-10, at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. Entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose. [Rule 17(12)(a)]

Return of buy-back [Section 68(10)]

A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (in case of listed companies) a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed.

The company shall file with the Registrar, and in case of a listed company with the Registrar and the SEBI, a return in the Form No. SH-11 along with the 'fee'. There shall be annexed to the return filed with the Registrar in Form No. SH-11, a certificate in Form No. SH- 15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and rules made thereunder. [Rule 17(13) and Rule 17(14)]

Penal Provisions [Section 68(11)]

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer to and application of Capital Redemption Reserve Account (Section 69)

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Circumstances prohibiting buy-back (section 70)

Under Section 70 of the Companies Act, 2013, no company shall directly or indirectly purchase its own shares or other specified securities—

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.
- No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92(Annual Return), 123(Declaration of Dividend), 127(punishment for failure to distribute dividend) and section 129 (Financial Statement).

INCOME TAX ASPECTS

Section 46A of the Income-tax Act, 1961 provides that any consideration received by a security holder 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 security holder 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.

BUY-BACK PROCEDURE FOR LISTED SECURITIES

In exercise of powers, SEBI notified Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018 w.e.f. September 11, 2018 vide Notification No. SEBI/LAD-NRO/GN/2018/32. All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations, 2018, in addition to the provisions of the Companies Act. These regulations broadly cover the following aspects:

1. Special resolution and its additional disclosure requirements
2. Methods of buy back including buy back through reverse book building, from existing shareholders through tender offer, etc.
3. Filing of offer documents, public announcement requirements.
4. offer procedure/opening of escrow account etc.,
5. General obligations of company, merchant banker etc

Special Resolution and its additional disclosure requirements (Regulation 5)

Sub-regulation (iv) of Regulation 5 of the Regulations, lays down that for the purposes of passing a special resolution the explanatory statement to be annexed to the notice for the general meeting shall contain disclosures as specified in Schedule I to the Regulations.

Sub-regulation (v) provides that a copy of the above resolution shall be filed with 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.

In case of Board approval

Regulation 5(vii) of the Regulations, provides that a company, authorized by a resolution passed by the Board of Directors at its meeting to buy back its shares or other specified securities, shall file a copy of the resolution, with the SEBI and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

Disclosures under Schedule I (Contents of Explanatory Statement)

An explanatory statement containing full and complete disclosure of all the material facts and the following disclosures prescribed in Schedule I of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders' approval:

(i) Date of the Board meeting at which the proposal for buy back was approved by the Board of Directors of the company;

(ii) Necessity for the buy back;

(iii) Maximum amount required under the buy back and its percentage of the total paid up capital and

free reserves;

(iv) Maximum price at which the shares or other specified securities are proposed be bought back and the basis of arriving at the buyback price;

(v) Maximum number of securities that the company proposes to buy back;

(vi) Method to be adopted for buyback as referred in sub-regulation (iv) of regulation 4;

(vii) (a) the aggregate shareholding of the promoter and of the directors of the 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 or the Meeting of the Board of Directors;

(b) aggregate number of shares or other specified securities purchased or sold by persons including persons mentioned in (a) above from a period of six months preceding the date of the Board Meeting at which the buyback 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;

(viii) Intention of the promoters and persons in control of the company to tender shares or other specified securities for buy-back indicating the number of shares or other specified securities ,details of acquisition with dates and price;

(ix) 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 institutions or banks;

(x) 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 or the meeting of the Board of Directors 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 will in their view 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 shall take into account the liabilities as if the company were being wound up under the provisions of the Companies Act, 1956 or Companies Act or the Insolvency and Bankruptcy Code, 2016 (including prospective and contingent liabilities);

(xi) A report addressed to the Board of Directors 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 of Directors have formed the opinion as specified in clause (x) on reasonable grounds

and that the company will not, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.

METHODS OF BUY-BACK

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 or other specified securities 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.

It may be noted that no offer of buy back for 15% or more of paid up capital and free reserves, shall be made from the open market.

In terms of Regulation 4(vii) a company shall not make any offer of buy-back within a period of one year reckoned from the date of expiry of buy-back period of the preceding offer of buy-back, if any."

Can a company buy back its shares or any specified securities through negotiated deal on or of the stock exchange?

No, Regulation 4(vi) does not permit buy back through negotiated deals (of and on stock exchange), private arrangement, spot transactions.

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. It may be noted that fifteen percent of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders.

Additional Disclosures.

In addition to disclosure required under Schedule I, following additional disclosures are required to be made to the explanatory statement:

(a) the maximum price at which the buy-back of shares or other specified securities shall be made and whether the Board of Directors of the company are being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;

(b) if the promoter intends to offer their shares or other specified securities,

(i) the quantum of shares or other specified securities proposed to be tendered, and

(ii) 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 or other specified securities acquired, the price and the date of acquisition.

Public announcement and Filing of offer documents (Regulation 7 & 8)

The company which has been authorised by a special resolution or a resolution passed by the Board of Directors at its meeting shall make a public announcement within two working days from the date of resolution 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 and shall contain all the material information as specified in Schedule II.

A copy of the public announcement along with the soft copy, shall also be submitted to the Board simultaneously through a merchant banker.

The company shall within five working days of the public announcement file with the Board a draft-letter of offer, along with soft copy, containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

The Board may give its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer. In the event the Board has sought clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

In the event the Board specifies any changes, the merchant banker to the buyback offer and the company shall carryout such changes in the letter of offer before it is dispatched to the shareholders.

The company shall file along with the draft letter of offer, a declaration of solvency in the prescribed form and in a manner prescribed in the Companies Act.

Offer Procedure (Regulation 9)

(1) A company making a buyback offer shall announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buyback offer.

(2) The letter of offer along with the tender form shall be dispatched to the security holders who are eligible to participate in the buyback offer, not later than five working days from the receipt of communication of comments from the Board.

(3) The date of the opening of the offer shall be not later than five working days from the date of dispatch of letter of offer.

(3A) The acquirer or promoter shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism as specified by the Board.

(4) The offer for buy back shall remain open for a period of ten working days.

(5) The company shall accept shares or other specified securities from the security holders on the basis of their entitlement as on record date.

(6) The shares proposed to be bought back shall be divided in to two categories; (a) reserved category for small shareholders and (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.

(7) After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in

the offer by security holders in that category and thereafter from security holders who have tendered over and above their entitlement in other category.

Escrow account

Regulation 9(xi) & (xii) 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 clause (b).
2. the escrow amount is payable in the following manner:
   (i) if the consideration payable does not exceed Rs 100 crores—25 per cent of the consideration payable;
   (ii) if the consideration payable exceeds Rs 100 crores—25 per cent upto Rs 100 crores and 10 per cent thereafter;
3. the escrow account referred to above shall consist of:
   (i) cash deposited with a scheduled commercial bank, or
   (ii) bank guarantee in favour of the merchant banker, or
   (iii) deposit of acceptable securities with appropriate margin, with the merchant banker, or
   (iv) a combination of (i), (ii) and (iii) 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 expiry of buy-back period;
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-fulfillment 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 10)

Regulations lays down that—

1. The company shall 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 ninety percent of 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. The company shall complete the verifications of offers received and make payment of consideration to those security holders whose offer has been accepted and return the shares or other specified securities to the security holders within seven working days of the closure of the offer.

Extinguishing of bought-back securities (Regulation 11)

The company shall extinguish and physically destroy the security certificates so bought back in the presence of a Registrar to issue or the Merchant Banker and the Statutory Auditor within fifteen days of the date of acceptance of the shares or other specified securities. The company shall also ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period.

The shares or other specified securities offered for buy-back if already dematerialised shall 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, the circulars and guidelines framed thereunder.

The company shall, furnish a certificate to the Board certifying compliance as specified above and duly certified and verified by -

(i) the registrar and whenever there is no registrar by the merchant banker;

(ii) two directors of the company one of whom shall be a managing director where there is one;

(iii) the statutory auditor of the company,

The certificate shall be furnished to the Board within seven days of extinguishment and destruction of certificates..

The company shall furnish, the particulars of the security certificates extinguished and destroyed, to the stock exchanges where the shares of the company are listed within seven days in which the securities certificates are extinguished and destroyed. The company shall also maintain a record of security certificates which have been cancelled and destroyed as prescribed in the Companies Act.

Odd-lot Buy-back (Regulation 12)

Regulation 12 states that the provisions pertaining to buy-back through tender offer as specified shall be applicable mutatis mutandis to odd-lot shares or other specified securities.

Buy-back from Open Market (Regulation 14 & 15)

Regulation 14 of the Regulations lays down that a buy-back of shares or other specified securities from the open market may be in any one of the following methods:

(i) Through stock exchange.

(ii) Book-building process.

The company shall ensure that at least 50% of the amount earmarked for buy back, as specified in resolutions (Board/special resolution) is utilized for buying back shares and other specified securities.

Buy-back through the stock exchange (Regulation 16 to 18)

Regulations provide that a company should buy-back its specified securities through the stock exchange as provided hereunder:

- The buy-back shall be made only on stock exchanges having nationwide trading terminals;
- the buy-back of securities should not be from the promoters or persons in control of the company;
- the company should appoint a merchant banker and make a public announcement as referred to in Regulation 7 pertaining to tender offer;
- the public announcement shall be made within 2 working days from the date of passing board of directors resolution or date of declaration of results of the postal ballot for special resolution, as relevant and shall contain disclosures as specified in Schedule IV;
- simultaneously with the issue of such public announcement, the company shall file a copy of the public announcement with the Board.
- the company shall submit the information regarding the shares or other specified securities bought-back, to the stock exchange on a daily basis in such form as may be specified by the Board and the stock exchange shall upload the same on its official website immediately;"
- the company shall upload the information regarding the shares or other specified securities bought-back on its website on a daily basis;
- the buy-back offer shall open not later than seven working days from the date of public announcement and shall close within six months from the date of opening of the offer.
- the company shall submit information regarding the shares or other specified securities bought back, to the stock exchange on daily basis in such form as may be specified by the board;
- the identity of the company as a purchaser would appear on the electronic screen when the order is placed.

Buy–back of physical shares or other specified securities (Regulation 19)

A company shall buy-back its shares or other specified securities in physical form through open market method as provided hereunder:

(a) a separate window shall be created by the stock exchange, which shall remain open during the buy-back period, for buy-back of shares or other specified securities in physical form.

(b) the company shall buy-back shares or other specified securities from eligible shareholders holding physical shares through the separate windows specified in clause (a), only after verification of the identity proof and address proof by the broker.

(c) the price at which the shares or other specified securities are bought back shall be the volume weighted

average price of the shares or other specified securities bought-back, other than in the physical form, during the calendar week in which such shares or other specified securities were received by the broker:

Provided that the price of shares or other specified securities tendered during the first calendar week of the buy-back shall be the volume weighted average market price of the shares or other specified securities of the company during the preceding calendar week.

Explanation: In case no shares or other specified securities were bought back in the normal market during calendar week, the preceding week when the company has last bought back the shares or other specified securities may be considered.

Escrow account (Regulation 20)

(1) The Company shall, before opening of the offer, create an escrow account towards security for performance of its obligations under these regulations, and deposit in escrow account 25 per cent of the amount earmarked for the buy-back as specified in the resolutions.

(2) The escrow account referred to in sub-regulation (1) may be in the form of,—

(a) cash deposited with any scheduled commercial bank; or

(b) bank guarantee issued in favour of the merchant banker by any scheduled commercial bank.

(3) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the company shall while opening the account, empower the merchant banker to instruct the bank to make payment of the amounts lying to the credit of the escrow account, to meet the obligations arising out of the buy-back.

(4) For such part of the escrow account as is in the form of a bank guarantee:

(a) the same shall be in favour of the merchant banker and shall be kept valid for a period of thirty days after the expiry of buy-back periodof the offer or till the completion of all obligations under these regulations, whichever is later.

(b) the same shall not be returned by the merchant banker till completion of all obligations under the regulations.

(5) Where part of the escrow account is in the form of a bank guarantee, the company shall deposit with a scheduled commercial bank, in cash, a sum of at least 2.5 per cent of the total amount earmarked for buy-back as specified in the resolutions as and by way of security for fulfillment of the obligations under the regulations by the company.

The same shall not be returned by the merchant banker till completion of all obligations under the regulations.

(6) The escrow amount may be released for making payment to the shareholders subject to atleast 2.5% of the amount earmarked for buy-back as specified in the resolutions , remaining in the escrow account at all points of time.

(7) On fulfilling the obligation specified in Regulation 15, the amount and the guarantee remaining in the escrow account, if any, shall be released to the company.

(8) In the event of non-compliance with regulation 15, the Board may direct the merchant banker to forfeit the

escrow account except in cases where,-

a. volume weighted average market price (VWAMP) of the shares or other specified securities of the company during the buy-back period was higher than the buy-back price as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

b. inadequate sell orders despite the buy orders placed by the company as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

c. such circumstances which were beyond the control of the company and in the opinion of the Board merit consideration.

(9) In the event of forfeiture for non-fulfillment of obligations specified in sub regulation (8), the amount forfeited shall be deposited in the Investor Protection and Education Fund of Securities and Exchange Board of India.

Extinguishment of certificates (Regulation 21)

Subject to the provisions of sub-regulation (2) and sub-regulation (3), the provisions of regulation 11 pertaining to extinguishment of certificates for tender offers shall apply for extinguishment of certificates..

(2) The company shall complete the verification of acceptances within fifteen days of the payout.

(3) The company shall extinguish and physically destroy the security certificates so bought back during the month in the presence of a Merchant Banker and the Statutory Auditor, on or before the fifteenth day of the succeeding month:

Provided that the company shall ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period..

Buy-back through book-building (Regulation 22)

A company can buy-back its shares or other specified securities through the book-building process as provided hereunder:

1. (a) The special resolution or the Board of Directors resolution, as the case may be, shall be passed in accordance with the Regulation 5.

   (b) The company should appoint a merchant banker and make public announcement.

   (c) A public announcement 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 9 shall aplly:

      (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.

   (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 V 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.

(j) The provisions of sub-regulation (ii) of regulation 10, pertaining to verification of acceptances and the provisions of regulation 10 pertaining to opening of special account and payment of consideration shall be applicable mutatis mutandis.

Extinguishment of certificates (Regulation 23)

The provisions pertaining to extinguishment of certificates for tender offer shall be applicable *mutatis mutandis.*

Obligations of the company for all buy-back procedure (Regulation 24)

According to Regulation 24 of the Regulations, 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 shares or other 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 his/their associates shall not deal in the shares or other specified securities of the company in the stock exchange or off market, including inter-se transfer of shares among the promoters during the period “from the date of passing the resolution of the board of directors or special resolution, as the case may be, till the closing of the offer.

(f) the company shall not raise further capital for a period of one year from the closure of buy-back period, except in discharge of its subsisting obligations.

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.

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

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.

The company shall not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable.

The company shall issue, within two days of the expiry of buy-back period, 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.

Obligations of the merchant banker (Regulation 25)

Regulation 25 provides that the merchant banker shall ensure that:

(a) the company is able to implement the offer;

(b) the provision relating to escrow account has been complied with;

(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 in terms of the Regulations;

(e) a due diligence certificate along with the draft letter of offer has been furnished to the Board;

(f) 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) due compliance of Sections 68, 69 and 70 of the Companies Act and any other laws or rules as may be applicable in this regard has been made;

(h) the bank with whom the escrow or special amount has been deposited releases the balance amount to the company only upon fulfillment of all obligations by the company under the regulations.

(i) a final report is submitted to the Board in the form specified within fifteen days from the date of expiry of buyback period.

LESSON ROUND UP

- According to section 61 of the Companies Act 2013 a limited company having a share capital derives its power to alter its share capital through its articles of association.
- 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 Tribunal on petition, reduce its share capital.

- "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.
- Diminution of capital, the company cancels shares which have not been taken or agreed to be taken by any person.
- According to Section 68(1) of the Companies Act, 2013 a company whether public or private, may purchase its own shares or other specified securities out of: (i) its free reserves; or(ii) the securities premium account; or (iii) the proceeds of any shares or other specified securities.
- When a company buys back its shares or other specified securities, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.
- Section 46A of the Income Tax Act, 1961 provides that any consideration received by a security holder 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 security holder as capital gains.
- All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations, 2018, in addition to the provisions of the Companies Act, 2013.

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, 2013? Explain the relevant provisions of the Act.
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 under SEBI (Buy-back of Securities) Regulations, 2018.
5. Discuss the obligation of Merchant Banker under SEBI (Buy-back of Securities) Regulations, 2018.

Lesson 12
Post Merger Re-Organisation

LESSON OUTLINE

- Factors in Post Merger Reorganization
- Impact of post merger reorganisation
- Integration of business and operation
- Post Merger Success and Valuation
- Human and Cultural factors
- Cultural Factors and post merger –examples
- Measuring Post-Merger Efficiency.

LEARNING OBJECTIVES

Corporate restructuring leads to significant changes in the organization touching various tangible as well as intangible aspects. Apart from various considerations involved in any restructuring and the benefits sought to be achieved there from, it is important that each concerned is aware of post facto actions that need to be completed to ensure smooth working of the organization post restructure.

The actions that need attention in the post restructure scenario find their roots somewhere in the beginning of the whole process. It is imperative that the team involved in the restructure understands the logical ends to each of the steps and sub-steps at the time when an organization is planning for the restructuring. Certain decisions taken in terms of the overall structuring plan, methodology adopted for specific actions forming part of the restructure could be irreversible or may have very little scope to make changes and therefore, it is essential to keep the end objective in mind while planning for the restructure. After reading this lesson you would be able to understand the issues and challenges involved generally after merger, which are to be carried out in conjunction with the strategic planning of merger, measuring post merger efficiency, etc.

INTRODUCTION

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.

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.

FACTORS IN THE POST MERGER REORGANISATION

It would not be inappropriate to divide all actions in the restructuring process in three stages viz. before, during and after, to ensure all actions are covered and put in right buckets to ensure proper planning for each of these actions. Post-restructure actions envisage actions required to be taken after the approval from the Court is obtained in case of a merger of two or more companies. In other words, these are the actions put in the third and final bucket where all prior actions before and during the restructure would flow down.

Restructure could be in the nature of merger, amalgamation, acquisition, de-merger, internal organizational restructuring, financial restructuring, realignment of business segments etc. The points stated below would at best apply to a merger/ amalgamation scenario. Some of these points may apply to other scenarios also. One will need to give a thought about the applicability of the points stated below to the relevant type of business restructuring.

1. Change of name and logo

If the restructure is going to result in change of name or where the Board of Directors decide to change the name of the entity post restructuring, the company will need to plan implementation of change of name on all name boards, letterheads, all branches/ locations where name of the Company has been posted/displayed, including company's website/internet. Similarly, actions need to be taken to modify the corporate logo, if the same is going to change as well.

If the company proposes to adopt a new branding strategy to impress its new logo in the minds of people, it will need to undertake suitable advertisement campaign for the same.

2. Revised organization chart

The company will need to work on updating its organization chart at all levels. It will need to reflect the new vision/mission, new thinking post restructure. In case of takeover, the organization chart may not change significantly; however the acquired entity may need to align its organization structure with the acquiring entity. Also, changes may be necessitated by vertical/ horizontal structures in the organization.

3. Communication

The company should provide proper and timely communication about the restructuring in the organization to all its employees, which would provide updated status, bring clarity on what's happening at the organizational level and avoid miscommunication.

Also, it would be useful to send a communication regarding changes in company policies as well. The company should also consider sending appropriate communication to bankers, auditors, advisors, etc. upon formal completion of the restructuring activity.

4. Employee compensation, benefits and welfare activities

Companies need to be sensitive with regard to terms and conditions of employment. Usually, courts would uphold terms of employment to be no less favorable than existing terms and conditions. Post acquisition, the parent company may want the acquired company to adopt compensation structure of the parent entity. It would result in re-aligning the structure as well as pay scales of existing employees. The company will have to carefully handle such sensitive areas to ensure employee satisfaction and comfort, which pays in the long run in building an image apart from preventing or reducing low employee turnout. Additionally, company would need to consider any prevailing fringe benefits and amenities provided to employees and the feasibility of continuing the same in the new set up (post restructure). For example - The company may re-negotiate insurance premium for employee related insurance policies (life, accident, medical as applicable) depending on the conditions of existing policy or the preferred insurance vendor recommended by acquiring entity.

5. Aligning company policies

The company would need to align/ amend its internal policies to reflect the organization in the post restructure scenario. This may not apply in all types of restructuring. Particularly in case of takeover, the acquiring entity is likely to insist all its policies on the acquired entity to bring consistency in the groups' policies. Specific changes to group policies may be needed depending on nature and size of business, location, applicability of relevant State laws. The challenge continues further in terms of implementing changes in the policies e.g. if acquired company has a policy to use laptops/ computers manufactured by DELL. If the acquiring company uses laptops/ computers manufactured by HP, the company would need to take decision to implement the group policy or make an exception till the time the existing laptops/ computers consume expected life and new ones are due for procurement. Similarly, it would be appropriate to revisit policies with respect to employee uniforms, mobile phones provided by the company, tie up with insurance agents to provide cover as per the terms and conditions acceptable to the parent company, HR-policies that impact office timings, leaves and so on.

6. Aligning accounting and internal database management systems

Besides passing appropriate accounting entries to capture the merger/ acquisition/ financial structure, the company may need to adopt accounting policies, practices based on those followed by its new

parent organization post acquisition. The company needs to understand any reporting and database requirements of acquiring company or merged entity to provide relevant data to the new management and to align existing systems with those of the parent/ merged entity. This may involve providing suitable training to concerned personnel and understanding issues, if any, to avoid incorrect reporting.

7. Re-visiting internal processes

The company which is subjected to restructuring will need to align its internal processes with that of the merged entity/ acquired entity e.g. domestic travel process, reimbursement of expenses process. Company's current process may involve issue of cheques to employees against expenses claimed; whereas merged/ acquiring entity credits its employee claims to a bank account maintained for the purpose. Accordingly, the company will need to open bank account (expense reimbursement account) for all its employees. Company will also need to create e-mail ids for employees of merging entity and ensure access to their previous data as well. In case of an acquisition, acquiring company may insist on changing the mail ids of acquired entity to ensure consistency with its internal requirements.

8. Re-allocation of people

Restructuring typically would entail re-allocation of persons operating on various positions/ grades in similar functions. At times, allocation in support functions becomes a challenge as now two persons handle the similar profile e.g. personnel in HR, finance, administration etc. This would require re-allocation of responsibilities or re-defining the responsibilities to specific geography/ line of business/ business units. In addition, a situation may arise where new positions get created to fit into the new organization structure post restructure. A careful planning is needed to avoid overlapping, underutilization of staff and to take care of career progression.

9. Engagement with statutory authorities

This is one of the important areas that deals with legal requirements and is close to the company secretary. It is essential to identify government authorities that need to be intimated formally about the merger/ amalgamation/takeover e.g. SEBI, Stock Exchange….etc.

Restructuring is also likely to require reflection of the changes to various government permissions, licenses, approvals granted in the past e.g. under labour and industrial laws, sales tax and service tax registrations, permissions under SEZ/STPI requirements where a unit of a merging entity now becomes part of the merged entity. Appropriate steps need to be carried out for updating registration of vehicles owned by merging entity prior to merger.

10. Record keeping

Maintenance of records of merging entity and making suitable entries in the records (e.g. registers under Companies Act reflecting changes in shareholding, directors etc. as applicable) of merged entity is a must. One will need to dive deep to ensure maintenance of all past records including statutory and non-statutory registers, original copies of various forms, returns, certificates, approvals, litigation and property records. Company may need to relocate the records to centralized storage maintained by the merged/new entity.

11. Immoveable Property

A restructuring may cause changes in property records e.g. consequent to merger if merging entity ceases to exist, merged entity would need to take steps to ensure that property records are updated to reflect the name of the merged (new) entity.

If a company is occupying leased premises, one should check conditions under the lease agreement and complete necessary formalities such as intimation to landlord or the like.

If a company has borrowed money against mortgage of property, the company will need to inform bank about the restructure and check if any formalities need to be completed as per bank's policies. While the order of the Hon'ble Court is sufficient to bring legal effect to a merger/ amalgamation, the bank may require formal intimation in the prescribed form within 7 days or so.

12. Expansion of existing teams to support larger organization

A restructuring is likely to put pressure on support staff, which was supporting employee strength before amalgamation e.g. in-house training department was probably handling technical training for 2000 employees. Post amalgamation with another company, the training function needs to cater to training requirements for 5000 employees. It is further likely that the amalgamating entity had an independent training department or had a sophisticated training module to conduct on-line trainings, which the amalgamated entity may not have; which would require further deliberations to implement better practices in the new organization.

13. Revised ISO certification and similar other certifications

Restructuring could lead to changes in existing certifications such as ISO or similar other certifications. With the addition to locations or changes in organization structure, suitable changes need to be reflected to the certifications obtained e.g. post acquisition, the acquiring company may decide to close down a branch of acquired company located in Bangalore, since acquiring company may have a large set up in Bangalore; which would require intimation to concerned bodies and completing necessary formalities to ensure all locations/ Functions in new set up are certified.

14. Re-visiting past decisions/government approvals/ compliances

Restructuring is not always about future decisions or actions. One would need to take a look at past decisions or approvals which were conditional and insist for re-visiting earlier decisions e.g. assuming that the Board of Directors of a company had passed a resolution for not paying any remuneration to non-executive directors. However, acquiring entity pays certain percentage of its profits to non-executive directors. Post acquisition and to fit into group policy, company would need to pass another resolution for payment of remuneration to non-executive directors. Take another example, where a company had obtained permission from Reserve Bank of India stating a condition that the permission is subject to condition that foreign shareholding in the company does not exceed X%. If post acquisition, the percentage of foreign shareholding passes stipulated percentage, the company would need to refer the matter to RBI and seek appropriate sanction. There would be a few issues which are disputable where the order of Court would operate and no formal process needs to be followed. However, it is recommended that a company should take appropriate steps to avoid multiple interpretation or possible non-compliance in such cases. Additionally, a company may be subjected to compliance with Operational Challenges Post Corporate Restructuring e.g. a non-listed company acquires a listed company to make the listed company as its subsidiary, certain provisions of listing agreement/ SEBI regulations would apply which apply to a holding company of a listed company, which was so far not applicable to such a non-listed company. Or where a merging entity had a unit in SEZ; now the merged entity would need to ensure compliances under regulations applicable to SEZ unit. Assume a company has obtained 100 software licenses required as a part of internal system used for a particular project. Post merger, if the size of such team increases to 150 members, company would need to procure additional licenses.

15. Contracts

It is an onerous exercise to check provisions in the existing contracts having connection to any form of restructuring. While order of the Hon'ble Court would prevail and shall ensure that the contracts entered by the merging entity shall continue to be transferred in the name of merged entity as if merged entity was the signing party from the relevant date, provisions contained in a contract with third party may require company to inform about such merger or may give rise to the other party to terminate the contract.

A lease agreement having committed period clause (providing for minimum period of lease during which the lease contract is not terminable by the landlord) may release the landlord from such restriction in the event of a restructure of the lessee entity. Likewise, the company may lose the benefits/ concessions under existing contract, unless company is able to re-negotiate those terms to its favor. Or a contract may provide for lifting the restrictions around fixed fees say for a period of three years, consequent to restructure. It is now imperative for the merged entity to check all such provisions triggering from a restructure rather than criticizing how badly the contract was negotiated by merging entity.

Further, the merged entity would need to check various rights and obligations spelt out in the contracts with third parties and should allocate teams to identify and ensure compliance of those requirements. A loan agreement may insist on the borrower company to obtain prior permission from the Bank. Restructuring is likely to trigger termination rights for other party to the contract, which could turn out to be dangerous from business continuity perspective.

16. Miscellaneous

A restructure would require changes to data displayed on the website of the company/ new entity as the case may be. It would require bringing appropriate changes in company's branding strategy, marketing material, employee visiting cards, employee identity cards, changes to any power of attorneys issued by the erstwhile entity, consolidation of existing bank accounts with the same bank, any action related to existing bank guarantees and other miscellaneous items such as crockery bearing company's logo, etc.

There could be many more aspects to a restructure beyond those stated above, depending on the peculiarities of restructuring by a company. A company should plan for a restructure and try to cover as many aspects as possible to ensure smooth transition and taking necessary actions to complete the restructuring process to its logical end.

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 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 was a good chance for upward revision in the offer price or a strategic deal between Sterlite and AV Birla group.

3. 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.
4. 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.
5. 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.
6. 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 process. 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. POST MERGER SUCCESS AND VALUATION

Every merger is not successful. The factors which help 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.

5. 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 uneasyness. 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.

Cultural Factors and post merger –examples

1. Acquisition of Wellcome group by Glaxo.

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 had 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.

2. Hindustan Lever Ltd. (HLL) and Tomco merger

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 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.

6. 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?

7. 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.

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 tehcnical 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 decade as is evident from the acquisition of Anglo Dutch steel company Corus and Jaguar Land Rover by India based Tata Group. 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.

Lesson 13
Case Studies

LESSON OUTLINE

- Demerger –L&T
- Overseas Acquisition – Tata Corus deal
- Merger of ICICI with ICICI Bank
- Slump sale – Piramal to Abbott
- Dr Reddy Laboratories- Multiple restructuring strategies.
- Leveraged buy- out – Bharti-Zain
- Overseas Acquisition – Daiichi Ranbaxy
- Acquisition – Patni by iGate
- Spice Jet

LEARNING OBJECTIVES

Restructuring may be made in various forms depending upon various factors like profitability, availability of resources, management of competition and such forms may be acquisition, merger, takeovers, leveraged buy outs, slump sale, overseas acquisition, etc. The case studies discussed in this lesson would enable the students to understand the purpose, issues, operational mechanism in general of different types of restructuring strategies that would ultimately results in better conceptual understanding of different strategies, benefits, purpose its synergies etc.

The case studies provided in this chapter are based on the provisions of the Companies Act, 1956.

CASE STUDIES

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.

	Event	*Year*
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 purpose. 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

Date	Particulars
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.

*FIPB abolished w.e.f. June 5, 2017 and approval to be given by concerned Administrative Ministries/Department.

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.

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)].

8. ACQUISITION OF PATNI BY iGATE

In this acquisition, the acquirers were Pan-Asia iGate Solutions, a company incorporated under the laws of the Republic of Mauritius and iGate Global Solutions Limited, a company incorporated under the Companies Act, 1956; Person acting in concert was iGate Corporation, which was incorporated under the laws of

Pennsylvania; The size of this deal was US$ 1.22 billion, which made it the second largest deal in the Indian IT space. The deal was interesting as Patni was two and half times bigger than iGate and iGate had taken a debt of around US$ 700 million to finance it.

The following agreements (Share/Securities (American Depository Shares) purchase agreement) triggered the open offer.

1. As per the share purchase agreement between the promoters of Patni Computers Ltd. and the acquirer, the acquirers to acquire 6,00,91,202 shares representing 45.64% of current equity capital of the target company at Rs.503.50 per share from the promoters of Patni.

2. As per the securities purchase agreement between PanAsia iGate Solutions and PE investor General Atlantic Mauritius Limited, a company incorporated under the laws of Mauritius, the acquirer to acquire 20161867 American Depository shares, representing 1 underlying share amounting to 15.31% of share capital at Rs.503.50.

3. As per the Share purchase agreement by Panasia iGate Solutions Limited and the General Atlantic Mauritius Limited, the acquirer to acquire 2752081 equity shares representing to 2.09% of share capital at Rs. 503.50.

4. Consequent to this, a public announcement for open offer was made on January 11, 2011 in all national dailies and vernacular language as required, to acquire 2, 70, 85, 565 shares of target company representing 20.6% of current equity capital at Rs.503.50.

5. Post offer public announcement was made on May 09, 2011 declaring the completion of offer. This has resulted in
    1. share acquired through share/securities purchase agreement 83005150 (i.e61.29%)
    2. Shares acquired in the offer 27085565 (ie 20%)
    3. total shareholding by the acquirer 110090715 shares (ie 81.29%)
    4. Post offer shareholding by public 25337108 (i.e 18.71%)
6. As the public holding has gone below the minimum public holding, the company excercised reverse book building the the shares of patni computers were delisted with effect from May 21, 2012.

SPICEJET LIMITED BEING TAKEN OVER BY MR AJAY SINGH

CASE STUDY- A BRIEF

The Back ground

SpiceJet is a public limited company listed on the Bombay Stock Exchange and National Stock Exchange. It is a scheduled passenger airline engaged in providing domestic and international airline services in India.

The Board of Directors of Spicejet Limited (the Company) at its meeting held on January 15, 2015, inter-alia, took on record the proposal of the principal shareholder and Promoter, Mr. Kalanithi Maran and KAL Airways Private Limited to transfer the ownership, management and control of the Company to Mr. Ajay Singh (the Acquirer) pursuant to a 'Scheme of Reconstruction and Revival for the takeover of ownership, management and control of SpiceJet Limited', that was to be filed before the Competent Authority, the

Ministry of Civil Aviation, Government of India.[1]

The Company has informed BSE that in furtherance of the earlier intimation dated January 15, 2015, the Company has on January 22, 2015 received the approval of the Competent Authority, the Ministry of Civil Aviation, Government of India for the 'Scheme of Reconstruction and Revival for the takeover of ownership, management and control of SpiceJet Limited' by Mr. Ajay Singh in accordance with the application made by the Company.[2]

The Board of Directors of the Company at its meeting held on January 29, 2015 took on record the Share Sale and Purchase Agreement dated January 29, 2015 between the Company, Mr. Kalanithi Maran, Kal Airways Private Limited and Mr. Ajay Singh pursuant to which the existing Promoter (i.e. Mr. Kalanithi Maran and Kal Airways Private Limited) have agreed to sell and transfer their entire shareholding aggregating to 350,428,758 equity shares (58.46%) to Mr. Ajay Singh. The Board has further, inter-alia, transacted on the following:

1. Increase in Authorised Share Capital of the Company to `20,000,000,000 (Rupees Twenty Thousand Million) divided into 1,500,000,000 (One Thousand Five Hundred Million) equity shares of `10 (Rupees Ten) each and 5,000,000 (Five Million) non-convertible Cumulative Redeemable Preference Shares `1,000 (Rupees One Thousand) each.

2. To create, offer, issue and allot upto 3,750,000 (Three Million Seven Hundred and Fifty Thousand) non-convertible Cumulative Redeemable Preference Shares of Rs.1,000 (Rupees One Thousand) each to Mr. Kalanithi Maran and/or Kal Airways Private Limited on preferential basis.

3. To create, issue, offer and allot equity shares/ warrants and/ or any instrument convertible into equity shares whether optionally or otherwise/ Global Depository Receipts (GDRs)/ American Depository Receipts (ADRs)/ Foreign Currency Convertible Bonds (FCCBs) ("Securities") for an aggregate amount not exceeding `15,000,000,000 (Rupees Fifteen Thousand Million only) or equivalent currency(ies) to any person or persons, whether or not shareholder of the Company.

4. Change in the registered office of the Company from State of Tamil Nadu to Delhi.

5. Alteration to the Articles of Association of the Company.

6. To conduct postal ballot exercise in order to obtain shareholders approval, wherever required, for above purposes in accordance with provisions of the Companies Act, 2013 and other applicable rules and regulations.

Further, it is to be noted that Mr. Kalanithi Maran, Mrs. Kavery Kalanithi and Mr. S. Natrajhen have resigned from the Board of the Company with immediate effect and the Board has accepted the same[3].

Approval of Competition Commission of India

On 9th February 2015, the Competition Commission of India (hereinafter referred to as the "Commission") received a notice under sub-section (2) of Section 6 of the Competition Act, 2002 ("Act") filed by Mr. Ajay Singh ("Acquirer"). The said notice was given to the Commission pursuant to the approval by the Ministry of Civil Aviation of a scheme of reconstruction and revival for takeover of the ownership, management and control of SpiceJet Limited ("SpiceJet") and execution of the Share Sale and Purchase Agreement between the Acquirer, SpiceJet and the two promoters of SpiceJet, namely, KAL Airways Private Limited and

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[1] BSE announcement

[2] BSE announcement

[3] Copy of spicejet letter to BSE

Mr. Kalanithi Maran (hereinafter KAL Airways Private Limited and Mr. Kalanithi Maran are collectively referred to as "Sellers"), dated 29th January 2015 ("SPA").

The proposed combination involves sale and transfer of equity shares aggregating to 58.46 percent of the share capital of SpiceJet by the Sellers to the Acquirer.

In terms of Regulation 14 of the Competition Commission of India (Procedure in regard to transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations"), vide letter dated 13th February 2015, the Acquirer was required to remove defects and provide certain information/document(s). The Acquirer filed its response on 17th February 2015 after seeking an extension in this regard.

The Acquirer is a first generation entrepreneur. It has been stated that the Acquirer inter-alia has experience in the businesses of information technology and airline operations.

As stated in the notice, the Acquirer is not associated with the operations or ownership of any other existing airline. Accordingly, there are no horizontal overlaps or vertical relationship between the SpiceJet and the Acquirer. As stated above, the proposed combination is a transfer of shares and control in SpiceJet from the sellers to the Acquirer. The proposed combination is, therefore, not likely to cause any appreciable adverse effect on competition in India.

Considering the facts on record and the details provided in the notice given under sub-section (2) of Section 6 of the Act and the assessment of the combination after considering the relevant factors mentioned in sub-section (4) of Section 20 of the Act, the Commission is of the opinion that the proposed combination is not likely to have appreciable adverse effect on competition in India and therefore, the Commission hereby approves the proposed combination under sub-section (1) of Section 31 of the Act.

This approval is without prejudice to any other legal/statutory obligations as applicable.[4]

Scheme of Reconstruction pursuant to Order of competent Authority – does not trigger open offer under SEBI (SAST) Regulations

Regulation 10(1)(d)(ii) of SEBI (SAST) Regulations 2011 states that Acquisition Pursuant to a scheme 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 does not trigger open offer as required under Regulation 3 or Regulation 4 of SEBI (SAST) Regulations 2011 even if the acquisition crosses the specified threshold limit for open offer.

Since the Ministry of Civil aviation, a Competent Authority approved the scheme of reconstruction, the acquirer Mr Ajay Singh did not go through the open offer process as mandated under SEBI (SAST) Regulations, 2011.

Report to SEBI

Regulation 10(6) of the SEBI (SAST) Regulations, 2011 provides that in respect of any acquisition made pursuant to exemption provided for in SEBI (SAST) Regulations, 2011, the acquirer should file a report with the stock exchanges where the shares of the company are listed, in prescribed form not later than 4 working days from the acquisition and the stock exchange shall forthwith disseminate such information to the public. Mr Ajay Singh, the acquirer accordingly filed such report on February 27, 2015 in respect of acquisitions made on February 23, 2015.

The details as stated in the report are as under:

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[4] Order of CCI

Sl No.	Name of the Transferor	Details of acquisition
1	Mr Kalanithi Maran	148910753 equity shares
2	KAL Airways Private Limited	201518005 equity shares
Total		350428758 equity shares

Existing holding by Mr Ajay Singh 11106866 (ie before acquisition)(i.e 1.85% of total capital of the company. New shares acquired, being 350428758 equity shares the total holding by Mr Ajay Singh would be 361535624 being 60.31% of total capital of target company. The prices were not disclosed.

The sale was through off market deal. The acquirer and the transferors have made disclosures as required under SEBI (Prohibition of Insider Trading) Regulations, 1992 being SEBI (Prohibition of Insider Trading) Regulations 2015 would be applicable from May 15, 2015. Disclosures were also made as required under SEBI (SAST) Regulations.

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.

SELF TEST QUESTIONS

1. Discuss a case study on Leveraged Buy Out?
2. Discuss a case study on acquisition resulting in delisting.

Lesson 14
Valuation Introduction and Techniques

LESSON OUTLINE

- Introduction
- Need and purpose of valuation
- When valuation is required
- Valuation motives
- Factors influencing valuation
- General principle
- Preliminary steps in valuation
- Valuation methods
  - Assets based
  - Earning based
  - Market based
  - Valuation standards

LEARNING OBJECTIVES

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, 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 to 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. After reading this lesson you will be able to understand the meaning, purpose and methods of valuation.

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.

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 to 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 is Valuation 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 shares’.
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 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. To determine purchase price of a 'block of shares', which may or may not give the holder thereof a controlling interest in the company.
11. To value the interest of dissenting shareholders under a scheme of amalgamation merger or reconstruction.
12. Conversion of debt instruments into shares.
13. Advancing a loan against the security of shares of the company by the Bank/Financial Institution.
14. As required by provisions of law such as the Companies Act, 2013 or Foreign Exchange Management Act, 1999 or Income Tax Act, 1961 or the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 [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 grant 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 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. (Do 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.

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 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 to 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.

General Principles of Business valuation

1. Value is determined at a specific point in time.
2. Value is prospective. It is equivalent to the present value, or economic worth, of all future benefits anticipated to accrue from ownership.
3. The market determines the required rate of return.

4. Value is influenced by liquidity.
5. The higher the underlying net tangible asset value base, higher the going concern value.

Preliminary Steps in Valuation

A business/corporate valuation involves analytical and logical application/analysis of historical/future tangible and intangible attributes of business. The preliminary study to valuation involves the following aspects:

1. Analysis of business history
2. Profit trends
3. Goodwill/Brand name in the market
4. Identifying economic factors directly affecting business
5. Study of exchange risk involved
6. Study of employee morale
7. Study of market capitalization aspects
8. Identification of hidden liabilities through analysis of material contracts.

Strategies Requiring Valuation – Examples

- Determining the consideration for Acquisition
- Determining the swap ratio for Merger/Demerger
- Sale/Purchase of Intangible assets including brands, patents, copyrights, trademarks, rights
- Determining the Fair value of shares for issuing ESOP
- Disinvestment of PSU stocks by the Government
- Liquidation /insolvency of company

METHODS OF VALUATION (VALUATION TECHNIQUES)

The most popular methods of valuation amongst other includes

1. Asset based valuation
2. Earnings based valuation
3. Market based valuation

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 its 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 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 posses 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. 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 therefor. Valuation based on earnings based on the rate of return on capital employed is a more modern method. 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.

Thus $P/E = \frac{P}{EPS}$

Where P is the current price of the shares

The share price can thus be determined as

$$P = EPS \times P/E \text{ ratio}$$

III. MARKET BASED APPROACH TO VALUATION

Market based methods help the strategic buyer estimate the subject business value by comparison to similar businesses. Where the company is listed, market price method helps in evaluating on the price on the secondary market. Average of quoted price is considered as indicative of the value perception of the company by investors operating under free market conditions. To avoid chances of speculative pressures, it is suggested to adopt the average quotations of sufficiently longer period. The valuer will have to consider the effect of issue of bonus shares or rights shares during the period chosen for average.

(i) Market Price Method is not relevant in the following cases:

- Valuation of a division of a company
- Where the share are not listed or are thinly traded
- In the case of a merger, where the shares of one of the companies under consideration are not listed on any stock exchange
- In case of companies, where there is an intention to liquidate it and to realise the assets and distribute the net proceeds.

(ii) In case of significant and unusual fluctuations in market price the market price may not be indicative of the true value of the share. At times, the valuer may also want to ignore this value, if according to the valuer, the market price is not a fair reflection of the company's underlying assets or profitability status. The Market Price Method may also be used as a back up for supporting the value arrived at by using the other methods.

(iii) It is important to note that regulatory bodies have often considered market value as one of the very important basis for preferential allotment, buyback, open offer price calculation under the Takeover Code.

(iv) In earlier days due to non-availability of data, while calculating the value under the market price method, high and low of monthly share prices were considered. Now with the support of technology, detailed data is available for stock prices. It is now a usual practice to consider weighted average market price considering volume and value of each transaction reported at the stock exchange.

(v) If the period for which prices are considered also has impact on account of bonus shares, rights issue etc., the valuer needs to adjust the market prices for such corporate events.

