

SEMINAR

CORPORATE MERGERS, DEMERGERS AND ACQUISITIONS

CRITICAL ASPECTS OF COMPANY LAW PRACTICAL EXPERIENCES

1. JURISDICTION OF EACH PETITION

- will lie with the NCLT of the State in which the Registered Office of the Company whether transferor or Transferee is situated.
- If two companies having their registered offices in two states each company will approach the NCLT having jurisdiction in that state

2. FEATURES TO BE LOOKED INTO WHILE DRAFTING THE SCHEME INTO

A. Authority to Amalgamate/Merger:

- Memorandum of Association must provide for the power to amalgamate the company with the other company.
- if the MoA specifically prohibits the company from any amalgamation or merger the company cannot proceed with the same unless the same is amended to provide such right.
- if object clause does not specify for power to Amalgamate or demerger or compromise or arrangement etc the process becomes ultravires.
- RD always insists on express clause for amalgamation in the object clause in its MoA.

B. Appointed Date versus Effective Date:

- **“Section 232 (6) - 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.”**
- Appointed Date:
 - i. acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree
 - ii. Date on which assets and liabilities of the transferor company vest in and stand transferred to the transferee company;
 - iii. Accounts on the appointed date form the basis for valuation of shares and determination of share exchange ratio;
 - iv. Appointed date is relevant for the purpose of assessment of income of the transferor and transferee companies;
- Effective Date:

- i. Date on which the scheme comes into effect
- ii. Date on which Scheme is complete & effective i.e. certified copy of the Tribunal order is filed with the RoC or last of the approvals is obtained
- iii. From the effective date amalgamation becomes effective and transferor company stands dissolved.

- **Marshall Sons (1997) 88 Comp Cases 528 SCJ—Supreme court** - Amalgamation takes effect on the appointed date
- **Equitas Housing Finance Ltd and Equitas Micro Finance Ltd with Equitas Finance Ltd in CP Nos. 119 to 121 of 2016**, the Madras High Court held that “the appointed date” need not necessarily be a specific calendar date and can be a future date
- **Accelyst Solutions-** Modification of scheme can be done by NCLT for cogent reasons, otherwise best left to the management.
- **General Circular No. 9/2019 dated 21.08.2019** issued by MCA clarified that – Section 232(6) enables to choose and state an appointed date in the scheme.

– This date may be a **specific calendar date**

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

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

C. NATURE OF BUSINESS FROM THE APPOINTED DATE AND TILL THE EFFECTIVE DATE

- Transferor to carry business in good faith and with prior mutual consultation of the transferee.
- with reasonable diligence, business prudence and should not take any business decisions without prior mutual consultation of the transferee company.
- companies can execute a shareholders’ agreement, which could be effective between Appointed Date and Effective Date, otherwise the scheme would end up being bulky for court purposes.
- The shareholders agreement contain the ways and means of taking decisions in ordinary course of business, list of transactions which would require the approval of the transferee, appointment and removal of key managerial personnel, banking transactions etc.

D. Transferor company shall be wound up without dissolution

- The Transferor company after it transfers its assets and liabilities etc would end being dissolved without winding up. Therefore report of the Official liquidator is asked for under the Act.

- Transferor shall lose its legal existence

E. Valuation report IS MANDATORY

- Sec 230 (2) (v) “A valuation in respect of shares and the property and all assets tangible and intangible, movable and immovable of the company by a registered valuer”
- 232 (2) (d) “The report of the expert with regard to the valuation if any
- Swap ratio is the shares being issued to shareholders of Transferor company of shares in transferee company based on the valuation report.
- Difference in Swap ratio or such allocation among different categories of shareholders may be **considered as detrimental to the interest of shareholders.**
- May draw the attention of the Tribunal and Income Tax Department (ITD) **questioning on fairness of consideration.**
- The authorities may object different ratio between the stakeholder would be unfair and unjust to the shareholders,
- Even if done the rationale behind the commercial decision would have to be justified with reasoning before the Tribunal.
- Courts have ruled that **if the swap ratio is as per the valuation report** and if such ratio is accepted by the Board of Directors in their meeting and by the majority shareholders (more than 90% in value) (suggested to have 100% approval), then Court/Tribunal/Registrar of Companies/Regional Director/ITD may not object on swap ratio/exchange ratio.
- **Hindustan Lever Employees Union v. Hindustan Lever Limited, [1995] (Suppl.) (1) SCC 499:**

"The Court's obligation is to be satisfied that the valuation was in accordance with law and it was carried out by an independent body.... 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 emphasised 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.... Counsel 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."