Following methods are used for valuation under this approach:

(i) Comparable companies multiple approach – Market multiples of comparable listed companies are computed and applied to the company being valued to arrive at a multiple based valuation.

(ii) Comparable transaction multiples method – This technique is mostly used for valuing a company for M&A, the transaction that have taken place in the industry which are similar to the transaction under consideration are taken into account.

(iii) Market value approach – The market value method is generally the most preferred method in case of frequently traded shares of companies listed on stock exchanges having nationwide trading as it is perceived that the market value takes into account the inherent potential of the company.

MARKET COMPARABLES

This method is generally, applied in case of unlisted entities. This method estimates value by relating the same to underlying elements of similar companies for past years. It is based on market multiples of 'comparable companies'. For example

- Earnings/Revenue Multiples (Valuation of Pharmaceutical Brands)
- Book Value Multiples (Valuation of Financial Institution or Banks)
- Industry Specific Multiples (Valuation of cement companies based on Production capacities)

- Multiples from recent M&A Transactions.

Though this method is easy to understand and quick to compute, it may not capture the intrinsic value and may give a distorted picture in case of short term volatility in the markets. There may often be difficulty in identifying the comparable companies.

This method estimates value by relating the same to underlying elements of similar companies for past years. It is based on market multiples of 'comparable companies'. Philosophical basis behind the method is that there is a comparable asset in the market which is already valued, which can form basis of valuation of an asset. This method of valuation is also known as relative valuation.

Following steps are involved in this method of valuation :

- Comparable assets are identified and their market values are obtained
- Market values are converted into standardized values, since the absolute price cannot be compared
- Standardized value or multiple for the asset being analyzed are compared with the standardized value of the comparable asset, controlling for any difference between the firms that might affect the multiple, to judge whether the asset is under or over valued

The following metric can be used as a basis for relative valuation :

- Sales – EV/Sales
- EBITDA – EV/EBITDA
- EBIT – EV/EBIT
- Earnings/Net Profit – Price-to-Earnings Ratio
- Book Value – Price to Book
- Cash Flow – EV/Cash Flow

Industry Specific variable (Price per ton capacity of steel, per store value in the days of retail boom, price per click in e-commerce).

Which multiple should one use?

While a range of values can be obtained from a number of multiples, the best estimate value is obtained using one multiple. Multiple that seems to make the most sense for that sector should be used. For example

- *In retailing:* The focus is usually on same store sales and profit margins and so the revenue multiple is the most common in this sector.
- *In financial services:* The emphasis is usually on return on equity. Book Equity is often viewed as a scarce resource, since capital ratios are based upon it. Price to book ratios dominate
- *In technology:* Growth is usually the dominant theme. PEG ratios were invented in this sector.

Other aspects as to the methods of valuation

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.

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 loosing 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.

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 it's 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.

Valuation by Registered Valuer

Registered Valuer is one among the many new concepts introduced by the Companies Act, 2013 to

provide for a proper mechanism for valuation of the various assets and liabilities related to a company and to standardize the procedure thereof.

Registered Valuer means a person registered as a Valuer under Chapter XVII of the Act. A person who is registered as a Registered Valuer in pursuance of Section 247 of the Act with the Central Government and whose name appears in the register of Registered Valuers maintained by the Central Government or any authority, institution or agency, as may be notified by the Central Government only can act as a registered valuer.

As per Section 247 of the Act -

(1) Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.

(2) The valuer appointed shall,—

(a) make an impartial, true and fair valuation of any assets which may be required to be valued;

(b) exercise due diligence while performing the functions as valuer;

(c) make the valuation in accordance with such rules as may be prescribed; and

(d) not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during or after the valuation of assets.

(3) If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees:

Provided that if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(4) Where a valuer has been convicted under sub-section (3), he shall be liable to— (i) refund the remuneration received by him to the company; and (ii) pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

The Companies (Registered Valuers and Valuation) Rules, 2017

The Central Government vide its Notification No. NO.GSR 1316(E) [F.NO.1/27/2013-CL-V], dated 18-10-2017 notified the Companies (Registered Valuers and Valuation) Rules, 2017.

The notification of these Rules shall, while bringing about a clarity regarding various aspect of valuation will have a major impact on the industry, professionals, stakeholders and the government as well. These rules envisage formation of Registered Valuers Organisations for enrolling and imparting continuous education to Registered Valuers.

Though there is some consensus among professional valuers about generally accepted approaches, methods and procedures; however, a need was felt for education, training, regulation and standardization of prevalent practices in valuation. The notification of these Rules will lead to the setting-up of Valuation Standards that will improve transparency and governance.

Introduction of Valuation Standards will ensure that the valuation reports disclose a true, fair and complete view and result in greater objectivity in valuation procedures. The increased transparency and fairness in the valuation system shall also boost stakeholders' confidence alongside plugging of loopholes in valuation.

Eligibility for registered valuers (Rule 3)

Sub-rule 1 provides that a person shall be eligible to be a registered valuer if he-
(a) is a valuer member of a registered valuers organisation;

Explanation.— For the purposes of this clause, "a valuer member" is a member registered valuers organisation who possesses the requisite educational qualifications and experience for being registered as a valuer;

(b) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;

(c) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;

(d) possesses the qualifications and experience as specified in rule 4;

(e) is not a minor;

(f) has not been declared to be of unsound mind;

(g) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;

(h) is a person resident in India;

Explanation.— For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999) as far as it is applicable to an individual;

(i) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

(j) has not been levied a penalty under section 271J of Income-tax Act, 1961 (43 of 1961) and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and

(k) is a fit and proper person:

Explanation.— For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

(i) integrity, reputation and character,

(ii) absence of convictions and restraint orders, and

(iii) competence and financial solvency.

Sub-rule 2 provides that No partnership entity or company shall be eligible to be a registered valuer if-

(a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate of another company or body corporate;

(b) it is undergoing an insolvency resolution or is an undischarged bankrupt;

(c) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), (f), (g), (h), (i), (j) and (k) of sub-rule (1);

(d) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or

(e) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer.

Qualifications and experience (Rule 4)

An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:

(a) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or

(b) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or

(c) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership.

Explanation-I.─ For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

Explanation-II.─ Qualifying education and experience for various asset classes, is given in an indicative manner in Annexure–IV of these rules. 8

Explanation III – for the purposes of this rule and Annexure IV, 'equivalent' shall mean professional and technical qualifications which are recognised by the Ministry of Human Resources and Development as equivalent to professional and technical degree.

Conduct of valuation (Rule 8)

(1) The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18:

Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per-

(a) internationally accepted valuation standards;

(b) valuation standards adopted by any registered valuers organisation.

(2) The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of

the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.

(3) The valuer shall, in his report, state the following:-

(a) background information of the asset being valued;

(b) purpose of valuation and appointing authority;

(c) identity of the valuer and any other experts involved in the valuation;

(d) disclosure of valuer interest or conflict, if any;

(e) date of appointment, valuation date and date of report;

(f) inspections and/or investigations undertaken;

(g) nature and sources of the information used or relied upon;

(h) procedures adopted in carrying out the valuation and valuation standards followed;

(i) restrictions on use of the report, if any;

(j) major factors that were taken into account during the valuation;

(k) conclusion; and

(l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

Functions of a Valuer (Rule 10)

A valuer shall conduct valuation required under the Act as per these rules.

Eligibility for registered valuers organisations (Rule 12)

(1) An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if ─

(i) it has been registered under section 25 of the Companies Act, 1956 (1 of 1956) or section 8 of the Companies Act, 2013 (18 of 2013) with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes and has in its bye laws the requirements specified in Annexure-III;

(ii) It is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession;

Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-

(a) an organisation registered as a society under the Societies Registration Act, 1860 (21 of 1860) or any relevant state law, or;

(b) an organisation set up as a trust governed by the Indian Trust Act, 1882 (2 of 1882).

(2) The organisation referred to in sub-rule (1) shall be recognised if it –

(a) conducts educational courses in valuation, in accordance with the syllabus determined by the authority, under rule 5, for individuals who may be its valuers members, and delivered in class room or through distance education modules and which includes practical training;

(b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation ;

(c) conducts training for the individual members before a certificate of practice is issued to them;

(d) lays down and enforces a code of conduct for valuers who are its members, which includes all the provisions specified in Annexure-I;

(e) provides for continuing education of individuals who are its members;

(f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and

(g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.

(3) A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013 (18 of 2013), and include in its bye laws the requirements specified in Annexure- III, within one year from the date of commencement of these rules.

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 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.

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 Standards

Valuation Standards aims to provide uniformity in valuation of various tangible and intangible classes of assets that provides consistent delivery of standards.

The International Valuation Standards Council

The ***International Valuation Standards Council*** is the established international standard setter for valuation. Through the International Valuation Standards Board, the IVSC develops and maintains standards on how to undertake and report valuations, especially those that will be relied upon by investors and other third party stakeholders. The IVSC also supports the need to develop a framework of guidance on best practice for valuations of the various classes of assets and liabilities and for the consistent delivery of the standards by properly trained professionals around the globe.

The IVSC has published International Valuation Standards (IVS) since 1985.

Membership of IVSC is open to organisations of users, providers, professional institutes, educators, and regulators of valuation services. IVSC members appoint the IVSC Board of Trustees.

In nutshell, valuations of businesses, business ownership interests, securities, tangible or intangible assets may be performed for a wide variety of purposes including the following:

- Valuation for financial transactions such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions.
- Valuation for Dispute Resolution and/ or litigation/pending litigation relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, employment disputes and intellectual property disputes.
- Valuation for Compliance-oriented engagements, for example:
  - (a) Financial reporting and
  - (b) Tax matters such as corporate reorganizations; income tax, Property tax, purchase price allocations; and charitable contributions.

  Other purposes like valuation for planning, internal use by the owners, etc.

  The same business may have different values if different standard of value is used and different approaches are adopted. The rising demand for valuation services has given new avenues for the finance professionals. Going forward more and more professional would be engaged in performing valuation services.

LESSON ROUND UP

- 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 valuation methods can be divided into three broad categories viz., asset based, earning based and

market based methods.

- Asset based 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.
- 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.
- The Market Price Method evaluates the value on the basis of prices quoted on the stock exchange.

SELF TEST QUESTIONS

1. What is the purpose of valuations?
2. What are the different types of valuation?
3. What is discounted cash flow method?
4. How do you carry out valuation exercise based on market comparables?

Lesson 15

Regulatory Aspects of Valuation with Reference to Corporate Strategies

LESSON OUTLINE

- Regulatory aspects as regards valuation
    1. Valuation of shares under FDI policy
    2. Valuation of shares under SEBI Regulations
- Valuation of sweat equity shares
- Valuation under SEBI (SAST) Regulations 2011
- SEBI (Share Based Employee Benefits) Regulations, 2014
- Valuation under ESOP guidelines
- Valuation under delisting regulations
- Valuation under SEBI (ICDR) Regulations, 2018
- Taxation aspects
- Valuation of different strategies
- Mergers & Acquisitions
- Demerger
- Slump sale
- Liquidation

LEARNING OBJECTIVES

There are various methodologies for valuing a business, all having different relevance depending on the purpose of valuation. There are many methodologies that a valuer may use to value the shares of a company/business. In practice, the valuer normally uses different methodologies of valuation and arrives at a fair value for the entire business by combining the values arrived using various methods. These methodologies includes asset based approach, earnings based approach and market based approach. The concepts of these approaches are dealt in the previous lesson. Besides regulatory aspects also impact valuation. For example there are regulatory prescriptions for valuation of shares under SEBI (SAST) Regulations, 2011 SEBI (ICDR) Regulations, 2009 SEBI (Share Based Employee Benefits) Regulations, 2014, FEMA/Consolidated FDI Policy, Income Tax Act, 1961, etc. After reading this lesson you will be able to understand the regulatory aspects of valuation, different valuation methodologies for different strategies including taxation aspects.

"Price is what you pay & Value is what you get". ***—Warren Buffet***

INTRODUCTION

Understanding Corporate valuation is not only a pre-requisite during different types of restructuring phase of the company. It is required at frequent intervals to identify the economic value creation and any destruction if any occurred. It is also important to note that value is different from the price. The process of valuation includes a detailed and comprehensive analysis taking into an account the past present and future earnings prospects and analysis of physical and intangible assets and general economic and industry conditions. Determination of realistic value of a firm is indeed a difficult process. Some times market price of the share of the company may be an approximate indication of the firm. Market price again depends on current earnings and the future growth. Market price of shares may not be feasible for unlisted company for which asset based approach of valuation might be a feasible option.

The Ministry of Corporate Affairs (the then Department of Company Affairs) has constituted an Expert Group in 2002 under the Chairmanship of Mr. Shardul S. Shroff to suggest guidelines on valuation of shares in connection with amalgamation, merger, de-merger, acquisition, buy-back, etc.,

The Expert Group is of the view that there are two circumstances under which the prescribed valuation guidelines may apply to the companies.

These are:

(i) Circumstances under which a valuation from the Registered Valuer(s) is mandatory and

(ii) Circumstances under which a valuation from the Registered Valuer(s) is recommended but not mandatory.

The Expert Group has adopted two basic principles for identifying the circumstances under which the mandatory valuation is required. These circumstances include:

(i) Whenever a shareholder's resolution, ordinary or special, is required to authorize the transaction or where the shareholders are required to take a decision on values which may have a bearing on or help in making the decision ; and

(ii) All Related Party transactions described herein.

Without limiting the generality of the above, some of the specific circumstances under which the Expert Group opines that the company/Board of Directors should seek a mandatory valuation from a Registered Valuer(s) are:

(i) All Schemes of Compromise and Arrangement

(ii) Sale of a business, including investment business and disposal of a controlling interest in an undertaking or a company, through disposal of shares, an undertaking or a substantial part thereof including a slump sale / itemised sale

(iii) All equity and equity linked investments where shareholders approval is required

(iv) Purchases, Sales, combinations and restructuring entailing acquisition or disposal of business, an undertaking or part of an undertaking, securities, equity and preference capital, and outstanding debt and liabilities, where Related Parties are counterparties.

However, the valuation should not be mandatory for transactions, which are not material in nature. The Expert Group is of the view that it cannot straightjacket the test of materiality either on a

monetary test or a pro rata principle without reference to the context and purpose, e.g. the transfer of a small percentage may result in a change of control and would be considered material. Materiality may be in the context of liabilities, contingent liabilities or valuable transferred rights. While the test of materiality must therefore be applied in each case, due consideration should be given to asset/liability value, turnover and profit contribution in making this determination;

(v) All preferential allotments made to Related Parties and persons controlling the company

(vi) Specified recapitalisation situations - whether effected through a buyback of shares under the SEBI (Buy-back of Securities) Regulations, 1998 or Open offers by persons in management or promoters, or a capital reduction under Section 100 or in any other manner, which have the effect of 'squeezing out' minority shareholders, for enhancing the control of the promoters or persons in management beyond 90% or more of the issued share capital, or which have the declared or stated objective of delisting the company. Mandatory valuations are also recommended where persons in management or the promoters become shareholders of 90% or more of the issued share capital of the company and seek to negotiate the exit of minority shareholders, provided there is substantial minority interest in such a situation.

The Expert Group is of the view that under the following circumstances, a valuation opinion may not be prescribed as a company activity requiring disclosure to shareholders. These circumstances include :

(i) Capital reduction, unless covered in paragraph 2.2.3 (v) above;

(ii) Issue of shares to public through a public offering;

(iii) Rights issue under the Companies Act;

(iv) Disinvestment of Central and State Public Sector Undertaking; and

(v) Family settlements.

VALUATION DOCUMENTATION

Valuation exercise is based on observation, inspection, analysis and calculation. During this process, the valuer goes through various documents, records his observation, makes relevant calculation and records these calculation and analysis results. In this process many documents are generated which forms the basis of his conclusion on the valuation of the subject matter. It is very necessary for him to preserve all such records so that these documents may help him to substantiate his conclusion on valuation. Moreover, these documents also become a matter of reference in future.

Objectives of Documentation in Valuation Exercise

Documentation is "an essential element" of Valuation quality. Valuation documentation provides the principal written record to support the following:

- The Valuer's report assertion that the valuation exercise was performed with due diligence and in accordance of generally accepted valuation principles; and
- The Valuers' conclusions about Valuation of the subject matter of the Valuation exercise and other related aspects of valuation.

Valuation documentation must clearly demonstrate that the Valuation exercise was in fact performed in compliance with generally accepted valuation principles and applicable standards. It must provide a clear link to valuation conclusions and must contain sufficient information, in sufficient detail, for a clear understanding of the following:

- The nature, timing, and extent of the valuation exercise
- The work performed;
- The purpose of the valuation
- The source of the information analyzed and supporting evidential matter obtained, examined, and evaluated; and
- The conclusions reached.

The following are the more specific purposes of documentation in Valuation exercise:

- Assisting Valuer to plan and perform the Valuation Exercise
- Assisting those responsible to direct, supervise, and review the work performed;
- Providing and demonstrating the accountability of those performing the work (i.e., compliance with applicable standards);
- Assisting quality-control reviewers to understand and assess how the engagement team reached and supported significant conclusions;
- Enabling internal and external inspection teams and peer reviewers to assess compliance with professional, legal, and regulatory standards and requirements; and
- Assisting successor Valuer.

Inadequate documentation makes it difficult or impossible to determine if the Valuation exercise was actually done.

LIST OF DOCUMENTS

During the course of Valuation exercise, a valuation expert collects/prepares various documents. The documents so obtained or prepared may be different from assignment to assignment but an indicative list of documents to be maintained is as given,

1. Documents pertaining to Basic information of client entity i.e. Details about Company Promoters, Key Management professional of the Company, Memorandum of Association, Article of Association, Prospectus, prior three years financial statements.
2. Copy of valuation engagement with the Client
3. Copy of Previous valuation report of the subject matter of valuation exercise, if any.
4. Documents which are pertaining to assumptions and limiting conditions in the valuation assignment.
5. Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest.
6. Documents pertaining to selection of Valuation approach used in the valuation assignment including the rationale and support for their use.
7. Any restriction or limitation on the scope of the Valuer's work or the data available for analysis
8. Basis for using any valuation assumption during the valuation engagement.
9. Documents pertaining to any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied.

Other documentation considered relevant to the engagement by the Valuer.

DOCUMENTATION RETENTION

Generally Valuation exercise is done in connection with statutory, legal or personal matters. It is necessary that documents pertaining to valuation should be maintained as per applicable legislation on subject matter of valuation.

Documentation pertaining to Valuation exercise needs to maintained at,

1. Valuer's end
2. Client's end in form of valuation report along with annexure and exhibits.

Period for Retention of Documents at Valuer's end

No legislation has been framed yet which specifies the period for documentation retention at valuer's end. However Government or professional Institute may bring guidelines on this matter. According to Standard on Auditing (SA) 230 on Audit documentation, an Auditor should retain the documentation pertaining to an Audit assignment for a period of 7 years.

Period for Retention of Documents at Client's end

Retention period of Valuation document at Clients' end would depend on the purpose of valuation exercise. If valuation has got carried on for the purpose of Companies Act, Companies (Preservation and Disposal of Records) Rules, 1966 will apply. Similarly if valuation has been carried on for the purpose of Income-tax Act, provision relating to Income-tax Act, 1961 and Income-tax Rules, 1962 will apply.

Judicial Pronouncement on Valuation Principles/Valuation Reports

Some of the salient dicta of Courts in relation to valuation principles and valuation reports are stated under:

In *Bahoo J. Coyajee v. Shanta Genevieve Prommeret Parulekar [1991] (3) Bom. LR 319*, the Court observed:

"If the thing complained of is a thing which in substance the majority of the company are entitled to do or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes".

In *Miheer H. Mafatlal v. Mafatlal Industries Ltd. [1996] 87 Comp. Cas. 792 (SC),* the Hon'ble Supreme Court held:

> "If Share Exchange Ratio is fixed by Chartered Accountant upon consideration of various factors and approved by majority of shareholders in meeting, the Court will not disturb ratio".

In *Re. Maknam Investments Ltd. [1995] (4) Comp.LJ page 330*, the Calcutta High Court observed:

> "Court does not go into the matter of fixing of exchange ratios in great detail or to sit in appeal over the expert decision of concerned chartered accountant of repute. Court only sees whether there is any manifest unreasonableness or manifest fraud involved in the matter".

In *Hindustan Lever Employees Union v. Hindustan Lever Limited [1995] (Supp.) (1) SCC 499 at 517(519),* the Hon'ble Court stated:

"The valuation of shares is a technical matter. It requires considerable skill and experience. There are bound to be differences of opinion among accountants as to what is the correct value of the shares of a company. It was emphasized that more than 99% of the shareholders had approved the valuation. The test of fairness of this valuation is not whether the offer is fair to a particular shareholder…. who may have reasons of his own for not agreeing to the valuation of the shares, but the overwhelming majority of the shareholders have approved of the valuation. The Court should not interfere with such valuation".

The Hindustan Lever case also repelled the case that valuation particulars needed a proper disclosure as material facts in the Explanatory Statement. It confirmed the judgment of *Jitendra R. Sukhadia v. Alembic Chemical Works Co. Ltd.,(1987) 3 Comp.L.J 141 (Guj)* as follows:

"How this exchange ratio was worked out, however, was not required to be stated in the statement contemplated under Section 394(1)(a)".

The Hindustan Lever's judgment (1995) Supp. (1) SCC 499 at 502 noted:

"In the absence of it being shown to be vitiated by fraud and malafide, the mere fact that the determination done by slightly different method might have resulted in different conclusion would not justify interference of Court."

Regulatory aspects as to valuation

SEBI Regulations

1. Pricing under SEBI (ICDR) Regulations, 2018
2. Determination of offer price under SEBI (Delisting of Equity Shares) Regulations, 2009
3. Offer Price under SEBI (SAST) Regulations, 2011
4. Price of sweat equity shares under SEBI (Issue of Sweat Equity) Regulations, 2002
5. Valuation under SEBI (Share Based Employee Benefits) Regulations, 2014

Consolidated FDI policy 2017

Pricing in Public Issue as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

Pricing

(1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case may be.

(2) The issuer shall undertake the book building process in the manner specified in Schedule XIII.

Differential pricing

(1) An issuer may offer specified securities at different prices, subject to the following:

(a) retail individual investors or retail individual shareholders [or employees entitled for reservation made under regulation 33 may be offered specified securities at a price not lower than by more than ten percent of the price at which net offer is made to other categories of applicants, excluding anchor investors;

(b) in case of a book built issue, the price of the specified securities offered to the anchor investors

shall not be lower than the price offered to other applicants;

(c) In case the issuer opts for the alternate method of book building in terms of Part D of Schedule XIII, the issuer may offer specified securities to its employees at a price not lower than by more than ten percent of the floor price:

(2) Discount, if any, shall be expressed in rupee terms 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 specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty per cent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band 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 issue in the same newspapers in which the pre issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.

(5) The announcement referred to in sub-regulation (4) 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” of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Regulation 27 - Face value of equity shares

The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing of equity shares - Frequently traded shares

(a) If listed for more than 26 weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:

(a) The average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

(b) The average of the weekly high and low of the volume weighted average 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 26 weeks

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than twenty six weeks as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be 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 compromise, arrangement and amalgamation under sections 391 to 394 of the Companies Act, 1956 or sections 230 to 234 the of the Companies Act, 2013 as applicable, 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 volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period the equity lshares have been listed preceding the relevant date; or

(c) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

Further where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

Further also any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

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 the provisions of the Companies Act, 2013.

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 under SEBI (Share Based Employee Benefits) Regulations, 2014

The company granting option to its employees pursuant to ESOS will have the freedom to determine the exercise price subject to conforming to the accounting policies specified in Regulation 15 of the SEBI (Share Based Employee Benefits) Regulations, 2014.

Thus, the Regulation 15 states that the any company implementing any of the share based schemes shall follow the requirements of the 'Guidance Note on accounting for employee share – based Payments' (Guidance Note) or Accounting Standards as prescribed by the Institute of Chartered Accountants of India (ICAI) including the disclosure requirements. However, where the existing Guidance Note or Accounting Standards do not prescribe accounting treatment or disclosure requirements for any of the schemes then the company shall comply with the relevant Accounting Standard.

Valuation under SEBI (Delisting of Equity Shares) Regulations, 2009

(1) The offer price shall be determined through book building in the manner specified in Schedule II of these regulations, after fixation of floor price under sub-regulation (2) and disclosure of the same in the public announcement and the letter of offer. 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 be determined in terms of regulation 8 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Valuation of Sweat Equity Shares for unlisted companies under the Companies (Share Capital and Debentures) Rules, 2014

Under the Companies (Share Capital and Debentures) Rules, 2014, the sub rules of rule 8 Issue of sweat equity shares states that the:

- The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.
- A copy of gist along with critical elements of the valuation report obtained under clause (6) and clause (7) shall be sent to the shareholders with the notice of the general meeting.
- Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-
  (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
  (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

SEBI (SAST) Regulations, 2011

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.

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.

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.

Pricing under the Consolidated FDI Policy 2017 (Effective from August 28, 2017)

- Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than -
  a. the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company are listed on any recognised stock exchange in India;
  b. the fair valuation of shares done by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis, where the shares of the company are not listed on any recognised stock exchange in India; and
  c. the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

However, where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, as applicable, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

- Issue of Foreign Currency Convertible Bonds (FCCBs) and Depository Receipts (DRs)

  The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of

issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.

- Issue of Rights/Bonus Shares

  The offer on right basis to the person resident outside India shall be:

  (a) in the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company;

  (b) in the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

What should be the content of valuation report for corporate strategies?

The expert group of Ministry of Corporate Affairs (the then Department of Company Affairs), which was discussed about in the beginning of the chapter suggests the following coverage in the Valuation Report for Corporate Strategies.

Contents of Summarized Valuation Report

Considering the shareholders interest and the need for transparency and upholding corporate governance principles and after taking into consideration aspects of minority interest, transparency and corporate governance the Expert Group recommends that the following matters should compulsorily be covered in the summarized Valuation Report, in a clear, unambiguous and non-misleading manner, consistent with the need to maintain confidentiality.

- Background Information
- Purpose of Valuation and Appointing Authority
- Identity of the valuer and any other experts involved in the valuation
- Disclosure of valuer Interest/Conflict, if any
- Date of Appointment, Valuation Date and Date of Report
- Sources of Information
- Procedures adopted in carrying out the Valuation
- Valuation Methodology
- Major Factors influencing the Valuation
- Conclusion
- Caveats, Limitations and Disclaimers.

1. Background Information

The valuation report should briefly cover the following:

- Brief particulars of company or business which is the valuation subject
- Proposed Transaction
- Key historical financials

- Capital structure of the company, if relevant, and any changes as a result of the proposed transaction
- Shareholding pattern, any significant changes (Promoters/FIs), and any changes as a result of the transaction (Note – a table of before and after shareholding patterns ought to be disclosed)
- High/low/average market volumes/price for last six months, where applicable
- Related party issues with respect to the transaction.

2. Purpose of Valuation & Appointing Authority

The context and purpose of the valuation and the appointing authority commissioning the exercise must be clearly stated e.g. the Management's decision to seek an advisory opinion should be disclosed, or, the Audit Committee Chairman's decision to appoint or the appointment of an independent valuer itself should be disclosed with the date of the decision.

3. Identity of the valuer and any other experts involved in the valuation

Identity of the Registered Valuer (with his registration number) as well as organization doing the valuation and any other experts consulted in the process of valuation. The separation of the advisory team and details of the Chinese walls maintained between the independent valuer team and the advisory team, if appointed with particulars of the degree of strict separation and compliance of Chinese walls should be mentioned.

4. Disclosure of Valuer Interest/Conflict, if any

The Expert Group also recommends that a valuer shall disclose in his Report, possible sources of conflict and material interests, including association or proposed association/with the company, its associates, the counter-party to the transaction or its associates, in the form of auditor, lead advisor or in any other capacity, together with the nature of the fee arrangements for the same. If the valuer has a separate advisory engagement, the conflict disclosure should clearly record that neither the valuer or the members of the team working on the independent valuation have directly or indirectly, through the client or otherwise shared any advisory perspective or have been influenced or undertaken advocating a management position in determining the value.

5. Date of Appointment, Valuation Date and Date of Report

The Report should clearly state the date of the appointment of the valuer, Valuation Date (i.e. the date as of which the valuation assessment is done if this be other than the date of the report) and the date of the report.

6. Sources of Information

The valuer should clearly indicate in the report the principal sources of information, both internal and external, which have been relied upon for the purpose of valuation.

7. Procedures adopted in carrying out the valuation

Procedures adopted in carrying out a valuation may vary with circumstances, nature and purpose of valuation as well as information and time available. The principal procedures actually adopted by the valuer in carrying out the valuation should be set out briefly in the report. Such procedures may typically include:

- Review of Past Financials
- Review and Analysis of Financial Projections
- Industry Analysis
- SWOT Analysis

- Comparison with similar transactions
- Comparison with other similar listed companies
- Discussions with Management
- Review of principal agreements/documents etc.

The valuer should also include in his report:

- an affirmative statement that information provided and assumptions used by Management/Others in developing projections have been appropriately reviewed, enquiries made regarding basis of key assumptions in context of analysis of business being valued and the industry/economy; and
- an affirmative statement on adequacy of information and time for carrying out the valuations; with such modifications as may be appropriate and warranted. The affirmative statement shall not negate the professional liability for expertise applied in determining value and if the degree of inadequacy of information is severe, fundamental questions and information as assessed by the valuer as key for the appropriate stage of valuation needs to be disclosed.

8. Valuation Methodology

Whereas one method may be more or less applicable to a particular case, they are often used in conjunction to arrive at the fair value of a company/asset/business. The following are some of the methods which are often used for valuations. The methods enumerated below are merely illustrative and not exhaustive.

- *Asset Approach*

  Book Value, Adjusted Book Value, and Liquidation Value
- *Income Approach*

  Capitalization of Earnings, Capitalization of Excess Earnings, and

  Discounted Future Earnings/Cash Flows.
- *Market Approach*

  Current Market Prices, Historical Market Prices, Price to Earnings, Price to Revenue, Price to Book Value, Price to Enterprise Value, etc.
- *Comparable Transactions/Valuations*

  Comparable International and Domestic Transactions.

  The valuation methodology adopted by the valuer has to be disclosed. The valuer should mention in the report the rationale and appropriateness for the adoption of a particular method or a combination of methods and emphasis/reliance placed on the chosen method/combination of methods in reaching the final conclusion.

9. Major Factors influencing the Valuation

The valuer should also mention any key factors which have a material impact on the valuation, including inter alia the size or number of the corporate assets or shares, its/their materiality or significance, minority or majority holding and changes on account of the transaction, any impacts on controlling interest, diminution or augmentation therein and marketability or lack thereof.

10. Conclusion

In conclusion, the report must contain a clear statement of the value ascribed to the business/assets in question.

11 Caveats, Limitations and Disclaimers

Any caveats, limiting condition or other disclaimers to the report must be clearly stated with appropriate specificity i.e. the valuer shall not disclaim liabilities for hisexpertise or deny his duty of care.

Valuation Strategies for Mergers

A fair market valuation is an estimate or opinion of the theoretical worth of a company's equity based upon its underlying assets, income generating ability, and comparable transactions. There are accepted procedures, methods and formulae for preparing valuations. These accepted approaches and methods have been tested in tax, legal and other contentious matters. Different valuation approaches will frequently yield strikingly different results for a given company. It's the duty of the analyst or valuator to select the approach that is most appropriate given the facts and circumstances of the company. The asset approach might be most appropriate when valuing a capital intensive company with steady sales. The asset based approach may not be appropriate for a service industry. Further a combined approach may also be used in some strategies.

RANBAXY LABORATORIES LIMITED – A CASE STUDY

Background: Ranbaxy was founded in 1937 and derived its name from that of its founders – Ranjit Singh and Gurbax Singh. It started out as the Indian distributor of vitamins and anti tuberculosis drugs for a Japanese pharmaceutical company. After the Second World War, Ranbaxy continued its role as a distributor and ventured in manufacturing drugs by setting up its first plant in 1961. Ranbaxy's first real breakthrough came in 1969 with Calmpose, a copy of Roche patented Vellum tranquillizer. By 1971, Ranbaxy had extended its strong position in anti infectives in the Indian market and expanded manufacturing capacity to keep pace with sales.

Strategic Shift

Due to the changing business conditions, it had become essential in 1993 to change the strategy of the company in order to tap rising opportunities. The senior management team of Ranbaxy underwent a strategic planning exercise called Vision 2003. Ranbaxy aimed to achieve two milestones by 2003; 1 billion in revenues and the development of one new therapeutic chemical molecule. The mission statement to become an international, research based pharmaceutical company was posed with many challenges at all levels of the company. The company had to redefine its product offerings and the markets it served. In structuring the foreign ventures, Ranbaxy focused on the entire value chain to maximize margins. In February 2004, Ranbaxy crossed as $1 billion mark in its turnover.

In 2003, a gain a strategic planning revival exercise took place with a new plan in place called Vision 2012:

- Aspire to be a $ 5 billion company by 2012
- Become a top 5 global generics pharma company
- Significant income from the proprietary products

The company has decided to focus on the following therapeutic areas to meet its Vision 2012:

- Infectious Diseases (Anti-bacterial and Anti-fungals),
- Urology (Benign Prostatic Hyperplasia (BPH) and Urinary Incontinence),
- Metabolic Diseases (Type 2 Diabetes, Hyperlipidemia) and
- Inflammatory/Respiratory diseases (Asthma, Chronic Pulmonary Obstructive Disease and Rheumatoid Arthritis).

These choices allow Ranbaxy to enter large markets with significant unattended medical needs and to build on its research strengths. In 2008, Ranbaxy achieved a consolidated sale of $ 1.7 billion. Its geographic and

therapeutic sales break up is shown in Table 12.6 below:

Table 1 – Geographic and Therapeutic Sales of Ranbaxy in 2008

Region	***%***	***Major Therapy***	***%***
North America	27	Anti-infective	37
European Union	20	Cardiovascular	16
India	18	Gastrointestinal	NA
Asia (Excluding India)	6	Musculoskeletal	8
Russia and Ukraine	7	Central Nervous System	6
Africa and Latin Amarica	12	Respiratory	6

The Deal Value

According to details of the deal, the enterprise value of Ranbaxy is estimated to be US $ 8.5 billion at 737 price per share. The negotiated price of 737 represented a premium of 31.4% over the market price of Ranbaxy on the day of announcement. When the deal finally closed in November 2008, DIS had acquired 63.92% of the equity share capital of Ranbaxy as given below in table 2.

Table 2. – Daiichi-Sankyo acquisition of Ranbaxy

Date of Acquisition	***Particulars***	***Number of Shares***	***% of Shareholding***
October 15, 2008	Acquisition of Shares under Open Offer pursuant to Regulation 10 & 12 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997 @ 737 per share	92,519,126	22.01
October 20, 2008	Allotment of Shares on Preferential basis @ 737 per share	46,258,063	11.00
October 20, 2008	Acquisition of Shares from the then Promoters of the Company @ 737 per share (First tranche)	81,913,234	19.49
November 07, 2008	Acquisition of Shares from the then Promoters of the Company @ 737 per share (First tranche)	48,020,900	11.42
Total		**268,711,323**	**63.92**

How much did Daiichi-Sankyo pay

Nature of Transaction	***Acquisition Consideration (in million yens)***
Open market share purchases	169,407
Share purchases from founding family (Gain of Promoters)	230,970
Share purchases by issuances of new shares	85,001

(Money infused in Ranbaxy's balance sheet)		
Direct acquisition related expenditures	2,974	
Total	488,352	

How did Daiichi-Sankyo value Ranbaxy

Assets and Liabilities	***Value Attributed (Yen billions)***	
Book value of assets and liabilities (Cash, Inventory etc.)	78.8	
Inventories	2.0	
(Increase in inventories in fair value)		
Tangible assets (Land)	10.0	
Intangible assets (Leasehold land)	5.9	
Intangible assets (Increase in current products, etc. to fair value)	41.0	
In-process R&D expenses	6.9	
Deferred tax liability	(20.0)	
Minority Interests	(45.0)	83.69
Goodwill	408.7	
Total consideration	483.3	

Valuation of Ranbaxy Laboratories Ltd.

Price paid per share by Daiichi	737
52 week high/low as on 11th June 2008 for Ranbaxy share	593/300
Valuation of 63.92% stake by Daiichi19804 crores	
Valuation of 100% equity of Ranbaxy as per the deal	30982 crores
Enterprise Valuation of Ranbaxy (on a fully diluted basis)	$8.5 billion
Market Capitalization of Ranbaxy as on 30th	
May 2009 (Conclusion of Deal)	10434 crores

Table 3 – Impact of Ranbaxy deal on Daiichi-Sankyo Balance Sheet

Region	***In Yens Billion***	***Remarks***
Net Profit/(Loss) for Daiichi-Sankyo in FY 2008	97.6	Recording of Y 351.3 billion in extraordinary losses due to a one-time write-off goodwill pertaining to the investment in Ranbaxy.
Net Profit/(Loss) for Daiichi-Sankyo in FY 2008	(215.5)	
Net cash used in investing activities in FY 2008	49.4	It is due to the cash acquisitions of shares in U3 Pharma and Ranbaxy, which entitled cash outflows
Net cash used in investing activities in FY 2009	413.8	
Short term bank loans in FY 2009	0.1	Borrowings for the acquisition of Ranbaxy's

		share Y + 240.0 billion
Short term bank loans in FY 2009	264.3	Increase by consolidation of Ranbaxy

Financing of Deal

Daiichi-Sankyo funded the acquisition through debt and existing cash reserves. Daiichi-Sankyo has taken a short and long term loans of 240 billion yens. That's almost 50% of the total funding requirement of the deal.

Strategic Reasons

The acquisition shall pave this way for creating a new and complementary hybrid business model that provides sustainable growth by diversification that spans the full spectrum of pharma business. The expected synergistic benefits are summarized in the exhibit below:

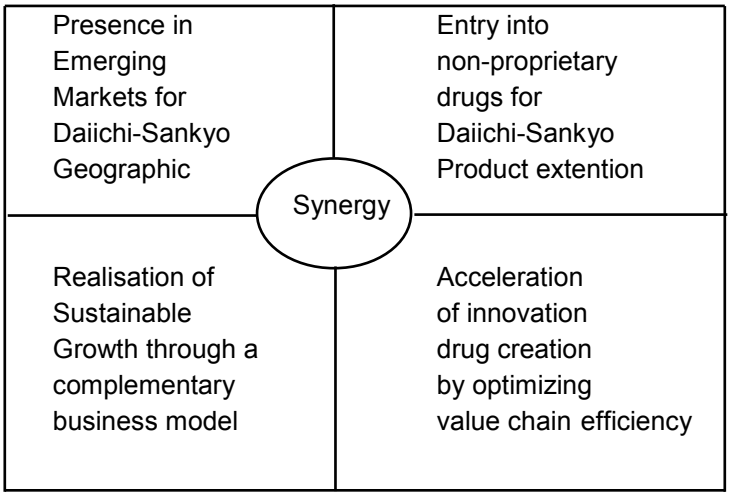


FIGURE 4

While DIS grew at 4.7% in 2007 to $7.12 billion, Ranbaxy grew at over 10% to $ 1.6 billion. While the world pharma industry grew at 6%, the generic segment is growing at 11%. The pursuit of the hybrid business model would help DIS to improve its growth rate substantially. Daiichi would be able to extend its reach to 56 countries from 21 countries where they currently operate.

Benefits to Daiichi Sankyo

In addition to the expected synergies, DIS will be benefited most by the low-cost manufacturing infrastructure and supply chain strengths of Ranbaxy. Further, DIS will be able to bring in efficiency in its operations by sourcing APIs6 and finished dosage products from Ranbaxy's 9 manufacturing plants in India and many more in other countries.

The R&D facilities of Ranbaxy would be used by DIS to not only reduce some of its R&D expenses, but also use competencies of Ranbaxy scientists to faster new product development. DIS is also expected to get Zenotech's expertise in the areas of biologies, oncology and specialty injectibles. (i)

Benefits to Ranbaxy

According to the promoters of Ranbaxy, the deal was meant to take it to the next level of growth. With India

honouring the product Patent regime from 2005, Generic drug companies are finding it more difficult to make similar versions of innovative drugs. (ii) further, tough times ahead has forced global generic majors to merge or buy or become generic behemoths, e.g., Sandoz's acquisition of German company Hexal in 2005.

Besides, there was a strong feeling that perhaps the game is over for Indian drug companies unless they pull up their socks and strengthen their R&D. Analysts feel that promoters of Ranbaxy could visualize this in advance and got the best possible deal while the going was still good and made a very decent, honorable and attractive exit.

Risk Involved

The Food and Drug Administration (FDA) issued two warning letters to Ranbaxy Laboratories and an Import Alert for generic drug produced by Ranbaxy's Dewas and Paonta Sahib plants in India on 16 September 2008. US officials could detain at the US border, any API and finished drugs manufactured at these plants. Analysts estimate the loss of business to Ranbaxy as a result of this development to be at $40 million. This development has resulted in sharp fall of Ranbaxy share price by 6.6% on BSE.

Just a week after DIS announcement Ranbaxy announced the settlement of its protracted multi-country battle over Pfizer's $12 billion cholesterol drug lipitor. Ranbaxy had entered into an agreement wit Pfizer Inc. to settle most of the patent litigation worldwide over lipitor. After the announcement, Ranbaxy shares saw a dip by 7.7% as against Bombay Stock Exchange (B.S.E.) dip of 2.2%.

Analysts have expressed their doubt about the price paid for the acquisition as it was quite high compared to the present pricing of other Indian generic drug making companies. This many put severe strain on DIS's financials.

Notes:

1. In October 03, 2007, Ranbaxy entered into share purchase agreement with the promoters of Zenotech Laboratories Ltd. (ZLL) for acquiring 27.35% shares of ZLL' at a price of 160 per share. On the completion of the above acquisition, Ranbaxy made the public announcement to the shareholders of ZLL' to acquire upto 20% shares at a price of 160 per share. On the completion of the above acquisition, Ranbaxy' holds 46.79% shares of ZLL. As on October 20, 2008, Ranbaxy held 46.85% shares of ZLL'. As a result of acquisition of Ranbaxy by DIS, DIS has indirectly acquired 46.85% shares of ZLL'. In July, the Madurai bench of the Madras High Court had given stay on the open offer, following complaints made by minority shareholders. However, DIS got relief from the Supreme Court to go ahead with the offer.

2. India changed its policy of Patent regime from product to process in 1970 after enactment of Indian Patent Act. This has opened doors of reverse engineering to prepare formulations. This has helped Indian pharma companies in developing their capabilities at manufacturing low cost APIs, which global majors were selling at extremely high prices. In 2005, the wheel of patent perfection came a full circle as India amended the Patent Act, to recognize the product patent under the obligation of WTO regime.

3. Under the agreement, Ranbaxy will delay the start of its 180 days exclusively period for a generic version of lipitor, until November 2011. While the settlement avoided further legal cost for Ranbaxy in fighting Pfizer, if it had won the case, Ranbaxy could have introduced generic version as early as March 2010.

4. DIS plans to record a valuation loss of $3.99 billion on its shares in its India based subsidiary

Ranbaxy Laboratories to reflect the decline in the market value of shares.

On a non correlated basis DIS plans to record a non-cash valuation loss of $3.99 billion on its shares in Ranbaxy in its third quarter to reflect a more than 50% decline in market value of these securities versus the purchase price. The company said in a statement on the company's website.

DIS sees no impact on its forecasts for non-consolidated net-sales, operating income or ordinary income for the third-quarter as a result of these anticipated extraordinary losses. The company also sees no impact in cash flows. However, these items will have a significant negative impact on the company's consolidated financial results for the net income for the year 2008-09. Reacting to this news DIS shares fell 1.2% on the Tokyo stock exchange.

Valuation for liquidation/insolvency

Net Realisable Value Method

This method is generally used in case of liquidation. Where the business of the company is being liquidated, its assets have to be valued as if they were individually sold and not on a going concern basis. Liabilities are deducted from the liquidation value of the assets to determine the liquidation value of the business. One should also consider liabilities which will arise on closure such as retrenchment compensation, termination of critical contracts, etc. Tax consequences of liquidation should also be considered. Any distribution to the shareholders of the company on its liquidation, to the extent of accumulated profits of the company is regarded as deemed dividend. Dividend Distribution tax will have to be captured for such valuation.

Valuation of Slump Sale

The concept of Slump Sale was incorporated in the Income tax Act, 1961 ('the IT Act') by the Finance Act, 1999 when Section 2(42C) was inserted defining the term 'slump sale' as 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. Prior to the insertion of Section 2(42C), Courts have held that slump sale is a sale of a business on a going concern basis where the lumpsum price cannot be attributed to individual assets or liabilities.

The undertaking has to be transferred as a result of sale. If an undertaking is transferred otherwise than by way of sale, say, by way of exchange, compulsory acquisition, extinguishment, inheritance by will, etc., the transaction may not be covered by Section 2(42C). The consideration for transfer is a lump sum consideration. This consideration should be arrived at without assigning values to individual assets and liabilities.

As regards the valuation of slump sale it is appropriate to brief the provisions of Section 50B of the Income Tax Act, 1961.

Section 50B provides the mechanism for computation of capital gains arising on slump sale. Capital gains arising on slump sale are calculated as the difference between sale consideration and the net worth of the undertaking. Net worth is deemed to be the cost of acquisition and cost of improvement for the purpose of calculation of capital gains tax.

Net worth is defined in Explanation 1 to Section 50B as the difference between 'the aggregate value of total assets of the undertaking or division' and 'the value of its liabilities as appearing in books of account'

The 'aggregate value of total assets of the undertaking or division' is the sum total of :

1. WDV as determined u/s.43(6)(c)(i)(C) in case of depreciable assets.

2. The book value in case of other assets.

Valuation of Assets in a Demerger

Valuation of demerger is based on Section 19AA of demerger under the Income Tax Act 1961.

As per Section 2 (19AA) "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 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.

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 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 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 or 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 fulfils 81 [such conditions as may be notified in the Official Gazette 82, by the Central Government];

Following Explanation 5 inserted after Explanation 4 in clause (19AA) of section 2 by the Taxation Laws (Amendment) Act, 2016, w.e.f. 1-4-2017 :

Explanation 5.—For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette.

As per Section 2(19AAA) "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company;

A demerger scheme usually involves the allotment of shares in the transferee company to the shareholders of the transferor company, in lieu of their reduction of their interest in the transferee company having a mirror image of shareholdings. If post demerger as part of strategy, intention is to create holding subsidiary relationship or retain part stake than it is possible to allot shares of the transferee company to the transferor company.

In the context of a demerger scheme, a valuation exercise is mandatory in order to determine the number of shares to be issued to the shareholders of the transferor company in consideration for the spin off/demerger of the undertaking or undertakings If demerger is going to be in 'Shell Company', than valuation is primarily to determine the capital structure of the Transferee/Resultant Company.

If the demerged and resulting companies belong to same group of management and shareholders are common, share exchange ratio based on Net Asset Based valuation model may be adopted. Any other business valuation method may also be adopted considering the same shareholding as it will not impact value for the shareholders in demerged company post-demerger. In ideal situation like the companies are profitable and shareholders are different, it is recommendable to use Profit Based Valuation model for deciding on the share exchange ratio. While demerging to the shell company, there is no value of the shell company. Therefore, any no of shares may be issued to the shareholders of the demerged company as there will not be any impact on the shareholders' wealth.

There may be various situations and objectives wherein demerger schemes are implemented. Fair valuation only considers the status of the businesses and other macro factors but it also considers very big picture of implication of valuation/share exchange ratio. It does also consider costs such as stamp duty involved in adopting any valuation model.

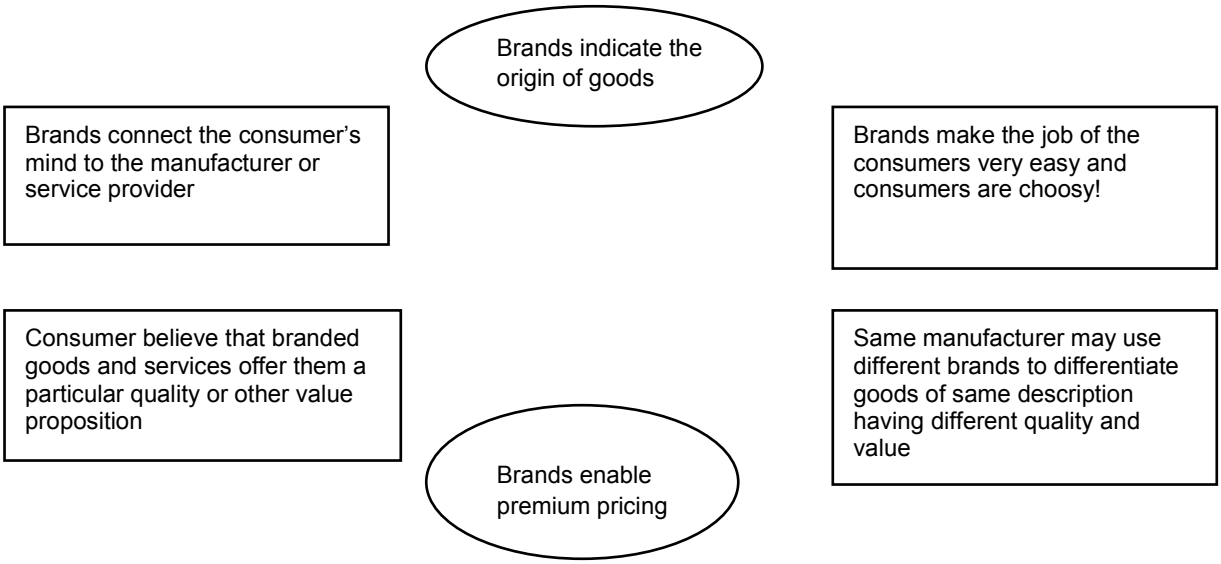
VALUATION OF BRANDS

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.

Protection of 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:

Sl. No.	*Query*
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 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 may 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.	Hs 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?
25.	Can you furnish state wise turnover for three financial years?
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? 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 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?
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.

Investors have become more active in protecting their value. Any transaction of purchase/ sale of business/ companies require determination of fair value for the transaction to satisfy stakeholders and/or Regulators. Business valuation is an unformulated and subjective process. Understanding the finer points of valuing a business is a skill that takes time to perfect. There are various methodologies for valuing a business, all having different relevance depending on the purpose of valuation. Key aspects of valuation along with various restructuring options have been explained hereunder:

A clear understanding of the purpose for which the valuation is being attempted is very important aspect to be kept in mind before commencement of the valuation exercise. The structure of the transactions also plays very important role in determining the value. For example, if only assets are being transferred out from a Company, valuation of equity shares is of no importance. The 'general purpose' value may have to be suitably modified for the special purpose for which the valuation is done. The factors affecting that value with reference to the special purpose must be judged and brought into final assessment in a sound and reasonable manner.

LESSON ROUND UP

- Corporate valuation is not only a pre-requisite during different types of restructuring phase of the company. It is required at frequent intervals to identify the economic value creation and any destruction if any occurred.
- The process of valuation includes a detailed and comprehensive analysis taking into an account the past present and future earnings prospects and analysis of physical and intangible assets and general economic and industry conditions.
- The valuation of shares is a technical matter. It requires considerable skill and experience. There are bound

to be differences of opinion among accountants as to what is the correct value of the shares of a company.

- 'Slump sale' as 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.
- Section 50B of the Income Tax Act, 1961 provides the mechanism for computation of capital gains arsing on slump sale. Capital gains arising on slump sale are calculated as the difference between sale consideration and the net worth of the undertaking. Net worth is deemed to be the cost of acquisition and cost of improvement for the purpose of calculation of capital gains tax.
- Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.
- A demerger scheme usually involves the allotment of shares in the transferee company to the shareholders of the transferor company, in lieu of their reduction of their interest in the transferee company having a mirror image of shareholders. If post demerger as part of strategy, intention is to create holding subsidiary relationship or retain part stake than it is possible to allot shares of the transferee company to the transferor company.
- Black's Dictionary defines brand as a word, mark, symbol, design, term, or a combination of these, both visual and oral, used for the purpose of identification of some product or service.

SELF TEST QUESTIONS

1. Discuss the objective of corporate valuation in the emerging business environment.
2. Enumerate the content of valuation report for corporate strategies.
3. Critically examine the valuation of demerger under the Income-tax Act, 1961.
4. Explain the importance of Brand valuation.
5. Discuss briefly the functions of Brand.

Lesson 16
INSOLVENCY – CONCEPTS AND EVOLUTION

LESSON OUTLINE

- Insolvency/Bankruptcy - the concepts
- Historical developments of Insolvency Laws in India
- A Brief on regulatory framework on corporate insolvency in India
- A brief on historical background of insolvency laws in UK
- The Existing Regulatory framework in UK
- The evolution of Insolvency Laws in the US along with timeline
- The current Bankruptcy code in the US

LEARNING OBJECTIVES

The laws relating to insolvencies and bankruptcies in the earlier centuries were framed for penalizing the defaulting debtors and in the most of the cases with imprisonment. As the historical aspects relating to insolvencies evidences that the European insolvency framework, started in the 15th century was the preliminary base for countries that had developed insolvency framework in the subsequent centuries. There has been revamping shift in the global regulatory framework towards corporate insolvency. The principal focus of modern insolvency legislation and business debt restructuring practices are not liquidation and elimination of insolvent entities but on the remodeling of the financial and organizational structure of debtors experiencing financial distress so as to permit the rehabilitation and continuation of their business. Indeed, Chapter 11 of US Bankruptcy Code is considered to be one of the best insolvency frameworks in the global platform. Companies Act 2013 also facilitates rehabilitation of debtor instead of winding up. If the rehabilitation is not possible it enables effective winding up of companies in time bound manner through single regulator National Company Law Tribunal. The whole exercise of rehabilitation and liquidation are done in time bound manner through single forum, National Company Law Tribunal.

After reading this lesson you will be able to understand the historical and emerging aspects of insolvency process in India, UK and USA.

INSOLVENCY/BANKRUPTCY – THE CONCEPT

Insolvency is when an individual, corporation, or other organization cannot meet its financial obligations for paying debts as they are due. Bankruptcy is not exactly the same as insolvency. Technically, bankruptcy occurs when a court has determined insolvency, and given legal orders for it to be resolved. Bankruptcy is a determination of insolvency made by a court of law with resulting legal orders intended to resolve the insolvency. Insolvency describes a situation where the debtor is unable to meet his/her obligations. Bankruptcy is a legal scheme in which an insolvent debtor seeks relief.

Do you know the origin of the Word Bankruptcy?

The Old Bridge, better known as the Ponte Vecchio, is a world renowned monument, oldest segmental arched bridge in Europe that draws thousands of people to Florence every year. Commerce on bridge began almost at the same time when the more enterprising decided to take advantage of the increased pedestrian traffic that crossed the bridge, especially military. The first merchants consisted mostly of tanners, blacksmiths and butchers. A curious fact regarding the word bankruptcy derives from the economic activity on Ponte Vecchio.

The word bankruptcy originated from the trade that was carried out on the bridge. If a merchant ran out of money and was seriously in debt, the table from where he sold his goods known as a ''banca'' was broken i.e. "rotta" in two by soldiers in an act called "banca rotta" or broken bench or break the bench. Without a banca a merchant could not do business.

Historical developments of Insolvency Laws in India

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) was passed, which 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. The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 are two major enactments that deal with personal insolvency and have parallel provisions and their substantial content is also similar but the two differ in respect of their territorial jurisdiction. While Presidency Towns Insolvency Act, 1909 applies in Presidency townsnamely, Kolkata, Mumbai and Chennai, Provincial Insolvency Act, 1920 applies to all provinces of India. These two Acts are applicable to individuals as well as to sole proprietorships and partnership firms.

Under the Constitution of India 'Bankruptcy & Insolvency' is provided in Entry 9 List III - Concurrent List, (Article 246 –Seventh Schedule to the Constitution) i.e. both Center and State Governments make laws relating to this subject.

The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 were two major enactments that deal with personal insolvency. These Acts stand repealed after the enactment of Insolvency and Bankruptcy Code, 2016.

Reforms in Insolvency Law for Corporate Side

Over the last two decades, the Indian financial system has undergone tremendous transformation. Various financial sector reforms have been initiated aimed at promoting an efficient, well-diversified and competitive financial system with the ultimate objective of improving the allocative efficiency of resources so as to accelerate economic development. 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.

Committees on Insolvency

Tiwari Committee

Due to the incidence of industrial sickness which was resulting in loss of production, loss of employment, loss of government revenue, blockage of funds advanced by the banks etc, a committee was constituted under the Chairman ship of Shri T Tiwari, Chairman, Industrial Reconstruction Corporation of India to look into the causes of Industrial sickness and to suggest remedial measures. Based on the recommendations of Tiwari Comkittee SICA was enacted. Due to misuse of SICA by erring promoters and others, BIFR failed to fulfill the purpose and mandate as envisaged in SICA.

N L Mitra Committee

A Standing Committee on International Financial Standards and Codes has been set up by Governor, Reserve Bank of India on December 8, 1999 with the objectives of identifying and monitoring developments in global standards and codes pertaining to various segments of the financial system, considering all aspects of applicability of such standards and codes to the Indian financial system, chalking out the desirable road map for aligning India's standards and practices in the light of evolving international practices. The Standing Committee in its first meeting held at New Delhi on January 13, 2000 decided to constitute non official Advisory Groups in ten major subject areas encompassing 43 different standards/codes. In this regard, one of the subject area identified is "Bankruptcy Laws". Accordingly, an Advisory Group on "Bankruptcy Laws" under the Chairmanship of Dr. N. L. Mitra, Director, National Law School of India, University, Bangalore

The N. L. Mitra Committee noted that Indian laws on cross border insolvency are outdated and that they are not comparable to any standards set in international legal requirement and as such, stands apart and alone. It also noted that in the event of an international insolvency proceeding involving an Indian company, Indian courts are unlikely to provide any aid or assistance to a foreign liquidator or other insolvency official if this were to be prejudicial to the companies' creditors on the basis of how those creditors are or would have been treated under any equivalent Indian law insolvency proceeding.

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 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.

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:

	0-5 years	*5-10 Years*	*10-15 Years*	*15-20 Years*	*20-25 Years*	*25 Years and Above*	*Total*
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 to the 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/NCALT 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.

Banking Laws Reforms Committee

The Bankruptcy Law Reforms Committee (Chairman: Dr. T. K. Viswanathan) submitted its report to the Finance Ministry on November 4, 2015.

The objectives of the Committee were to resolve insolvency with:

(i) lesser time involved,

(ii) lesser loss in recovery, and

(iii) higher levels of debt financing across instruments.

The Committee has presented its report in two parts: Volume 1, with its rationale and design for legislation, and Volume 2, with the Draft Insolvency and Bankruptcy Bill.

Insolvency refers to a situation where individuals or organisations are unable to meet their financial obligations. If insolvency cannot be resolved, a company proceeds towards liquidation of assets, and an individual goes in for bankruptcy resolution.

The Committee has recommended a consolidation of the existing legal framework, by repealing two laws and amending six others.

It has proposed to repeal the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. In addition, it has proposed to amend: (i) Companies Act, 2013, (ii) Sick Industrial Companies (Special Provisions) Repeal Act, 2013, (iii) Limited Liability Partnership Act, 2008, (iv) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (v) Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and (vi) Indian Partnership Act, 1932.

The Committee observed that currently creditors have limited power, in case the debtor defaults in making the payment. They are able to recover only 20% of the debt amount on an average, which ultimately leads to lending being restricted to a few large companies.

The Committee also observed that decisions regarding the defaulting firm are business decisions, and should be taken by the creditors.

Presently, laws in India bring together the legislature, executive and judiciary for insolvency resolution.

The Committee has moved away from this approach, and has proposed to establish a Creditors committee, where the financial creditors will have votes in proportion to their magnitude of debt. The creditors committee will undertake negotiations with the debtor, to come up with a revival or repayment plan.

Insolvency and Bankruptcy Resolution

The report outlines the procedure for insolvency resolution for companies and individuals. The process may be initiated by either the debtor or the creditors.

Presently, only secured financial creditors (creditors holding collateral against loans), can file an application for declaring a company sick. The Committee has proposed that operational creditors, such as employees whose salaries are due, be allowed to initiate the insolvency resolution process (IRP).The entire IRP will be managed by a licensed insolvency professional.

During the IRP, the professional will control and manage the assets of the debtor, to ensure that they are protected, while the negotiations take place.

The Committee has proposed to set up Insolvency Professional Agencies. The agencies will admit insolvency professionals as members and develop a code of conduct. An environment where the agencies compete with each other, to achieve greater efficiency and better performance has been envisioned.

The report recommends speedy insolvency resolution and time bound negotiations between creditors and the debtors. To ensure this, a 180 day time period for completion of the IRP has been recommended. For cases with high complexity, this time period may be extended by 90 days, if 75% of the creditors agree.

Information Utilities:

The committee has proposed to establish information utilities which will maintain a range of information about firms, and thus avoid delays in the IRP, typically caused by a lack of data.

Insolvency regulator:

The Committee has proposed to establish the Insolvency and Bankruptcy Board of India as the regulator, to maintain oversight over insolvency resolution in the country.

The Board will regulate the insolvency professional agencies and information utilities, in addition to making regulations for insolvency resolution in India.

Bankruptcy and Insolvency Adjudicator:

The Committee observed that individual and company insolvency resolution has similar goals. However, the infrastructure for individual insolvency resolution has to be spread across the country. Hence, the Committee proposes two tribunals to adjudicate grievances under the law:

(i) the National Company Law Tribunal will continue to have jurisdiction over insolvency resolution and liquidation of companies and limited liability partnerships; and

(ii) the Debt Recovery Tribunal will have jurisdiction over insolvency and bankruptcy resolution of individuals.

Regulatory Framework in India – Corporate Insolvency

The Companies Act, 2013 provides for regulation of insolvency, including rehabilitation, winding up and liquidation of companies in time bound manner. It incorporates international best practices based on models suggested by the United Nations Commission on International Trade Law (UNCITRAL). The powers and jurisdiction of Company Law Board, Board of Industrial and Financial Reconstruction and High Court in this regard, is being exercised by National Company Law Tribunal and 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 companies – 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.

The Act also provides for larger role for professionals like Company Secretaries to act as interim administrator/Company administrator and Company liquidators. Companies Act, 2013 provides following remedies:

The Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016 includes provision for determination of sickness, application for revival, appointment of interim/Company administrator, time bound revival process and if revival not possible, time bound winding up process through single regulator 'National Company Law Tribunal'. The relevant provisions are described in separate chapter.

Securitisation Act

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act) empowered banks or financial institutions with a presence in India or which have been notified by the Government of India to recover on non-performing assets without court intervention. An asset is classified as non-performing if interest or installments of principal due remain unpaid for more than 180 days. SARFAESI Act provides three alternative methods for recovery of non-performing assets, including taking possession, selling and leasing the assets underlying the security interests such as movable property (tangible or intangible, including accounts receivable) and immovable property without the intervention of the courts. The SARFAESI Act is not available to secured creditors, which are not Indian banks, or financial institutions notified. The provisions of SARFAESI Act are dealt in detail in lesson no. 18.

United Kingdom Insolvency Framework

A Brief on Historical background on UK Insolvency Framework

In England, the first bankruptcy law was enacted in 1542, being Statute 34 Henry VIII. Under this act a debtor was still looked upon as in a sense an offender, and the law was mainly for the benefit of creditors, providing for an equal distribution of the debtor's assets among his creditors, but not releasing the debtor from his debts. The early bankruptcy laws of England were exclusively an instrument of debt-collection: its finality was to seize the debtor's assets *against* the strong protections to private property offered by the Common law, since medieval times. The procedure thus worked rather as a continuation of private remedies with different, collective, legal instruments.

The Current Regulatory Framework in UK

The 1982 Report of the Insolvency Law review Committee, *Insolvency Laws and Practice* (commonly known as "the Cork Report") recommended the adoption of Unified Insolvency legislation in the United Kingdom. Ultimately the *Insolvency Act, 1986 (UK)* was enacted and this encompasses both types of insolvency administrations, including corporate restructuring.

The existing UK insolvency framework is defined by the Insolvency Act 1986. According to the Act, failing companies are either liquidated or submitted to an insolvency process that may allow them to be rescued as going concerns.

The Insolvency Act, 1986 deals with the insolvency of individuals and companies. The Act is divided into three groups and 14 Schedules as follows:

Group 1 deals with Company Insolvency

Group 2 deals with Insolvency of Individuals and

Group 3 deals with Miscellaneous Matters Bearing on both Company & Individual Insolvency

Basically, a company in financial difficulties may be made subject to any of five statutory procedures.

1. administration;
2. company voluntary arrangement;
3. scheme of arrangement;
4. receivership (including administrative receivership); and
5. liquidation (winding-up).

With the exception of schemes of arrangement, which fall within the ambit of the Companies Act, 2006, these are formal insolvency procedures governed by the Insolvency Act, 1986.

The administration procedure was introduced by the Insolvency Act, 1986 and substantially revised by the Enterprise Act, 2002 to include a streamlined procedure allowing the company or (more often) its directors to appoint an administrator without the involvement of the Court subject to conditions.

Firms are in fact liquidated if they become the subject of a compulsory liquidation order obtained from the court by a creditor, shareholder or director. Alternatively, the company may itself decide to pass a liquidation resolution – subject to the approval of a creditors' meeting – for the company to be wound-up (a Creditors Voluntary Liquidation). Either way, the result of both these procedures is the winding-up of the company. Neither process makes any attempt to rescue or sustain the company as a legal entity.

The Insolvency Act 1986 also introduced three new procedures that held out the possibility of a company

being brought back to life as a viable entity. These measures represented an attempt to emulate the 'rescue culture' that characterised the corporate sector in the US.

The first of these procedures – 'Company Voluntary Arrangements' (CVAs) – provides a way in which a company in financial difficulty can come to a binding agreement with its creditors.

The second procedure – 'Administration' – offers companies a breathing space during which creditors are restrained from taking action against them. During this period, an administrator is appointed by a court to put forward proposals to deal with the company's financial difficulties.

A third option – 'Administrative Receivership' – permits the appointment of a receiver by certain creditors (normally the holders of a floating charge) with the objective of ensuring repayment of secured debts.

The Enterprise Act, 2002 attempted to embed a rescue culture by creating entry routes into administration that did not require a court order, and simplified the means by which a company could 'emerge' from administration. It also prohibited – with certain exceptions – the right of creditors to appoint an administrative receiver (which had previously blocked a company's ability to opt for administration).

In addition, the Act explicitly established a 'hierarchy of purposes' for the administration process. The primary duty of administrators was defined as rescuing the company as a going concern (a duty that does not exist for an administrative receiver). Only if this is not practicable – or not in the interests of creditors as a whole – is the administrator allowed to consider other options, such as realising the value of property in order to make a distribution to creditors.

US Bankruptcy laws

The evolution of Insolvency Laws in US along with timeline

As we read earlier, England first established a bankruptcy law in 1542. Under the English law, bankruptcy was treated as a criminal act punishable by imprisonment or death. Only merchants were eligible for bankruptcy and only creditors could institute bankruptcy proceedings.

The English bankruptcy system was the model for bankruptcy laws in the English colonies in America and in the American states after independence from England in 1776.

Early American bankruptcy laws were only available to merchants and generally involved imprisonment until debts were paid or until property was liquidated or creditors agreed to the release of the debtor. The laws were enacted by each individual state and were inconsistent and discriminatory. For example, the laws and courts of one state might not enforce debts owed to citizens of other states or debts of certain types. The system was not uniform and some states became known as debtor's havens because of their unwillingness to enforce commercial obligations.

The lack of uniformity in bankruptcy and debt enforcement laws hindered business and commerce between the states. The United States Constitution as adopted in 1789 provides in Article I, Section 8, Clause 4 that the states granted to Congress the power to establish uniform laws on the subject of bankruptcies throughout the United States.

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

Article I, Section 8, Clause 4 of US Constitution

However, until 1898 there was no bankruptcy law in continuous effect in the United States. The Congress enacted temporary bankruptcy statutes in 1800, 1841 and 1867 to deal with economic downturns. However, those laws were temporary measures and were repealed as soon as economic conditions stabilized. The Act of 1800 was repealed in 1803. The Act of 1841 was repealed in 1843 and the Act of 1867 only lasted until 1878.

These early laws only permitted merchants, traders, bankers and factors to be placed in bankruptcy proceedings. The Acts of 1800 and 1841 vested jurisdiction in the federal district courts. The district court judges were given the power to appoint commissioners or assignees to take charge of and liquidate a debtor's property.

A permanent bankruptcy statute was not enacted until 1898. The National Bankruptcy Act of 1898 was based upon the liquidation of a debtor's non-exempt assets to pay creditors. In 1938 the law was amended to provide for the rehabilitation or reorganization of a debtor as an alternative to liquidation of assets. The Bankruptcy Act of 1898, together with its amendments, was known as the Bankruptcy Act. Under the Bankruptcy Act, the district court had jurisdiction over bankruptcy cases, but could appoint a referee in bankruptcy to oversee the administration of bankruptcy cases, the allowance of claims and the distribution of payments to creditors. The Bankruptcy Act governed bankruptcy in the United States for 80 years.

After a series of critical studies and review of the then existing law and practice, Congress passed the Bankruptcy Reform Act of 1978.

Since 1978

The US Congress enacted the "Bankruptcy Code" in 1978. The Bankruptcy Code, which is codified as title 11 of the United States Code, has been amended several times since its enactment. It is the uniform federal law that governs all bankruptcy cases.

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (often called the "Bankruptcy Rules") and local rules of each bankruptcy court. The Bankruptcy Rules contain a set of official forms for use in bankruptcy cases. The Bankruptcy Code and Bankruptcy Rules (and local rules) set forth the formal legal procedures for dealing with the debt problems of individuals and businesses.

Six basic types of bankruptcy cases are provided for under the Bankruptcy Code.

- **Chapter 7** bankruptcy leading to liquidation. In this type of bankruptcy, a court-appointed trustee or administrator takes possession of any nonexempt assets, liquidates these assets (for example, by selling at an auction), and then uses the proceeds to pay creditors.
- **Chapter 9** entitled Adjustment of Debts of a Municipality, provides essentially for reorganization. Only a "municipality" may file under chapter 9, which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts.
- **Chapter 11** entitled Reorganization, ordinarily is used by commercial enterprises that desire to continue operating a business and repay creditors concurrently through a court-approved plan of reorganization..
- **Chapter 12** allows a family farmer or fisherman to continue to operate the business while the plan is being carried out.
- **Chapter 13** enables individuals with regular income to develop a plan to repay all or part of their debts. Under this chapter, debtors propose a repayment plan to make installments to creditors over three to five years.

- **Chapter15** is to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country.

The Evolution of U.S. Bankruptcy Law- a time line

- **1787 -** The U.S. Constitution (Article I, sec. 8) authorizes Congress to establish uniform bankruptcy laws throughout the nation..
- **Bankruptcy Act of 1800**, the first federal bankruptcy law, the Act authorizes district court judges to appoint nonjudicial commissioners to oversee and help administer bankruptcy proceedings.
- **1803**- Citing excessive costs and corruption, Congress repeals the Act of 1800.
- **Bankruptcy Act of 1841** grants district courts "jurisdiction in all matters and proceedings in bankruptcy," including developing rules for proceedings and appointing bankruptcy commissioners and assignees.
- **1843** High administrative costs, lack of state law exemptions, and creditor frustration lead to the 1841 Act's repeal.
- **Bankruptcy Act of 1867** (14 Stat. 517) marks the first time Congress refers to district courts as "constituted courts of bankruptcy" with original jurisdiction in all bankruptcy matters.
- **1874** Congress amends the 1867 Act so that debtors can create a plan for distributing assets among creditors as a way to settle a case.
- **1878** In response to abuses and excessive fees, Congress repeals the Acts of 1867 and 1874.
- **Bankruptcy Act of 1898** (30 Stat. 544), is the first long-term bankruptcy legislation. In effect for the next 80 years, the Act establishes the position of referee to oversee administration of bankruptcy cases. Referees are appointed to two-year terms by the district judge and can be removed only for incompetency, misconduct, or neglect of duty. They are paid a percentage of funds brought into the estate. Besides the referee position, the 1898 Act establishes the office of trustee (previously assignee) in bankruptcy. In general, the Act is perceived as pro-debtor, establishing relatively narrow exceptions to discharge. Corporations are ineligible for voluntary relief, butsome can be involuntary debtors. (Amendments enacted in 1910 make corporations eligible for voluntary bankruptcy.
- **Chandler Act of 1938** (52 Stat. 840, 841), an overhaul of the 1898 Act, reworks previous reorganization amendments into "Chapters":
- **Bankruptcy Reform Act of 1978** (92 Stat. 2657), superseding the 1898 Act, establishes bankruptcy courts in each district and allows for separate bankruptcy judges, appointed by the President and confirmed by the Senate, to serve 14-year terms beginning in 1984. While bankruptcy courts may now hear all matters arising in or related to bankruptcy cases, judges remain non- Article III adjuncts of the district courts. Also, a new Chapter 11 (replacing X, XI, and XII) and Chapter 13, which offers a "super" discharge, make filing and reorganizing easier for businesses and individuals.
- **Bankruptcy Reform Act of 1994** (Public Law 103-394) creates the second National Bankruptcy Commission to investigate changes in bankruptcy law. The Act expands bankruptcy courts' ability to hold jury trials in some proceedings and encourages circuit councils to establish bankruptcy appellate panels.
- **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005** attempts to overhaul 1978 code with specific reference to consumer protection, restoring personal responsibilities and integrity in the bankruptcy system.

LESSON ROUND UP

- Insolvency is when an individual, corporation or other organization cannot meet its financial obligations for paying debts as they are due. Bankruptcy is not exactly the same as insolvency.
- The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 are two major enactments that deal with personal insolvency.
- Corporate insolvencies in India are majorly governed by the Companies Act, 2013, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002.
- In England, the first bankruptcy law was enacted in 1542, being Statute 34 Henry VIII.
- The existing UK insolvency framework is defined by the Insolvency Act 1986.
- The US Congress enacted the "Bankruptcy Code" in 1978.
- Six basic types of bankruptcy cases are provided for under the Bankruptcy Code.
- Chapter 7 bankruptcy leading to liquidation.
- Chapter 9, entitled Adjustment of Debts of a Municipality, provides essentially for reorganization.
- Chapter 11, entitled Reorganization, ordinarily is used by commercial enterprises that desire to continue operating a business.
- Chapter 12 allows a family farmer or fisherman to continue to operate the business while the plan is being carried out.
- Chapter 13 enables individuals with regular income to develop a plan to repay all or part of their debts.
- Chapter 15 is to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country.

SELF TEST QUESTIONS

1. Explain the corporate insolvency framework in India.
2. European insolvency framework has been taken as base in many countries. Explain.
3. Write briefly about the evolution of insolvency framework in the US.
4. Explain different modes of corporate insolvency under US bankruptcy code.

Lesson 17
Corporate Insolvency and Resolution Process

LESSON OUTLINE

Insolvency and Bankruptcy Code, 2016

- Introduction
- Background
- Institutional Infrastructure
- Functions of Insolvency Professional Agencies
- Duties of Insolvency Professionals etc.
- Corporate Insolvency Resolution Process
- Fast Track Process
- Voluntary Liquidation
- Appeals and Appellate Authority
- Fresh Start Process

LEARNING OBJECTIVES

The Insolvency and Bankruptcy Code, 2016 that received President's assent on May 28, 2016, is a consolidated legislation providing for insolvency resolution process of individuals, partnership firms, Limited Liability Partnerships and Corporate. The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships and individuals. NCLT and Debt Recovery Tribunal play a vital role as an Adjudicating Authority. The Code facilitates time-bound process for insolvency resolution and liquidation. It proposes to repeal and amend a number of legislations. The Code also introduces new regulator "Insolvency and Bankruptcy Board of India" (The Board). The adjudication process in relation to Corporates and LLPs would be under National Company Law Tribunal and in relation to individuals and partnerships under Debt Recovery Tribunal. The insolvency process will be handled by insolvency professional who shall be a Member of the Insolvency Professional Agencies and registered with the Board.

This chapter also covers basics of corporate insolvency resolution process under "The Insolvency and Bankruptcy Code 2016". It also covers consolidated step by step flow charts on insolvency resolution process by financial creditor, operational creditor and corporate debtor, role of insolvency resolution professional etc.

1. Historical Background

In the wake of sickness in the country's industrial climate prevailing in the eighties, the Government of India set up in 1981, a Committee of Experts under the Chairmanship of Shri T. Tiwari to examine the matter and recommend suitable remedies therefore. Based on the recommendations of the Committee, the Government of India enacted a special legislation namely, the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) commonly known as the SICA.

The main objective of SICA is to determine sickness and expedite the revival of potentially viable units or closure of unviable units (unit herein refers to a Sick Industrial Company). It was expected that by revival, idle investments in sick units will become productive and by closure, the locked up investments in unviable units would get released for productive use elsewhere.

The Sick Industrial Companies (Special Provisions) Act, 1985 (hereinafter called the Act) was enacted with a view to securing the timely detection of sick and potential sick companies owning industrial undertakings, the speedy determination by a body of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies and the expeditious enforcement of the measures so determined and for matters connected therewith or incidental thereto.

The Board of experts named as the Board for Industrial and Financial Reconstruction (BIFR) was set up in January, 1987 and got functional with effect from 15th May 1987. The Appellate Authority for Industrial and Financial Reconstruction (AAIFR) was constituted in April 1987. Government companies were brought under the purview of SICA in 1991 when extensive changes were made in the Act including, inter-alia, changes in the criteria for determining industrial sickness.

The major constraint of the SICA 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 because of various factors including non-applicability of SICA to non-industrial companies and small/ancillary companies, misuse of immunity provided under Section 22 of SICA etc.

In view of this, the Insolvency and Bankruptcy Code, 2016 was notified on the May 28, 2016.

Notification of National Company Law Tribunal under the SICA (Special Provisions) Repeal Act 2003

The Ministry of Finance (MoF), vide notification nos. S.O. 3568(E) and 3569(E), has notified on 1 December, 2016 (appointed date) as the date on which the provisions of Sick Industrial Companies (Special Provisions) Repeal Act, 2003 (Repeal Act) shall come into force. The Repeal Act provides for repeal of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and related matters. Therefore, the SICA is repealed with effect from 1 December, 2016. The BIFR and AAIFR stand dissolved with effect from that date, and all proceedings before them stand abated.

The section 4(b) of the SICA (Special Provisions) Repeal Act 2003 was also amended by section 252 of the Insolvency and Bankruptcy Code 2016.

Ministry of Corporate Affairs through its Gazette Notification Dated 1st November 2016 appointed 1st day of November 2016 to give effect to section 252 of the Insolvency Code.

The effect of the amended section 4(b) is that from the date notified by the Government all proceedings pending before the BIFR and AAIFR shall stands abated and will come to an end. However, it shall be open to the company whose appeal, reference or inquiry has abated to initiate fresh proceedings (that is, the corporate insolvency resolution process under the Insolvency Code) before the National Company Law Tribunal ("NCLT") in accordance with the provisions of Insolvency Code, within 180 days of the commencement of the Insolvency Code and to get the protection under section 14 of the IBC 2016.

Transfer of Pending Proceedings in Courts and BIFR

The Ministry of Corporate Affairs had issued the Gazette Notification dated 07th December 2016 relating to (Transfer of Pending Proceedings) Rules, 2016 appointing 15th December 2016 for Transfer of Pending proceedings relating to revival of sick companies from High Court and Board of Industrial and Financial Reconstruction to National Company Law Tribunal.

Status of Appeal made under the SICA Act 1985

At present the SICA Act, 1985 is repealed and the company in respect of which such appeal or reference or inquiry stands abated in BIFR and AAIFR may make reference to NCLT under the Insolvency and Bankruptcy Code 2016 by filing fresh application for Corporate Insolvency Resolution Process (CIRP) within 180 days from the commencement of IBC 2016.

The Insolvency and Bankruptcy Code 2016

The Insolvency and Bankruptcy Code, 2016 is an Act to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.

Background

In India, there were multiple laws like Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) and the Companies Act, 2013 dealing with insolvency and bankruptcy of companies, limited liability partnerships, partnerships firms, individuals and other legal entities in India. As a result High Courts, District Courts, the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR) and the Debt Recovery Tribunals (DRTs), have jurisdiction at various stages, giving rise to the potential systemic delays and complexities in the process whereas liquidation of companies is handled by the high courts, individual cases are dealt with under the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. The present legal framework does not aid lenders in effective and timely recovery of defaulted assets and causes undue strain on the Indian credit system. 'Insolvency means the situation where an entity cannot raise enough cash to meet its obligations or to pay debts as they become due for payment and bankruptcy means when a person voluntary declares him as an insolvent and goes to the court. On declaring the person as 'bankrupt', the court is responsible to liquidate the personal property of the insolvent and distribute it among the creditors of the

insolvent. In the year 1999, the Government of India set up a High Level Committee headed by Justice V.B. Eradi, Judge of Supreme Court of India 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 completed its work and submitted its report to the Central Government in the year 2000. The committee 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.

In December 2002, Indian Parliament passed the Companies (Second Amendment) Act, 2002 to restructure the Companies Act, 1956 including the setting up of NCLT and NCLAT. Dr J J Irani committee was set up to deal with of the Second Amendment Act. On 31st May, 2005, Dr J J Irani committee handed over its report to Government of India. Key recommendations of the committee were time bound proceedings, applicability and accessibilities, moratorium and suspension of proceedings, operating agencies, appointment of Administrators and their duties, Creditor's committee and liquidators, increased role of professionals, insolvency practitioners, cross border insolvency etc.

Considering the abovementioned recommendations, the Government set in motion a plan to overhaul the existing bankruptcy laws and replace them with one that will facilitate easy and time-bound closure of businesses. The draft legislation was based on the report of a high-level panel headed by former law secretary T.K. Viswanathan. The Finance Ministry put up the Insolvency and Bankruptcy Bill, 2015 drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance on its website for public comments.

After a public consultation process and recommendations from a joint committee of Parliament, (both houses of Parliament) it was passed on 05th May, 2016 by the Parliament as The Insolvency and Bankruptcy Code, 2016 and came into force vide notification dated 28th May, 2016. The enactment of the Code is a historical development for economic reforms in India, its effect will be seen in due course when the institutional infrastructure and implementing rules as envisaged under the Code are operational for some time.

Multiplicity of laws and adjudicating authorities for insolvency and bankruptcy of various entities were a hindrance towards resolution of recovery problems of creditors and declaration of insolvency, their revival plan and liquidation of corporate entities. The objective of Insolvency and Bankruptcy Code, 2016 is to consolidate multiple laws and adjudicating authorities dealing with insolvency, bankruptcy, revival and/or liquidation of various entities including individuals, partnership firms, corporate entities etc. Earlier laws pertaining to DRT and SARFAESI were the exclusive forums for banks/financial institutions while BIFR and Companies Act had limited application for sick companies, their revival and/or liquidation. The Insolvency and Bankruptcy Code, 2016 will overcome these kinds of problems.

The Code

The Insolvency and Bankruptcy Code, 2016 (the Code) extends to the whole of India (except Part III which deals with Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms of the Code which shall not extend to the State of Jammu and Kashmir).

The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships firms, Limited Liability Partnership firms and individuals (other than financial firms). The Government is proposing a separate framework for bankruptcy of failing banks and financial sector entities.

One of the fundamental features of the Code is that it allows creditors to assess the viability of a debtor as a business decision, and agree upon a plan for its revival or a speedy liquidation. The Code creates a new

institutional framework, consisting of a regulator, insolvency professional agencies, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate the formal and time bound insolvency resolution process and liquidation.

The Code addresses several problems that plague the current system. It consolidates multiplicity of laws, provides a time bound process for resolution of insolvency, makes information available for rational decision-making, shortens and clarifies the appeal process and manner of distribution of recovery proceeds. The Code outlines a 2-stage process with the first stage being the insolvency resolution process and the second stage being liquidation process triggered upon failure of resolution.

The Objectives

The objective of the Insolvency and Bankruptcy Code is to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the priority of payment of government dues and to establish an Insolvency and Bankruptcy Fund, and matters connected therewith or incidental thereto. An effective legal framework for timely resolution of insolvency and bankruptcy would support development of credit markets and encourage entrepreneurship. It would also improve Ease of Doing Business, and facilitate more investments leading to higher economic growth and development.

The Code seeks to provide for designating the NCLT and DRT as the Adjudicating Authorities for corporate persons and firms and individuals, respectively, for resolution of insolvency, liquidation and bankruptcy. The Code separates commercial aspects of insolvency and bankruptcy proceedings from judicial aspects. The Code also seeks to provide for establishment of the Insolvency and Bankruptcy Board of India (Board) for regulation of insolvency professionals, insolvency professional agencies and information utilities. Insolvency professionals will assist in completion of insolvency resolution, liquidation and bankruptcy proceedings envisaged in the Code. Information Utilities would collect, collate, authenticate and disseminate financial information to facilitate such proceedings. The Code also proposes to establish a fund to be called the Insolvency and Bankruptcy Fund of India for the purposes specified in the Code.

An insolvency resolution process can be initiated by either a creditor, or by the debtor, upon an event of default. A revival plan is to be proposed and agreed by the parties within 180 days from the admission of the application. Making this process time bound is very essential as the value of the assets can erode substantially with the passage of time. In the event of disagreement or if a decision is not taken within the stipulated time-frame the applicant automatically moves to the next stage of Insolvency Process.

The liquidation process will be led by a regulated insolvency professional, the liquidator. The liquidator will form an estate of the assets of the company and hold the estate as a fiduciary for the benefit of all the creditors. The secured creditors may relinquish their security interest in the estate, or realise its security post verification from the liquidator. The recoveries that are obtained are paid out to the various claimants through a well-defined waterfall process. The cost of insolvency will be paid first followed by workmen's dues and secured creditors on *pari-pasu* basis. Next in line will be unsecured creditors followed by government dues.

Insolvency and Bankruptcy

The terms 'insolvency' and 'bankruptcy' arise from one common feature namely inability to pay the debts. Black's Law Dictionary defines the terms as under:

Insolvency:

The condition of a person who is insolvent; inability to pay one's debts; lack of means to pay one's debts. Such a relative condition of a man's assets and liabilities that the former, if all made immediately available, would not be sufficient to discharge the latter. Or the condition of a person who is unable to pay his debts as they fall due, or in the usual course of trade and business.

Bankruptcy:

The state or condition of one who is a bankrupt; amenability to the bankruptcy laws; the condition of one who has committed an act of bankruptcy, and is liable to be proceeded against by his creditors therefor, or of one whose circumstances are such that he is entitled, on his voluntary application, to take the benefit of the bankruptcy laws. The term is used in a looser sense as synonymous with 'insolvency'.

Important Definitions under Corporate Insolvency Resolution Process Regulations

As per Insolvency and Bankruptcy Code 2016, Corporate Insolvency Resolution process can be initiated by

(a) Financial Creditor;

(b) Operational Creditor; and

(c) Corporate Debtor.

It is important to understand the terms financial debt, operational debt, financial creditor, operational creditor etc.

"debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;

"creditor" means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decreeholder;

"corporate person" means a company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider;

"corporate debtor" means a corporate person who owes a debt to any person;

"insolvency professional" means a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207;

"insolvency professional agency" means any person registered with the Board under section 201 as an insolvency professional agency;

"information utility" means a person who is registered with the Board as an information utility under section 210;

"financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to;

"financial debt" means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes –

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on nonrecourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

Explanation. - For the purposes of this sub-clause, -

(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and

(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;

"financial information", in relation to a person, means one or more of the following categories of information, namely :

(a) records of the debt of the person;

(b) records of liabilities when the person is solvent;

(c) records of assets of person over which security interest has been created;

(d) records, if any, of instances of default by the person against any debt;

(e) records of the balance sheet and cash-flow statements of the person; and

(f) such other information as may be specified.