F. PAYMENT OF STAMP DUTY & SHIFTING OF REGISTERED OFFICES

- if the companies to the merger are located in more than one state, then the stamp duty on the Order sanctioning the arrangement shall be payable in each of those states.
- The Bombay High Court order in the case of **The Chief Controlling Revenue Authority and Anr. vs. M/s Reliance Industries Limited Mumbai and Anr. AIR 2016 Bom 108,:** when the companies involved in a scheme of merger are located in more than one state, then the approval of the Tribunal in both states is required, therefore the stamp duty also will have to be paid on both instruments, i.e. on both Tribunal orders.

G. MINORITY SHAREHOLDERS' INTERESTS:

- Keeping interests of minority shareholders crucial.
- Scheme should not be prejudicial to the interests of the minority shareholders
- if the Tribunal believes that Scheme is prejudicial to the interests of the minority shareholders, this may be rejected.
- obtain the written consent from all the shareholders on the merger Scheme

Shareholder still has a right to object before the court when the matter is pending before the NCLT

H. CHALLENGES/ DEAL BREAKERS IN CASE OF MERGER:

- a. The timelines will depend on material compliance irregularities
 - (i) Foreign Exchange Management Act, 1999 (FEMA),
 - (ii) Companies Act, 2013,
 - (iii) Income Tax Laws (including pending assessments).
 - (iv) PMLA, customs etc
- d. objections from any stakeholders (e.g. creditors, customers or employees)
- e. creditors using this opportunity to try and force a settlement in respect of any outstanding payment disputes
- f. Creditors may approach the Tribunal to file objections.**
- g. The transferor and transferee companies will have to ensure that employees being transferred are provided no lesser benefits than what they enjoy prior to the Merger (including continuity of service).

Employees have an opportunity to file objections before Tribunal against the proposed scheme.

3. TWO MOTIONS

A. FIRST MOTION

FILING THE APPLICATION

1. Seek dispensation

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

Creditors **yes**

Shareholders **no**

Sec 230(9) If the consent of 90% of the value of the creditors has been obtained then NCLT may dispense with their meeting else the same has to be convened.

2. collect noc's from shareholders and creditors

3. CA certificates

4. Date of reckoning of list

- 5. Audited financial statements**
- 6. Unaudited financial statements**

Whether Auditor's Certificate for Compliance of Accounting Standards

Proviso to clause 232(3) (B) proviso

provides that auditor's certificate for compliance of Accounting Standards

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

Latest audited financial statements and
Provisional upto 2 months prior to filing

Sec 232(2)(e). "a supplementary accounting statement if the last annual accounts of any of the merging company relate to financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme

Seek holding of the meeting

Chairman & Scrutinizer will be appointed by NCLT who will be professionals such as CA, company secretary or Advocates

Physical

How to conduct

consent of the shareholder(s)/ creditors(s) obtained online?

Virtual

How to conduct

Voting Procedure

Letters of authorisation

voting lines kept open for three days and on date of meeting

Online voting

Email sent to all shareholders or creditors with ID and password for voting

After meeting chairman and scrutinizer files their reports with the NCLT

Merits Of The Scheme Cannot Be Considered At The Application Stage

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

B. SECOND MOTION

FILING THE PETITION

Documents required

Notices will be directed to be sent

4. NOTICE OF THE SCHEME IS TO BE SERVED TO

- a. Central Government Regional director (section 394A);
- b. Registrar of Companies;
- c. Official Liquidator, if required;
- d. Nodal Income Tax commissioner
- e. Competition commission of India
- f. Sectoral regulator

Section 230 (5) Specific timeline of 30 days to respond to the notice for the statutory authorities. **Failing which it shall be presumed that they have no objections**

This is not being followed. All statutory authorities will need to be chased to give their NOC otherwise NCLT does not pass orders.