"financial service" includes any of the following services, namely :–

(a) accepting of deposits;

(b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;

(c) effecting contracts of insurance;

(d) offering, managing or agreeing to manage assets consisting of financial products belonging to

another person;

(e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of –

(i) buying, selling, or subscribing to, a financial product;

(ii) availing a financial service; or

(iii) exercising any right associated with a financial product or financial service;

(f) establishing or operating an investment scheme;

(g) maintaining or transferring records of ownership of a financial product;

(h) underwriting the issuance or subscription of a financial product; or

(i) selling, providing, or issuing stored value or payment instruments or providing payment services;

"financial service provider" means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator;

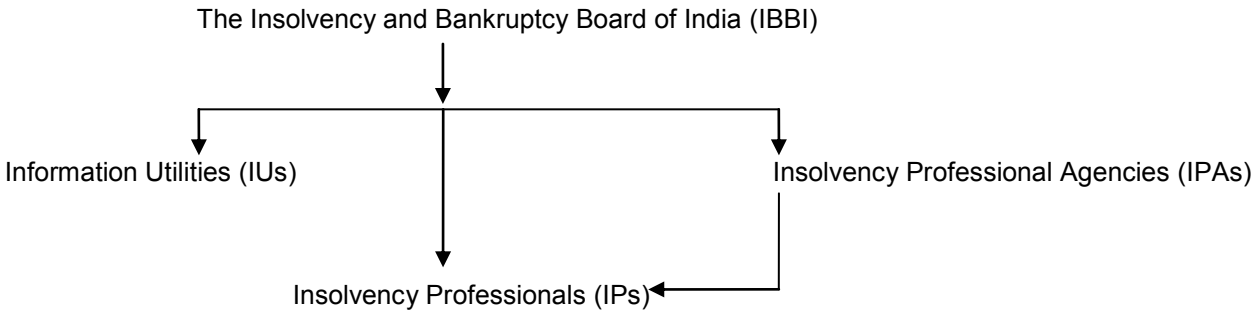
"financial sector regulator" means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government;

"operational creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred;

"**operational debt"** means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

Institutions under Insolvency and Bankruptcy Code, 2016

The Code provides for setting up of the following institutions to ensure effective governance and implementation of the provisions of the law.



(a) Insolvency and Bankruptcy Board of India (IBBI)

Section 3(1) of IBC, 2016: Board means the Insolvency and Bankruptcy Board of India established under sub-section (1) of Section 188. The Code provides for the establishment of the Board called Insolvency and Bankruptcy Board of India.

The Board shall consist of the following members, who shall be appointed by the Central Government:

1. Chairperson
2. Three members amongst the officers of the Central Government not below the rank of Joint Secretary or equivalent, one of each to represent the Ministry of Finance, the Ministry of Corporate Affairs and Ministry of Law, ex officio.
3. One member nominated by the Reserve Bank of India, ex officio.
4. Five other members to be nominated by the Central Government, out of which three shall be the whole-time members.

The Chairperson and the other members shall be persons of ability, integrity and standing, who have shown capacity in dealing with problems relating to insolvency or bankruptcy and have special knowledge and experience in the field of law, finance, economics, accountancy or administration.

Powers of the Board

The Board has 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:—

(i) The discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;

(ii) Summoning and enforcing the attendance of persons and examining them on oath;

(iii) Inspection of any books, registers and other documents of any person at any place;

(iv) Issuing of commissions for the examination of witnesses or documents. (Sec-196).

Role of the Board includes

1. Regulating all matters related to insolvency and bankruptcy process.
2. Setting out eligibility requirements of insolvency intermediaries i.e., Insolvency Professionals, Insolvency Professional Agencies and Information Utilities.
3. Regulating entry, registration and exit of insolvency intermediaries.
4. Making model bye laws for Insolvency Professional Agencies.
5. Setting out regulatory standards for Insolvency Professionals.
6. Specifying the manners **in which Information Utilities can collect and store data.**

(b) Insolvency Professional Agencies (IPAs)

Section 3(20) of IBC, 2016: Insolvency professional agency means any person registered with the Board under section 201 as an insolvency professional agency. These agencies are required to get registered and obtain certificate of registration from the Board. The Board shall have regard to the following principles while registering the insolvency professional agencies, namely: 1. Promote the professional development of and regulation of insolvency professionals. 2. Promote good professional and ethical conduct amongst insolvency professionals. 3. Protect the interests of debtors, creditors etc. 4. Promote the services of competent insolvency professionals to cater to the needs of debtors, creditors etc. 5. Promote the growth of insolvency professional agencies for the effective resolution of insolvency and bankruptcy processes under this Code.

The Insolvency and Bankruptcy Board of India (Insolvency Professional Agencies)

Regulations, 2016 (“IPA Regulations”)

The IPA Regulations provides that only a company registered under section 8 of the Companies Act, 2013, with the sole object of functioning as an insolvency professional agency under the Insolvency Code shall be entitled to be registered as an insolvency professional agency (“IPA”).

At present the following few Insolvency Professional Agencies are registered under section 8 of the Companies Act, 2013 and registered with Insolvency and Bankruptcy Board of India.

1. ICSI Insolvency Professionals Agency.
2. Insolvency Professional Agency of Institute of Cost Accountants of India.
3. Indian Institute of Insolvency Professionals of ICAI.

Functions of the Insolvency professional agencies are:-

1. To grant membership to persons who fulfil all requirements set out in its byelaws on payment of Membership fee.
2. Lay down standards of professional conduct for its members;
3. Monitor the performance of its members;
4. Safeguard the rights, privileges and interests of insolvency professionals who are its members;
5. Suspend or cancel the membership of insolvency professionals who are its members on the grounds set out in its bye-laws;
6. Redress the grievances of consumers against insolvency professionals who are its members; and
7. Publish information about its functions, list of its members, performance of its members and such other information as may be specified by regulations.

(c) Insolvency Professionals (IPs)

Section 3(19) of IBC, 2016: Insolvency Professional means a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207. The Code provides for insolvency professionals as intermediaries who would play a key role in the efficient working of the insolvency and bankruptcy process. These professionals will be enrolled as a member of an insolvency professional agency and registered with Insolvency and Bankruptcy Board of India. The Board may specify the categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field, as it deems fit.

The Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016, was notified on November 23, 2016, which provides that an individual who possess such qualifications and experience and who has passed qualifying examinations shall be enrolled with the insolvency professional agency as a professional member. The Insolvency Professional shall act as a resolution professional or as Liquidator.

Functions of Insolvency Professionals

The functions of Resolution Professional inter alia includes:

1. Conducting Resolution process.
2. Conducting Meeting of Creditors
3. Management of Operations of Corporate debtor as going concern

4. Preparation of Information Memorandum
5. Submission of resolution plan
6. Conducting of Liquidation process under the order of Adjudicating Authority if the resolution plan is not accepted or approved etc.

Every Insolvency Professional shall abide by the following code of conduct:-

- To take reasonable care and diligence while performing his duties.
- To comply with all requirements and terms and conditions specified in the bye laws of the Insolvency professional agency of which he is a member.
- To allow the insolvency professional agency to inspect his records.
- To submit a copy of the records of every proceedings before the adjudicating authority to the board as well as to the Insolvency professional agency of which he is a member.
- To perform his function in such manner and subject to such conditions as may be prescribed.

Therefore, The Code provides for insolvency professionals as intermediaries who would play a key role in the efficient working of the bankruptcy process. The Code contemplates insolvency professionals as a class of regulated but private professionals having minimum standards of professional and ethical conduct.

In the resolution process, the insolvency professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business during the moratorium period and helps the creditors in reaching a consensus for a revival plan. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee.

(d) Information Utility

Section 3(21) of IBC, 2016: Information Utility means a person who is registered with the Board as an information utility under Section 210.

A person shall obtain a certificate of registration by the Board to carry on its business as information utility under this Code. The purpose of this intermediary (Information utility) is to remove information dependency on the debtor’s management for critical information that is required to resolve insolvency. And this information would be available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings.

Obligations of Information Utility:-

- Collect, collate, authenticate and disseminate financial information of debtors in a universally accessible format with in a centralised electronic databases.
- Get the information received from various persons authenticated by all concerned parties before storing such information.
- Provide access to the financial information stored by it to any person who intends to access such information.
- Have the ability to operate with other information utilities.

The Code requires creditors to provide financial information of debtors to multiple utilities on an ongoing basis. Such information would be available to creditors, resolution professionals, liquidators and other

stakeholders in insolvency and bankruptcy proceedings. The purpose of this is to remove information asymmetry and dependency on the debtor's management for critical information that is needed to swiftly resolve insolvency

Accordingly the Information Utilities will serve as a repository of financial information of a company. The financial and operational creditors will have an obligation to submit the relevant information to the IUs. The information maintained in these IUs will be available to all relevant parties on the payment of a fee.

Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017

These Regulations were issued by IBBI w.e.f. April 1, 2017. These provide the framework in relation to Registraion, Shareholding and Governance, Technical standards and bye-laws, Core services, Duties and Cancellation of registration of the Information Utilities.

Access to information

(1) An information utility shall allow the following persons to access information stored with it:

(a) the user which has submitted the information;

(b) all the parties to the debt and the host bank, if any, if the information is of the categories in section 3 (13) (a), (c) and (d);

(c) the corporate person and its auditor, if the information is of the categories in section 3 (13) (b) and (e);

(d) the insolvency professional, to the extent provided in the Code;

(e) the Adjudicating Authority;

(f) the Board;

(g) any person authorised to access the information under any other law; and

(h) any other person who the persons referred to in (a), (b) or (c) have consented to share the information with.

(2) An information utility shall in all cases enable the user to view:

(a) the date the information was last updated;

(b) the status of authentication; and

(c) the status of verification while providing access to the information.

(3) An information utility shall provide information to the Adjudicating Authority and Board free of charge.

(e) Adjudication Authorities:

The National Company Law Tribunal is the adjudicating authority to deal with the insolvency matters of Companies and Limited Liability Partnership Firms. Appeals from NCLT orders lie to the National Company Law Appellate Tribunal and thereafter to the Supreme Court of India.

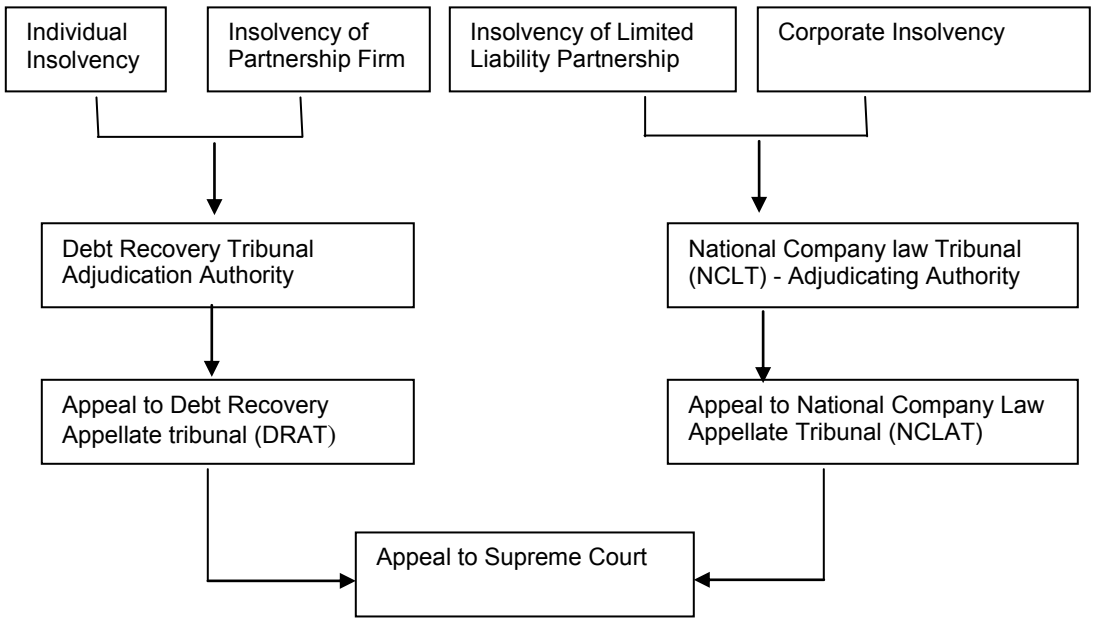
- NCLAT shall be the appellate authority to hear appeals arising out of the orders passéd by the Board in respect of Insolvency Professional Agency or Insolvency Professional or Information Utilities.
- The Debt Recovery Tribunal is the adjudicating authority to deal with the insolvency & bankruptcy

matters of Individual & Partnership Firms. Appeals from DRT orders lie to the Debt Recovery Appellate Tribunal and thereafter to the Supreme Court of India.

- In keeping with the broad philosophy that insolvency resolution must be commercially and professionally driven (rather than court driven), the role of adjudicating authorities is limited to ensuring due process rather than adjudicating on the merits of the insolvency resolution.

Insolvency Resolution and Liquidation for Corporate Persons

The Insolvency Adjudication Process



Part II of the Code deals with matters relating to the insolvency and liquidation of Companies and Limited Liability Partnership Firms where the minimum amount of the default is Rupees one lakh and this amount can be increased up to Rupees one crore by the Central Government.

Filing of an Application before the Adjudicating Authority:

Any of the following can file an application before the Adjudicating authorities:

- Financial Creditors are the creditors to whom corporate debtor owes financial debt
- Operational Creditors are the creditors to whom corporate debtor owes operational debts such as claims for goods and services, employees, etc.
- Corporate Applicant means corporate debtor or its shareholders, partner, management personnel or employees

On receipt of an application, the Adjudicating Authority shall within fourteen days by order may:

- Admit the application if it is complete
- Reject the application, if it is incomplete

Before rejecting an application, the Adjudicating Authority gives a notice to the applicant to rectify the defect from the application within seven days of receipt of such notice from the Adjudicating Authority.

Persons who are not entitled to initiate corporate insolvency resolution

The following persons shall not be entitled to make application to NCLT for initiation of corporate insolvency resolution process:-

(a) a corporate debtor undergoing a corporate insolvency resolution process; or

(b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or

(c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months preceding the date of making application; or

(d) a corporate debtor in respect of whom a liquidation order has been passed so that finality of the liquidation order is ensured.

For making an application, a corporate debtor includes a corporate applicant in respect of such corporate debtor.

Application to NCLT for initiation of Corporate Insolvency Resolution Process

For making application for initiation of corporate insolvency resolution process, the eligible persons will have to take the following steps keeping in view their status as applicants:

Application by financial creditor

- A financial creditor can file application either by itself or jointly with other financial creditor(s) when a default in respect of a financial debt owed not only to the applicant financial creditor, but to any other financial creditor of the corporate debtor is made.
- The application shall be made in prescribed form in prescribed manner and shall be accompanied by prescribed fee.
- The following documents shall be enclosed with the application:-

  (a) Record of the default recorded with the information utility or such other record or evidence of default as may be specified. ("Information utility" means a person who is registered with the Insolvency and Bankruptcy Board of India as an information utility under section 210 of the Code.)

  (b) The name of the resolution professional proposed to act as an interim resolution professional; and

  (c) Any other information as may be specified by the Insolvency and Bankruptcy Board of India.

The application is to be made to the National Company Law Tribunal (NCLT) which is designated as the Adjudicating Authority for the purpose.

If the NCLT, within 14 days of receipt of the application is satisfied on the basis of the evidence furnished that a default has occurred and the application is complete and there is no disciplinary proceeding pending against the proposed insolvency professional, it shall admit the application and within 7 days of the admission of the application communicate the order of admission to the financial creditor and the corporate debtor concerned. The corporate insolvency process shall commence from the date of admission of the application.

Where, however, default is not made or the application is incomplete or any disciplinary proceeding is pending against the proposed insolvency professional, NCLT may reject the application within 14 days of the receipt of the application and it shall, within 7 days of rejection of the application communicate the order of rejection to the financial creditor.

Application by operational creditor

- On occurrence of the default, the operational creditor has to deliver a demand notice of unpaid operational debt or copy of invoice demanding repayment of the amount involved in the default to the corporate debtor in the prescribed form and prescribed manner.
- The corporate debtor must, within 10 days of the receipt of the demand notice or the copy of the invoice as above, bring to the notice of the operational creditor existence of any dispute, if any, and record of the pendency of any suit or arbitration proceeding filed before the receipt of the notice or the copy of the invoice in relation to such dispute. Where the amount of debt has been already paid, the corporate debtor must bring to the notice of the operational debtor the payment of unpaid operational debt by sending an attested copy of the record of electronic transfer of unpaid amount from the bank account of the corporate debtor or by sending an attested copy of the record that the operational creditor has encashed the cheque issued by the corporate debtor.
- After the expiry of 10 days from the date of delivery of demand notice or the copy of the invoice, if the operational creditor does not receive payment or notice of dispute as above, the operational creditor may file application to NCLT in prescribed form and in prescribed manner and the application has to be accompanied by prescribed fee for initiation of corporate insolvency resolution process.
- The following documents shall be enclosed with the application:-

  (a) Copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;

  (b) an affidavit to the effect that there is no notice given by the corporate debtor relating to the dispute of the unpaid operational debt;

  (c) copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available;

  (d) a copy of any record with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available; and

  (e) any other proof confirming that there is no payment of any unpaid operational debt by the corporate debtor or such other information, as may be prescribed.
- An operational creditor initiating corporate insolvency resolution process may propose a resolution professional to act as an interim resolution professional.

Within 14 days of the receipt of the application, NCLT shall admit the application if the following requirements are fulfilled:-

(a) The application is complete.

(b) There is no payment of the unpaid operational debt.

(c) The invoice or notice for payment to the corporate debtor has been delivered by the corporate creditor.

(d) No notice of dispute has been received by the operational creditor or there is no record of dispute in the information utility.

(e) There is no disciplinary proceeding pending against any resolution professional proposed, if any.

The decision of admission of the application will be communicated by NCLT to the operational debtor and the corporate debtor. The corporate insolvency resolution process shall commence from the date of admission of the application.

NCLT may reject the application in the following circumstances:-

(a) if the application is incomplete;

(b) if there has been payment of the unpaid operational debt;

(c) if the creditor has not delivered the invoice or notice for payment to the corporate debtor;

(d) if the notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility; and

(e) if any disciplinary proceeding is pending against any proposed resolution professional.

Before rejecting the application, NCLT will have to give notice to the applicant to rectify the defect in his application within 7 days of such notice from NCLT. NCLT shall communicate the decision of rejection of the application to the operational creditor and the corporate debtor.

Application by the corporate debtor

Where a corporate debtor has committed a default, a corporate applicant thereof may file an application to NCLT for initiating corporate insolvency resolution process by taking the following steps:-

- The application shall be filed in prescribed form containing prescribed particulars in prescribed manner and the application shall be accompanied by prescribed fee.
- Corporate debtor shall enclose the following documents to the application:-

(a) the information relating to its books of account and such other documents for such period as may be specified;

(b) The information relating to the resolution professional proposed to be appointed as an interim resolution professional.

(c) the special resolution passed by shareholders of the corporate debtor or the resolution passed by at least three-fourth of the total number of partners of the corporate debtor, as the case may be, approving filing of the application.

The NCLT shall, by an order, admit the application within 14 days of the receipt of the application if it is complete and no disciplinary proceeding is pending against the proposed resolution professional. The corporate insolvency resolution process shall commence from the date of admission of the application.

If the application is incomplete or any disciplinary proceeding is pending against the proposed resolution professional], NCLT may reject the application, but before rejecting the application, NCLT shall give notice to the applicant to rectify the defects in the application within 7 days from the date of receipt of the notice.

Timelines for completion of Insolvency Resolution Process

The Corporate Insolvency resolution process shall be completed within one hundred and eighty days from the date the application is admitted by the National Company Law Tribunal. If the process cannot be completed within one hundred and eighty days then one time extension of ninety days subject to resolution passed at a meeting of the committee of creditors by a vote of sixty-six percent of the voting shares. Here, ‘committee of creditors’ means the committee which shall comprise of all financial creditors of the Company or Limited Liability Partnership Firms. After admission of the application, National Company Law Tribunal

shall by an order:

- Declare a Moratorium
- Cause a Public Announcement
- Appoint an Interim Resolution Professional

As per section 12A, the Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be prescribed.

Moratorium

The NCLT shall by order declare a moratorium on the debtor's operations for the period of the Insolvency Resolution orders Process. This operates as a 'calm period' during which no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets/ legal rights/ beneficial interest can take place against the debtors.

The order of moratorium shall have effect till the completion of corporate insolvency process.

Public announcement

The public announcement shall contain the following information about the corporate debtor:

1. Name and address
2. Name of the Registrar with which it is incorporated
3. Last date for submission of claims
4. Details of interim professionals
5. Penalties for false or misleading claims
6. Date on which the corporate insolvency resolution process shall close

Appointment of interim resolution professional

The Adjudicating Authority shall appoint an Interim Resolution Professional within fourteen days from the insolvency commencement date.

Functions of interim professional are:

- To takeover the management of the affairs of the corporate debtor.
- All officers and managers of the corporate debtor shall act on the instructions of the interim professionals.
- Have access to all books of account, record and other relevant documents shall be managed by these professionals

The term of the interim resolution professional shall continue till the date of appointment of the resolution professional under section 22.

Committee of creditors

The Interim Resolution Professional shall identify the financial creditors and constitute a committee of creditors. Operational creditors are allowed to attend the meetings of committee if their dues are not less than ten percent of the debt but they do not have voting power. Each decision of the committee requires a

fifty-one per cent majority vote.

Appointment of resolution professional

The first meeting of the Committee shall be held within seven days of the constitution of the committee of creditors which may:

- Resolve to appoint the interim resolution professional as a resolution professional OR
- Replace the interim resolution professional by another resolution professional.

The Resolution Professional-

- Shall conduct the entire corporate insolvency process
- Manage operations of the corporate debtor
- Have the same powers as that of the interim professionals under the Code.

Resolution plan

- A resolution applicant may submit a resolution plan to the resolution professional.
- Final resolution professional examine the plan.
- Then he shall present such plan to the committee of creditors for their approval.
- After obtaining approval from the committee of creditors, resolution professional shall submit the approved plan to the Adjudicating Authority.
- If the Adjudicating Authority approves the plan, then this will be binding upon the employees, members, creditors and other stakeholders. And after approval of the plan, time period of moratorium ends.
- If application gets rejected, then NCLT shall pass an order of liquidation of the corporate debtor and requires such order shall be sent to the registering authority.

CORPORATE INSOLVENCY RESOLUTION PROCESS AT A GLANCE

Steps for the Corporate Insolvency Resolution process (CIRP) are as under:

The Financial Creditor/Operational Creditor or Corporate Debtor as the case may be, initiate the CIRP by application to NCLT under section 7, 8 and 10 respectively

↓

Financial Creditor on Default and operational Creditor after ten days from the date of delivery of demand notice can initiate CIRP

↓

A Financial Creditor and Corporate Debtor shall propose the name of IRP and Operational Creditor may propose the name of IRP

↓

NCLT within 14 days of receipt of application by order admit or reject application (before rejecting give notice to rectify the defect within 7 days of receipt of notice)

↓

Intimation of admission or rejection to be given by NCLT within seven days of admission or rejection

↓

NCLT to declare Moratorium, appoint Interim Resolution Professional (IRP) and cause public announcement

↓

Public announcement shall contain the information, such as name and address of the corporate debtor under the CIRP, name of the authority with which corporate debtor is registered, the last date for submission of claims and date on which CIRP will be closed; etc.

↓

Insolvency Commencement date starts from the date of admission of application and is to be completed within 180 days of commencement which can be extended to ninety days (one time) by NCLT

↓

Interim Resolution Professional to constitute Committee of Creditors comprising all financial creditors

↓

Management of affairs of corporate debtor as a going concern, powers of Board of Directors or the partners of debtor shall stand suspended and exercised by the Interim Resolution Professional (IRP)

↓

Committee of Creditors within 7 days of its constitution either to resolve to appoint IRP as Resolution Professional (RP) or replace IRP with another RP

↓

All decisions of committee of creditors shall be taken by vote of not less than 51% of voting share of financial creditors

↓

Preparation of information memorandum by RP for formulation of Resolution Plan by Resolution Applicant.

↓

Resolution Applicant prepares the Resolution plan based on information memorandum

↓

Submission of Resolution Plan by Resolution Applicant to be examined by RP and to be approved by 66% of voting share of financial creditors

↓

RP to submit approved Resolution Plan to NCLT which shall Approve or Reject/Order for Liquidation

↓

The approved plan shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

↓

Moratorium ends on the date of approval

↓

Appeal may be made to NCLAT on Rejection

Corporate Insolvency Resolution Process – Financial Creditors

1. Application to NCLT by Financial Creditor singly or jointly

A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application before the NCLT

when a default has occurred.

“Default includes a default in respect of a financial debt owned not only to applicant financial creditor but to any other financial creditor of the corporate debtor.”

2. Furnishing of evidence of default and other information along with application

The financial creditor shall, along with the application furnish

- a record of the default recorded with the information utility or such other record or evidence of default as may be specified,
- the name of the resolution professional proposed to act as an interim resolution professional and
- any other information as may be specified by the Board.

3. NCLT to ascertain the default within 14 days of application under sub section (4) of section 7

The NCLT shall within fourteen days of the receipt of the application, ascertain the existence of default from the records of information utilities or on the basis of evidence furnished by the financial creditor.

4. Grounds of admission/rejection of application as per provisions of section 7(5)

When National Company Law Tribunal is satisfied that a:

- Default has occurred – The application is complete, and there is no discrepancy proceedings pending against the proposed resolution professional, it may, by order, admit such application or
- Default has not occurred – The application is incomplete, or any disciplinary proceeding is pending against the proposed resolution professional, it may, by order, reject such application.

5. Notice of Rejection

The NCLT shall, before rejecting the application give notice to the applicant to rectify the defect in his application within seven days of receipt of such notice.

6. Acceptance of Application

The corporate insolvency resolution process shall commence from the date of admission of the application by NCLT

7. Notice of Acceptance of Application under sub-section (7) of section 7

The National Company law Tribunal shall communicate the order to the financial creditor within seven days of admission or rejection of such application, as the case may be.

8. NCLT to declare Moratorium, appoint interim resolution professional and cause a public announcement as per section 13

The NCLT shall after the admission of the application declare by order Moratorium, appointment of interim resolution professional and cause public announcement.

9. Moratorium period under sub-section (1) of section 14

The order of moratorium shall have effect from the date of admission of application for insolvency resolution

process and shall cease to have effect from the date of approval of resolution plan or liquidation order, as the case may be.

10. Effect of Moratorium as per clause (a) to (d) of sub-section (1) of section 14

The motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the insolvency resolution process (IRP). There should be no additional stress on the business after the public announcement of the IRP.

The NCLT shall by order prohibit the following namely:

1. The institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority.
2. Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein.
3. any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
4. the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

Note – The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

The provisions as specified above shall not apply to (a) such transaction as may be notified by the Central Government in consultation with any financial regulator; (b) a surety in a contract of guarantee to a corporate debtor..

11. Tenure of Interim Resolution Professional as per sub-section (5) of section 16

The NCLT shall appoint an interim resolution professional at the start of the Insolvency resolution process i.e. within fourteen days from the insolvency commencement date, if no disciplinary proceedings are pending against him.

The term of the interim resolution professional shall continue till the date of appointment of the resolution professional under section 22.

12. Contents of public announcement under section 15

The Public announcement shall contain the following information, namely:-

(a) name and address of the corporate debtor under the process, name of the authority with which the corporate debtor is incorporated or registered,

(b) the last date for submission of claims, as may be specified,

(c) details of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims,

(d) penalties for false or misleading claims and

(e) the date on which the corporate insolvency resolution process shall close, which shall be the one

hundred and eightieth day from the date of the admission of the application, as the case may be.

The public announcement under this section shall be made in such manner as may be specified.

13. Management of Affairs of Corporate Debtor under section 17

From the date of appointment of interim resolution professional –

- the management of the affairs of the corporate debtor shall vest with the interim resolution professional;
- powers of Board of Directors or the partners as the case may be shall stand suspended and exercised by the interim resolution professional.
- The officers and the managers shall report and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional.
- The financial institutions maintaining accounts of the corporate debtor shall act and furnish all the information relating to corporate debtor available with them to interim resolution professional.

Following are the powers vested with interim resolution professional with the management of the corporate debtor –

(a) to act and execute in the name and on behalf of the corporate debtor all deeds, receipts, and other documents, if any;

(b) to take such actions, in the manner and subject to such restrictions, as may be specified by the Board;

(c) have the authority to access the electronic records of corporate debtor from information utility having financial information of the corporate debtor;

(d) have the authority to access the books of account, records and other relevant documents of corporate debtor available with government authorities, statutory auditors, accountants and such other persons as may be specified.

(e) be responsible for complying with the requirements under any law for the time being in force on behalf of the corporate debtor.

14. Duties of interim resolution professional under section 18

The interim resolution professional shall perform the following duties, namely:-

(a) collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor information relating to – business operations for the previous two years, financial and operational payments for the previous two years, list of assets and liabilities as on the initiation date and such other matters as may be specified;

(b) receive and collate all the claims submitted by creditors to him, pursuant to the public announcement; ,

(c) constitute a committee of creditors;

(d) monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors;

(e) file information collected with the information utility, if necessary; and

(f) take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets including –

(i) assets over which the corporate debtor has ownership rights which may be located in a foreign country;

(ii) assets that may or may not be in possession of the corporate debtor;

(iii) tangible assets, whether movable or immovable;

(iv) intangible assets including intellectual property;

(v) securities including shares held in any subsidiary of the corporate ,financial instruments, insurance policies;

(vi) assets subject to the determination of ownership by a court or authority,

(g) to perform such other duties as may be specified by the Board.

Explanation: For the purpose of this section 'Assets' shall not include:

- assets owned by a third party in possession of the corporate debtor held under trust or under contractual arrangements including bailment,
- assets of any Indian or foreign subsidiary of the corporate debtor; and
- such other assets as may be notified by the Central Government in consultation with any financial sector regulator.

15. Committee of Creditors

- **Interim Resolution Professional to Constitute a Committee of Creditors**

  The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

- **Committee of Creditors to Comprise of all Financial Creditors**

  The committee of creditors shall comprise all financial creditors of the corporate debtor.

- **Financial Creditor who is a related party to corporate Debtor not eligible to Vote.**

  Financial creditor or the authorised representative of the financial creditor referred to in sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors.

  Related Party means related party as defined under Section 5(24 or 24A) of the Insolvency and Bankruptcy Code, 2016.

- **Position of Financial Creditor in case of Consortium agreement**

  Subject to sub-sections (6) and (6A), where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

- **Position of Financial Creditor when he is also an operational Creditor**

If, any person is a financial creditor as well as an operational creditor, such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor and shall be included in the committee of creditors, with voting share proportionate to the extent of financial debts owed to such creditor. Such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

- **Assignment of operational debt to financial creditor.**

  If an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

- **Manner of determining the voting share by financial creditor**

  The Insolvency and Bankruptcy Board of India may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A).

- **Decisions of Committee of Creditors**

  All decisions of the committee of creditors shall be taken by a vote of not less than fifty-one per cent of voting share of the financial creditors.

  Provided that where a corporate debtor does not have any financial creditors, the committee of creditors shall be constituted and comprise of such persons to exercise such functions in such manner as may be specified by the Board.

16. Appointment of Resolution professional (RP) under section 22

The committee of creditors may, in their first meeting held within seven days of the constitution of committee, by a majority of vote of not less than sixty-six per cent of voting share of financial creditor, either resolve to appoint the interim resolution professional as resolution professional subject to a written consent from the interim resolution professional in the specified form or replace the interim resolution professional by another resolution professional. Replacement of resolution professional can also be done by committee in the meeting during the process period by filing an application before the NCLT for appointment of proposed resolution professional along with a written consent from the proposed resolution professional in the specified form.

NCLT shall forward the name proposed to the Insolvency and Bankruptcy Board of India (the Board) for confirmation and shall make such appointment after confirmation by the Board. If no confirmation is received within ten days of the receipt of the name so proposed from the Board then NCLT shall by order, direct the Interim resolution professional to continue to function until such time the Board confirms the appointment of proposed resolution professional.

17. Duties of Resolution professional under section 25

The resolution professional has wider role, in addition to monitoring and supervising the entity, controlling its assets. Resolution professional conduct the entire corporate insolvency resolution process and manage the operations of the corporate debtor during the process period. He/she becomes the manager of the negotiation between the debtor and the creditors in assessing the viability of the entity.

In this role he/she has the responsibility of managing all information so that debtors and creditors are equally informed about the business in the negotiations. Finally, he/she is responsible for inviting and collecting proposals to keep the entity going. It shall be the duty of resolution professional to preserve and protect the assets of corporate debtor including the continued business operations of corporate debtor.

Following actions need to be undertaken for this purpose :

1. take immediate custody and control of all the assets of the corporate debtor, including the business records of the corporate debtor,
2. represent and act on behalf of the corporate debtor with third parties, exercise rights for the benefit of the corporate debtor in judicial, quasi judicial or arbitration proceedings,
3. raise interim finances subject to the approval of the committee of creditors,
4. appoint accountants, legal or other professionals in the manner as specified by the Board,
5. maintain an updated list of claims,
6. convene and attend all meetings of the committee of creditors,
7. prepare the information memorandum in accordance with section 29,
8. invite prospective resolution applicants, who fulfil such criteria as may be laid down by him with the approval of committee of creditors, having regard to the complexity and scale of operations of the business of the corporate debtor and such other conditions as may be specified by the Board, to submit a resolution plan or plans,
9. present all resolution plans at the meetings of the committee of creditors,
10. file application for avoidance of transactions in accordance with Chapter III, if any; and
11. such other actions as may be specified by the Board.

Prior approval of committee of creditors by vote of sixty-six percent of voting shares is required for the following actions:

(a) raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting;

(b) create any security interest over the assets of the corporate debtor;

(c) change the capital structure of the corporate debtor, including by way of issuance of additional securities, creating a new class of securities or buying back or redemption of issued securities in case the corporate debtor is a company;

(d) record any change in the ownership interest of the corporate debtor;

(e) give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting;

(f) undertake any related party transaction;

(g) amend any constitutional documents of the corporate debtor;

(h) delegate its authority to any other person;

(i) dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties;

(j) make any change in the management of the corporate debtor or its subsidiary;

(k) transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business;

(l) make changes in the appointment or terms of contract of such personnel as specified by the

committee of creditors; or

(m) make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor.

No action shall be approved by the committee of creditors unless approved by a vote of sixty-six per cent of the voting shares. Any such actions taken by the resolution professional without approval of the committee of creditors shall be considered *void*.

18. Meeting of Committee of Creditors under section 24

Members of the committee may meet in person or by such electronic means as may be specified. Resolution professional shall conduct all the meetings, including giving notices of each meeting to members of committee of creditors, including the authorised representatives referred to in sub-sections (6) and (6A) of section 21 and sub-section (5), members of the suspended Board of Directors or the partners of the corporate persons, as the case may be and operational creditors or their representatives if the amount of their aggregate dues is not less than ten per cent of the debt..

Any creditor who is also a member of committee may appoint an insolvency professional other than resolution professional to represent such creditor in a meeting of creditors and the fees payable to such professional will be borne by such creditors.

Resolution professional shall determine voting share as specified by Board, each creditor shall vote proportionately according to the financial debt owed to such creditor.

19. Preparation of information memorandum under section 29

Resolution professional shall prepare an information memorandum for formulating resolution plan.

The resolution professional shall provide to the resolution applicant access to all relevant information in physical and electronic form, provided such resolution applicant undertakes:-

- to comply with provisions of law for the time being in force relating to confidentiality and insider trading,
- to protect any intellectual property of the corporate debtor it may have access to; and
- not to share relevant information with third parties unless clauses (a) and (b) of sub-section 2 are complied with.

“relevant information” means the information required by the resolution applicant to make the resolution plan for the corporate debtor, which shall include the financial position of the corporate debtor, all information related to disputes by or against the corporate debtor and any other matter pertaining to the corporate debtor as may be specified”.

Section 29A inserted w.e.f. 23-11-2017 mentions the persons not eligible to be resolution applicant.

20. Submission of resolution plan under section 30

A resolution applicant may submit a resolution plan along with an affidavit stating that he is eligible under section 29A to the resolution professional prepared on the basis of the information memorandum. The resolution professional will examine and confirm that each resolution plan shall provide the following:-

(a) the payment of insolvency resolution process costs in a manner specified by the Board in priority to the repayment of other debts of the corporate debtor;

(b) the payment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under section 53;

(c) the management of the affairs of the Corporate debtor after approval of the resolution plan;

(d) the implementation and supervision of the resolution plan;

(e) does not contravene any of the provisions of the law for the time being in force;

(f) conforms to such other requirements as may be specified by the Board.

Explanation — For the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013 or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

21. Approval of Resolution plan by Committee of Creditors

The Committee of creditors may approve a resolution plan by a vote of not less than sixty-six percent of voting share of the financial creditors, after considering its feasibility and viability, and such other requirements as may be specified by the Board. Section 5(28) defines voting share as follows:

> "voting share" means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor."

22. Approval of Resolution plan by NCLT (section 31)

If NCLT is satisfied that the resolution plan as approved by the committee of creditors confirms the above requirements, it shall by order approve the resolution plan and moratorium period ends here.

It shall be binding on corporate debtor, its employees, members, creditors, guarantors and other stakeholders involved in resolution plan. If resolution plan does not confirm to the requirements above, it may by order, reject resolution plan.

Provided that the Adjudicating Authority shall, before passing an order for approval of resolution plan, satisfy that the resolution plan has provisions for its effective implementation.

23. Order under section 31

After the Order of approval passed by NCLT, the moratorium order shall cease to have effect and resolution professional shall forward all records relating to the conduct of corporate insolvency resolution process and resolution plan to the Board to be recorded on its database.

The resolution applicant shall, pursuant to the resolution plan approved under sub-section (1), obtain the necessary approval required under any law for the time being in force within a period of one year from the date of approval of the resolution plan by the Adjudicating Authority under sub-section (1) or within such period as provided for in such law, whichever is later:

Provided that where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.

Any appeal from the order of NCLT approving resolution plan shall be made in the manner and on the

grounds laid down in sub-section (3) of section 61. They are as follows:

(i) the approved resolution plan is in contravention of the provisions of any law for the time being in force;

(ii) there has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period;

(iii) the debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board;

(iv) the insolvency resolution process costs have not been provided for repayment in priority to all other debts; or

(v) the resolution plan does not comply with any other criteria specified by the Board.

Liquidation

(1) Where the Adjudicating Authority, - (a) before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under section 12 or the fast track corporate insolvency resolution process under section 56, as the case may be, does not receive a resolution plan under sub-section (6) of section 30; or

(b) rejects the resolution plan under section 31 for the non-compliance of the requirements specified therein, it shall –
(i) pass an order requiring the corporate debtor to be liquidated in the manner as laid down in this Chapter;
(ii) issue a public announcement stating that the corporate debtor is in liquidation; and
(iii) require such order to be sent to the authority with which the corporate debtor is registered.

(2) Where the resolution professional, at any time during the corporate insolvency resolution process but before confirmation of resolution plan, intimates the Adjudicating Authority of the decision of the committee of creditors approved by not less than sixty-six per cent. of the voting share to liquidate the corporate debtor, the Adjudicating Authority shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1).

(3) Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order as referred to in sub-clauses (i), (ii), (iii) of clause (b) subsection (1).

(4) On receipt of an application under sub-section (3), if the Adjudicating Authority determines that the corporate debtor has contravened the provisions of the resolution plan, it shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1).

(5) Subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:
Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority,

(6) The provisions of sub-section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

(7) The order for liquidation under this section shall be deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor, except when the business of the corporate debtor is continued during the liquidation process by the liquidator.

Fast track corporate insolvency resolution process (section 55)

(1) A corporate insolvency resolution process carried out in accordance with this Chapter IV shall be called as fast track corporate insolvency resolution process.
(2) An application for fast track corporate insolvency resolution process may be made in respect of the following corporate debtors, namely:
(a) a corporate debtor with assets and income below a level as may be notified by the Central Government; or
(b) a corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government; or
(c) such other category of corporate persons as may be notified by the Central Government.

Time period for completion of fast track corporate insolvency resolution process (section 56)

(1) Subject to the provisions of sub-section (3), the fast track corporate insolvency resolution process shall be completed within a period of ninety days from the insolvency commencement date.
(2) The resolution professional shall file an application to the Adjudicating Authority to extend the period of the fast track corporate insolvency resolution process beyond ninety days if instructed to do so by way of a resolution passed at a meeting of the committee of creditors and supported by a vote of seventy five per cent of the voting share.
(3) On receipt of an application under sub-section (2), if the Adjudicating Authority is satisfied that the subject matter of the case is such that fast track corporate insolvency resolution process cannot be completed within ninety days, it may, by order, extend the duration of such process beyond the said period ninety days by such further period, as it thinks fit, but not exceeding forty-five days:

Provided that any extension of the fast track corporate insolvency resolution process under this section shall not be granted more than once.

Manner of initiating fast track corporate insolvency resolution process (section 57)

An application for fast track corporate insolvency resolution process may be filed by a creditor or corporate debtor as the case may be, alongwith -
(a) the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board; and
(b) such other information as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

Voluntary Liquidation of corporate persons (section 59)

A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of Chapter V. The voluntary liquidation of a corporate person under sub-section (1) shall meet such conditions and procedural requirements as may be specified by the Board.

Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017

These Regulations came into force on 1st April, 2017. These Regulations shall apply to the voluntary liquidation of corporate persons under Chapter V of Part II of the Insolvency and Bankruptcy Code, 2016.

Initiation of Liquidation

(1) Without prejudice to section 59(2), liquidation proceedings of a corporate person shall meet the following conditions, namely:

(a) a declaration from majority of (i) the designated partners, if a corporate person is a limited liability partnership, (ii) individuals constituting the governing body in case of other corporate persons, as the case may be, verified by an affidavit stating that- (i) they have made a full inquiry into the affairs of the corporate person and they have formed an opinion that either the corporate person has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the liquidation; and (ii) the corporate person is not being liquidated to defraud any person;

(b) the declaration under sub-clause (a) shall be accompanied with the following documents, namely:

(i) audited financial statements and record of business operations of the corporate person for the previous two years or for the period since its incorporation, whichever is later;

(ii) a report of the valuation of the assets of the corporate person, if any prepared by a registered valuer;

(c) within four weeks of a declaration under sub-clause (a), there shall be:

(i) a resolution passed by a special majority of the partners or contributories, as the case may be, of the corporate person requiring the corporate person to be liquidated and appointing an insolvency professional to act as the liquidator; or

(ii) a resolution of the partners or contributories, as the case may be, requiring the corporate person to be liquidated as a result of expiry of the period of its duration, if any, fixed by its constitutional documents or on the occurrence of any event in respect of which the constitutional documents provide that the corporate person shall be dissolved, as the case may be, and appointing an insolvency professional to act as the liquidator:

Provided that the corporate person owes any debt to any person, creditors representing two-thirds in value of the debt of the corporate person shall approve the resolution passed under sub-clause (c) within seven days of such resolution.

(2) The corporate person shall notify the Registrar and the Board about the resolution under sub-regulation (1) to liquidate the corporate person within seven days of such resolution or the subsequent approval by the creditors, as the case may be.

(3) Subject to approval of the creditors under sub-regulation (1), the liquidation proceedings in respect of a corporate person shall be deemed to have commenced from the date of passing of the resolution under sub-clause (c) of sub-regulation (1).

Appointment of Liquidator

(1) An insolvency professional shall not be appointed by a corporate person if he is not eligible under Regulation 6.

(2) The resolution passed under regulation 3(2)(c) or under section 59(3)(c), as the case may be, shall

contain the terms and conditions of the appointment of the liquidator, including the remuneration payable to him.

Eligibility for appointment as liquidator

An insolvency professional shall be eligible to be appointed as a liquidator if he, and every partner or director of the insolvency professional entity of which he is a partner or director is independent of the corporate person.

Proceeds of Liquidation and Distribution of Proceeds

Distribution

(1) The liquidator shall distribute the proceeds from realization within six months from the receipt of the amount to the stakeholders.

(2) The liquidation costs shall be deducted before such distribution is made.

(3) The liquidator may, with the approval of the corporate person, distribute amongst the stakeholders, an asset that cannot be readily or advantageously sold due to its peculiar nature or other special circumstances.

Completion of liquidation

(1) The liquidator shall endeavor to complete the liquidation process of the corporate person within twelve months from the liquidation commencement date.

(2) In the event of the liquidation process continuing for more than twelve months, the liquidator shall hold a meeting of the contributories of the corporate person within fifteen days from the end of the twelve months from the liquidation commencement date, and at the end every succeeding twelve months till dissolution of the corporate person.

Appeals and Appellate Authority (section 61)

(1) Notwithstanding anything to the contrary contained under the Companies Act 2013, any person aggrieved by the order of the Adjudicating Authority under this part may prefer an appeal to the National Company Law Appellate Tribunal.

(2) Every appeal under sub-section (1) shall be filed within thirty days before the National Company Law Appellate Tribunal:
Provided that the National Company Law Appellate Tribunal may allow an appeal to be filed after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not filing the appeal but such period shall not exceed fifteen days.

(3) An appeal against an order approving a resolution plan under section 31 may be filed on the following grounds, namely:
(i) the approved resolution plan is in contravention of the provisions of any law for the time being in force;
(ii) there has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period;
(iii) the debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board;
(iv) the insolvency resolution process costs have not been provided for repayment in priority to all other

debts; or
(v) the resolution plan does not comply with any other criteria specified by the Board.

(4) An appeal against a liquidation order passed under section 33 may be filed on grounds of material irregularity or fraud committed in relation to such a liquidation order.

Appeal to Supreme Court (section 62)

Any person aggrieved by an order of the National Company Law Appellate Tribunal may file an appeal to the Supreme Court on a question of law arising out of such order under this Code within forty-five days from the date of receipt of such order. The Supreme Court may, if it is satisfied that a person was prevented by sufficient cause from filing an appeal within forty-five days, allow the appeal to be filed within a further period not exceeding fifteen days.

Civil court not to have jurisdiction (section 63)

No civil court or authority shall have jurisdiction to entertain any suit or proceedings in respect of any matter on which National Company Law Tribunal or the National Company Law Appellate Tribunal has jurisdiction under this Code. Civil court not to have jurisdiction.

FRESH START PROCESS

Eligibility for making an application (section 80)

(1) A debtor, who is unable to pay his debt and fulfils the conditions specified in subsection (2), shall be entitled to make an application for a fresh start for discharge of his qualifying debt.
(2) A debtor may apply, either personally or through a resolution professional, for a fresh start in respect of his qualifying debts to the Adjudicating Authority if –
(a) the gross annual income of the debtor does not exceed sixty thousand rupees;
(b) the aggregate value of the assets of the debtor does not exceed twenty thousand rupees;
(c) the aggregate value of the qualifying debts does not exceed thirty -five thousand rupees;
(d) he is not an undischarged bankrupt;
(e) he does not own a dwelling unit, irrespective of whether it is encumbered or not;
(f) a fresh start process, insolvency resolution process or bankruptcy process is not subsisting against him; and
(g) no previous fresh start order under this Chapter has been made in relation to him in the preceding twelve months of the date of the application for fresh start.

Application for fresh start order (section 81)

(1) When an application is filed under section 80 by a debtor, an interim-moratorium shall commence on the date of filing of said application in relation to all the debts and shall cease to have effect on the date of admission or rejection of such application, as the case may be.
(2) During the interim-moratorium period, -
(i) any legal action or legal proceeding pending in respect of any of his debts shall be deemed to have been stayed; and
(ii) no creditor shall initiate any legal action or proceedings in respect of such debt.
(3) The application under section 80 shall be in such form and manner and accompanied by such fee, as

may be prescribed.
(4) The application under sub-section (3) shall contain the following information supported by an affidavit, namely: –
(a) a list of all debts owed by the debtor as on the date of the said application along with details relating to the amount of each debt, interest payable thereon and the names of the creditors to whom each debt is owed;
(b) the interest payable on the debts and the rate thereof stipulated in the contract;
(c) a list of security held in respect of any of the debts,
(d) the financial information of the debtor and his immediate family for up to two years prior to the date of the application;
(e) the particulars of the debtor's personal details, as may be prescribed;
(f) the reasons for making the application;
(g) the particulars of any legal proceedings which, to the debtor's knowledge has been commenced against him;
(h) the confirmation that no previous fresh start order under this Chapter has been made in respect of the qualifying debts of the debtor in the preceding twelve months of the date of the application.

Punishment where no specific penalty or punishment is provided (section 235A)

If any person contravenes any of the provisions of this Code or the rules or regulations made thereunder for which no penalty or punishment is provided in this Code, such person shall be punishable with fine which shall not be less than one lakh rupees but which may extend to two crore rupees.

Limitation (section 238A)

The provisions of the Limitation Act, 1963 shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal, the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal, as the case may be.

Application of this Code to micro, small and medium enterprises (section 240A)

Notwithstanding anything to the contrary contained in this Code, the provisions of clauses (c) and (h) of section 29A shall not apply to the resolution applicant in respect of corporate insolvency resolution process of any micro, small and medium enterprises.

LESSON ROUND UP

- The Insolvency Resolution Process (IRP) for individuals and unlimited liability partnerships varies from that of companies and LLPs. The Debt Recovery Tribunal (“DRT”) shall be the Adjudicating Authority with jurisdiction over individuals and unlimited liability partnership firms. Appeals from the order of DRT shall lie to the Debt Recovery Appellate Tribunal (“DRAT”). The National Company Law Tribunal (“NCLT”) shall be the Adjudicating Authority with jurisdiction over companies, limited liability entities. Appeals from the order of NCLT shall lie to the National Company Law Appellate Tribunal (“NCLAT”).
- The Code proposes to establish an Insolvency Regulator (The Insolvency and Bankruptcy Board of India) to exercise regulatory oversight over
  - Insolvency Professionals,
  - Insolvency Professional Agencies; and
  - Information Utilities

- The Pending proceedings relating to revival of sick companies were transferred from High Court and Board of Industrial and Financial Reconstruction to National Company Law Tribunal.
- An insolvency resolution process can be initiated by either a creditor, or by the debtor, upon an event of default
- The Code cover Insolvency of individuals, unlimited liability partnerships, Limited Liability partnerships (LLPs) and companies.
- The Code proposes to regulate insolvency professionals and insolvency professional agencies. Under Regulator's oversight, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role over errant members leading to the development of a competitive industry for insolvency professionals.
- The Code proposes for information utilities which would collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies. An individual insolvency database is also proposed to be set up with the goal of providing information on insolvency status of individuals.
- The Code proposes a swift process and timeline of 180 days for dealing with applications for corporate insolvency resolution. This can be extended for 90 days by the Adjudicating Authority as only one time extension. During insolvency resolution period (of 180/270 days), the management of the debtor is placed in the hands of an interim resolution professional/ resolution professional.

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 Insolvency and Bankruptcy Code, 2016.
2. Enumerate various Institutional mechanism under the Insolvency and Bankruptcy Code, 2016?
3. Write short notes on—
   (a) Insolvency and Bankruptcy Board of India (IBBI)
   (b) Role of Companies Secretary under the IBC, 2016.
4. Write short notes on Insolvency and Bankruptcy Code, 2016.
5. Explain the function of Insolvency Professional Agencies.
6. Write a short note on the Committee of Creditors under the Corporate Insolvency Resolution process?

Lesson 18
Securitisation

LESSON OUTLINE

- Introduction
- Scheme of the Act
- Constitutional validity of the Act
- Definitions of terms and expressions
- Important provisions
- Procedure for Registration
- Enforcement of security interest
- Measures for asset reconstruction
- Offences
- Securities Interest (Enforcement) Rules, 2002.

LEARNING OBJECTIVES

The banks and financial institutions (FIs) were facing numerous problems in recovery of defaulted loans on account of delays in disposal of recovery proceedings. The Government, therefore, enacted the Recovery of Debts and Bankruptcy Act, 1993 and SARFAESI Act in 2002 for the purpose of expeditious recovery of Non-Performing Assets (NPAs) of the banks and FIs.

The Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was amended in 2004 and 2012 respectively. In 2016, the Indian Parliament has passed the Enforcement of Security Interests and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 to improve the efficacy of Indian debt recovery laws.

The objective of the study lesson is to familiarize the students with the legal requirements stipulated under the SARFAESI Act.

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.

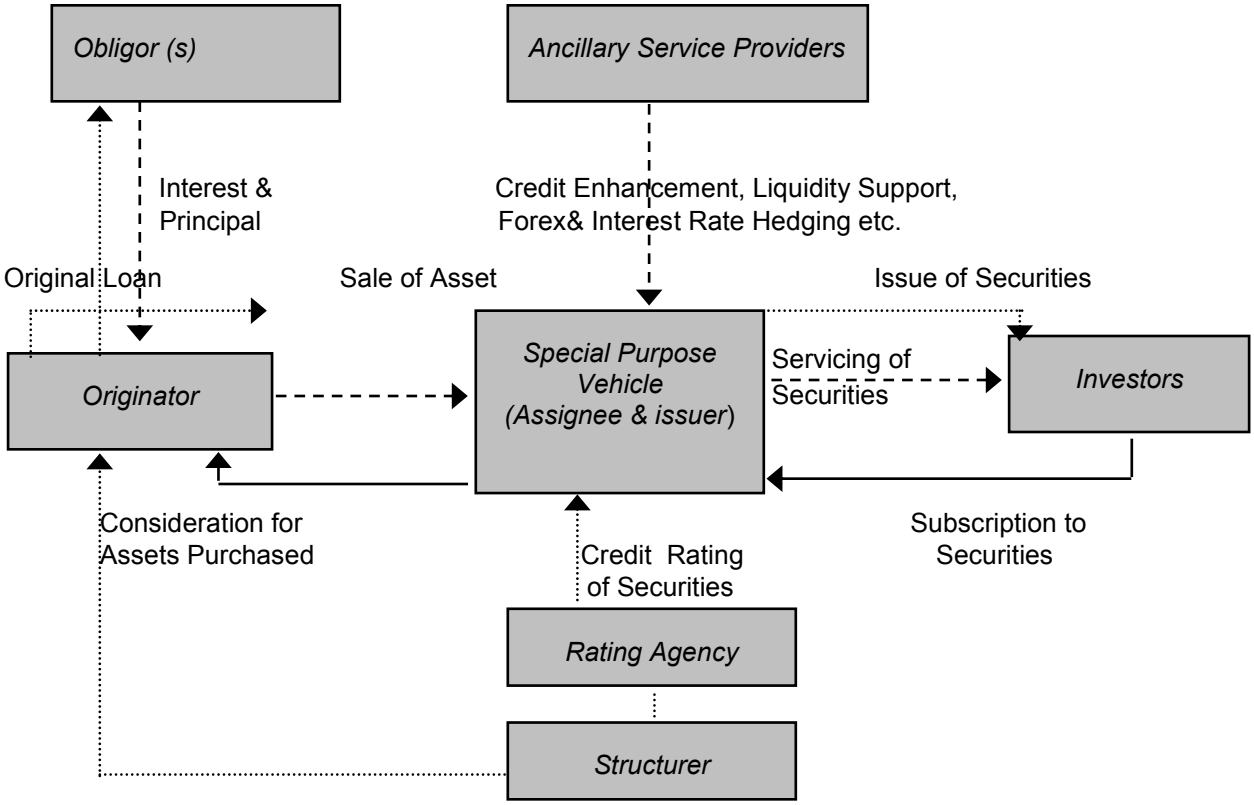
This requires a bank to hold assets till repayment of loan. The funds of the bank are blocked in these loans and to meet its growing fund requirement a bank has to raise additional funds from the market. Securitisation is a way of unlocking these blocked funds.

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 fro the Obligator.

Source: rbi.org.in

Steps in securitisation:

(i) Acquisition of Financial Assets by Asset 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 (Asset 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.

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 filling 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) 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.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 enacted with a view to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The Act enables the banks and financial institutions to realise long-term assets, manage problems of liquidity, asset liability mis-match 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 said Act further provides for setting up of asset reconstruction companies which are empowered to take possession of secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured assets and take over the management of the business of the borrower.

With increasing levels of non-performing or stressed assets in the Indian financial services sector, reforming the debt recovery and bankruptcy framework has been a key focus area for the Indian government. The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016 was introduced by the Minister of Finance, Mr. ArunJaitley, in LokSabha on May 11, 2016. It seeks to amend four laws: (i) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), (ii) Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI), (iii) Indian Stamp Act, 1899 and (iv) Depositories Act, 1996.

Following the recent enactment of the Insolvency and Bankruptcy Code, 2016 (Bankruptcy Code), the Indian parliament has now passed the Enforcement of Security Interests and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 to improve the efficacy of Indian debt recovery laws. The amendment act introduces a number of changes to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act) and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act). These changes will however come into effect as and when the government issues appropriate notifications in the Official Gazette to implement the relevant provisions of the amendment.

STATEMENT OF OBJECTS AND REASONS OF SARFAESI ACT

It is necessary at the outset, to reiterate the statement of objects and reasons for the SARFAESI 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 sell them without the intervention of the court.

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 improves 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 SARFAESI 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 SARFAESI 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 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 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

Section 2 of The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) defines various terms used in the Act.

Section **2** (1): In the SARFAESI Act, unless the context otherwise requires,-

(*a*) "Appellate Tribunal" means a Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);

(*b*) "asset reconstruction" means acquisition by any [*asset 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;

[(ba) "asset reconstruction company"*means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both;*][1]

1 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

(c) "bank"*means—*

(i) *a banking company; or*

(ii) *a corresponding new bank; or*

(iii) *the State Bank of India; or*

(iv) *a subsidiary bank; or*

(iva) *a multi-State co-operative bank; or*

(v) *such other bank which the Central Government may, by notification, specify for the purposes of this Act;*

(*f*) "borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a [*asset reconstruction company*] consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance [*or who has raised funds through issue of debt securities*];

(*g*) "Central Registry" means the registry set up or cause to be set up under sub-section (1) of section 20;

[(ga) "company" *means a company as defined in clause (20) of section 2 of the Companies Act, 2013 (18 of 2013);*][2]

[(ha) "debt" *shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and includes—*

(i) *unpaid portion of the purchase price of any tangible asset given on hire or financial lease or conditional sale or under any other contract;*

(ii) *any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable any borrower to acquire the intangible asset or obtain licence of such asset;*][3]

(*i*) "Debts Recovery Tribunal" means the Tribunal established under sub-section (1) of section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993); [name changed Recovery of Debts and Bankruptcy Act, 1993]

[(ia) "debt securities" *means debt securities listed in accordance with the regulations made by the Board under the Securities and Exchange Board of India Act, 1992 (15 of 1992);*][4]

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2 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

3 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (*ha*), as inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, w.r.e.f. 11-11-2004, read as under :

'(*ha*) "debt" shall have the meaning assigned to it in clause (*g*) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);'

4 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

[*(j)* "default" *means*—

*(*i*)* *non-payment of any debt or any other amount payable by the borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor; or*

*(*ii*)* *non-payment of any debt or any other amount payable by the borrower with respect to debt securities after notice of ninety days demanding payment of dues served upon such borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of such debt securities;*][5]

(*k*) "financial assistance" means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution [*including funds provided for the purpose of acquisition of any tangible asset on hire or financial lease or conditional sale or under any other contract or obtaining assignment or licence of any intangible asset or purchase of debt securities*];

(*l*) "financial asset" means debt or receivables and includes—

(i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or

(ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or

(iii) a mortgage, charge, hypothecation or pledge of movable property; or

(iv) any right or interest in the security, whether full or part underlying such debt or receivables; or

(v) 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

[(va) any beneficial right, title or interest in any tangible asset given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire such tangible asset; or

(vb) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable the borrower to acquire such intangible asset or obtain licence of the intangible asset; or][6]

(vi) any financial assistance;

(*m*) "financial institution" means—

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5 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (*j*), as amended by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, w.r.e.f. 11-11-2004, read as under :

'(j) "default" means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor;'

6 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

i. a public financial institution within the meaning of section 4A of the Companies Act, 1956 (1 of 1956);

ii. any institution specified by the Central Government under sub-clause (*ii*) of clause (*h*) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);

iii. the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958 (42 of 1958);

[(iiia) a debenture trustee registered with the Board and appointed for secured debt securities;

(iiib) asset reconstruction company, whether acting as such or mana-ging a trust created for the purpose of securitisation or asset reconstruction, as the case may be;][7]

iv. any other institution or non-banking financial company as defined in clause (*f*) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934), which the Central Government may, by notification, specify as financial institution for the purposes of this Act;

[*(*ma*)* "financial lease" *means a lease under any lease agreement of tangible asset, other than negotiable instrument or negotiable document, for transfer of lessor's right therein to the lessee for a certain time in consideration of payment of agreed amount periodically and where the lessee becomes the owner of the such assets at the expiry of the term of lease or on payment of the agreed residual amount, as the case may be;*][8]

(*n*) "hypothecation" means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallisation of such charge into fixed charge on movable property;

[*(*na*)* "negotiable document" *means a document, which embodies a right to delivery of tangible assets and satisfies the requirements for negotiability under any law for the time being in force including warehouse receipt and bill of lading;*][9]

(*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 any 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];

(*q*) "obligor" means a person liable to the originator, whether under a contract or otherwise, to pay a financial asset or to discharge any obligation in respect of a financial asset, whether existing, future, conditional or contingent and includes the borrower;

(*r*) "originator" means the owner of a financial asset which is acquired by a [*asset reconstruction company*][10] for the purpose of securitisation or asset reconstruction;

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7 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

8 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

9 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

10 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

(*t*) "property" means—

i) immovable property;

ii) movable property;

iii) any debt or any right to receive payment of money, whether secured or unsecured;

iv) receivables, whether existing or future;

v) intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature [*as may be prescribed by the Central Government in consultation with Reserve Bank*];[11]

(*u*) [qualified buyer][12]" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or [*asset reconstruction company*][13] 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, [*any category of non-institutional investors as may be specified by the Reserve Bank under sub-section (1) of section 7*][14] or any other body corporate as may be specified by the Board;

(*z*) "securitisation" means acquisition of financial assets by any [*asset reconstruction company*][15] from any originator, whether by raising of funds by such [*asset reconstruction company*] from [*qualified buyers*][16] by issue of security receipts representing undivided interest in such financial assets or otherwise;

(*zb*) "security agreement" means an agreement, instrument or any other document or arrangement under which security interest is created in favour of the secured creditor including the creation of mortgage by deposit of title deeds with the secured creditor;

(*zc*) "secured asset" means the property on which security interest is created;

[(zd) "secured creditor" *means—*

I. any bank or financial institution or any consortium or group of banks or financial institutions holding any right, title or interest upon any tangible asset or intangible asset as specified in clause (l);

II. debenture trustee appointed by any bank or financial institution; or

III. an asset reconstruction company whether acting as such or manag- ing a trust set up by such asset reconstruction company for the securitisation or reconstruction, as the case may be; or

IV. debenture trustee registered with the Board appointed by any company for secured debt securities; or

V. any other trustee holding securities on behalf of a bank or financial institution,in whose favour security interest is created by any borrower for due repayment of any

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11 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

12 Substituted for "qualified institutional buyer" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

13 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

14 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f.4-11-2016

15 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

16 Substituted for "qualified institutional buyers" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

financial assistance.][17]

(*ze*) "secured debt" means a debt which is secured by any security interest;

[*(zf)* "security interest" *means right, title or interest of any kind, other than those specified in section 31, upon property created in favour of any secured creditor and includes—*

i. any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property, given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit provided to enable the borrower to acquire the tangible asset; or

ii. such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset;][18]

(*zg*) "security receipt" means a receipt or other security, issued by a [*asset reconstruction company*][19] to any [*qualified buyer*][20] 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 securitisation;

Asset Reconstruction Companies [ARC]

"Asset Reconstruction Company", means a company registered with Reserve Bank under section 3 of SARFAESI Act for the purposes of carrying on the business of asset reconstruction or securitisation, or both.

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

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17 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (*zd*), as amended by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, w.r.e.f. 11-11-2004, read as under :

'(*zd*) "secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes—

(*i*) debenture trustee appointed by any bank or financial institution; or

(*ii*) securitisation company or reconstruction company, whether acting as such or managing a trust set up by such securitisation company or reconstruction company for the securitisation or reconstruction, as the case may be; or

(*iii*) any other trustee holding securities on behalf of a bank or financial institution,

in whose favour security interest is created for due repayment by any borrower of any financial assistance;'

18 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (zf) read as under :

'(zf) "security interest" means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31;'

19 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

20 Substituted for "qualified institutional buyer" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

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.

Regulation of Securitisation and Reconstruction of Financial Assets of Banks and Financial Institutions

Section 3 of SARFAESI Act deals with the Registration of [*Asset Reconstruction Companies*][21].

(1) No *asset reconstruction company* shall 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 net owned fund of not less than two crore rupees or such other higher amount as the Reserve Bank, may, by notification, specify:*][22]

Provided that the Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of *asset reconstruction companies*:

Provided further that an*asset reconstruction company*, existing on the commencement of this Act, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement and notwithstanding anything contained in this sub-section may continue to carry on the business of securitisation or asset reconstruction until a certificate of registration is granted to it or, as the case may be, rejection of application for registration is communicated to it.

(2) Every *asset reconstruction company* shall make an application for registration to the Reserve Bank in such form and manner as it may specify.

(3) The Reserve Bank may, for the purpose of considering the application for registration of a*asset reconstruction company* to commence or carry on the business of securitisation or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such *asset reconstruction company*, or otherwise, that the following conditions are fulfilled, namely:—

(*a*) that the *asset reconstruction company* has not incurred losses in any of the three preceding financial years;

(*b*) that such *asset 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 buyers*][23] or other persons;

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21 Substituted for "securitisation companies or reconstruction companies" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

22 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (b) read as under :

"(*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 :"

23 Substituted for "qualified institutional buyers" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

(*c*) that the directors of *asset reconstruction company* have adequate professional experience in matters related to finance, securitisation and reconstruction;

(*d*) [***][24]

(*e*) that any of its directors has not been convicted of any offence involving moral turpitude;

[(f) *that a sponsor of an asset reconstruction company is a fit and proper person in accordance with the criteria as may be specified in the guidelines issued by the Reserve Bank for such persons;*][25]

(*g*) that *asset reconstruction company* has complied with or is in a position to comply with prudential norms specified by the Reserve Bank;

[(*h*) that*asset 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 specified in sub-section (3) are fulfilled, grant a certificate of registration to the *asset reconstruction company* to commence or carry on business of securitisation or asset reconstruction, subject to such conditions, which it may consider, fit to impose.

(5) The Reserve Bank may reject the application made under sub-section (2) if it is satisfied that the conditions specified in sub-section (3) are not fulfilled:

Provided that before rejecting the application, the applicant shall be given a reasonable opportunity of being heard.

(6) Every *asset reconstruction company*, shall obtain prior approval of the Reserve Bank for any substantial change in its management **[***including appointment of any director on the board of directors of the asset reconstruction company or managing director or chief executive officer thereof***]**[26] or change of location of its registered office or change in its name:

Provided that the decision of the Reserve Bank, whether the change in management of an *asset reconstruction company* is a substantial change in its management or not, shall be final.

Explanation.—For the purposes of this section, the expression "substantial change in management" means the change in the management by way of transfer of shares or **[***change affecting the sponsorship in the company by way of transfer of shares or***]**[27] amalgamation or transfer of the business of the company.

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24 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its omission, clause (d) read as under :

"(*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;"

25 Substitutedby the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016. Prior to its substitution, clause (*f*) read as under :

"(*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;"

26 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

27 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

Cancellation of Certificate of Registration (Section 4)

Section 4 of the SARFAESI Act deals with the Cancellation of certificate of registration.

(1) The Reserve Bank may cancel a certificate of registration granted to an *asset reconstruction company*, if such company—

(*a*) ceases to carry on the business of securitisation or asset reconstruction; or

(*b*) ceases to receive or hold any investment from a [*qualified buyer*][28]; or

(*c*) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

(*d*) at any time fails to fulfil any of the conditions referred to in clauses (*a*) to (*g*) of sub-section (3) of section 3; or

(*e*) fails to—

I. comply with any direction issued by the Reserve Bank under the provisions of this Act; or

II. maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

III. submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

IV. obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

Provided that before cancelling a certificate of registration on the ground that the *asset reconstruction company* has failed to comply with the provisions of clause (*c*) or has failed to fulfil any of the conditions referred to in clause (*d*) or sub-clause (*iv*) of clause (*e*), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interests of the investors or the *asset reconstruction company*, 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.

(2) A *asset reconstruction company* aggrieved by the order of [***][29] 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.

(3) A *asset reconstruction company*, which is holding investments of **[***qualified buyers***]**[30] 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*asset 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.

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28 Substituted for "qualified institutional buyers" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

29 Words "rejection of application for registration or" omitted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, w.r.e.f. 11-11-2004.

30 Substituted for "qualified institutional buyers" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

Acquisition of rights or interest in financial assets (Section 5)

Section 5 of the SARFAESI deals with the Acquisition of rights or interest in financial assets.

(1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any *asset 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.

[(1A) Any document executed by any bank or financial institution under sub-section (1) in favour of the asset reconstruction company acquiring financial assets for the purposes of asset reconstruction or securitisation shall be exempted from stamp duty in accordance with the provisions of section 8F of the Indian Stamp Act, 1899 (2 of 1899):

Provided that the provisions of this sub-section shall not apply where the acquisition of the financial assets by the asset reconstruction company is for the purposes other than asset reconstruction or securitisation.**]**[31]

(2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the asset reconstruction company, such asset reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

[(2A) If the bank or financial institution is holding any right, title or interest upon any tangible asset or intangible asset to secure payment of any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire the tangible asset or assignment or licence of intangible asset, such right, title or interest shall vest in the asset reconstruction company on acquisition of such assets under sub-section (1).**]**[32]

(3) Unless otherwise expressly provided by this Act, 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 of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the asset reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, asset reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of asset reconstruction company, as the case may be.

(4) If, on the date of acquisition of financial asset under sub-section (1), any suit, appeal or other proceeding of whatever nature relating to the said financial asset 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 (1 of 1986) the same shall not abate, or be discontinued or be, in any way,

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31 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

32 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

prejudicially affected by reason of the acquisition of financial asset by the asset reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the asset reconstruction company, as the case may be.

[(5) On acquisition of financial assets under sub-section (1), the asset reconstruction company, may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the asset reconstruction company in such pending suit, appeal or other proceedings.][33]

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 an *asset reconstruction company*[34], 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 *asset reconstruction company*[35] 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, 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 shall, accordingly, apply to such execution.

Notice to obligor and discharge of obligation of such obligor (Section 6)

Section 6 deals with the Notice to obligor and discharge of obligation of such obligor

(1) The bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any *asset reconstruction company*, to the concerned obligor and any other concerned person and to the concerned registering authority (including Registrar of Companies) in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial assets had been registered.

(2) Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned *asset reconstruction*

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33 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012, w.e.f. 15-1-2013.

34 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

35 Substituted for "securitisation company or reconstruction company" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

company, as the case may be, and payment made to such company in discharge of any of the obligations in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.

(3) Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution, any money or other properties subsequently received by the bank or financial institution, shall constitute monies or properties held in trust for the benefit of and on behalf of the *asset reconstruction company*, as the case may be, and such bank or financial institution shall hold such payment or property which shall forthwith be made over or delivered to such *asset reconstruction company*, as the case may be, or its agent duly authorised in this behalf.

Issue of security by raising of receipts or funds by asset reconstruction company(Section 7)

Section 7 of the SARFAESI Act deals with the issue of security by raising of receipts or funds by asset reconstruction company.

(1) Without prejudice to the provisions contained in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992), any *asset reconstruction company*, may, after acquisition of any financial asset under sub-section (1) of section 5, offer security receipts to *qualified buyers*[*or such other category of investors including non-institutional investors as may be specified by the Reserve Bank in consultation with the Board, from time to time,*][36]for subscription in accordance with the provisions of those Acts.

(2) A *asset reconstruction company* may raise funds from the *qualified buyers* by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investments made by a *qualified buyer* and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

[(2A)(*a*) The scheme for the purpose of offering security receipts under sub-section (1) or raising funds under sub-section (2), may be in the nature of a trust to be managed by the *asset reconstruction company*, and the *asset reconstruction company* shall hold the assets so acquired or the funds so raised for acquiring the assets, in trust for the benefit of the *qualified buyers* holding the security receipts or from whom the funds are raised.

(*b*) The provisions of the Indian Trusts Act, 1882 (2 of 1882) shall, except in so far as they are inconsistent with the provisions of this Act, apply with respect to the trust referred to in clause (*a*) above.][37]

(3) In the event of non-realisation under sub-section (2) of financial assets, the '*qualified buyers* of *asset reconstruction company*, holding security receipts of not less than seventy-five per cent of the total value of the security receipts issued under a scheme by such company, shall be entitled to call a meeting of all the *qualified buyers* and every resolution passed in such meeting shall be binding on the company.

(4) The *qualified buyers* shall, at a meeting called under sub-section (3), follow the same procedure, as nearly as possible as is followed at meetings of the board of directors of the *asset reconstruction company*, as the case may be.

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36 Substituted for "(other than by offer to public)" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f.4-11-2016

37 Substituted for "qualified institutional buyer" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

Exemption from registration of security receipt (Section 8)

Section 8 deals with the exemption from registration of security receipt.

Notwithstanding anything contained in sub-section (1) of section 17 of the Registration Act, 1908 (16 of 1908),—

(*a*) any security receipt issued by the [*asset reconstruction company*], as the case may be, under sub-section (1) of section 7, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest, to or in immovable property except insofar as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument; or

(*b*) any transfer of security receipts,

shall not require compulsory registration.

Measures for Asset reconstruction (Section 9)[38]

Section 9.deals with the measures for Asset Reconstruction.

(1) Without prejudice to the provisions contained in any other law for the time being in force, an asset reconstruction company may, for the purposes of asset reconstruction, provide for any one or more of the following measures, namely:—

(a) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;

(b) the sale or lease of a part or whole of the business of the borrower;

(c) rescheduling of payment of debts payable by the borrower;

(d) enforcement of security interest in accordance with the provisions of this Act;

(e) settlement of dues payable by the borrower;

(f) taking possession of secured assets in accordance with the provisions of this Act;

(g) conversion of any portion of debt into shares of a borrower company:

Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

(2) The Reserve Bank shall, for the purposes of sub-section (1), determine the policy and issue necessary directions including the direction for regulation of management of the business of the borrower and fees to be charged.

(3) The asset reconstruction company shall take measures under sub-section (1) in accordance with policies and directions of the Reserve Bank determined under sub-section (2). **]**

Other functions of asset reconstruction company (Section 10)

Section 10 deals with the other functions of asset reconstruction company.

(1) Any *asset reconstruction company* registered under section 3 may—

(*a*) act as an agent for any bank or financial institution for the purpose of recovering their dues

38. Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

from the borrower on payment of such fee 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 *asset reconstruction company* shall act as a manager if acting as such gives rise to any pecuniary liability.

(2) Save as otherwise provided in sub-section (1), no *asset reconstruction company* which has been granted a certificate of registration under sub-section (4) of section 3, shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction :

Provided that *asset reconstruction company* which is carrying on, on or before the commencement of this Act, any business other than the business of securitisation or asset reconstruction or business referred to in sub-section (1), shall cease to carry on any such business within one year from the date of commencement of this Act.

Explanation.—For the purposes of this section, *asset reconstruction company* does not include its subsidiary.

Resolution of disputes (Section 11)

Section 11 deals with the resolution of disputes. It provides that where any dispute relating to securitisation or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely, the bank, or financial institution, or *asset reconstruction company* or *qualified buyer*, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996 (26 of 1996), as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

Power of Reserve Bank to determine policy and issue directions (Section 12, 12A and 12B)

Section 12 deals with the power of Reserve Bank to determine policy and issue directions.

(1) If the Reserve Bank is satisfied that in the public interest or to regulate financial system of the country to its advantage or to prevent the affairs of any *asset reconstruction company* from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such *asset reconstruction company*, it is necessary or expedient so to do, it may determine the policy and give directions to all or any *asset reconstruction company* in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the *asset reconstruction company*, as the case may be, and such company shall be bound to follow the policy so determined and the directions so issued.

(2) Without prejudice to the generality of the power vested under sub-section (1), the Reserve Bank may give directions to any *asset reconstruction company* generally or to a class of *asset reconstruction companies* or to any *asset reconstruction company* in particular as to—

(*a*) the type of financial asset of a bank or financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;

(*b*) the aggregate value of financial assets which may be acquired by any *asset reconstruction company*;

[*(c) the fee and other charges which may be charged or incurred for management of financial assets acquired by any asset reconstruction company;*

(d) *transfer of security receipts issued to qualified buyers.*][39]

Section 12A deals with the power of Reserve Bank to call for statements and information.

It states that the Reserve Bank may at any time direct a asset reconstruction company to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of such asset reconstruction company (including any business or affairs with which such company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act.

[Section 12B deals with the power of Reserve Bank to carry out audit and inspection.

(1) The Reserve Bank may, for the purposes of this Act, carry out or caused to be carried out audit and inspection of an asset reconstruction company from time to time.

(2) It shall be the duty of an asset reconstruction company and its officers to provide assistance and co-operation to the Reserve Bank to carry out audit or inspection under sub-section (1).

(3) Where on audit or inspection or otherwise, the Reserve Bank is satisfied that business of an asset reconstruction company is being conducted in a manner detrimental to public interest or to the interests of investors in security receipts issued by such asset reconstruction company, the Reserve Bank may, for securing proper management of an asset reconstruction company, by an order—

(a) *remove the Chairman or any director or appoint additional directors on the board of directors of the asset reconstruction company; or*

(b) *appoint any of its officers as an observer to observe the working of the board of directors of such asset reconstruction company:*

Provided that no order for removal of Chairman or director under clause (a) shall be made except after giving him an opportunity of being heard.

(4) It shall be the duty of every director or other officer or employee of the asset reconstruction company to produce before the person, conducting an audit or inspection under sub-section (1), all such books, accounts and other documents in his custody or control and to provide him such statements and information rela-ting to the affairs of the asset reconstruction company as may be required by such person within the stipulated time specified by him. **]**[40]

Enforcement of Security interest by a Creditor (Section 13)

(1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 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

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39 Clauses (*c*) and (*d*) inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

40 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4) :

[Provided *that*—

(i) the requirement of classification of secured debt as non-performing asset under this sub-section shall not apply to a borrower who has raised funds through issue of debt securities; and

(ii) in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee.][41]

(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.

(3A) If, on receipt of the notice under sub-section (2), 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 fifteen days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

Provided 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.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), 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 :

Provided 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 :

Provided further that where 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;

(*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.

41 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

Case Law

Powers under Companies Act cannot be wielded by Company Judge to interfere with proceedings by a secured creditor who has opted to stay outside winding up process to realize its secured interests as per provisions of SARFAESI Act:

Pegasus Assets Reconstruction (P.) Ltd. *v.* Haryana Concast Ltd, CIVIL APPEAL NOS. 3646 OF 2011, 9293-9294 OF 2014 AND 14736 TO 14738 OF 2015, DATEDDECEMBER 29, 2015, [2015] 64 taxmann.com 394 (SC)

Section 283 of the Companies Act, 2013/Section 456 of the Companies Act, 1956, read with section 13 of the Securitisation And Reconstruction of Financial Assets And Enforcement of Security Interest Act, 2002. The Supreme court in the matter of Winding up and Custody of company's property opined that SARFAESI Act is a complete code in itself and there is no lacuna or ambiguity in it to warrant reading something more into it or to borrow anything from Companies Act. The Court mentioned that as per section 13 of SARFAESI Act, a secured creditor has right to enforce its security interest without intervention of court or tribunal and the powers under Companies Act cannot be wielded by Company Judge to interfere with proceedings by a secured creditor who has opted to stay outside winding up process to realize its secured interests as per provisions of SARFAESI Act.

(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.

(5A) Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale.

(5B) Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under sub-section (4) of section 13.

(5C) The provisions of section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply to the immovable property acquired by secured creditor under sub-section (5A).

(6) Any transfer of secured asset after taking possession thereof or takeover 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) Where the amount of dues of the secured creditor together with all costs, charges and expenses

incurred by him is tendered to the secured creditor at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets,—

(i) *the secured assets shall not be transferred by way of lease assignment or sale by the secured creditor; and*

(ii) *in case, any step has been taken by the secured creditor for transfer by way of lease or assignment or sale of the assets before tendering of such amount under this sub-section, no further step shall be taken by such secured creditor for transfer by way of lease or assignment or sale of such secured assets.*][42]

(9)[Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of][43] 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 under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors :

Provided that 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 Act:

Provided further that 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 the Act, 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 the Act:

Provided also that the liquidator referred to in the second proviso shall intimate the secured creditor the workmen's dues in accordance with the provisions of the 1956 (1 of 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:

Provided also that 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:

Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

Explanation.—For the purposes of this sub-section,—

(*a*) "record date" means the date agreed upon by the secured creditors representing not less than [sixty per cent] in value of the amount outstanding on such date;

(*b*) "amount outstanding" shall include principal, interest and any other dues payable by the

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42 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

43 Substituted for "In the case of" by the Insolvency and Bankruptcy Code, 2016, w.e.f.15-11-2016.

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 clauses (*a*) to (*d*) of sub-section (4) in relation to the secured assets under this Act.

(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.

In the case of *Nik-Nish Retail Pvt. Ltd &Anr. Versus Union Bank &Ors. G.A. 1380 of 2012 in W.P. 6 of 2010 25 June, 2012, DipankarDatta, J,* the Calcutta High Court held that the scheme of the Act envisages grant of 60 days time to the defaulter for clearance of the liability or to raise objection. Even if the defaulting party falls short of paying Rs. 1/- of the amount specified in the demand notice within the permitted period, its account would still be a 'non- performing asset' and continue to be treated as such and the secured creditor is, in the circumstances, entitled to initiate further action in terms of provisions of the Act including taking measures to take possession of the secured assets after the period of 60 days has expired if no objection is received in the meantime or the objection to the demand notice has been overruled. Question of waiver does not and cannot arise simply because certain payments had been credited in the cash credit account. The period of 60 days is the time limited for clearing the liability and if the liability does not stand cleared, notwithstanding part payment the secured creditor is well within its right to exercise power conferred by Section 13(4) of the Act.

Assistance by Chief Metropolitan Magistrate or the District Magistrate

Section 14 of the SARFAESI Act provides for assistance for taking possession of secured asset from the Chief Metropolitan Magistrate or the District Magistrate.

(1) Where the possession of any secured asset is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him-

a) take possession of such asset and documents relating thereto; and

b) forward such asset and documents to the secured creditor.

Provided that any application by the secured creditor shall be accompanied by an affidavit duly affirmed by

the authorised officer of the secured creditor, declaring that—

(i) the aggregate amount of financial assistance granted and the total claim of the Bank as on the date of filing the application;

(ii) the borrower has created security interest over various properties and that the Bank or Financial Institution is holding a valid and subsisting security interest over such properties and the claim of the Bank or Financial Institution is within the limitation period;

(iii) the borrower has created security interest over various properties giving the details of properties referred to in sub-clause (*ii*) above;

(iv) the borrower has committed default in repayment of the financial assistance granted aggregating the specified amount;

(v) consequent upon such default in repayment of the financial assistance the account of the borrower has been classified as a nonperforming asset;

(vi) affirming that the period of sixty days notice as required by the provisions of sub-section (2) of section 13, demanding payment of the defaulted financial assistance has been served on the borrower;

(vii) the objection or representation in reply to the notice received from the borrower has been considered by the secured creditor and reasons for non-acceptance of such objection or representation had been communicated to the borrower;

(viii) the borrower has not made any repayment of the financial assistance in spite of the above notice and the Authorised Officer is, therefore, entitled to take possession of the secured assets under the provisions of sub-section (4) of section 13 read with section 14 of the principal Act;

(ix) that the provisions of the Act and the rules made thereunder had been complied with.

Provided further that on receipt of the affidavit from the Authorised Officer, the District Magistrate or the Chief Metropolitan Magistrate, as the case may be, shall after satisfying the contents of the affidavit pass suitable orders for the purpose of taking possession of the secured assets **[***within a period of thirty days from the date of application***]**[44]:

[Provided further *that if no order is passed by the Chief Metropolitan Magistrate or District Magistrate within the said period of thirty days for reasons beyond his control, he may, after recording reasons in writing for the same, pass the order within such further period but not exceeding in aggregate sixty days:***]**[45]

Provided also that the requirement of filing affidavit stated in the first proviso shall not apply to proceeding pending before any District Magistrate or the Chief Metropolitan Magistrate, as the case may be, on the date of commencement of this Act.]

(1A) The District Magistrate or the Chief Metropolitan Magistrate may authorise any officer subordinate to him,—

(*i*) to take possession of such assets and documents relating thereto; and

(*ii*) to forward such assets and documents to the secured creditor.

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44 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

45 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

(2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as may, in his opinion, be necessary.

(3) No act of the Chief Metropolitan Magistrate or the District Magistrate any officer authorised by the Chief Metropolitan Magistrate or District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

Manner and effect of takeover of Management

Section 15 of the SARFAESI Act provides for the manner and effect of takeover of management.

(1) When the management of business of a borrower is taken over by a*asset reconstruction company* under clause (*a*) of section 9 or, as the case may be, by a secured creditor under clause (*b*) of sub-section (4) of section 13], the secured creditor may, by publishing 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, appoint as many persons as it thinks fit—

(*a*) in a case in which the borrower is a company as defined in the Companies Act, 1956 (1 of 1956), to be the directors of that borrower in accordance with the provisions of that Act; or

(*b*) in any other case, to be the administrator of the business of the borrower.

(2) On publication of a notice under sub-section (1),—

(*a*) in any case where the borrower is a company as defined in the Companies Act, 1956 (1 of 1956), all persons holding office as directors of the company and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;

(*b*) any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;

(*c*) the directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the notice;

(*d*) the directors appointed under this section shall, for all purposes, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source whatsoever.

(3) 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,—

(*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 the secured creditor;

(*c*) 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.

(4) Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realisation of his debt in full, restore the management of the business of the borrower to him:

[Provided *that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower.***]**[46]

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'.

The Reserve Bank of India vide its Circular No. RBI/2009-2010/418 DNBS/ PD (SC/RC) No. 17 /26.03.001/2009-10 April 21, 2010 issued Guidelines on Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010.

1. Short Title and Commencement

(a) These guidelines shall be known as "The Change in or Take Over of the Management of the business of the borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010".

(b) These guidelines shall come into force with effect from April 21, 2010.

Explanation: For the purpose of these guidelines: (i) ''change in management'' means effecting change by the borrower at the instance of SC/RC in the person who has responsibility for the whole or substantially whole of the management of the business of the borrower and / or other relevant personnel.

(ii) The term ''Takeover of management" means taking over of the responsibility for the management of the business of the borrower with or without effecting change in management personnel of the borrower by the SC/RC.