5. ISSUES TO BE EXAMINED BY REGIONAL DIRECTOR

- a. Whether companies forming part of scheme are sensitive sectors categories companies
- b. Whether any of the companies listed on Stock exchanges have given NOC from stock exchanges
- c. Whether any foreign entity is involved and necessary approvals obtained
- d. Whether the companies or its directors have contravened any provisions of Act?
- e. Whether the companies involved have been inspected
- f. Whether Valuation report submitted, if so share exchange ratio is as per report and accounting principles
- g. Whether transfer of Employees and their interest is protected
- h. Whether Accounting Treatment clause is as per accounting standards
- i. Whether meeting of class of shareholders/creditors is conducted
- j. Whether details of related party transactions are furnished
- k. Whether Corporate social responsibility CSR requirements have been met up with
- l. Whether consideration is made in cash other than of shares
- m. Whether provisions of buy back is attracted
- n. Whether any reduction of share capital is involved and if so provisions have been followed
- o. Whether authorized share capital of transferee company is sufficient?
- p. Whether compliance of FEMA/RBI Guidelines has been done ?
- q. Whether any qualification has been made by Statutory Auditor ?
- r. Whether a listed company is merging with an unlisted company ?
- s. Whether the promoters holding in listed company is increased?
- t. Whether there are any violations which require compounding
- u. Whether there are any pending cases against the Company or Directors in the economic offence courts

6. ISSUES TO BE EXAMINED BY ROCS

- 1. Filing Position of eforms and financial statements and annual returns.
- 2. Investor Grievances.
- 3. Inspection / Investigation / Technical Scrutiny.

4. Pending Prosecution.
5. Furnishes comments on the scheme.

7. ISSUES TO BE EXAMINED BY OFFICIAL LIQUIDATOR

- a. Past filings of annual returns
- b. Minute & Statutory registers
- c. Read out checklist of OL

8. HOW OBSERVATIONS ARE FILED WITH NCLT BY WAY OF AN AFFIDAVIT & ADJUDICATION

- RD and ROC file affidavits before the court with their observations.
- Petitioner files reply affidavits
- NCLT has to adjudicate these and pass orders on points
- NCLT currently sends back the reply given by Petitioners for a final reply from RD, which is not what should be done as NCLT has to adjudicate
- In case the ROC and the OL have no objection, the NCLT will sanction the scheme

Third parties have no locus standi- **MS.Essar Telecommunications ... vs Unknown on 21 April, 2011-Madras High Court**

9. ISSUES CONSIDERED BY COURT IN A SCHEME OF ARRANGEMENT

- a. Compliance with the Provisions
- b. Protection of interest of creditors and shareholders
- c. Reasonable arrangement
- d. Not for tax evasion
- e. Scheme in consonance with public interest

In the case of In Re: **Apex Investments Pvt. Ltd. (1992) CLA 20(Del)**, the Hon'ble Delhi High Court held that an arrangement for reconstruction or amalgamation of a company is essentially a contract and therefore parties are free to decide its terms and conditions and consideration to be paid

10. TIME PERIOD FOR FILING THE ORDER WITH THE ROC

Section 230(8)- Order is to filed within 30 days from the receipt of the order.

11. SINGLE WINDOW CLEARANCE

- Scheme under Sections 230 and 232 is a complete code in itself and considering the principle of 'single window clearance' it is not necessary for the petitioner-company to get separate clearances prescribed under the Companies Act,

- PMP Auto Industries Ltd., In re [1994] 80 Comp Cas 289,
- Rangkala Investments Ltd., In re [1997] 89 Comp Cas 754 (Guj).
- Scheme can have different arrangements merger, demerger, reduction of capital , change in regd office etc

12. REJECTION OF SCHEMES

- Due to irregularities & NNON compliances - **Ashish O Lalpuria vs Kumaka Industries Ltd & Ors on 20 October, 2020-NCLT Mumbai**
- Full disclosure not having been made to shareholders for the merger -**Sree Rama Multi tech ltd -Gujarat High Court.**
- Scheme or any ingredient cannot be against the provision of law- **Indian Seamless-Bombay High court**
- Sanctioned scheme order Modification -company has not come with clean hands **Delhi High Court M/S. Spice Communications ... vs -- on 4 July, 2011**
- Post amalgamation events cannot be taken into account- **Winfield Agro Services Pvt. Ltd. vs Unknown on 25 January, 1996 - Andhra High court**