2. Object of the Guidelines: The objective of these guidelines is to ensure fairness, transparency, nondiscrimination and non arbitrariness in the action of Securitisation Companies or Reconstruction Companies and to build in a system of checks and balances while effecting change in or take over of the management of the business of the borrower by the SC/RCs under Section 9(a) of the SARFAESI Act. The SC/RCs shall follow these guidelines while exercising the powers conferred on them under Section 9(a) of the SARFAESI Act, 2002.

3. Powers of SC/RC and Scope of the Guidelines: A SC/RC may resort to change in or take over of the management of the business of the borrower for the purpose of realization of its dues from the borrower

46 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

subject to the provisions of these guidelines. The SC/RCs resorting to take over of management of the business of the borrower shall do so after complying with the manner of takeover of the management in accordance with the provisions of Section 15 of the SARFAESI Act. On realization of its dues in full, the SC/RC shall restore the management of the business to the borrower as provided in Section 15(4) of the SARFAESI Act.

4. Eligibility conditions to exercise power for change in or take over of management: In the circumstances set forth in paragraph 5 (a) A SC/RC may effect change in or take over the management of the business of the borrower, where the amount due to it from the borrower is not less than 25% of the total assets owned by the borrower; and 3 (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% of the outstanding security receipts agree to such action. Explanation: 'Total Assets' means total assets as disclosed in its latest audited Balance Sheet immediately preceding the date of taking action.

5. Grounds for effecting change in or takeover of management: Subject to the eligibility conditions set forth in paragraph 4, SC/RC shall be entitled to effect change in management or take over the management of business of the borrower on any of the following grounds : (a) the borrower makes a willful 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% or more (in aggregate) of its assets secured to the SC/RC 4 (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% 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, willful default in repayment of amount due, includes - 5 (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 willful 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 willful must be intentional, deliberate and calculated.

6. Policy regarding change in or take over of management: (A) Every SC / RC shall frame policy guidelines regarding change in or take over 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 take over 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 take over 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 6 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 take over 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 take over of the management of the business of the borrower has become necessary (iv) The SC/RC shall identify suitable personnel / agencies, who can take over 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 take over 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 7 any manner and should not receive any pecuniary benefit from the SC/RC except for services rendered for acting as member of IAC.

7. Procedure for change in or take over of management: (a) The SC/RC shall give a notice of 60 days to the borrower indicating its intention to effect change in or take over 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 take over of the management of the business of the borrower, which shall be communicated to the borrower.

8. Reporting SC/RCs shall report to the Bank all cases where they have taken action to cause change in or take over 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/ 2008-2009 dated September 26, 2008.

No compensation to directors for loss of office (Section 16)

Section 16 states that no compensation is payable to directors for loss of office

(1) Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of

the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act of any contract of management entered into by him with the borrower.

(2) Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager or any such person in charge of management to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

Application against measures to recover secured debts (Section 17)

[Section 17 deals with the a*pplication against measures to recover secured debts*.

17. (1) Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may make an application along with such fee, as may be prescribed, to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken:

Provided that different fees may be prescribed for making the application by the borrower and the person other than the borrower.

Explanation.—For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under this sub-section.

(1A) An application under sub-section (1) shall be filed before the Debts Recovery Tribunal within the local limits of whose jurisdiction—

(a) *the cause of action, wholly or in part, arises;*

(b) *where the secured asset is located; or*

(c) *the branch or any other office of a bank or financial institution is maintaining an account in which debt claimed is outstanding for the time being.*]

(2) The Debts Recovery Tribunal shall consider whether any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor for enforcement of security are in accordance with the provisions of this Act and the rules made thereunder.

(3) If, the Debts Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that any of the measures referred to in sub-section (4) of section 13, taken by the secured creditor are not in accordance with the provisions of this Act and the rules made thereunder, and require restoration of the management or restoration of possession, of the secured assets to the borrower or other aggrieved person, it may, by order,—

(a) declare the recourse to any one or more measures referred to in sub-section (4) of section 13 taken by the secured creditor as invalid; and

(b) restore the possession of secured assets or management of secured assets to the borrower or such other aggrieved person, who has made an application under sub-section (1), as the case may be; and

(c) pass such other direction as it may consider appropriate and necessary in relation to any of the recourse taken by the secured creditor under sub-section (4) of section 13.]

(4) If, the Debts Recovery Tribunal declares the recourse taken by a secured creditor under sub-section (4) of section 13, is in accordance with the provisions of this Act and the rules made thereunder, then, notwithstanding anything contained in any other law for the time being in force, the secured creditor shall be entitled to take recourse to one or more of the measures specified under sub-section (4) of section 13 to recover his secured debt.

(4A) Where—

(i) *any person, in an application under sub-section (1), claims any tenancy or leasehold rights upon the secured asset, the Debt Recovery Tribunal, after examining the facts of the case and evidence produced by the parties in relation to such claims shall, for the purposes of enforcement of security interest, have the jurisdiction to examine whether lease or tenancy,—*

a. *has expired or stood determined; or*

b. *is contrary to section 65A of the Transfer of Property Act, 1882 (4 of 1882); or*

c. *is contrary to terms of mortgage; or*

d. *is created after the issuance of notice of default and demand by the Bank under sub-section (2) of section 13 of the Act; and*

(ii) the Debt Recovery Tribunal is satisfied that tenancy right or leasehold rights claimed in secured asset falls under the sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) of clause (i), then notwithstanding anything to the contrary contained in any other law for the time being in force, the Debt Recovery Tribunal may pass such order as it deems fit in accordance with the provisions of this Act.

(5) Any application made under sub-section (1) shall be dealt with by the Debts Recovery Tribunal as expeditiously as possible and disposed of within sixty days from the date of such application:

Provided that the Debts Recovery Tribunal may, from time to time, extend the said period for reasons to be recorded in writing, so, however, that the total period of pendency of the application with the Debts Recovery Tribunal, shall not exceed four months from the date of making of such application made under sub-section (1).

(6) If the application is not disposed of by the Debts Recovery Tribunal within the period of four months as specified in sub-section (5), any part to the application may make an application, in such form as may be prescribed, to the Appellate Tribunal for directing the Debts Recovery Tribunal for expeditious disposal of the application pending before the Debts Recovery Tribunal and the Appellate Tribunal may, on such application, make an order for expeditious disposal of the pending application by the Debts Recovery Tribunal.

(7) Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far may be, dispose of application in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and the rules made thereunder.]

Appeal to Appellate Tribunal (Section 18)

18. (1) Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal along with such fee, as may be prescribed to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal :

Provided that different fees may be prescribed for filing an appeal by the borrower or by the person other than the borrower:

Provided further that no appeal shall be entertained unless the borrower has deposited with the Appellate Tribunal fifty per cent of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less:

Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of debt referred to in the second proviso.

(2) Save as otherwise provided in this Act, the Appellate Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and rules made thereunder.

Validation of fees levied

Section 18A: Any fee levied and collected for preferring, before the commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, an appeal to the Debts Recovery Tribunal or the Appellate Tribunal under this Act, shall be deemed always to have been levied and collected in accordance with law as if the amendments made to sections 17 and 18 of this Act by sections 10 and 12 of the said Act were in force at all material times.

Appeal to High Court in certain cases

Section 18B: Any borrower residing in the State of Jammu and Kashmir and aggrieved by any order made by the Court of District Judge under section 17A may prefer an appeal, to the High Court having jurisdiction over such Court, within thirty days from the date of receipt of the order of the Court of District Judge:

Provided that no appeal shall be preferred unless the borrower has deposited, with the Jammu and Kashmir High Court, fifty per cent of the amount of the debt due from him as claimed by the secured creditor or determined by the Court of District Judge, whichever is less:

Provided further that the High Court may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of the debt referred to in the first proviso.]

Right to lodge a caveat

Section 18C deals with the right to lodge a caveat

(1) Where an application or an appeal is expected to be made or has been made under sub-section (1) of section 17 or section 17A or sub-section (1) of section 18 or section 18B, the secured creditor or any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal, may lodge a caveat in respect thereof.

(2) Where a caveat has been lodged under sub-section (1),—

(*a*) the secured creditor by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made under sub-section (1);

(*b*) any person by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made under sub-section (1).

(3) Where after a caveat has been lodged under sub-section (1), any application or appeal is filed before the Tribunal or the court of District Judge or the Appellate Tribunal or the High Court, as the case may be, the

Tribunal or the District Judge or the Appellate Tribunal or the High Court, as the case may be, shall serve a notice of application or appeal filed by the applicant or the appellant on the caveator.

(4) Where a notice of any caveat has been served on the applicant or the Appellant, he shall periodically furnish the caveator with a copy of the application or the appeal made by him and also with copies of any paper or document which has been or may be filed by him in support of the application or the appeal.

(5) Where a caveat has been lodged under sub-section (1), such caveat shall not remain in force after the expiry of the period of ninety days from the date on which it was lodged unless the application or appeal referred to in sub-section (1) has been made before the expiry of the said period.

Right of borrower to receive compensation and costs in certain cases (Section 19)

Section 19 provides that if the Debts Recovery Tribunal or the Court of District Judge, on an application made under section 17 or section 17A or the Appellate Tribunal or the High Court on an appeal preferred under section 18 or section 18A, holds that the possession of secured assets by the secured creditor is not in accordance with the provisions of this Act and rules made thereunder and directs the secured creditors to return such secured assets to the [93][*concerned borrowers or any other aggrieved person, who has filed the application under section 17 or section 17A or appeal under section 18 or section 18A, as the case may be, the borrower or such other person*] shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court of District Judge or Appellate Tribunal or the High Court referred to in section 18B.

Setting up of Central Registry (Section 20)

Section 20 deals with the setting up of Central Registry.

(1) The Central Government may, by notification, set-up or cause to be set-up from such date as it may specify in such notification, a registry to be known as the Central Registry with its own seal for the purposes of registration of transaction of securitisation and reconstruction of financial assets and creation of security interest under this Act.

(2) The head office of the Central Registry shall be at such place as the Central Government may specify and for the purpose of facilitating registration of transactions referred to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.

(3) The Central Government may, by notification, define the territorial limits within which an office of the Central Registry may exercise its functions.

(4) The provisions of this Act pertaining to the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the Registration Act, 1908 (16 of 1908), the Companies Act, 1956 (1 of 1956), the Merchant Shipping Act, 1958 (44 of 1958), the Patents Act, 1970 (39 of 1970), the Motor Vehicles Act, 1988 (59 of 1988), and the Designs Act, 2000 (16 of 2000) or any other law requiring registration of charges and shall not affect the priority of charges or validity thereof under those Acts or laws.

Section 20A deals with the Integration of registration systems with Central Registry.

(1) The Central Government may, for the purpose of providing a Central database, in consultation with State Governments or other authorities opera-ting registration system for recording rights over any property or creation, modification or satisfaction of any security interest on such property, integrate the registration

records of such registration systems with the records of Central Registry established under section 20, in such manner as may be prescribed.

Explanation.—For the purpose of this sub-section, the registration records includes records of registration under the Companies Act, 2013 (18 of 2013), the Registration Act, 1908 (16 of 1908), the Merchant Shipping Act, 1958 (44 of 1958), the Motor Vehicles Act, 1988 (59 of 1988), the Patents Act, 1970 (39 of 1970), the Designs Act, 2000 (16 of 2000) or other such records under any other law for the time being in force.

(2) The Central Government shall after integration of records of various registration systems referred to in sub-section (1) with the Central Registry, by notification, declare the date of integration of registration systems and the date from which such integrated records shall be available; and with effect from such date, security interests over properties which are registered under any registration system referred to in sub-section (1) shall be deemed to be registered with the Central Registry for the purposes of this Act.

Section 20B deals with the Delegation of powers.

It provides that the Central Government may, by notification, delegate its powers and functions under this Chapter, in relation to establishment, operations and regulation of the Central Registry to the Reserve Bank, subject to such terms and conditions as may be prescribed.

Central Registrar (Section 21)

Section 21 deals with the Central Registrar.

(1) The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction of financial assets and security interest created over properties, to be known as the Central Registrar.

(2) The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Central Registrar, such functions of the Central Registrar under this Act as he may, from time to time, authorise them to discharge.

Register of Securitisation, reconstruction and security interest transactions

Section 22 deals with the Register of securitisation, reconstruction and security interest transactions.

(1) For the purposes of this Act, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to—

(*a*) securitisation of financial assets;

(*b*) reconstruction of financial assets; and

(*c*) creation of security interest.

(2) Notwithstanding anything contained in sub-section (1), it shall be lawful for the Central Registrar to keep the records wholly or partly in computer, floppies, diskettes or in any other electronic form subject to such safeguards as may be prescribed.

(3) Where such register is maintained wholly or partly in computer, floppies, diskettes or in any other electronic form, under sub-section (2), any reference in this Act to entry in the Central Register shall be construed as a reference to any entry as maintained in computer or in any other electronic form.

(4) The register shall be kept under the control and management of the Central Registrar.

Filing of Particulars

Filing of transactions of securitisation, reconstruction and creation of security interest.

23.[*(1)***]**[47] The particulars of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fee as may be prescribed **[***]**[48]:

[***][49]

[**Provided [***]**[50]that the Central Government may, by notification, require registration of all transactions of securitisation, or asset reconstruction or creation of security interest which are subsisting on or before the date of establishment of the Central Registry under sub-section (1) of section 20 within such period and on payment of such fees as may be prescribed.]

[(2) The Central Government may, by notification, require the registration of transaction relating to different types of security interest created on different kinds of property with the Central Registry.

(3) The Central Government may, by rules, prescribe forms for registration for different types of security interest under this section and fee to be charged for such registration. **]**[51]

Modification of security interest registered under this Act.

Section 24 provides that whenever the terms or conditions, or the extent or operation, of any security interest registered under this Chapter are or is modified, it shall be the duty of the ;'*asset reconstruction company* or the secured creditor, as the case may be, to send to the Central Registrar, the particulars of such modification, and the provisions of this Chapter as to registration of a security interest shall apply to such modification of such security interest.

Satisfaction of Security interest (Section 25)

Section 25 deals with the a*sset reconstruction company* or secured creditor to report satisfaction of security interest.

(1) The *asset reconstruction company* or the secured creditor as the case may be, shall give intimation to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the *asset reconstruction company* or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such payment or satisfaction.

(1A) On receipt of intimation under sub-section (1), the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.

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47 Renumbered as sub-section (1) by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

48 Words ", within thirty days after the date of such transaction or creation of security, by the securitisation company or reconstruction company or the secured creditor, as the case may be" omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

49 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

50 Word "further" omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

51 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

(2) If the concerned borrower gives an intimation to the Central Registrar for not recording the payment or satisfaction referred to in sub-section (1), the Central Registrar shall on receipt of such intimation, cause a notice to be sent to the *asset reconstruction company* or the secured creditor calling upon it to show cause within a time not exceeding fourteen days specified in such notice, as to why payment or satisfaction should not be recorded as intimated to the Central Registrar.

(3) If no cause is shown, the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.

(4) 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 deals with the right to inspect particulars of securitisation, reconstruction and security interest transactions.

(1) The particulars of securitisation or reconstruction or security interest entered in the Central Register of such transactions kept under section 22 shall be open during the business hours for inspection by any person on payment of such fee as may be prescribed.

(2) The Central Register referred to in sub-section (1) maintained in electronic form, shall also be open during the business hours for the inspection by any person through electronic media on payment of such fee as may be prescribed.

Section 26A deals with the rectification by Central Government in matters of registration, modification and satisfaction, etc.

(1) The Central Government, on being satisfied—

(a) that the omission to file with the Registrar the particulars of any transaction of securitisation, asset reconstruction or security interest or modification or satisfaction of such transaction or; the omission or mis-statement of any particular with respect to any such transaction or modification or with respect to any satisfaction or other entry made in pursuance of section 23 or section 24 or section 25 of the principal Act was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors; or

(b) that on other grounds, it is just and equitable to grant relief,

may, on the application of a secured creditor or *asset reconstruction company* or any other person interested on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for filing of the particulars of the transaction for registration or modification or satisfaction shall be extended or, as the case may require, the omission or mis-statement shall be rectified.

(2) Where the Central Government extends the time for the registration of transaction of security interest or securitisation or asset reconstruction or modification or satisfaction thereof, the order shall not prejudice any rights acquired in respect of the property concerned or financial asset before the transaction is actually registered.

Section 26B[52] deals with the registration by secured creditors and other creditors.

(1) The Central Government may by notification, extend the provisions of Chapter IV relating to Central

52 Chapter IVA, consisting of sections 26B to 26E, inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

Registry to all creditors other than secured creditors as defined in clause (zd) of sub-section (1) of section 2, for creation, modification or satisfaction of any security interest over any property of the borrower for the purpose of securing due repayment of any financial assistance granted by such creditor to the borrower.

(2) From the date of notification under sub-section (1), any creditor including the secured creditor may file particulars of transactions of creation, modification or satisfaction of any security interest with the Central Registry in such form and manner as may be prescribed.

(3) A creditor other than the secured creditor filing particulars of transactions of creation, modification and satisfaction of security interest over properties created in its favour shall not be entitled to exercise any right of enforcement of securities under this Act.

Section 26C deals with the Effect of the registration of transactions, etc.

(1) Without prejudice to the provisions contained in any other law, for the time being in force, any registration of transactions of creation, modification or satisfaction of security interest by a secured creditor or other creditor or filing of attachment orders under this Chapter shall be deemed to constitute a public notice from the date and time of filing of particulars of such transaction with the Central Registry for creation, modification or satisfaction of such security interest or attachment order, as the case may be.

(2) Where security interest or attachment order upon any property in favour of the secured creditor or any other creditor are filed for the purpose of registration under the provisions of Chapter IV and this Chapter, the claim of such secured creditor or other creditor holding attachment order shall have priority over any subsequent security interest created upon such property and any transfer by way of sale, lease or assignment or licence of such property or attachment order subsequent to such registration, shall be subject to such claim:

Provided that nothing contained in this sub-section shall apply to transactions carried on by the borrower in the ordinary course of business.

(4) Every authority or officer of the Central Government or any State Government or local authority, entrusted with the function of recovery of tax or other Government dues and for issuing any order for attachment of any property of any person liable to pay the tax or Government dues, shall file with the Central Registry such attachment order with particulars of the assessee and details of tax or other Government dues from such date as may be notified by the Central Government, in such form and manner as may be prescribed.

(5) If any person, having any claim against any borrower, obtains orders for attachment of property from any court or other authority empowered to issue attachment order, such person may file particulars of such attachment orders with Central Registry in such form and manner on payment of such fee as may be prescribed.

Section 26D deals with the right of enforcement of securities.

Notwithstanding anything contained in any other law for the time being in force, from the date of commencement of the provisions of this Chapter, no secured creditor shall be entitled to exercise the rights of enforcement of securities under Chapter III unless the security interest created in its favour by the borrower has been registered with the Central Registry.

Section 26E deals with the Priority to secured creditors.

Notwithstanding anything contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all

revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.

Explanation.—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.**]**

Penalties

27. If a default is made—

(*a*) in filing under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a [9][*asset reconstruction company*] or secured creditor; or

(*b*) in sending under section 24, the particulars of the modification referred to in that section; or

(*c*) 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:

Provided that provisions of this section shall be deemed to have been omitted from the date of coming into force of the provisions of this Chapter and section 23 as amended by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. **]**[53]

Penalties for non-compliance of direction of Reserve Bank

As per Section 28[54] of the Act, 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

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.

Non-Applicability in certain cases

Section 31 deals with the provisions of this Act not to apply in certain cases.

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 (9 of 1872) or the Sale of Goods Act, 1930 (3 of 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 (9 of 1872);

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53 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

54 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

(c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934 (24 of 1934);

(d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);

(e) [***][55]

(f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 (3 of 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 (5 of 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.

Civil Court not to have jurisdiction

Section 34 provides that 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).

In the case of ***BPV Classic Tea Factory (P.)Ltd*. v. *Corporation Bank,*** **[2008] 87 SCL 14 (MAD.)** It was held that SARFAESI Act, 2002 is a special Act while Companies Act, 1956, 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

Section 35 provides that 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.

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

55 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**. Prior to its omission, clause (*e*) read as under :

"(*e*) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;"

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.

Rule making power

Power of Central Government to make rules

38. (1) The Central Government may, by notification and in the Electronic Gazette as defined in clause (*s*) of section 2 of the Information Technology Act, 2000 (21 of 2000), make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—

[(*a*) *other business or commercial rights of similar nature under clause (*t*) of section 2;*][56]

[(*aa*)] the form and manner in which an application may be filed under sub-section (10) of section 13[57];

(*b*) the manner in which the rights of a secured creditor may be exercised by one or more of his officers under sub-section (12) of section 13;

[(*ba*) the fee for making an application to the Debts Recovery Tribunal under sub-section (1) of section 17;

(*bb*) the form of making an application to the Appellate Tribunal under sub-section (6) of section 17;

(*bc*) the fee for preferring an appeal to the Appellate Tribunal under sub-section (1) of section 18;]

[(bca) *the manner of integration of records of various registration systems with the records of Central Registry under sub-section (1) of section 20A;*

(bcb) *the terms and conditions of delegation of powers by the Central Government to the Reserve Bank under section 20B.*]

(*c*) the safeguards subject to which the records may be kept under sub-section (2) of section 22;

(*d*) the manner in which the particulars of every transaction of securitisation shall be filed under section 23 and fee for filing such transaction;

[(da) *the form for registration of different types of security interests and fee thereof under sub-section (3) of section 23;*][58]

(*e*) the fee for inspecting the particulars of transactions kept under section 22 and entered in the Central Register under sub-section (1) of section 26;

(*f*) the fee for inspecting the Central Register maintained in electronic form under sub-section (2) of section 26;

[(fa) *the form and the manner for filing particulars of transactions under sub-section (2) of section 26B;*

(fb) *the form and manner of filing attachment orders with the Central Registry and the date under sub-section (4) of section 26B;*

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56 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

57 Clause (*a*) renumbered as clause (*aa*) by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

58 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

(fc) *the form and manner of filing particulars of attachment order with the Central Registry and the fee under sub-section (5) of section 26B.*][59]

(*g*) any other matter which is required to be, or may be, prescribed, in respect of which provision is to be, or may be, made by rules.

(3) Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

SECURITY INTEREST (ENFORCEMENT) RULES, 2002

Demand notice

Rule 3 (1) provides that the service of demand notice as referred to in sub-section (2) of section 13 of the SRFAESI Act shall be made by delivering **[***including hand delivery*][60] 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 authorisedofficer, 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.

[*(5) The demand notice may invite attention of the borrower to provisions of sub-section (8) of section 13 of the Act, in respect of time available to the borrower, to redeem the secured assets.***]**[61]

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

59 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

60 Inserted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016

61 Sub-rule (5) inserted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

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 [fifteen days][62] 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 [fifteen days][63] 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.

[(2A) The borrower shall be intimated by a notice, enclosing the panchnama drawn in Appendix I and the inventory made in Appendix II.

(2B) All notices under these rules may also be served upon the borrower through electronic mode of service, in addition to the modes specified under rule 3.][64]

(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;

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62 Substituted for "seven days" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

63 Substituted for "seven days" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

64 Sub-rules (2A) and (2B) inserted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

(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 *including through e-auction mode*[65]; 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 the Form given in Appendix II-A to be published in two leading newspapers, including one in vernacular language having wide circulation in

65 Clause (*c*) substituted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016**.** Prior to its substitution, said clause read as under :
"(c) holding public auction; or"

the locality.

[Provided further that if sale of movable property by any one of the methods specified under sub-rule (1) fails and the sale is required to be conducted again, the authorised officer shall serve, affix and publish notice of sale of not less than fifteen days to the borrower for any subsequent sale.**]**[66]

(3) Sale by any methods other than public auction or public tender, shall be on such terms as may be settled **[***between the secured creditors and the proposed purchaser***]**[67].

(4) The authorized officer shall upload the detailed terms and conditions of the sale of the movable secured assets on the web-site of the secured creditor, which shall include,

(a) details about the borrower and the secured creditor;

(b) complete description of movable secured assets to be sold with identification marks or numbers, if any, on them;

(c) reserve price of the movable secured assets , 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) deposit of earnest money as may be stipulated by the secured creditor;

(f) any other terms or conditions which the authorsed officer considers it necessary for a purchaser to know the nature and value of movable secured assets.

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.

[(2A) All notices under these rules may also be served upon the borrower through electronic mode of service, in addition to the modes prescribed under sub-rule (1) and sub-rule (2) of rule 8.]**[68]**

(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 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

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66 Second proviso inserted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

67 Substituted for "between the parties in writing" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

68 Sub-rule (2A) inserted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

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 *[including through e-auction mode]*[69]; or

(d) by private treaty.

[Provided that in case of sale of immovable property in the State of Jammu and Kashmir, the provisions of Jammu and Kashmir Transfer of Property Act, 1977 shall apply to the person who acquires such property in the State. **]**[70]

(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 the Form given in Appendix IV-A to be published in two leading newspapers including one in vernacular language having wide 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;

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69 Clause (*c*) substituted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016**.** Prior to its substitution, said clause read as under :

"(c) by holding public auction; or"

70 Inserted by the Security Interest (Enforcement) (Amendment) Rules, 2012, w.e.f. 12-7-2012.

(c) reserve price of the immovable secured assets 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) deposit of earnest money as may be stipulated by the secured creditor;

(f) any other terms and conditions, which the authorized officer considers it necessary for a purchaser to know the nature and value of the property.

In the case of *Pvt. Ltd. &Orsvs Union Of India &Ors on 14 November, 2011 writ petition no. 1956 of 2011 decided on 14 November 2011Dr. D.Y. Chandrachud, A.A. Sayed JJ* in the High Court of judicature at Bombay held that Rule 8(6) of the Rules of 2002 provides the necessary safeguard if the action is taken in arbitrary and unreasonable manner and if the valuation of the property is not properly fixed.

The whole object of Rule 8 (6) of the Rules of 2002 appears to be that the borrower gets clear thirty days' notice before the sale takes place. During this period, the borrower can raise objections and can also point out before the appropriate forum as regards the correct and true valuation of the property. The essential purpose of sub-rule (5) of Rule 8 of the Rules of 2002 is to see that there is proper valuation by an approved valuer, who would be considered as an expert, and the view of the secured creditor on the aspect of fixation of reserved price is taken into consideration by the authorized officer. Just because the borrower is excluded from Rule 8 (5) of the Rules of 2002 or has no voice at the time when the valuation is fixed and the reserved price is also fixed, by itself will not render Rule 8 (5) unconstitutional.

(7) Every notice of sale shall be affixed on a conspicuous part of the immovable property and the authorised officer shall upload the detailed terms and conditions of the sale, on the web- site of the secured creditor, which shall include;

(8) Sale by any method other than public auction or public tender, shall be on such terms as may be settled **[***between the secured creditor and the proposed purchaser in writing***]**[71].

Time of sale, issue of sale certificate and delivery of possession, etc. (Rule 9)

[(1) No sale of immovable property under these rules, in first instance 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) of rule 8 or notice of sale has been served to the borrower:

Provided further that if sale of immovable property by any one of the methods specified by sub-rule (5) of rule 8 fails and sale is required to be conducted again, the authorised officer shall serve, affix and publish notice of sale of not less than fifteen days to the borrower, for any subsequent sale.**]**[72]

(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

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71 Substituted for "between the parties in writing" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

72 Sub-rule (1) substituted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.Prior to its substitution, said sub-rule read as under :

"(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."

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 8][73] :

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, i.e. on the same day or not later than next working day, as the case may be, pay a deposit of twenty five per cent of the amount of the sale price, which is inclusive of earnest money deposited, if any, to the authorised officer conducting the sale and in default of such deposit, the property shall be sold again.**]**[74]

(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 purchaser and the secured creditor, in any case not exceeding three months**]**[75].

(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.

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.

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73 Substituted for "rule 9" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

74 Sub-rule (3) substituted by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016. Prior to its substitution, said sub-rule read as under:

"(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."

75 Substituted for "as may be agreed upon in writing between the parties" by the Security Interest (Enforcement) (Amendment) Rules, 2016, w.e.f. 3-11-2016.

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.

GOLF TECHNOLOGIES (P). LTD & ANR v. AXIS BANJ LTD & ORS (DEL)

SARFAESI Act – section 13 and 17 – jurisdiction of civil court- recovery proceedings initiated by bank against the defaulting borrower- borrower filed civil suit alleging fraud played by the bank- whether maintainable

ISSUE

The plaintiffs' case is that the letter dated 31.12.2012 was not issued by them and that it was fraudulently created by the Bank, hence the transfer of monies from the plaintiffs' account to M/s. Tulip Telecom Limited was wrong and the said amount was depleted from their account only to classify it as an NPA. This according to the plaintiffs amounts to fraud and would form the basis of the maintainability of the present suit.

This is a suit challenging the measures taken by defendant Bank under Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest. The ground alleged in the suit is fraud by the bank played upon the plaintiffs.

On 21.4.2015, after summons were issued, the Bank took a preliminary objection to the maintainability of the suit on the ground that the appropriate remedy available to the plaintiffs is under Section 17 of the Act and that it was always open to the plaintiffs to have approached the Debts Recovery Tribunal (for short "DRT") concerned for the reliefs sought in the present suit. Accordingly, the learned counsels for the parties were heard on the issue of maintainability of the suit.

Decision held – Suit Dismissed

Grounds for Dismissal

- As per Mardia Chemicals (supra), jurisdiction of civil courts can be invoked only when the action of the secured creditor is alleged to be fraudulent or his claim so absurd and untenable.The plaint does not aver any complicated facts leading to the case of fraud or how the measures adopted by the Bank are fraudulent/absurd/ untenable. There is nothing in the plaint which would lead to the conclusion that the plaintiffs' case falls under the exception carved out by Mardia Chemicals (supra), i.e., the plaintiffs' grievances ought to be determined in a suit.

- There is no force in the contention of advanced on behalf of the plaintiffs that the DRT is not empowered to determine the issues sought to be agitated in the present suit. It is not as if the remedy provided under Section 17 of the Act is illusory. The expression "evidence produced by the parties" occurring in Section 17(3) would include all such which can be produced by the plaintiffs to show that the measures taken by the Bank under Section 13 were not in conformity with the provisions of the Act. Is has been so held in V.Thulasi (supra).

- In the context of the preceding discussion this Court is of the view that the ground of fraud raised by the plaintiff can be duly addressed in proceedings under Section 17 of the SARFAESI Act, 2002 and the said plea of fraud, in the peculiar facts and circumstances of the case, does not fall in the exception carved out in Mardia Chemicals (supra).

Therefore, the suit is not maintainable and is accordingly, dismissed.

LESSON ROUND UP

- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is enacted with a view to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.
- 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.
- 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).
- 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.
- In exercise of the powers conferred by subsection (1) and CL (b) of sub-section (2) of Sec. 38 read with sub-sections (4), (10) and (12) of Sec. 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Central Government notified Security Interest (Enforcement) Rules, 2002.
- Rule 8(6) of the Rules of 2002 provides the necessary safeguard if the action is taken in arbitrary and unreasonable manner and if the valuation of the property is not properly fixed. The whole object of Rule 8 (6) of the Rules of 2002 appears to be that the borrower gets clear thirty days' notice before the sale takes place. During this period, the borrower can raise objections and can also point out before the appropriate forum as regards the correct and true valuation of the property.

SELF TEST QUESTIONS

1. Write short notes on the following:
   (a) Non-performing Assets
   (b) Securitization Companies
   (c) Securitization
   (d) Bank
2. What measures are given to Asset Securitization Companies under the SARFAESI Act, 2002 ?
3. Comment on constitutional validity of the Rule 8 of Security Interest (Enforcement) Rules, 2002.
4. Explain the “Right to lodge a caveat” under SARFAESI Act, 2002.
5. Explain the overriding power of SARFAESI Act, 2002 over Companies Act with decided case law.

Lesson 19
Debt Recovery

LESSON OUTLINE

- Need and object of the Act
- Important Definitions
- 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
- Act having overriding effect.

LEARNING OBJECTIVES

The banks and financial institutions (FIs) were facing numerous problems in recovery of defaulted loans on account of delays in disposal of recovery proceedings. In order to ensure speedy adjudication of the matters relating to recovery of debts due to banks and financial institutions, the *Recovery of Debts and Bankruptcy Act, 1993* was passed. It provides a procedure which is different from the existing Code of Civil Procedure. To ensure expeditious adjudication and recovery of dues of banks and financial institutions, remove legal anomalies and strengthen the Recovery Tribunals.

This chapter contains overview of the Act, establishment of Tribunals and procedure thereof etc. The objective of the study lesson is to familiarize the students with the legal requirements stipulated under the *Recovery of Debts and Bankruptcy Act, 1993.*

Recovery of Debts and Bankruptcy Act, 1993 is an Act to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.

NEED AND OBJECT

Recovery of Debts [and Bankruptcy][1] Act, 1993 was passed by the Parliament of India, with a view to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions, [insolvency resolution and bankruptcy of individuals and partnership firms][2] and for matters connected therewith or incidental thereto. It extends to the whole of India except the State of Jammu and Kashmir. It shall be deemed to have come into force on the 24th day of June, 1993.

Sub-section 1(4) provides that [Save as otherwise provided, the provisions of this Act][3] shall 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.

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).

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

1. Substituted for "Due to Banks and Financial Institutions" by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.
2. Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.
3. Substituted for "The provisions of this Act" by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

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.

Constitutional validity of the Recovery of Debts [and Bankruptcy] Act, 1993

In case of *Union of India v. Delhi High Court Bar Association, (2002) 4 SCC 275,* the petitioners have challenged the constitutional validity of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 on the ground that the Act is unreasonable and is violative of Art. 14 of the Constitution and that it is beyond the legislative competence of the Parliament to enact such a law. This Act had been challenged for depriving a person of legal remedies in ordinary civil courts. However, the Supreme Court held that there is no such right that the dispute should be adjudicated only by a civil court, and the replacement of the jurisdiction of civil courts by independent and specialized tribunals is completely legal and constitutional.

Important Definitions

Section 2 of the **Recovery of Debts [and Bankruptcy][4] Act,** 1993 (the Act) defines various terms used in the Act, as given under:

Section 2(a) "Appellate Tribunal" means an Appellate Tribunal established under sub-section (1) of Section 8.

Section 2(d) "Bank" means

(i) banking company;

(ii) a corresponding new bank;

(iii) State Bank of India;

(iv) a subsidiary bank; or

(v) a Regional Rural Bank;

(vi) a multiState co-operative bank[5].

Section 2(e) - "Banking Company" shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949.

Section 2(ea) - "Chairperson" means a chairperson of an Appellate Tribunal appointed under Section 9.

Section 2(g): "Debts" means any liability (inclusive of interest) which is claimed as due from any person

4. Substituted for "Due to Banks and Financial Institutions" by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.
5. Inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012, w.e.f. 15-1-2013.

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 [*and includes any liability towards debt securities which remains unpaid in full or part after notice of ninety days served upon the borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of debt securities or;]*[6]

Section 2(ga):*"debt securities" means debt securities listed in accordance with regulations made by the Securities and Exchange Board of India under the Securities and Exchange Board of India Act, 1992 (15 of 1992);*[7]

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.

Section 2(ja) 'Presiding officer' means the presiding officer of the Debts Recovery Tribunal appointed under Sub-section (1) of Section 4.

Section 2(jb) "property" means—

(a) immovable property;

(b) movable property;

(c) any debt or any right to receive payment of money, whether secured or unsecured;

(d) receivables, whether existing or future; and

(e) intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature, as may be prescribed by the Central Government in consultation with Reserve Bank.

Under Section 2(la) "secured creditor" shall have the meaning as assigned to it in clause (zd) of sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)[8];

Section 2(lb) "security interest" *"security interest" means mortgage, charge, hypothecation, assignment or any other right, title or interest of any kind whatsoever upon property, created in favour of any bank or financial institution and includes—*

(a) such right, title or interest upon tangible asset, retained by the bank or financial institution as owner of the property, given on hire or financial lease or conditional sale which secures the

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6 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**

7 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**

8 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016.**

obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or any credit provided to enable the borrower to acquire the tangible asset; or

(b) such right, title or interest in any intangible asset or licence of any intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit extended to enable the borrower to acquire the intangible asset or licence of intangible asset; **]**

Section 2(o) "Tribunal" means the Tribunal established under Sub-section (1) of Section 3.

ESTABLISHMENT OF TRIBUNAL

Section 3 of the Act deals with the establishment of tribunal.

(1) 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.

[(1A) The Central Government shall by notification establish such number of Debts Recovery Tribunals and its benches as it may consider necessary, to exercise the jurisdiction, powers and authority of the Adjudicating Authority conferred on such Tribunal by or under the Insolvency and Bankruptcy Code, 2016.][9]

(2) The Central Government shall also specify, in the notification referred to in sub-section (1), the areas within which the Tribunal may exercise jurisdiction for entertaining and deciding the applications filed before it.

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

Section 4 of the Act deals with the Composition of Tribunal.

(1) A Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer) to be appointed, by notification, by the Central Government.

[(2) Notwithstanding anything contained in sub-section (1), the Central Government may—

(a) authorise the Presiding Officer of any other Tribunal established under any other law for the time being in force to discharge the function of the Presiding Officer of a Debt Recovery

9 Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

Tribunal under this Act in addition to his being the Presiding Officer of that Tribunal; or

(b) *authorise the judicial Member holding post as such in any other Tribunal, established under any other law for the time being in force, to discharge the functions of the Presiding Officer of Debts Recovery Tribunal under this Act, in addition to his being the judicial Member of that Tribunal.* **]**[10]

Qualifications for appointment of Presiding Officer and Term

Section 5 provides that a person shall not be qualified for appointment as the Presiding Officer of a Tribunal unless he is, or has been, or is qualified to be, a District Judge.

Section 6 provides that the [*Presiding Officer of a Tribunal shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment.* **Provided** *that no person shall hold office as the Presiding Officer of a Tribunal after he has attained the age of sixty-five years.*][11]

Section 7 deals with the Staff of Tribunal. Sub-section (1) provides that the Central Government shall provide the Tribunal with one or more Recovery Officers and such other officers and employees as that government may think fit. Sub-section (2) states that the Recovery Officers and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer. Sub-section (3) provides that the salaries and allowances and other conditions of service of the Recovery Officers and other officers and employees of a Tribunal shall be such as may be prescribed.

ESTABLISHMENT OF APPELLATE TRIBUNAL

Section 8 (1) The Central Government shall, by notification, establish one or more Appellate Tribunals, to be known as the Debts Recovery Appellate Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act:

[Provided that the Central Government may authorise the Chairperson of any other Appellate Tribunal, established under any other law for the time being in force, to discharge the functions of the Chairperson of the Debts Recovery Appellate Tribunal under this Act in addition to his being the Chairperson of that Appellate Tribunal.**]**[12]

[(1A) The Central Government shall, by notification, establish such number of Debt Recovery Appellate Tribunals to exercise jurisdiction, powers and authority to entertain appeal against the order made by the Adjudicating Authority under Part III of the Insolvency and Bankruptcy Code, 2016.**]**[13]

(2) The Central Government shall also specify in the notification referred to in sub-section (1) the Tribunals in relation to which the Appellate Tribunal may exercise jurisdiction.

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10 Substitutedby the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**. Prior to its substitution, sub-section (2) read as under :
"(2) Notwithstanding anything contained in sub-section (1), the Central Government may authorise the Presiding Officer of one Tribunal to discharge also the functions of the Presiding Officer of another Tribunal."

11 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**.

12 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**.

13 Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

[(3) Notwithstanding anything contained in sub-sections (1) and (2), the Central Government may authorise the Chairperson of one Appellate Tribunal to discharge also the functions of the Chairperson of other Appellate Tribunal.][14]

Composition of Appellate Tribunal, Qualifications and its Term

Section 9 of the Act provides that an Appellate Tribunal shall consist of one person only (hereinafter referred to as the Chairperson of the Appellate Tribunal) to be appointed, by notification, by the Central Government.

Section 10 of the Act deals with the qualifications for appointment of Chairperson of the Appellate Tribunal. It provides that a person shall not be qualified for appointment as the Chairperson of an Appellate Tribunal unless he:

(a) is, or has been, or is qualified to be, a Judge of a High Court; or

(b) 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

(c) has held office as the Presiding Officer of a Tribunal for at least three years.

Section 11 provides that the Chairperson of an Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:

Provided that no person shall hold office as the Chairperson of an Appellate Tribunal after he has attained the age of seventy years. **]**[15]

JURISDICTION, POWERS AND AUTHORITY OF TRIBUNALS

Section 17. (1) A Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain and decide applications from the banks and financial institutions for recovery of debts due to such banks and financial institutions.

[*(1A) Without prejudice to sub-section (1),—*

(a) the Tribunal shall exercise, on and from the date to be appointed by the Central Government, the jurisdiction, powers and authority to entertain and decide applications under Part III of Insolvency and Bankruptcy Code, 2016.

(b) the Tribunal shall have circuit sittings in all district headquarters. **]**[16]

(2) An Appellate Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain appeals against any order made, or deemed to have been made, by a Tribunal under this Act.

[(2A) Without prejudice to sub-section (2), the Appellate Tribunal shall exercise, on and from the date to be appointed by the Central Government, the jurisdiction, powers and authority to entertain appeals against the order made by the Adjudicating Authority under Part III of the Insolvency and Bankruptcy Code, 2016. **]** [17]

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14 Inserted by the Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000, w.r.e.f. 17-1-2000.

15 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**.

16 Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

17 Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

Section 17A. (1) The Chairperson of an Appellate Tribunal shall exercise general power of superintendence and control over the Tribunals under his jurisdiction including the power of appraising the work and recording the annual confidential reports of Presiding Officers.

(1A) For the purpose of exercise of general powers of superintendence and control over Tribunals under sub-section (1), the Chairperson may—

(i) direct the Tribunals to furnish, in such form, at such intervals and within such time, information relating to pending cases both under this Act and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), or under any other law for the time being in force, number of cases disposed of, number of new cases filed and such other information as may be considered necessary by the Chairperson;

(ii) convene meetings of the Presiding Officers of Tribunals periodically to review their performance.

(1B) Where on assessment of the performance of any Presiding Officer of the Tribunal or otherwise, the Chairperson is of the opinion that an inquiry is required to be initiated against such Presiding Officer for misbehaviour or incapacity, he shall submit a report to the Central Government recommending action against such Presiding Officer, if any, under section 15, and for reasons to be recorded in writing for the same. **]**[18]

(2) The Chairperson of an Appellate Tribunal having jurisdiction over the Tribunals may, on the application of any of the parties or on his own motion after notice to the parties, and after hearing them, transfer any case from one Tribunal for disposal to any other Tribunal.]

CASE LAW:

Debt Recovery Tribunal constituted under DRT Act has jurisdiction to entertain an appeal as per section 17 against action initiated under section 13(4) even if amount involved is less than Rs. 10 lakhs

State Bank of Patiala *v.* Mukesh Jain, CIVIL APPEAL NO. 210 OF 2007, DATED NOVEMBER 8, 2016, [2016] 76 taxmann.com 132 (SC),

Section 17, read with sections 13 and 34, of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and section 1 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

In this case the Supreme Court on the matter of right to appeal opined that provisions of section 1(4) of DRT Act which limits jurisdiction of Tribunal to `10 lakh deals with original jurisdiction of Tribunal under provisions of DRT Act and not with appellate jurisdiction. Thus, Debt Recovery Tribunal constituted under DRT Act has jurisdiction to entertain an appeal as per section 17 against action initiated under section 13(4) even if amount involved is less than `10 lakhs.

Bar of Jurisdiction:

Section 18: On and from the appointed day, no court or other authority shall have, or be entitled to

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18 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **1-9-2016**.

exercise, any jurisdiction, powers or authority (except the Supreme Court, and a High Court exercising jurisdiction under articles 226 and 227 of the Constitution) in relation to the matters specified in section 17:

[Provided that any proceedings in relation to the recovery of debts due to any multi-State co-operative bank pending before the date of commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) shall be continued and nothing contained in this section shall, after such commencement, apply to such proceedings.][19]

APPLICATION TO THE TRIBUNAL

Section 19 of the Act deals with the **Application to the Tribunal.**

(1) 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—

(a) *[the branch or any other office of the bank or financial institution is maintaining an account in which debt claimed is outstanding, for the time being; or]*[20]

(aa) [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][21]

(*b*) 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

(*c*) 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) Act, 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.]

(1A) Every bank being, multi-State co-operative bank referred to in sub-clause (*vi*) of clause (*d*) of section 2, may, at its option, opt to initiate proceedings under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) to recover debts, whether due before or after the date of commencement of the Enforcement of the Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 from any person instead of making an application under this Chapter.

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19 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012, w.e.f. 15-1-2013.

20 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

21 Clause (*a*) renumbered as clause (*aa*) by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

(1B) In case, a bank being, multi-State co-operative bank referred to in sub-clause (*vi*) of clause (*d*) of section 2 has filed an application under this Chapter and subsequently opts to withdraw the application for the purpose of initiating proceeding under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) to recover debts, it may do so with the permission of the Tribunal and every such application seeking permission from the Tribunal to withdraw the application made under sub-section (1A) shall be dealt with by it as expeditiously as possible and disposed of within thirty days from the date of such application:

Provided that in case the 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.]

(2) Where a bank or a financial institution, which has to recover its debt from any person, has filed an application to the Tribunal under sub-section (1) and against the same person 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.

(3) [Every application under sub-section (1) or sub-section (2) shall be in such form, and shall be accompanied with true copies of all documents relied on in support of the claim along with such fee, as may be prescribed][22] *:*

Provided that the fee may be prescribed having regard to the amount of debt to be recovered :

Provided further that nothing contained in this sub-section relating to fee shall apply to cases transferred to the Tribunal under sub-section (1) of section 31.

[Explanation—*For the purposes of this section, documents includes statement of account or any entry in banker's book duly certified under the Bankers' Books Evidence Act, 1891 (18 of 1891)]*[23]

(3A) [Every applicant in the application filed under sub-section (1) or sub-section (2) for recovery of debt, shall—

(a) state particulars of the debt secured by security interest over properties or assets belonging to any of the defendants and the estimated value of such securities;

(b) if the estimated value of securities is not sufficient to satisfy the debt claimed, state particulars of any other properties or assets owned by any of the defendants, if any; and

(c) if the estimated value of such other assets is not sufficient to recover the debt, seek an order directing the defendant to disclose to the Tribunal particulars of other properties or assets owned by the defendants.] [24]

[(3B) If any application filed before the Tribunal for recovery of any debt is settled prior to the commencement of the hearing before that Tribunal or at any stage of the proceedings before the final order is passed, the applicant may be granted refund of the fees paid by him at such rates as may be prescribed.][25]

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22 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

23 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

24 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

25 Sub-section (3A) renumbered as sub-section (3B) by the Enforcement of Security Interest and Recovery of Debts Laws and

[(4) On receipt of application under sub-section (1) or sub-section (2), the Tribunal shall issue summons with following directions to the defendant—

(i) *to show cause within thirty days of the service of summons as to why relief prayed for should not be granted;*

(ii) *direct the defendant to disclose particulars of properties or assets other than properties and assets specified by the applicant under clauses (*a*) and (*b*) of sub-section (3A); and*

(iii) *to restrain the defendant from dealing with or disposing of such assets and properties disclosed under clause (*c*) of sub-section (3A) pending the hearing and disposal of the application for attachment of properties]*[26]

[(4A) Notwithstanding anything contained in section 65A of the Transfer of Property Act, 1882 (4 of 1882), the defendant, on service of summons, shall not transfer by way of sale, lease or otherwise except in the ordinary course of his business any of the assets over which security interest is created and other properties and assets specified or disclosed under sub-section (3A), without the prior approval of the Tribunal:

Provided that the Tribunal shall not grant such approval without giving notice to the applicant bank or financial institution to show cause as to why approval prayed for should not be granted:

Provided further that defendant shall be liable to account for the sale proceeds realised by sale of secured assets in the ordinary course of business and deposit such sale proceeds in the account maintained with the bank or financial institution holding security interest over such assets.][27]

[(5)(i) The defendant shall within a period of thirty days from the date of service of summons, present a written statement of his defence including claim for set-off under sub-section (6) or a counter-claim under sub-section (8), if any, and such written statement shall be accompanied with original documents or true copies thereof with the leave of the Tribunal, relied on by the defendant in his defence:

Provided that where the defendant fails to file the written statement within the said period of thirty days, the Presiding Officer may, in exceptional cases and in special circumstances to be recorded in writing, extend the said period by such further period not exceeding fifteen days to file the written statement of his defence;

(ii) where the defendant makes a disclosure of any property or asset pursuant to orders passed by the Tribunal, the provisions of sub-section (4A) of this section shall apply to such property or asset;

(iii) in case of non-compliance of any order made under clause (ii) of sub-section (4), the Presiding Officer may, by an order, direct that the person or officer who is in default, be detained in civil prison for a term not exceeding three months unless in the meantime the Presiding Officer directs his release:

Provided that the Presiding Officer shall not pass an order under this clause without giving an opportunity of being heard to such person or officer.

Explanation.—For the purpose of this section, the expression 'officer who is in default' shall mean such

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Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

26 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

27 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

officer as defined in clause (60) of section 2 of the Companies Act, 2013 (18 of 2013)][28]

[(5A) On receipt of the written statement of defendant or on expiry of time granted by the Tribunal to file the written statement, the Tribunal shall fix a date of hearing for admission or denial of documents produced by the parties to the proceedings and also for continuation or vacation of the interim order passed under sub-section (4).

(5B) Where a defendant makes an admission of the full or part of the amount of debt due to a bank or financial institution, the Tribunal shall order such defendant to pay the amount, to the extent of the admission within a period of thirty days from the date of such order failing which the Tribunal may issue a certificate in accordance with the provisions of sub-section (22) to the extent of the amount of debt due admitted by the defendant.][29]

(6) 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 **[***along with original documents and other evidence relied on in support of claim of set-off in relation to any ascertained sum of money, against the applicant***]**.

(7) 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.

(8) A defendant in an application may, in addition to his right of pleading a set-off under sub-section (6), 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 defense 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.

(9) A counter-claim under sub-section (8) 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.

(10) The applicant shall be at liberty to file a written statement in answer to the counter-claim of the defendant within such period **[***as may be prescribed***]**[30].

[(10A) Every application under sub-section (3) or written statement of defendant under sub-section (5) or claim of set-off under sub-section (6) or a counter-claim under sub-section (8) by the defendant, or written statement by the applicant in reply to the counter-claim, under sub-section (10) or any other pleading whatsoever, shall be supported by an affidavit sworn in by the applicant or defendant verifying all the facts and pleadings, the statements pleading documents and other documentary evidence annexed to the application or written statement or reply to set-off or counter-claim, as the case may be:

Provided that if there is any evidence of witnesses to be led by any party, the affidavits of such

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28 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

29 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

30 Substituted for "as may be fixed by the Tribunal" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

witnesses shall be filed simultaneously by the party with the application or written statement or replies filed under sub-section (10A).

(10B) If any of the facts or pleadings in the application or written statement are not verified in the manner provided under sub-section (10A), a party to the proceedings shall not be allowed to rely on such facts or pleadings as evidence or any of the matters set out therein.][31]

[(11) Where a defendant sets up a counter-claim in the written statement and in reply to such claim the applicant contends that the claim thereby raised ought not to be disposed of by way of counter-claim but in an independent action, the Tribunal shall decide such issue along with the claim of the applicant for recovery of the debt.][32]

(12) [***][33]

(13) (A) Where, at any stage of the proceedings, [the Tribunal on an application made by the applicant along with particulars of property to be attached and estimated value thereof, or otherwise is satisfied**]**[34] that the defendant, with intent to obstruct or delay or frustrate the execution of any order for the recovery of 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 affect its value by misuse or creating third party interest,

the Tribunal may direct the defendant, within a time to be fixed by it, either to furnish security, in such sum as may be specified in the order, to produce and place at the disposal of the Tribunal, when required, the said property or the value of the same, or such portion thereof as may be sufficient to satisfy the certificate for the recovery of debt, or to appear and show cause why he should not furnish security.

(*B*) 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 in his favour or otherwise owned by the defendant as appears sufficient to satisfy any certificate for the recovery of debt.

(14) [***][35]

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31 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

32 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

33 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

34 Substituted for "the Tribunal is satisfied, by affidavit or otherwise" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016

35 Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016

(15) The Tribunal may also in the order direct the conditional attachment of the whole or any portion of the property specified under [*sub-section (13*][36].

(16) If an order of attachment is made without complying with the provisions of sub-section (13), such attachment shall be void.

(17) In the case of disobedience of an order made by the Tribunal under sub-sections (12), (13) and (18) or breach of any of the terms on which the order was made, the Tribunal may order the properties of the person guilty of such disobedience or breach to be attached and may also order such person to be detained in the civil prison for a term not exceeding three months, unless in the meantime the Tribunal directs his release.

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

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

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

(*c*) commit the same 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 the 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.

[(19) Where a certificate of recovery is issued against a company as defined under the Companies Act, 2013 (18 of 2013) and such company is under liquidation, the Tribunal may by an order direct that the sale proceeds of secured assets of such company be distributed in the same manner as provided in section 326 of the Companies Act, 2013 or under any other law for the time being in force.][37]

[(20) The Tribunal may, after giving the applicant and the defendant, an opportunity of being heard, in respect of all claims, set-off or counter-claim, if any, and interest on such claims, within thirty days from the date of conclusion of the hearings, pass interim or final order as it deems fit which may include order for payment of interest from the date on which payment of the amount is found due up to the date of realisation or actual payment.][38]

[(20A) Where it is proved to the satisfaction of the Tribunal that the claim of the applicant has been adjusted wholly or in part by any lawful agreement or compromise in writing and signed by the parties or where the defendant has repaid or agreed to repay the claim of the applicant, the Tribunal shall pass orders recording such agreement, compromise or satisfaction of the claim.]

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36 Substituted for "sub-section (14)" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016..

37 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

38 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

[(20AA) While passing the final order under sub-section (20), the Tribunal shall clearly specify the assets of the borrower over which security interest is created in favour of any bank or financial institution and direct the Recovery Officers to distribute the sale proceeds of such assets as provided in sub-section (20AB).

(20AB) Notwithstanding anything to the contrary contained in any law for the time being in force, the proceeds from sale of secured assets shall be distributed in the following orders of priority, namely:—

(i) the costs incurred for preservation and protection of secured assets, the costs of valuation, public notice for possession and auction and other expenses for sale of assets shall be paid in full;

(ii) debts owed to the bank or financial institution.

Explanation—For the purposes of this sub-section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency and bankruptcy proceedings are pending in respect of secured assets of the borrower, the distribution of proceeds from sale of secured assets shall be subject to the order of priority as provided in that Code.**]**[39]

[(21) (i) The Tribunal shall send a copy of its final order and the recovery certificate, to the applicant and defendant.

(ii) The applicant and the defendant may obtain copy of any order passed by the Tribunal on payment on such fee as may be prescribed.**]**[40]

[(22) The Presiding Officer shall issue a certificate of recovery along with the final order, under sub-section (20), for payment of debt with interest under his signature to the Recovery Officer for recovery of the amount of debt specified in the certificate.]**[41]**

[(22A) Any recovery certificate issued by the Presiding Officer under sub-section (22) shall be deemed to be decree or order of the Court for the purposes of initiation of winding up proceedings against a company registered under the Companies Act, 2013 (18 of 2013) or Limited Liability Partnership registered under the Limited Liability Partnership Act, 2008 (9 of 2008) or insolvency proceedings against any individual or partnership firm under any law for the time being in force, as the case may be.**]**[42]

(23) 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 a 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

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39 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

40 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

41 Substituted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

42 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 4-11-2016.

Tribunal which has issued it.

(24) The application made to the Tribunal under sub-section (1) or sub-section (2) shall be dealt with by it as expeditiously as possible and **[***every effort shall be made by it to complete the proceedings in two hearings, and***]** to dispose of the application finally within one hundred and eighty days from the date of receipt of the application.

(25) 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.]**[43]**

APPELLATE TRIBUNAL UNDER INSOLVENCY CODE

19A. The application made to Tribunal for exercising the powers of the Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016 shall be dealt with in the manner as provided under that Code.

Filing of recovery applications, documents and written statements in electronic form.

19A. (1) Notwithstanding anything to the contrary contained in this Act, and without prejudice to the provisions contained in section 6 of the Information Technology Act, 2000 (21 of 2000), the Central Government may by rules provide that from such date and before such Tribunal and Appellate Tribunal, as may be notified,—

(a) *application or written statement or any other pleadings and the documents to be annexed thereto required to be filed shall be submitted in the electronic form and authenticated with digital signature of the applicant, defendant or any other petitioner in such form and manner as may be prescribed;*

(b) *any summons, notice or communication or intimation as may be required to be served or delivered under this Act, may be served or delivered by transmission of pleadings and documents by electronic form and authenticated in such manner as may be prescribed.*

(2) Any interim or final order passed by the Tribunal or Appellate Tribunal displayed on the website of such Tribunal or Appellate Tribunal shall be deemed to be a public notice of such order and transmission of such order by electronic mail to the registered address of the parties to the proceeding shall be deemed to be served on such party.

(3) The Central Government may by rules provide that the electronic form for the purpose specified in this section shall be exclusive, or in the alternative or in addition to the physical form, therefor.

(4) The Tribunal or the Appellate Tribunal notified under sub-section (1), for the purpose of adopting electronic filing, shall maintain its own website or common website with other Tribunals and Appellate Tribunal or such other universally accessible repositories of electronic information and ensure that all orders or directions issued by the Tribunal or Appellate Tribunal are displayed on the website of the Tribunal or Appellate Tribunal, in such manner as may be prescribed.

Explanation.—For the purpose of this section,—

(a) *'digital signature' means the digital signature as defined under clause (*p*) of section 2 of the Information Technology Act, 2000 (21 of 2000);*

(b) *'electronic form' with reference to an information or a document means the electronic form*

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43 Substituted for "endeavour shall be made by it" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. **4-11-2016**.

*as defined under clause (r) of section 2 of the Information Technology Act, 2000 (21 of 2000).***]**

APPEAL TO THE APPELLATE TRIBUNAL

Section 20 deals with the Appeal to the Appellate Tribunal.

(1) Save as provided in sub-section (2), 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.

(2) No appeal shall lie to the Appellate Tribunal from an order made by a Tribunal with the consent of the parties.

(3) Every appeal under sub-section (1) shall be filed within a period of [thirty days][44] 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 be 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 [thirty days][45] if it is satisfied that there was sufficient cause for not filing it within that period.

(4) On receipt of an appeal under sub-section (1) [or under sub-section (1) of section 181 of the Insolvency and Bankruptcy Code, 2016][46], 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.

(5) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Tribunal.

(6) The appeal filed before the Appellate Tribunal under sub-section (1) 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.

Section 21 provides that 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 [fifty per cent] of the amount of debt so due from him as determined by the Tribunal under section 19:

Provided that the Appellate Tribunal may, for reasons to be recorded in writing, reduce the amount to be deposited by such amount which shall not be less than twenty-five per cent of the amount of such debt so due to be deposited under this section.

POWERS OF THE TRIBUNAL AND THE APPELLATE TRIBUNAL

Section 22 deals with the procedure and powers of the Tribunal and the Appellate Tribunal. Sub-section (1)

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44 Substituted for "forty-five days" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

45 Substituted for "forty-five days" by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

46 Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. a date yet to be notified.

provides that 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.

Sub-section (2) provides that 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.

Sub-section (3) provides that 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.

Sub-section (4) provides that [for the purpose of proof of any entry in the 'bankers books', the provisions of the Bankers' Books Evidence Act, 1891 (18 of 1891) shall apply to all the proceedings before the Tribunal or Appellate Tribunal. **]**[47]

Secton 22A provides that the Central Government may, for the purpose of this Act, by rules, lay down uniform procedure consistent with the provisions of this Act for conducting the proceedings before the Tribunals and Appellate Tribunals. **]**[48]

RIGHT TO LEGAL REPRESENTATION AND PRESENTING OFFICERS

Section 23(1) provides that 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.

Sub-section (2) states that 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.

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47 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

48 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

Limitations

Section 24 states that the provisions of the Limitation Act, 1963, shall, as far as may be, apply to an application made to a Tribunal.

RECOVERY OF DEBT DETERMINED BY TRIBUNAL

Modes of recovery of debts

Section 25 states that 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;

[*(*aa*)* *taking possession of property over which security interest is created or any other property of the defendant and appointing receiver for such property and to sell the same;* **]**[49]

(*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;

[*(*d*)* *any other mode of recovery as may be prescribed by the Central Government.* **]**[50]

Validity of certificate and amendment thereof

Section 26 deals with the Validity of certificate and amendment thereof.

(1) It shall not be open to the defendant to 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.

(2) Notwithstanding the issue of a certificate to a Recovery Officer, the Presiding Officer 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.

(3) The Presiding Officer shall intimate to the Recovery Officer any order withdrawing or cancelling a certificate or any correction made by him under sub-section (2).

Stay of proceedings under certificate and amendment or withdrawal thereof

Section 27 deals with the Stay of proceedings under certificate and amendment of withdrawal thereof.

[(1) Notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of any amount, the Presiding Officer, may by an order, grant time for payment of the amount, provided the defendant makes a down payment of not less than twenty-five per cent of the amount specified in the recovery certificate and gives an unconditional undertaking to pay the balance within a reasonable time, which is acceptable to the applicant bank or financial institution holding recovery certificate.

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49 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

50 Inserted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016

(1A) The Recovery Officer shall, after receipt of the order passed under sub-section (1), stay the proceedings until the expiry of the time so granted.

(1B) Where defendant agrees to pay the amount specified in the Recovery Certificate and proceeding are stayed by the Recovery Officer, the defendant shall forfeit right to file appeal against the orders of the Tribunal.

(1C) Where the defendant commits any default in payment of the amount under sub-section (1), the stay of recovery proceedings shall stand withdrawn and the Recovery Officer shall take steps for recovery of remaining amount of debt due and payable.][51]

(2) Where a certificate for the recovery of amount has been issued, the Presiding Officer 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.

(3) 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 Presiding Officer 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.

4) 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 Presiding Officer 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

Section 28 prescribes the other modes of recovery.

(1) 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 any one or more of the modes provided under this section.

(2) 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 (5 of 1908).

(3)(*i*) 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.

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51 Sub-sections (1), (1A), (1B) and (1C) substituted for sub-section (1) the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, w.e.f. 1-9-2016.

(*ii*) 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.

(*iii*) 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.

(*iv*) 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.

(*v*) 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.

(*vi*) 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.

(*vii*) 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.

(*viii*) The 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.

(*ix*) 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.

(*x*) If the person to whom a notice under this sub-section is sent 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 realisation of the amount as if it were a debt due from him, in the manner provided in sections 25, 26 and 27 and the notice shall have the same effect as an attachment of a debt by the Recovery Officer in exercise of his powers under section 25.

(4) 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.

[(4A) 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 of recovery is issued, to declare on affidavit the particulars of his or its assets.]

(5) 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 (43 of 1961).

APPLICATION OF CERTAIN PROVISIONS OF INCOME-TAX ACT

Section 29 of the Act provides that the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time shall, as far as possible, apply with necessary modifications as if the said provisions and the rules referred to the amount of debt due under this Act instead of to the Income-tax. Provided that any reference under the said provisions and the rules to the "assessee" shall be construed as a reference to the defendant under the Act.

In the case *of Union of India and another* v. *Delhi High Court Bar Association and others* (2002) 4 SCC 275, the three-Judge Bench, while dealing with the constitutional validity of the RDB Act, Supreme Court observed that "By virtue of Section 29 of the Act, the provisions of the Second and Third Schedules to the Income Tax Act, 1961 and the Income and the Income Tax (Certificate Proceedings) Rules, 1962, have become applicable for the realization of the dues by the Recovery Officer. Detailed procedure for recovery is contained in these Schedules to the Income Tax Act, including provisions relating to arrest and detention of the defaulter. It cannot, therefore, be said that the Recovery Officer would act in an arbitrary manner.

Furthermore, Section 30, after amendment by the Amendment Act, 2000, gives a right to any person aggrieved by an order of the Recovery Officer, to prefer an appeal to the Tribunal. Thus now an appellate forum has been provided against any orders of the Recovery Officer which may not be in accordance with the law. There is, therefore, sufficient safeguard which has been provided in the event of the Recovery Officer acting in an arbitrary or an unreasonable manner."

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).

In the cases of *Pravin Gada* v. *Central Bank of India [2013] 176 Comp Cas 101(SC), Allahabad Bank v. Canara Bank [2000] 101 Comp Cas 64(SC) and Rajsthan Financial Corporation v. Official Liquidator[2005] Com Cas 387(SC)*, Supreme Court held that anyone who is aggrieved by any act done by the Recovery Officer can prefer an appeal. The Debts Recovery Tribunal has the powers under the 1993 Act to make an enquiry as it deems fit and confirm, modify or set aside the order made by the Recovery Officer in exercise of powers under sections 25 to 28 of the 1993 Act. Thus, the auction, sale and challenge are completely codified under the 1993 Act, regard being had to the special nature of the legislation.

The official liquidator has a role under the 1956 Act. He protects the interests of the workmen and the creditors and, hence his association at the time of auction and sale is appropriate. He has been conferred locus to put forth his stand in these matters. Since it is the Debts Recovery Tribunal which would have the exclusive jurisdiction when a matter is agitated before the Debts Recovery Tribunal, the official liquidator does not have a choice either to approach the Debts Recovery Tribunal or the company court. The language of the 1993 Act, being clear, provides that any person aggrieved can prefer an appeal. The official liquidator whose association is mandatorily required is indubitably a person aggrieved relating to the action taken by the Recovery Officer which would include the manner in which the auction is conducted or the sale is confirmed. Under these circumstances, the official liquidator cannot have recourse to the doctrine of election. He has only one remedy, i.e., to challenge the order passed by the Recovery Officer before the Debts Recovery Tribunal and further appeal under the 1993 Act and not approach the company court to set aside the auction or confirmation of sale when a sale has been confirmed by the Recovery Officer under the 1993 Act.

Section 30A states that w*here an appeal is preferred against any order of the Recovery Officer, under section 30, by any person from whom the amount of debt is due to a bank or financial institution or consortium of banks or financial institutions, such appeal shall not be entertained by the Tribunal unless such person has deposited with the Tribunal fifty per cent of the amount of debt due as determined by the Tribunal.*

TRANSFER OF PENDING CASES

Section 31 deals with the Transfer of pending cases.

(1) Every suit or other proceeding pending before any court immediately before the date of establishment of a Tribunal under this Act, being a suit or proceeding the cause of action whereon it is based is such that it would have been, if it had arisen after such establishment, within the jurisdiction of such Tribunal, shall stand transferred on that date to such Tribunal :

Provided that nothing in this sub-section shall apply to any appeal pending as aforesaid before any court:

Provided further that any recovery proceedings in relation to the recovery of debts due to any multi-State co-operative bank pending before the date of commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 under the Multi-State Co-operative Societies Act, 2002 (39 of 2002), shall be continued and nothing contained in this section shall apply to such proceedings.]

(2) Where any suit or other proceeding stands transferred from any court to a Tribunal under sub-section (1),—

(a) the court shall, as soon as may be after such transfer, forward the records of such suit or other proceeding to the Tribunal; and

(b) the Tribunal may, on receipt of such records, proceed to deal with such suit or other proceeding, so far as may be, in the same manner as in the case of an application made under section 19 from the stage which was reached before such transfer or from any earlier stage as the Tribunal may deem fit.

Transfer of Pending Cases- Section 31 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993:

Indian Bank v. *Manilal Govindji Khona,* CIVIL APPEAL NO. 1416 OF 2015 FEBRUARY 3, 2015, [2015] 56 taxmann.com 133 (SC)

In a recovery suit filed by appellant-bank against respondent, High Court passed consent decree for suit amount. Respondent tendered amount in terms of decree which was refused by appellant. Thereafter, High Court directed Court receiver by its order, dated 3-12-1999, to sell mortgaged property of respondent. Accordingly, auction was held at which appellant purchased mortgaged property and Court receiver issued sale certificate.

The Supreme Court opined that in view of fact that DRT had been established in Mumbai and proceedings before High Court were automatically transferred to it in view of section 31, it was impermissible in law for High Court to direct Court receiver to sell property of respondent in public auction by executing Court decree, which action of Court receiver was void ab initio in law.

POWER OF TRIBUNAL TO ISSUE CERTIFICATE OF RECOVERY IN CASE OF DECREE OR ORDER

Section 31A specify the power of Tribunal to issue certificate of recovery in case of decree or order.

(1) Where a decree or order was passed by any court before the commencement of the Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000 and has not yet been executed, then, the decree-holder may apply to the Tribunal to pass an order for recovery of the amount.

(2) On receipt of an application under sub-section (1), the Tribunal may issue a certificate for recovery to a Recovery Officer.

(3) On receipt of a certificate under sub-section (2), the Recovery Officer shall proceed to recover the amount as if it was a certificate in respect of a debt recoverable under this Act.

PRIORITY TO SECURED CREDITORS

Section 31B provides that notwithstanding anything contained in any other law for the time being in force, the rights of secured creditors to realise secured debts due and payable to them by sale of assets over which security interest is created, shall have priority and shall be paid in priority over all other debts and Government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or local authority.

Explanation—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.

ACT TO HAVE OVER-RIDING EFFECT

Section 34 provides that save as provided under subsection (2), the provisions of this Act shall have effect notwithstanding anything inconsistent herewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

Sub-section (2) states that the provisions of this Act or the rules made there-under shall be in addition

to, and not in derogation of, the Industrial Finance Corporation Act, 1948, the State Financial Corporations Act, 1951, the Unit Trust of India Act, 1963, the Industrial Reconstruction Bank of India Act, 1984, the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and the Small Industries Development Bank of India Act, 1989 (39 of 1989)].

In the case of *Official Liquidator, U.P and Uttarakhand v. Allahabad Bank and Others [2013] 177 Comp Cas 426 (SC)* Supreme Court observed that Section 34 of the RDB Act would have overriding effect. The RDB Act is a comprehensive Code dealing with all the facets pertaining to adjudication, appeal and realization of the dues payable to the banks and financial institutions. The Debt Recovery Tribunal has exclusive jurisdiction exclusive jurisdiction to sell the properties in proceeding instituted by bank or financial institution, but at the time of auction sale, it is required to associate the Official Liquidator.

LESSON ROUND UP

- *Recovery of Debts and Bankruptcy Act, 1993* is an Act to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.
- The Act was passed to provide for the speedy adjudication of matters relating to recovery of debts due to banks and financial institutions.
- The RDB Act is a comprehensive Code dealing with all the facets pertaining to adjudication, appeal and realization of the dues payable to the banks and financial institutions.
- 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. The Debts Recovery Tribunal has the powers under the RDBFI Act, 1993 to make an enquiry as it deems fit and confirm, modify or set aside the order made by the Recovery Officer. The auction, sale and challenge are completely codified under the Act, regard being had to the special nature of the legislation.
- The provisions of the Limitation Act, 1963, shall, as far as may be, apply to an application made to a Tribunal.

SELF TEST QUESTIONS

1. State the philosophy behind enactment of Recovery of Debts due to Banks and Financial Institutions Act, 1993.
2. Explain the procedure for filing application to the Tribunal under the Act.
3. Appellate Tribunal vests power of a Civil Court under the Act. Discuss.
4. State overriding effect of the DRB Act with decided case law.

Lesson 20
WINDING UP

LESSON OUTLINE

- Introduction
- Is winding up and dissolution synonymous?
- Winding up under the Companies Act, 2013
- Winding up by Tribunal : Grounds
- Petition for the winding up
- Powers of the Tribunal
- Directions for filing statement of affairs
- Company Liquidators and their appointments
- Removal and replacement of liquidators
- Submission of the reports by the Company Liquidator and directions of the Tribunal
- Advisory Committees
- Submission of periodical reports to the Tribunal
- Powers and duties of the company liquidator
- Audit of Company liquidator's accounts
- Overriding Preferential Payments
- Fraudulent preferences
- Effect of floating charges
- Company Liquidation Dividend and Undistributed Assets Account
- Liquidation Process under the Insolvency and Bankruptcy Code, 2016

LEARNING OBJECTIVES

Corporate collapse implies business failure of the company, which may occur due to inadequate capital, fraudulent business practices, management inexperience and incompetence, failure to respond to change, recession, obsolescence, excessive gearing etc.

In the words of Prof. L.C.B. Gower, Winding-up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. A liquidator is appointed and he takes control of the company, collects its debts and finally distributes any surplus among the members in accordance with their rights. 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.

The Companies Act, 2013 provides for effective time bound winding up process. It also provides for aspects such as new grounds of winding up by NCLT, report of company liquidator, more powers to company liquidator, valuation of assets by registered valuer, professional assistance, concurrence of creditors for voluntary winding up, simplification of provisions by providing exclusive right to creditors to appoint the committee of inspection, remedy for fraudulent preference and so on.

After reading this lesson you will be able to understand the provisions relating to the winding up along with the liquidation process of the company under the Insolvency and Bankruptcy Code, 2016. However, it is to mention here that the rules relating to the winding up have not been notified yet.

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.

Is Winding up and dissolution synonymous?

The terms "Winding up" and "Dissolution" are sometimes erroneously used to mean the same thing. But, 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 handed over back to shareholders/old management. Dissolution is an act which puts an end to the life of the company.

Winding up under the Companies Act, 2013

The Companies Act, 2013 contain provisions for winding up of companies on various grounds including

inability of companies to pay their debts. The notification of the Insolvency and Bankruptcy Code, 2016 has deleted the provisions in the Companies Act regarding winding up of companies on the ground of inability to pay their debts and those relating to voluntary winding up of companies and detailing the requirements for insolvency resolution of corporate persons and voluntary winding in the Code itself. The code will exclusively be governing the insolvency resolution and liquidation of corporates.

The Companies Act, 2013 shall continue to govern winding up of companies on various other grounds excluding inability to pay debts. Sections 270 to 288, Sections 290 to 303, Section 324 and Sections 326 to 365 of Chapter XX of the Companies Act, 2013 contain the provisions related to winding up of the company.

MCA has notified these sections on 7th December, 2016 which came into force with effect from 15th December, 2016, whereas the rules relating to the winding up have not yet been notified by MCA.

Winding up by Tribunal: Grounds on which a Company may be wound up by the Tribunal

A company under Section 271 may be wound up by the tribunal if

(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) 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;

(c) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

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

Who may file Petition for the Winding up? [Section 272]

A petition to the Tribunal for the winding up of a company under Section 272(1) of the Act shall be presented by:

(a) the company;

(b) any contributory or contributories;

(c) all or any of the persons specified in clauses (a) and (b);

(d) the Registrar;

(e) any person authorised by the Central Government in that behalf; or

(f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.

Powers of Tribunal [Section 273]

Under Section 273(1) of the Act, the Tribunal may pass any of the following orders within ninety days from the date of presentation of the petition:

(a) dismiss it, with or without costs;

(b) make any interim order as it thinks fit;

(c) appoint a provisional liquidator of the company till the making of a winding up order;

(d) make an order for the winding up of the company with or without costs; or

(e) any other order as it thinks fit.

Refusal to make a winding up order by Tribunal

The Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

Further, Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy.

Filing statement of affairs of the Company [Section 274]

In case, where the Tribunal is satisfied that on a petition that the winding up of the company is to be made out, he may by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order which can be allowed a further period of thirty days in a situation of contingency or special circumstances.

In case, where the Company fails to file the statement of affairs, the tribunal shall forfeit the right of the company to oppose the petition and right of such directors and officers of the company as found responsible for such non-compliance.

Further, the director or the officer of the company who is in default will be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

Appointment of Company Liquidators by Tribunal [Section 275]

The Tribunal at the time of the passing of the order of winding up shall appoint an official liquidator or a Liquidator from the panel maintained under sub-section (2) as the Company Liquidator. The provisional liquidator or the Company Liquidator, as the case may, shall be appointed by the Tribunal from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016. The Tribunal may limit and restrict the powers of the provisional liquidator in the appointing order or by a subsequent order, but otherwise he shall have the same powers as a liquidator.

The terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company.

The liquidator is required to file a declaration within seven days from the date of appointment in the prescribed form disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment.

While passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, appointed under clause (c) of sub-section (1) of section 273, as the Company Liquidator for the conduct of the proceedings for the winding up of the company.

Removal and Replacement of Liquidator [Section 276]

In case where the reasonable cause being shown and for reasons to be recorded in writing, the tribunal may

remove the provisional liquidator or the Company Liquidator, on any of the following grounds:

(a) misconduct;

(b) fraud or misfeasance;

(c) professional incompetence or failure to exercise due care and diligence in performance of the powers and functions;

(d) inability to act as provisional liquidator or as the case may be, Company Liquidator;

(e) conflict of interest or lack of independence during the term of his appointment that would justify removal.

Further, In the event of death, resignation or removal of the liquidator the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing.

Intimation for Winding Up [Section 277]

Upon the order for appointment of provisional liquidator or for the winding up of a company, the tribunal shall within a period not exceeding seven days from the date of passing of the order give intimation of the appointment to the Company Liquidator or provisional liquidator and the Registrar.

The Registrar on receipt of the copy of order of appointment of provisional liquidator or winding up order shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made and in the case of a listed company, the Registrar shall intimate about such appointment or order, to the stock exchange or exchanges where the securities of the company are listed.

Such winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

Constitution of the Winding Up Committee

Within a period of three weeks from the date of passing of winding up order, the Company Liquidator is required to make an application to the Tribunal for constitution of a winding up committee comprising the

- Official Liquidator attached to the Tribunal;
- Nominee of secured creditors; and
- A professional nominated by the Tribunal.

to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function such as taking over assets, examination of the statement of affairs, recovery of property, cash or any other assets of the company including benefits derived therefrom, review of audit reports and accounts of the company, sale of assets, finalisation of list of creditors and contributories, compromise, abandonment and settlement of claims, payment of dividends, etc. The Company Liquidator shall be the convener of the meetings of the winding up committee.

Submission of Report to Tribunal by Winding up Committee

The Company Liquidator is required to place a report along with minutes of the meetings of the committee on monthly basis duly signed by the members present in the meeting for consideration till the final report for dissolution of the company is submitted before the Tribunal.

The Company Liquidator is also required to prepare the draft final report for consideration and approval of the winding up committee and the final report so approved by the winding up committee need to be submitted by the Company Liquidator before the Tribunal for passing of a dissolution order in respect of the company.

Effect of winding up order [Section 278]

The order for winding up of a company shall operate in favour of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories.

Stay of suits, etc., on winding up order [Section 279]

In case where a winding up order has been passed or a provisional liquidator has been appointed, no suit or other legal proceeding shall be commenced or if pending at the date of the winding up order (except any proceeding pending in appeal before the Supreme Court or a High Court), shall be proceeded with, by or against the company, except with the leave of the Tribunal and subject to such terms as may be imposed by the Tribunal. Any application for seeking leave required to be disposed of by the Tribunal within sixty days.

Submission of report by Company Liquidator [Section 281]

The liquidator is required to submit to the Tribunal, a report containing the following particulars, within sixty days from the order:

- the nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company:
- valuation Report of the assets obtained from registered valuers
- amount of capital issued, subscribed and paid-up;
- the existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and in the case of secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given;
- the debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof;
- guarantees, if any, extended by the company;
- list of contributories and dues, if any, payable by them and details of any unpaid call;
- details of trade marks and intellectual properties, if any, owned by the company;
- details of subsisting contracts, joint ventures and collaborations, if any;
- details of holding and subsidiary companies, if any;
- details of legal cases filed by or against the company; and
- any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include.

The Company Liquidator shall include in his report:

- 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 any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal.
- a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximising the value of the assets of the company.

In addition to this, The Company Liquidator is also required to make periodical reports to the Tribunal and in any case make a report at the end of each quarter with respect to the progress of the winding up of the company.

Directions of Tribunal for Dissolution [Section 282]

Upon the report of the Company Liquidator, the tribunal shall fix a time limit within which the entire proceedings shall be completed and the company be dissolved and at any stage of the proceedings, or on examination of the reports submitted to tribunal by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, the tribunal feels that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved.

Further, The Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof:

The Tribunal may consider for constituting a sale committee comprising such creditors, promoters and officers of the company to assist the Company Liquidator in sale.

Custody of company's properties [Section 283]

Upon the winding up order made by the tribunal the Company Liquidator or the provisional liquidator take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company which shall be deemed to be in the custody of the Tribunal from the date of the order for the winding up of the company.

Obligations of directors and managers [Section 286]

In the case of a limited company, any person who is or has been a director or manager, whose liability is unlimited under the provisions of this Act, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were at the commencement of winding up, a member of an unlimited company.

a person who has been a director or manager shall not be liable to make such further contribution,

- if he has ceased to hold office for a year or upwards before the commencement of the winding up;
- in respect of any debt or liability of the company contracted after he ceased to hold office;
- unless the Tribunal deems it necessary

Advisory committee [Section 287]

The Tribunal may direct for the constitution of an advisory committee to advise the Company Liquidator and

to report to the Tribunal consisting of not more than twelve members, being creditors and contributories of the company or such other persons in such proportion as the Tribunal.

The Company Liquidator is required to convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee.

The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time.

Powers and duties of Company Liquidator [Section 290]

The Company Liquidator, in a winding up of a company by the Tribunal, shall have the following power—

- to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;
- 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;
- to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels;
- to sell the whole of the undertaking of the company as a going concern;
- to raise any money required on the security of the assets of the company;
- to institute or defend any suit , prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company;
- to invite and settle claim of creditors, employees or any other claimant and distribute sale proceeds in accordance with priorities established under this Act;
- to inspect the records and returns of the company on the files of the Registrar or any other authority;
- 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 the other separate creditors;
- to draw, accept, make and endorse any negotiable instruments including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business;
- 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 which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself;
- to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself;

- to take all such actions, steps, or to sign, execute and verify any paper, deed, document, application, petition, affidavit, bond or instrument as may be necessary,—
  (1) for winding up of the company;
  (2) for distribution of assets;
  (3) in discharge of his duties and obligations and functions as Company Liquidator; and
- to apply to the Tribunal for such orders or directions as may be necessary for the winding up of the company.

Exercise and control of Company Liquidator's powers [Section 292]

The Company Liquidator while in the administration of the assets of the company and the distribution thereof among its creditors, have regard to any directions which may be given by the resolution of the creditors or contributories at any general meeting or by the advisory committee.

Further, any directions given by the creditors or contributories at any general meeting shall, in case of conflict, be deemed to override any directions given by the advisory committee.

Audit of Company Liquidator's accounts [Section 294]

The Company Liquidator is required to maintain proper and regular books of account including accounts of receipts and payments made by him. The Company Liquidator shall, at such times which shall not be less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments as such liquidator along with a declaration.

Further, the copy of the audited accounts shall be filed by the Company Liquidator with the Tribunal, and shall also be delivered to the Registrar which shall be open to inspection by any creditor, contributory or person interested.

In case of a Government company, the Company Liquidator shall forward a copy to

- to the Central Government, if that Government is a member of the Government company; or
- to any State Government, if that Government is a member of the Government company; or
- to the Central Government and any State Government, if both the Governments are members of the Government company.

The Company Liquidator shall also cause the accounts when audited, or a summary thereof, to be printed, and shall send a printed copy of the accounts or summary thereof by post to every creditor and every contributory.

Payment of debts by contributory and extent of set-off [Section 295]

The Tribunal may, at any time after passing of a winding up order, pass an order requiring any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due to the company, from him or from the estate of the person whom he represents, exclusive of any money payable by him or the estate by virtue of any call in pursuance of the Act.

The Tribunal, in making an order, may in the case of an unlimited company, allow to the contributory, by way of set-off, any money due to him or to the estate which he represents, from the company, on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit; and in the case of a limited company, allow to any director or manager whose liability is unlimited, or to his estate, such set-off.

In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call.

Power of Tribunal to make calls [Section 296]

The Tribunal may, at any time after the passing of a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company, make calls on all or any of the contributories for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and make an order for payment of any calls so made.

Power to summon suspected persons [Section 299]

The Tribunal at any time summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers, of the company, or known or suspected to be indebted to the company, or any person whom the Tribunal thinks to be capable of giving information concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company.

The Tribunal may examine any officer or person so summoned on oath concerning the matters aforesaid, either by word of mouth or on written interrogatories or on affidavit and may, in the first case, reduce his answers to writing and require him to sign them.

The Tribunal may require any officer or person so summoned to produce any books and papers relating to the company in his custody or power, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to such lien, and the Tribunal shall have power to determine all questions relating to that lien.

The Tribunal may direct the liquidator to file before it a report in respect of debt or property of the company in possession of other persons.

If the Tribunal finds that a person is indebted to the company, the Tribunal may order him to pay to the provisional liquidator or, as the case may be, the liquidator at such time and in such manner as the Tribunal may consider just, the amount in which he is indebted, or any part thereof, either in full discharge of the whole amount or not, as the Tribunal thinks fit, with or without costs of the examination or a person is in possession of any property belonging to the company, the Tribunal may order him to deliver to the provisional liquidator or, as the case may be, the liquidator, that property or any part thereof, at such time, in such manner and on such terms as the Tribunal may consider just.

Examination of Promoters, Directors [Section 300]

Upon the report of the Company stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.

Arrest of person trying to leave India or abscond [Section 301]

The Tribunal, if satisfied that a contributory or a person having property, accounts or papers of the company in his possession is about to leave India or otherwise to abscond, or is about to remove or conceal any of his

property, for the purpose of evading payment of calls or of avoiding examination respecting the affairs of the company, the Tribunal may cause the contributory to be detained until such time as the Tribunal may order; and his books and papers and movable property to be seized and safely kept until such time as the Tribunal may think fit.

Dissolution of company by Tribunal [Section 302]

When the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of such company.

The Tribunal shall on an application filed by the Company Liquidator or when the Tribunal is of the opinion that it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made, make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.

A copy of the order shall, within thirty days from the date thereof, be forwarded by the Company Liquidator to the Registrar who shall record in the register relating to the company a minute of the dissolution of the company.

If the Company Liquidator makes a default in forwarding a copy of the order within the aforesaid period, the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

PART III

PROVISIONS APPLICABLE TO EVERY MODE OF WINDING UP UNDER COMPANIES ACT, 2013

Debts of all descriptions to be admitted to proof [Section 324]

In every winding up (subject to, in the case of insolvent companies, to the application in accordance with the provisions of this Act or of the law of insolvency), all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company, a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason may not bear a certain value.

Overriding preferential payments [Section 326]

In the winding up of a company under the Companies Act, 2013, the debts relating to the *workmen's dues and the Dues of the Secured creditor on a pari passu basis* shall be paid in priority to all other debts:

Provided that in case of the winding up of a company, the sums referred above, which are payable for a period of two years preceding the winding up order, shall be paid in priority to all other debts (including debts due to secured creditors), within a period of thirty days of sale of assets and shall be subject to such charge over the security of secured creditors.

The term “Workmen” and “Workmen’s dues” can be referred as under:

"workmen", in relation to a company, means the employees of the company, being workmen within the meaning of clause (s) of section 2 of the Industrial Disputes Act, 1947;

"workmen's dues", in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely:—

i. all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;

ii. all accrued holiday remuneration becoming payable to any workman or, in the case of his death, to any other person in his right on the termination of his employment before or by the effect of the winding up order or resolution;

iii. unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act*, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;

iv. all sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company;

"workmen's portion", in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

Illustration: The value of the security of a secured creditor of a company is `1,00,000. The total amount of the workmen's dues is `1,00,000. The amount of the debts due from the company to its secured creditors is `3,00,000. The aggregate of the amount of workmen's dues and the amount of debts due to secured creditors is `4,00,000. The workmen's portion of the security is, therefore, one-fourth of the value of the security, that is ` 25,000.