13. CAN INSIGNIFICANT MINORITY OBJECT TO THE SCHEME

- Section 230(4) provides that a scheme can only be objected by persons holding (a) 10% or more of the shareholding; or (b) 5% or more of the total outstanding debt.
- No provision in the existing Companies Act specifically barring the insignificant minority to object to the scheme .
- What to do
 - a. Pay off the creditor
 - b. Buy off the shareholder
 - c. Court can hear and pass order on the application

14. EXITING MINORITY SHAREHOLDERS BY DECISION OF MAJORITY:

- ITW Signodge India Limited. In Re (2004) 52 SCL 147 (AP)
- Reckitt Benckister (India) Ltd. 122 (2005) DLT 61
- Sandwik Asia Limited 2009 (3) BOM CR 57
- Bom Organon India Limited 2010 (4) Bom CR 268
- Ram Kohli vs Indrama Investment Pvt Ltd Select ... on 16 May, 2013 Delhi high court

15. CAN INDIAN COMPANY BE MERGED WITH A FOREIGN COMPANY?

- Section 234 of the Companies Act 2013 provides for merger of the Indian Company with the Foreign Company and vice-versa subject to restrictions stipulated in the clause.
- Does not provide for demerger of Indian companies with foreign companies.

In Sun Pharmaceutical Industries matter the NCLT Ahmedabad held that Section 234 does not provide for demerger of Indian companies with foreign companies.

In Reliance life sciences matter the NCLT Mumbai Sanctioned the merger by absorption of Reliance Life Sciences B.V. which was the Transferor Company with Reliance Life Sciences Private Limited which was the Transferee Company.

16. MERGER OF LLP INTO COMPANY

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

- Merger of Real Image LLP with Qube Cinema Technologies P Ltd by NCLT Chennai
- merger of Vertis Microsystems LLP with Forgeahead Solutions Private Limited (filed under section 394 of Companies Act, 1956) by NCLT Mumbai.

very beautifully interpreted

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

17. WHETHER THE LIABILITY IN RESPECT OF ANY OFFENCE COMMITTED BEFORE MERGER GETS ABSOLVED AFTER MERGER

All liabilities and offences committed by the Company for which any Director being an officer in default would be responsible for would continue to be so even after merger is sanctioned.

18. STAMP DUTY ASPECTS

- Every instrument for transfer of property, whether movable or immovable, attracts stamp duty prescribed in Schedule-I of the Indian Stamp Act, 1899 (“Stamp Act”) –’
- Following ingredients must exist;
 - i. there should be an instrument of transfer, and

- ii. property, whether movable or immovable, should be transferred inter-vivos between the parties
- Applicability is determined on two grounds:
 - i. the State/states(s) in which the registered office of the Companies is situated and
 - ii. the situs of the properties being transferred under the Scheme
- Hindustan Lever Vs. State of Maharashtra (2004) 1 CLJ 148 (SC) - held that order of the Court is an instrument constituting a transfer inter-vivos and therefore, falls within the ambit of the definition of conveyance
- Emami Biotech Limited (CP. No. 627 of 2011) on 8-2-2012 Calcutta High court held that an order sanctioning a scheme of amalgamation or demerger under Section 394 of the Companies Act is an Instrument subject to Stamp duty
- Delhi Towers Limited vs. G.N.C.T. of Delhi [(2010) 159 Comp Cas 129 (Del)] it was held that the order of the High Court under section 394 of the Companies Act constitutes an instrument by virtue of which the assets and liabilities of the transferor/demerged company are transferred and vested in the transferee/resulting company disregarding the fact that there is no specific entry in the schedule-I of the Delhi Stamp Act and hence, made such order eligible to stamp duty.
- Rate of Stamp duty in Karnataka on Amalgamation, reconstruction or demerger Article 20(4) Schedule I
 - Three per cent on the market value of the property of the transferor company, located within the State of Karnataka and transferred to the transferee company: or
 - An amount equal to one per cent of the aggregate value of shares **issued or allotted** in exchange, or otherwise and in case of a subsidiary company, shares **merged (or cancelled)** with parent company and in addition, the amount of consideration if any, paid for such amalgamation; -**whichever is higher**
- **Chief Controlling Revenue Authority v. Reliance Industries Limited, AIR 2016 Bom 108** - Regarding levy of stamp duty on the Order in case of two different states, the judgement of the Bombay High Court as it was held that both the Orders will be subject to levy of stamp duty depending on the applicable rates in the two States. This matter has been appealed in the Supreme Court. Pending final judgement, the Supreme Court has stayed the Bombay High Court Order vide its Order dated 21.11.2016.