Preferential payments [Section 327]

The following sum shall be paid in priority after the payment of the Overriding Preferential payments to all other debts,—

- all revenues, taxes, cesses and rates due from the company to the Central Government or a State Government or to a local authority at the relevant date, and having become due and payable within the twelve months immediately before that date;
- all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered to the company and due for a period not exceeding four months within the twelve months immediately before the relevant date, subject to the condition that the amount payable under this clause to any workman shall not exceed such amount as may be notified;
- all accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him, on the termination of his employment before, or by the winding up order, or, as the case may be, the dissolution of the company;
- unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company, all amount due in respect of contributions payable during the

period of twelve months immediately before the relevant date by the company as the employer of persons under the Employees' State Insurance Act, 1948 (34 of 1948) or any other law for the time being in force;

- unless the company has, at the commencement of winding up, under such a contract with any insurer as is mentioned in section 14(See Appendix I) of the Workmen's Compensation Act, 1923 (8 of 1923), rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company:

  Provided that where any compensation under the said Act is a weekly payment, the amount payable under this clause shall be taken to be the amount of the lump sum for which such weekly payment could, if redeemable, be redeemed, if the employer has made an application under that Act;

- all sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company; and
- the expenses of any investigation held in pursuance of sections 213 and 216, in so far as they are payable by the company.

  Sections 326 and 327 shall not be applicable in the event of liquidation under the Insolvency and Bankruptcy Code, 2016.

Status of the Fraudulent Preference Transactions [Section 328]

In case, where a company has given preference to a person who is one of the creditors of the company or a surety or guarantor for any of the debts or other liabilities of the company, and the company does anything or suffers anything done which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in if that thing had not been done prior to six months of making winding up application, the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

Further, if the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within six months before making winding up application, the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

Liabilities and rights of Persons Fraudulently Preferred [Section 331]

Where a company is being wound up and anything made, taken or done after the commencement of the Act is invalid under section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt, to the extent of the mortgage or charge on the property or the value of his interest, whichever is less.

Effect of Floating Charge [Section 332]

Where a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except for the amount of any cash paid to the company at the time of, or subsequent to the creation of, and in

consideration for, the charge, together with interest on that amount at the rate of five per cent per annum or such other rate as may be notified by the Central Government in this behalf.

Disclaimer of Onerous Property [Section 333]

In case, where any part of the property of a company which is being wound up consists of:

- land of any tenure, burdened with onerous covenants;
- shares or stocks in companies;
- any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or
- unprofitable contracts,

the Company Liquidator has endeavoured to sell or has taken possession of the property or exercised any act of ownership in relation thereto or done anything in pursuance of the contract, with the leave of the Tribunal and subject to the provisions of this section, by writing signed by him, at any time within twelve months after the commencement of the winding up or such extended period as may be allowed by the Tribunal, disclaim the property.

Certain Attachments, Executions, etc., in Winding Up by Tribunal to be Void [Section 335]

In case of the wound up by the Tribunal, any attachment, distress or execution put in force**,** without leave of the Tribunal against the estate or effects of the company, after the commencement of the winding up**;** or any sale held, without leave of the Tribunal of any of the properties or effects of the company, after such commencement shall be void.

Any proceedings for the recovery of any tax or impost or any dues payable to the Government will not be void in this regard.

Offences by Officers of Companies in Liquidation [Section 336]

In case, if any person, who is or has been an officer of a company which, at the time of the commission of the alleged offence, is being wound up, by the Tribunal or which is subsequently ordered to be wound up by the Tribunal;

- does not, to the best of his knowledge and belief, fully and truly disclose to the Company Liquidator all the property, movable and 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 the business of the company;
- does not deliver up to the Company Liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control and which he is required by law to deliver up;
- does not deliver up to the Company Liquidator, or as he directs, all such books and papers of the company as are in his custody or under his control and which he is required by law to deliver up;

within the twelve months immediately before the commencement of the winding up or at any time thereafter,—

i. conceals any part of the property of the company to the value of one thousand rupees or more, or conceals any debt due to or from the company;

ii. fraudulently removes any part of the property of the company to the value of one thousand rupees

or more;

iii. conceals, destroys, mutilates or falsifies, or is privy to the concealment, destruction, mutilation or falsification of, any book or paper affecting or relating to, the property or affairs of the company;

iv. makes, or is privy to the making of, any false entry in any book or paper affecting or relating to, the property or affairs of the company;

v. fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making of any omission in, any book or paper affecting or relating to the property or affairs of the company;

vi. by any false representation or other fraud, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;

vii. under the false pretence that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for; or

viii. 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 of the property is in the ordinary course of business of the company;

- makes any material omission in any statement relating to the affairs of the company;
- knowing or believing that a false debt has been proved by any person under the winding up, fails for a period of one month to inform the Company Liquidator thereof;
- after the commencement of the winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company;
- after the commencement of the winding up or at any meeting of the creditors of the company within the twelve months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses; oris guilty of any false representation or fraud for the purpose of obtaining the consent 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,

he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees:

Explanation.- For the purposes of the expression "officer" includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

Penalty for frauds by officers [Section 337]

An officer of a company upon the subsequently order for winding up shall not,

- by false pretences or by means of any other fraud, induced any person to give credit to the company; with intent to defraud creditors of the company or any other person, has made or caused to be made any gift or transfer of, or charge on, or has caused or connived at the levying of any execution against, the property of the company; or
- with intent to defraud creditors of the company, has concealed or removed any part of the property of the company since the date of any unsatisfied judgment or order for payment of money obtained against the company or within two months before that date.

In such cases, the officer shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

Liability where proper accounts not kept [Section 338]

Where a company is being wound up, if it is shown that proper books of account were not kept by the company throughout the 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 the winding up, whichever is shorter, every officer of the company who is in default shall, 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, be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

Liability for fraudulent conduct of business [Section 339]

If in the course of the 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 persons or for any fraudulent purpose, the Tribunal, on the application of the Official Liquidator, or the Company Liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that any person, who is or has been a director, manager, or officer of the company or any persons who were knowingly parties to the carrying on of 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 Tribunal may direct:

Where any business of a company is carried on with such intent or for such purpose as is mentioned above, every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be liable for action under section 447 of the Companies Act, 2013.

Power of Tribunal to assess damages against delinquent directors, etc. [Section 340]

If in the course of winding up of a company, it appears that any person who has taken part in the promotion or formation of the company, or any person, who is or has been a director, manager, Company Liquidator or officer of the company has misapplied, or retained, or become liable or accountable for, any money or property of the company or has been guilty of any misfeasance or breach of trust in relation to the company.

The Tribunal may, on the application of the Official Liquidator, or the Company Liquidator, or of any creditor or contributory, made within the period specified in that behalf, inquire into the conduct of the person, director, manager, Company Liquidator or officer aforesaid, and order him to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Tribunal considers just and proper, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the Tribunal considers just and proper.

In the matters where such person may be criminally liable, the aforesaid application shall be made within five years from the date of the winding up order, or of the first appointment of the Company Liquidator in the winding up, or of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer.

Prosecution of delinquent officers and members of company [Section 342]

In case where it appears to the Tribunal in the course of a winding up by the Tribunal, that any person, who is or has been an officer, or any member, of the company has been guilty of any offence in relation to the

company, the Tribunal may, either on the application of any person interested in the winding up or *suo motu*, direct the liquidator to prosecute the offender or to refer the matter to the Registrar.

When any prosecution is instituted, it shall be the duty of the liquidator and of every person, who is or has been an officer and agent of the company to give all assistance in connection with the prosecution which he is reasonably able to give.

Explanation— For the purposes of this sub-section, the expression "agent", in relation to a company, shall include any banker or legal adviser of the company and any person employed by the company as auditor.

If a person fails or neglects to give required assistance, he shall be liable to pay fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

"Being Wound up" to be mentioned in All Communication and Letters [Section 344]

Where a company is being wound up, whether by the Tribunal or voluntarily, every invoice, order for goods or business letter issued by or on behalf of the company or a Company Liquidator of the company, or a receiver or manager of the property of the company, being a document on or in which the name of the company appears, shall contain a statement that the company is being wound up.

In case of the contravention, the company, and every officer of the company, the Company Liquidator and any receiver or manager, who wilfully authorises or permits the non-compliance, shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees.

Disposal of books and papers of company [Section 347]

When the affairs of a company have been completely wound up and it is about to be dissolved, the books and papers of such company and those of the Company Liquidator may be disposed of in such manner as the Tribunal directs.

After the expiry of five years from the dissolution of the company, no responsibility shall devolve on the company, the Company Liquidator, or any person to whom the custody of the books and papers has been entrusted, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.

Information to be furnished to tribunal, if the winding up is not concluded within one year [Section 348]

If the winding up of a company is not concluded within one year after its commencement, the Company Liquidator shall, unless he is exempted from so doing, either wholly or in part by the Central Government, within two months of the expiry of such year and thereafter until the winding up is concluded, at intervals of not more than one year or at such shorter intervals, if any, file a statement in such form containing such particulars as may be prescribed, duly audited, by a person qualified to act as auditor of the company, with respect to the proceedings in, and position of, the liquidation, with the Tribunal. Further, a copy shall simultaneously be filed with the Registrar and shall be kept by him along with the other records of the company.

In case if a Government company in liquidation, the Company Liquidator is required to forward a copy thereof

- to the Central Government, if that Government is a member of the Government company;
- to any State Government, if that Government is a member of the Government company; or

- to the Central Government and any State Government, if both the Governments are members of the Government company.

In case of the contravention, the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the failure continues.

If a Company Liquidator makes wilful default in causing the statement referred above, audited by a person who is not qualified to act as an auditor of the company, the Company Liquidator shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one lakh rupees, or with both.

Company Liquidator to deposit monies into scheduled bank [Section 350]

Every Company Liquidator of a company is required to deposit the monies received by him in his capacity as such in a scheduled bank to the credit of a special bank account opened by him in that behalf:

Provided that if the Tribunal considers that it is advantageous for the creditors or contributories or the company, it may permit the account to be opened in such other bank specified by it.

If any Company Liquidator at any time retains for more than ten days a sum exceeding five thousand rupees or such other amount as the Tribunal may, on the application of the Company Liquidator, authorise him to retain, then, unless he explains the retention to the satisfaction of the Tribunal, he shall–

- pay interest on the amount so retained in excess, at the rate of twelve per cent per annum and also pay such penalty as may be determined by the Tribunal;
- be liable to pay any expenses occasioned by reason of his default; and
- also be liable to have all or such part of his remuneration, as the Tribunal may consider just and proper, disallowed, or may also be removed from his office.

Neither the Official Liquidator nor the Company Liquidator of a company shall deposit any monies received by him in his capacity as such into any private banking account.

Company Liquidation Dividend and Undistributed Assets Account [Section 352]

Where any company is being wound up and the liquidator has in his hands or under his control any money representing dividends payable to any creditor but which had remained unpaid for six months after the date on which they were declared or assets refundable to any contributory which have remained undistributed for six months after the date on which they become refundable, the liquidator shall forthwith deposit the said money into a separate special account to be known as the Company Liquidation Dividend and Undistributed Assets Account maintained in a scheduled bank.

The liquidator shall on the dissolution of the company, pay into the Company Liquidation Dividend and Undistributed Assets Account any money representing unpaid dividends or undistributed assets in his hands at the date of dissolution.

The liquidator, when making any payment referred above shall furnish to the Registrar, a statement in the prescribed form, setting forth, in respect of all sums included in such payment, the nature of the sums, the names and last known addresses of the persons entitled to participate therein, the amount to which each is entitled and the nature of his claim thereto, and such other particulars as may be prescribed.

The liquidator shall be entitled to a receipt from the scheduled bank for any money paid to it and such receipt shall be an effectual discharge of the Company Liquidator in respect thereof.

Where a company is being wound up voluntarily, the Company Liquidator shall, when filing a statement in pursuance of sub-section (1) of section 348, indicate the sum of money which is payable under sub-sections (1) and (2) of this section during the six months preceding the date on which the said statement is prepared, and shall, within fourteen days of the date of filing the said statement, pay that sum into the Company Liquidation Dividend and Undistributed Assets Account.

Any person claiming to be entitled to any money paid into the Company Liquidation Dividend and Undistributed Assets Account, whether paid in pursuance of this section or under the provisions of any previous company law may apply to the Registrar for payment thereof, and the Registrar, if satisfied that the person claiming is entitled, may make the payment to that person of the sum due:

Provided that the Registrar shall settle the claim of such person within a period of sixty days from the date of receipt of such claim, failing which the Registrar shall make a report to the Regional Director giving reasons of such failure.

Any money paid into the Company Liquidation Dividend and Undistributed Assets Account in pursuance of this section, which remains unclaimed thereafter for a period of fifteen years, shall be transferred to the general revenue account of the Central Government, but a claim to any money so transferred may be preferred above and shall be dealt with as if such transfer had not been made and the order, if any, for payment on the claim will be treated as an order for refund of revenue.

Any liquidator retaining any money which should have been paid by him into the Company Liquidation Dividend and Undistributed Assets Account shall:

- pay interest on the amount so retained at the rate of twelve per cent per annum and also pay such penalty as may be determined by the Registrar:
- Provided that the Central Government may in any proper case remit either in part or in whole the amount of interest which the liquidator is required to pay under this clause;
- be liable to pay any expenses occasioned by reason of his default; and
- where the winding up is by the Tribunal, also be liable to have all or such part of his remuneration, as the Tribunal may consider just and proper, to be disallowed, and to be removed from his office by the Tribunal.

Meetings to ascertain wishes of creditors or contributories [Section 354]

In all matters relating to the winding up of a company the Tribunal may:

- have regard to the wishes of creditors or contributories of the company, as proved to it by any sufficient evidence;
- if it thinks fit for the purpose of ascertaining those wishes, direct meetings of the creditors or contributories to be called, held and conducted in such manner as the Tribunal may direct; and
- appoint a person to act as chairman of any such meeting and to report the result thereof to the Tribunal.

While ascertaining the wishes of creditors and contributories as above regard shall be had to the value of each debt of the creditor and number of votes which may be cast by each contributory respectively.

Powers of Tribunal to declare dissolution of company void [Section 356]

Where a company has been dissolved, whether in pursuance of the provision of Companies Act, 2013 or

otherwise, the Tribunal may at any time within two years of the date of the dissolution, on application by the Company Liquidator of the company or by any other person who appears to the Tribunal to be interested, make an order, upon such terms as the Tribunal thinks fit, declaring the dissolution to be void, and thereupon such proceedings may be taken as if the company had not been dissolved.

It shall be the duty of the Company Liquidator or the person on whose application the order was made, within thirty days after the making of the order or such further time as the Tribunal may allow, to file a certified copy of the order with the Registrar who shall register the same, and if the Company Liquidator or the person fails so to do, the Company Liquidator or the person shall be punishable with fine which may extend to ten thousand rupees for every day during which the default continues.

Exclusion of certain time in computing period of limitation [Section 358]

Notwithstanding anything in the Limitation Act, 1963 (36 of 1963), or in any other law for the time being in force, in computing the period of limitation specified for any suit or application in the name and on behalf of a company which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the company to a period of one year immediately following the date of the winding up order shall be excluded.

Liquidation Process under the Insolvency and Bankruptcy Code, 2016 [Section 33 to 54]

The liquidation process starts with the winding up order and ends with the order of dissolution of the corporate debtor. It involves realization of the assets of the entity in liquidation and distribution of the realization proceeds among the creditors and other stakeholders who have claim to share the proceeds and other incidental activities by virtue of the liquidator being the trustee for the stakeholders as discussed hereunder:

Taking possession and control of the liquidation estate of corporate debtor

Section 36 of the Code lists the assets which shall form the liquidation estate and which the liquidator shall hold as fiduciary for the benefit of all creditors. Section 36 also mentions the assets which shall not form part of the liquidation estate. The liquidator has to take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor and take appropriate measures to protect and preserve the same. He shall have the power to access any information systems for the purpose of identification of the liquidation estate assets relating to the corporate debtor in terms of section 37.

Consolidation, verification, admission/rejection and determination of valuation of claims

The liquidator shall have the power to access any information system for the purpose of admission and proof of claims and identification of assets to be held in liquidation estate. The creditors can also call for financial information of the corporate debtor from the liquidator. Section 38 stipulates a time bound period of 30 days from the date of commencement of the liquidation process for collection of claims by the liquidator. The methods by which the different categories of creditors can submit and prove their claims have also been specified. Financial creditors can prove their claims by providing the record of claim as stored in an information utility. The liquidator shall verify the claims submitted by the creditors within such time as specified by the Board by regulations. He may require any creditor or the corporate debtor or any other person to produce any other document or evidence which he thinks necessary for the purpose of verifying the whole or any part of the claim. After verification, the liquidator may either admit or reject the claim, in whole or in part, as the case may be. Where he rejects a claim, he shall record the reasons for such rejection in writing. The decision of admission or rejection of the claim shall be communicated to the creditor and the corporate debtor within 7 days of such admission or rejection. The value of claims shall be determined by the

liquidator in such manner as may be specified by the Board in regulations. A creditor may appeal to NCLT against the decision of the liquidator rejecting the claim within 14 days of the receipt of such decision.

Evaluation and sale/disposal of the assets of corporate debtor

Subject to the directions of NCLT, the liquidator shall have the powers and duties to evaluate the assets and property of the corporate debtor in the manner as may be specified in the regulations by the Board. He can carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary. He shall also have power to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or sell the same in parcels in such manner as may be specified by the Board in regulations.

Avoidance of preferential transactions, undervalued transactions, transactions defrauding creditors and extortionate credit transactions

Sections 44 to 51 provide for avoidance of preferential transactions, undervalued transactions, transactions defrauding creditors and extortionate credit transactions entered into by the corporate debtor within the specified period prior to the liquidation order as discussed hereunder:

Preferential transactions

During the course of corporate insolvency resolution process or the liquidation process it may come to the notice of the resolution professional or the liquidator that any preferential transaction has been made with any person within the period of one year preceding the insolvency commencement date or such transaction was made with a related party within a period of two years preceding the insolvency commencement date, an application may be made by the resolution professional or the liquidator to NCLT for avoidance of such preferential transaction. Section 44 specifies the orders that may be passed by NCLT in relation to the avoidance of a preferential transaction. The orders are aimed at reversing the effects of the preferential transaction and requiring the person to whom preference is granted to pay back any gains he may have made as a result of such preference. An order of NCLT, however, shall not affect any interest in property which was acquired from a person other than the corporate debtor or any interest derived from such interest and was acquired in good faith and for value or shall not require a person, who received a benefit from the preferential transaction in good faith and for value to pay the liquidator or the resolution professional. Where a person, who has acquired an interest in property from another person other than the corporate debtor, or who has received a benefit from the preference or such another person to whom the corporate debtor gave the preference had sufficient information of the initiation or commencement of insolvency resolution process of the corporate debtor or is a related party, it shall be presumed that the interest was acquired or the benefit was received otherwise than in good faith unless contrary is shown. A person shall be deemed to have sufficient information or opportunity to avail such information if a public notice regarding the corporate insolvency resolution process has been made.

Undervalued transactions

A transaction which was made with any person within the period of one year preceding the insolvency commencement date or a transaction made with a related party within the period of two years preceding the insolvency commencement date shall be considered undervalued where the corporate debtor,-

(a) Makes a gift to a person; or

(b) Enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor and such transaction has not taken place in the ordinary course of business.

The liquidator or the resolution professional may make an application to NCLT for declaring such transaction void under section 45 and to reverse the effect of such transaction. The provision is aimed at preventing the siphoning away of corporate assets by the management of the corporate debtor, which has knowledge of the corporate debtor's poor financial condition and may enter into such transaction in the vicinity of insolvency. If the liquidator or the resolution professional does not make such application to NCLT knowingly, disciplinary proceedings can be ordered by NCLT against them. In that case, a creditor, member or a partner of the corporate debtor, as the case may be, may make an application to NCLT. NCLT may pass order restoring the position as it existed before such transactions and reversing the effects thereof and the order may provide for the following:-

(a) Require any property transferred as part of transaction, to be vested in the corporate debtor;

(b) Release or discharge, in whole or in part, any security interest granted by the corporate debtor;

(c) Require any person to pay such sums, in respect of benefits received by such person, to the liquidator or the resolution professional, as the case may be, as the NCLT may direct; or

(d) Require the payment of such consideration for the transaction as may be determined by an independent expert.

Transactions defrauding creditors

Section 49 strikes at transactions entered into with the intention of putting the assets of the corporate debtor beyond the reach of, or otherwise prejudicing the interests of a person who is making or may make a claim, against the corporate debtor. As it involves fraud, there is no time limit for challenging such transactions. On application being made, NCLT may order restoring the position as it existed before such transaction as if the transaction had not been entered into and protecting the interests of persons who are victims of such transactions. Third party transactions entered into in good faith may not be affected by NCLT order.

Extortionate credit transactions

Where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period of two years preceding the insolvency commencement date, the liquidator or the resolution professional, as the case may be, may make an application to NCLT for avoidance of the transaction if the terms of such transaction required exorbitant payments to be made by the corporate debtor. The Board may, in regulations, specify the circumstances in which a transaction shall be covered under the definition of extortionate credit transaction. Any debt extended by any person providing financial services which is in compliance with any law for the time being in force in relation to such debt, however, shall in no event be considered as an extortionate credit transaction. Where NCLT is satisfied that the terms of a credit transaction required exorbitant payments to be made by the corporate debtor, it shall, by order- (a) Restore the position as it existed prior to such transaction; (b) Set aside the whole or part of the debt created on account of the extortionate credit transaction; (c) Modify the terms of the transaction; (d) require any person who is, or was, a party to the transaction to repay any amount received by such person; or (e) Require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

Distribution of assets

In terms of section 53, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified in the regulations by the Board, namely,-

(a) The insolvency resolution process costs and the liquidation costs paid in full;

(b) The following debts which rank equally between and among the following:-

(i) workmen's dues for the period of 24 months preceding the liquidation commencement date; and

(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52 (see para 10.4 supra);

(c) wages and any unpaid dues owed to employees other than workmen for the period of 12 months preceding the liquidation commencement date;

(d) financial debts owed to unsecured creditors; (e) the following dues shall rank equally between and among the following:-

(i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;

(ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest.

(f) Any remaining debts and dues;

(g) Preference shareholders, if any, and

(h) Equity shareholders or partners, as the case may be.

Any contractual arrangements between recipients with equal ranking, if disrupting the order of priority shall be disregarded. The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients and the proceeds to the relevant recipient shall be distributed after such deduction. At each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full.

Dissolution of corporate debtor.

Where the assets of the corporate debtor have been completely liquidated, the liquidator shall make an application to NCLT for the dissolution of such corporate debtor and NCLT shall order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly. A copy of an order of dissolution shall be forwarded to the authority with which the corporate debtor is registered within 7 days from the date of such order in terms of section 54.

LESSON ROUND UP

- 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.
- Sections 270 to 288, Sections 290 to 303, Section 324 and Sections 326 to 365 of Chapter XX of the Companies Act, 2013 contain the provisions related to winding up of the company.
- The winding up proceedings relating to a company's inability to pay debts is now covered under the provisions of the Insolvency and Bankruptcy Code, 2016, and are deleted from Companies Act 2013. Though the adjudicating authority continues to be the NCLT, the adjudication will be under the Insolvency and Bankruptcy Code, 2016.
- Companies Act 2013 has only provisions relating to winding up of solvent companies through the NCLT, and

winding up of unregistered companies.

- The Winding up rules under the Companies Act, 2013 are not yet notified by Ministry of Corporate Affairs.

SELF TEST QUESTIONS

1. Describe the ground on which a company may be wound up by the Tribunal.
2. Briefly explain the provisions relating to the constitution of the Winding up Committee and its Report to Tribunal.
3. Briefly explain the Content of initial report by Company Liquidator under section 281 of the Companies Act, 2013.
4. Briefly explain the provisions relating to the preferential payment and overriding preferential Payment.
5. Describe the provisions relating to the Company Liquidation Dividend and Undistributed Assets Account.

Lesson 21
Cross Border Insolvency

LESSON OUTLINE

- Corporate Insolvency Vs. Individual insolvency
- Development of UNCITRAL Model law
- Salient features of Model law
- UNCITRAL Legislative guide on insolvency law
- Summary of World Bank Principles
- Chapter 11 of US Bankruptcy code
- Reforms in Insolvency laws
- Legislative response to the reform process

LEARNING OBJECTIVES

Although the number of cross-border insolvency cases has increased significantly since the 1990s, the adoption of national or international legal regimes equipped to address the issues raised by those cases has not kept pace. The lack of such regimes has often resulted in inadequate and uncoordinated approaches to cross-border insolvency that are not only unpredictable and time-consuming in their application, but lack both transparency and the tools necessary to address the disparities and, in some cases, conflicts that may occur between national laws and insolvency regimes. These factors have impeded the protection of the value of the assets of financially troubled businesses and hampered their rescue.

United Nations Commission on International Trade Law (UNCITRAL), with the general mandate to further the progressive harmonization and unification of the law of international trade, has developed a Model Law which is designed to assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency. Further, the World Bank and Asian Development Bank have also contributed to legislative developments in dealing with cross-border insolvency. Chapter 11 of US Bankruptcy Code is considered as one of the effective ways of rehabilitation of bankrupt corporates.

After reading this lesson you will be able to understand the overall view of UNCITRAL Model Law, World Bank principles, Chapter 11 of US Bankruptcy Code and other emerging aspects of insolvency laws.

INTRODUCTION

The organisation of insolvency proceedings with an international element is not an easy or straightforward matter. Solutions to the phenomenon of cross-border insolvency are reliant on a number of complex and interrelated questions to which the courts and legislatures in different jurisdictions have provided varying answers.

Cross-border insolvency (sometimes called international insolvency) regulates the treatment of financially distressed debtors where such debtors have assets or creditors in more than one country. Typically, cross-border insolvency is more concerned with the insolvency of companies which operate in more than one country rather than the bankruptcy of individuals. Like traditional conflict of laws rules, cross-border insolvency focuses upon three areas: choice of law rules, jurisdiction rules and enforcement of judgment rules. However, in relation to insolvency, the principal focus tends to be the recognition of foreign insolvency officials and their powers.

Cross-border insolvency problems are not limited to the failure of major international businesses. Even in small cases, assets may be located in various countries, for good or for bad reasons. A domestic business may have foreign branches or subsidiaries, or a foreign business may have domestic branches or subsidiaries. Property located in a foreign country may provide security for a debt so that domestic assets can be used to pay unsecured creditors. Foreign creditors may have valid claims in domestic bankruptcy cases, and domestic creditors may have valid claims in foreign bankruptcy cases. Any one of these situations raises a transnational insolvency problem. The increase in transnational insolvencies arises from the growth in international trade. Traditionally, banking institutions financed international transactions through letters of credit and resolved any problems that arose when particular debtors were unable to settle their international accounts. The growth of multinational businesses in the twentieth century has largely bypassed the banking system and created the possibility of transnational insolvencies.

The impact of international insolvency law is not limited to the legal issues involved in the pathology of failed and failing businesses. International insolvency law is also a major front-end factor in international investment and the extension of international credit. The availability and effectiveness of insolvency procedures is an important point in assessing non-market risk: It is thus an important investment consideration for both private investors and public institutions such as the World Bank and the International Monetary Fund. The legal rules governing insolvency law and practice are rooted deeply in the legal traditions of individual countries.

In part this arises because insolvency law preempts and supersedes many rules of both substantive and procedural law. Moreover, the importance of national economic interests varies from country to country, resulting in very different insolvency laws.

DEVELOPMENT OF UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW (UNCITRAL) MODEL LAW

The United Nations Commission on International Trade Law (UNCITRAL) was established in 1966 as a subsidiary body of the General Assembly of the United Nations with the general mandate to further the progressive harmonization and unification of the law of international trade.

The UN General Assembly is the main deliberative, policymaking and representative organ of the United Nations. Comprising all 193 Members of the United Nations, it provides a unique forum for multilateral discussion of the full spectrum of international issues covered by its Charter. India is a member of UN General Assembly and UNCITRAL.

The General Assembly recognised that differences in national laws regarding international trade were barriers to the effective flow of trade. The purpose of UNCITRAL was to harmonize and unify the law of international trade. As part of this programme of harmonization, the UNCITRAL has developed a Model Law on Cross-Border Insolvency ("the Model Law").

In December 1997, the General Assembly endorsed the Model Law on Cross Border Insolvency, developed and adopted by the UNCITRAL. The Model Law was accompanied by a Guide to Enactment that provided background and explanatory information to assist those preparing the legislation necessary to implement the Model Law and judges and others responsible for its application and interpretation.

The Model Law is not a law in its own right and has no force; rather it provides (as the name suggests) a legal text for incorporation into national law.

The following circumstances necessitated the harmonization of legislations across nations with reference to cross-border insolvency:

- Continuing global expansion of trade and investment.
- Increasing incidences of cross-border insolvency due to integration of trade across countries.
- National insolvency laws of different countries have by and large not kept pace with the trend.
- Inadequate and inharmonious legal approaches due to differences in regulatory platform across countries that hampers the rescue of financially troubled businesses and impede the protection of the assets of the insolvent debtor against dissipation.

The UNCITRAL Model Law aims at harmonization of legislations across countries

The United Nations Commission on International Trade Law (UNCITRAL) has a mandate from the General Assembly of the United Nations to harmonize and unify the law of international trade. As part of this programme of harmonization, the Commission has developed a Model Law on Cross-Border Insolvency ("the Model-Law") in order to create and maintain harmony in regulatory aspects of insolvency mechanism across countries. The Commission approved the text of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) in May 1997. 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 to have harmony among regulatory frameworks.

The objectives

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 different countries dealing with 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.

Key provisions of Model Law

The Model Law focuses on four identified elements, viz.

(a) access;

(b) recognition;

(c) relief (assistance) and

(d) cooperation.

(a) Access

The provisions relating

(i) to access give representatives of foreign insolvency proceedings and creditors a right of access to the courts of an enacting (domestic) country to seek assistance; and

(ii) to authorize representatives of local proceedings being conducted in the enacting country (domestic) to seek assistance elsewhere.

For example, in a cross-border insolvency involving Indian and Australian companies, the access is with respect to representatives of Australian proceedings to Indian court and vice versa.

(b) Recognition

These core provisions accord recognition to orders issued by foreign courts commencing qualifying foreign proceedings and appointing the foreign representative of those proceedings. Provided it satisfies specified requirements, a qualifying foreign proceeding should be recognized as either a main proceeding, taking place where the debtor had its centre of main interests at the date of commencement of the foreign proceeding or a non-main proceeding, taking place where the debtor has an establishment. Recognition of foreign proceedings under the Model Law has several effects - principal amongst them is the relief accorded to assist the foreign proceeding.

(c) Relief

A basic principle of the Model Law is that the relief considered necessary for the orderly and fair conduct of cross-border insolvencies should be available to assist foreign proceedings. By specifying the relief that is available, the Model Law neither imports the consequences of foreign law into the insolvency system of the enacting State nor applies to the foreign proceedings the relief that would be available under the law of the enacting State.

Key elements of the relief include interim relief at the discretion of the court between the making of an application for recognition and the decision on that application, an automatic stay upon recognition of main proceedings and relief at the discretion of the court for both main and non-main proceedings following recognition.

(d) Cooperation and coordination

These provisions address cooperation among the courts of different countries where the debtor's assets are located and coordination of concurrent proceedings concerning that debtor. The Model Law expressly empowers courts to cooperate in the areas governed by the Model Law and to communicate directly with foreign counterparts.

Cooperation between courts and foreign representatives and between representatives, both foreign and local, is also authorized. The provisions addressing coordination of concurrent proceedings aim to foster decisions that would best achieve the objectives of both proceedings, whether local and foreign proceedings or multiple foreign proceedings.

Situations under which model law can be applied for cross border insolvencies- Examples

- Access to local representatives for foreign records and access to foreign representatives to local records
- Request for assistance by foreign court/foreign representatives in a foreign proceedings
- Co-ordination of concurrent proceedings, etc.

Let us understand certain basic terms

(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.

(g) 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.

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.

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 proceedings 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 also used 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 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 proceeding 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 rogatory[1] 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.

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);

(e) 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

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1. Seeking information by one Court from another, especially foreign Court.

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) above, 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 above said 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; and

(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 it is 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; and

(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 adaptable 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; and

(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.

UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAWS[1]

Purpose

The Legislative Guide provides a comprehensive statement of the key objectives and principles that should be reflected in the insolvency laws of respective countries. It is intended to inform and assist insolvency law reforms around the world, providing a reference tool for national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided aims at achieving a balance between the need to address a debtor's financial difficulty as quickly and efficiently as possible; the interests of the various parties directly concerned with that financial difficulty, principally creditors and other stakeholders in the debtor's business; and public policy concerns, such as employment and taxation. The Legislative Guide assists the reader to evaluate the different approaches and solutions available and to choose the one most suitable to the local context.

The purpose of the Legislative Guide on Insolvency Law is

(i) to assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors.

(ii) 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.

Key provisions

The Legislative Guide is divided into three parts:

Part one discusses the key objectives of an insolvency law, structural issues such as the relationship between insolvency law and other laws, the types of mechanisms available for resolving a debtor's financial difficulties and the institutional framework required to support an effective insolvency regime.

Part two deals with core features of an effective insolvency law, following as closely as possible the various stages of an insolvency proceeding from their commencement to discharge of the debtor and closure of the proceedings. Key elements are identified as including: standardized commencement criteria; a stay to protect the assets of the insolvency estate that includes actions by secured creditors; post-commencement finance; participation of creditors; provision for expedited reorganization proceedings; simplified requirements for submission and verification of claims; conversion of reorganization to liquidation when reorganization fails; and clear rules for discharge of the debtor and closure of insolvency proceedings.

Part three addresses the treatment of enterprise groups in insolvency, both nationally and internationally. While many of the issues addressed in *parts one* and *two* are equally applicable to enterprise groups, there are those that only apply in the enterprise group context. *Part three* thus builds upon and supplements *parts one* and *two*. At the domestic level, the commentary and recommendations of *part three* cover various mechanisms that can be used to streamline insolvency proceedings involving two or more members of the same enterprise group. These include: procedural coordination of multiple proceedings concerning different debtors; issues concerning post-commencement and post-application finance in a group context; avoidance provisions; substantive consolidation of insolvency proceedings affecting two or more group members; appointment of a single or the same insolvency representative to all group members subject to insolvency; and coordinated

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1 http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html

reorganization plans. In terms of the international treatment of groups, *part three* focuses on cooperation and coordination, extending provisions based upon the Model Law on Cross-Border Insolvency to the group context and, as appropriate, considering the applicability to the international context of the mechanisms proposed to address enterprise group insolvencies in the national context.

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 directors' and officers' 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 non-performance 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 any 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 favourable 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 off 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 towards untroubled borrowers.

US BANKRUPTCY CODE

Six basic types of bankruptcy situations are dealt with under the US Bankruptcy Code.

Chapter 7 bankruptcy leading to liquidation. In this type of bankruptcy, a court-appointed trustee or administrator takes possession of any nonexempt assets, liquidates these assets (for example, by selling at an auction), and then uses the proceeds to pay creditors.

Chapter 9, entitled Adjustment of Debts of a Municipality, provides essentially for reorganization. Only a "municipality" may file under chapter 9, which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts.

Chapter 11, entitled Reorganization, ordinarily is used by commercial enterprises that desire to continue operating a business and repay creditors concurrently through a court-approved plan of reorganization.

Chapter 12 allows a family of farmer or fisherman to continue to operate the business while the plan is being carried out.

Chapter 13, enables individuals with regular income to develop a plan to repay all or part of their debts. Under this chapter, debtors propose a repayment plan to make installments to creditors over three to five years.

Chapter 15 provides effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country.

US BANKRUPTCY CODE – CHAPTER 11

American bankruptcy procedures enable sick Companies to restructure its debt obligations even while remaining operational. In this context, one must recognise that in the US the well known Chapter 11 bankruptcy proceedings are considered as re-organization/ resurrection process for corporates. Many companies are known to have revived under Chapter 11. Further, Chapter 11 ensures the emergence of companies with sustainable debt levels and profitable working.

One of the most remarkable events in recent business history has been the decision of General Motors Corporation USA to file bankruptcy proceedings — a decision forced on the company after it lost market share in the ongoing recession. Its assets were significantly lower than its liabilities. It has emerged from 40 days bankruptcy protection after creating a "new GM" made up of the best assets with fewer brand, fewer employees, etc. For that matter, Chapter 11 could even recover WorldCom which *emerged from bankruptcy as MCI during 2004.*

Section 363 under Chapter 11 of US Bankruptcy law is an established procedure which enables companies to sell assets free of debts and encumbrances to preserve the value of the enterprise. A company under Chapter 11 can choose to sell off particular assets. A bankrupt company, the "debtor," might use this Code to "reorganize" its business and become profitable again.

The key to a successful Chapter 11 case is the continued operation of the debtor's business. In addition to running the business, the debtor or the trustee must fulfill additional duties required by the Bankruptcy Code and work with creditors, the court, and other parties to obtain financing for ongoing business operations.

Salient Features of Chapter 11

- Chapter 11 is not a declaration of insolvency.
- Companies don’t file under Chapter 11 to liquidate; they do so in order to continue operating and to take the necessary steps to emerge as a financially stronger business, reorganizing their

operations or balance sheet or in some cases by selling substantially all its assets.

- Management remains in control of the business during the chapter 11 rehabilitative process. Trustees, administrators and monitors typically are not appointed.
- Chapter 11 normally does not cause interruption to business operations.
- The company is given breathing room during the process - an "automatic stay" generally prevents parties from taking legal action against the company or taking the company's assets.
- Most publicly-held companies prefer to file under Chapter 11 rather than Chapter 7 because they can still run their business and control the bankruptcy process. Chapter 11 provides a process for rehabilitating the business of the company.

Sometimes the company successfully works out a plan to return to profitability; sometimes, in the end, it liquidates. Under Chapter 11 reorganization, a company usually keeps doing business and its stock and bonds may continue to trade in securities markets.

The U.S. Trustee, the bankruptcy arm of the Department of Justice, appoints one or more committees to represent the interests of creditors and stockholders in working with the company to develop a plan of reorganization to enable it to get out of debt. The plan must be accepted by the creditors, bondholders, and stockholders, and confirmed by the court. However, even if creditors or stockholders vote aginst the plan, the court can disregard the vote and still confirm the plan if it finds that the plan treats creditors and stockholders fairly.

Committees of creditors and stockholders negotiate a plan with the company to relieve the company from repaying part of its debt so that the company is able to get back to its normal condition.

After the committees work with the company to develop a plan, the bankruptcy court must find that it legally complies with the Bankruptcy Code before the plan can be implemented.

Thus, Chapter 11 bankruptcy involves a reorganization plan that accommodates debt reorganization through a payment plan and the major advantage is that the debtors generally remain in possession of their property and operate their business under the supervision of Court. Chapter 11 debtors also often keep a substantial portion of their assets. The provisions of Chapter 11 allow the debtor, relief from pending obligations and the opportunity to reorganize its business and restructure debts while continuing to operate the business. Under this chapter a company can choose to sell off particular assets. Accordingly, subsidiaries outside US need not be included in the Chapter 11 filings.

There is therefore no change in the legal status of its subsidiaries that are kept out of Chapter 11 filings. Further, Debtors Audit, Debtors Counselling, Mandatory debtor education, etc. are provided under US Bankruptcy laws which help in minimizing the fraudulent bankruptcies. In the light of the above, a need is felt to have similar legal framework in India which allows continuity of business during bankruptcy proceedings, control over the management of company filing bankruptcy application, keeping subsidiaries / certain assets outside the purview of bankruptcy application, etc. in line with Chapter 11 of US Bankruptcy Code.

Recent Developments in India

The Insolvency Law Committee constituted by the Ministry of Corporate Affairs submitted second part of its Report in October 2018 after deliberating on the existing provisions of cross-border insolvency in the Insolvency and Bankruptcy Code, 2016 (sections 234 and 235) and the UNCITRAL Model Law on Cross Border Insolvency. The Committee noted that the existing provisions in the Code do not provide a comprehensive framework for cross-border insolvency matters. The Committee provided a comprehensive framework for this purpose based on the UNCITRAL Model Law on Cross-Border

Insolvency, 1997. The Committee has proposed a draft Part on Cross Border Insolvency which could be made a part of the Code by inserting a separate part for this purpose.

LESSON ROUND UP

- A company is said to be insolvent when its liabilities exceed its assets which results in its inability 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 workout systems, formal commercial insolvency law frame works, etc.

SELF TEST QUESTIONS

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

1. Write short note on:
   (i) UNCITRAL Model Law
   (ii) Foreign proceedings
   (iii) State
2. Under UNCITRAL Model Law, what are the reliefs that may be granted upon recognition of a foreign proceeding under Article 21.
3. What are the World Bank Principles? Why and how these are designed?
4. Chapter 11 of US Bankruptcy Code is preferred by many corporates based in the US. Discuss.

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING, VALUATION AND INSOLVENCY

PP-CRVI

TEST PAPER

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet 'A Guide to CS Students" providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may down load from http://www.icsi.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the 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, VALUATION AND INSOLVENCY

TEST PAPER

(This Test Paper is for recapitulation and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.)

Time Allowed: 3 hours *Maximum Marks: 100*

PART A (50 Marks)
(Corporate Restructuring)

1. (a) Comment on the following statements:
   - (i) The provision of the Companies Act, 2013 are likely to bring a paradigm shift in the manner in which these important restructurings are implemented.
   - (ii) Declaration of solvency by a company in case of Merger.
   - (iii) Ind AS 103 has a wider scope in comparison to AS-14.
   - (iv) An open offer once made cannot be withdrawn except in the certain circumstance.
   - (v) Is demerger different from reconstruction of a Company? *(3 marks each)*

   (b) Explain the procedures for investigation of Combination under the Competition Act, 2002. *(5 marks)*

2. (a) Explain the various Consideration, which shall be considered upon the Amalgamation of Companies.

   (b) In the light of the various judicial announcement, whether stamp Duty is payable on a tribunal order Sanctioning the Amalgamation.

   (c) Describe the entitlement of the dissenting shareholders in case of the Amalgamation of banking companies. *(5 marks each)*

OR

2A. (i) Reduction of capital is one of the modes of re-organisation of capital structure of the company. Explain the procedural aspects involved in reduction of capital.

   (ii) State the object and reasons for buy-back of shares. Explain the provisions relating to buy back of shares through book-building route.

   (iii) In case of merger and amalgamation, describe the content and procedure for providing notice of meeting to the stakeholder. *(5 marks each)*

3. (a) Minority interest is to be considered in the course of mergers. Do you agree? Explain the same with regulatory provisions under the companies Act, 2013

   (b) Discuss the various instrument available in India for Funding of Mergers and Amalgamation.

   (c) Briefly explain the factors relevant for post-merger evaluation and analyse its success.

   (5 marks each)

PART B (30 MARKS)
(Valuation)

4. (a) Explain the steps for carrying out valuation exercise based on market comparables.
   (b) Enumerate the content of valuation report for corporate strategies.
   (c) How do you value the shares issued to a person residing outside India. *(5 marks each)*

5. (a) Discus the salient features of the Asset Based Valuation and Earning Based Valuation methods of valuation.
   (b) Discuss briefly how valuation strategies differ under different restructuring plans.
   (c) What are the objectives of Documentation in Valuation Exercise? *(5 marks each)*

PART C (20 Marks)

(Insolvency)

6. (a) Explain different modes of corporate insolvency under US Bankruptcy Code.
   (b) Explain the term "Right to lodge a caveat" under the provisions of SARFAESI Act, 2002. *(5 marks each)*
   (c) Discuss Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016. *(10 marks)*

OR

6A. (i) Enumerate in detail the particulars required to be stated by a Company Liquidator in his report to the tribunal.

   (ii) The "Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002" was challenged in various courts. Discuss the constitutional validity of the Act?

(10 mark each)