19. FAST TRACK SCHEME

- Section 233 provides for simplified procedures in respect of merger and amalgamation of:
 - a. Holding company and its wholly owned subsidiary or such other class of companies, as may be prescribed; OR
 - b. Two or more small companies subject to the process given under clause 233 of the Companies Act
- Section 2(85): Small Company means a company other than a public company whose:
 - (a) paid up share capital does not exceed Rs. 50 Lac or such higher amount as may be prescribed which shall not be more than Rs. 5 crore; OR
 - (b) turnover of which as per its last profit and loss account does not exceed Rs. 2 crore or such other amount as may be prescribed which shall not be Rs.20 crore.
- Notice of the proposed scheme is to be sent to the ROC and OL or any persons affected by the scheme and they are to provide their objections or suggestions within 30 days of this notice at the registered office of the Transferor and Transferee Company(s).
- These objections and suggestions have to be considered at a general meeting of the respective companies and the scheme has to be duly approved by at least 90% of the total number of shares.
- Each of the companies involved is required to **file a declaration of solvency** with the concerned ROC
- Scheme is to be approved by 90% in value of the creditors or class of creditors either by way of written consents or by a meeting wherein notice is to be sent to these creditors at least 21 days in advance
- Transferee Company shall file a copy of the approved scheme with the Central Government, ROC and OL

Exception 1 – As under Section 2(85) it is mentioned that **Small Public Company does not Come** under the Expression Small Company therefore they cannot take advantage of section 233 Of Companies Act, 2013.

Exception 2 – Demerger cannot be done under Section 233 as the section only mentions Merger and amalgamations.

FEATURES TO BE LOOKED INTO

Prohibition of Treasury Stock

Section 233(10) Act prohibits the continuation of any shareholding in transferor Company by transferee Company which means that any shareholding which the transferee Company had in transferor company has to come to Zero At the time of Merger shares held by Transferee Company in the Transferor Company have to be cancelled and extinguished.

Clubbing of Authorized Capital

Section 233 (1) of the Act give states that if any Fee was paid by the Transferor Company (Amalgamating) on its authorized capital preceding to its merger or amalgamation with the

transferee company (Amalgamated) shall be set-off contrary to the fees payable by the transferee company on its authorized capital improved by the merger or amalgamation.

Shareholder Approval

Section 233 (1), (b) of Act states that the consent of shareholders holding at least 90% of the total number of shares is required

Creditors Approval

Section 233 (1), (b) of Act, states that approval of (9/10th) in value of the creditors or class of creditors is required in small private companies' creditors are not in large number, so if 90% by value hold by few creditors than it may create problem in taking approval.

Dispensation from the Meeting

If 90% in value of creditors agree by mode of affidavit then a meeting of creditors can be dispensed.

If concerns are received from the Registrar of Companies about the flaws of the scheme and if the Central Government is convinced with the concerns Of Registrar of Companies that scheme is not in the public interest or in the interest of Creditors then RD will reject.

At that point either way NCLT will need to be approached.

20. ANNUAL REPORTING TO ROC

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

21. RECALL OF MERGER ORDERS

Courts have been very cautious in allowing such prayers for recall.

Anand Electronics and Industries Ltd. and Dharmapuri Paper Mills P Ltd. [CP 144 and 145/95

– After the Merger Order, two applications CA 282 and 283/96 were filed in CP 144 and 145/95 to rescind the order sanctioning the scheme citing business reasons

– The learned single Judge of madras High court **refused to rescind** stating that

- (i) it is a suo moto reconsideration by the Boards of the companies
- (ii) it is not open to company to seek sanction and annulment of such sanction at the whim and pleasure of the Boards of the companies.

It was Appealed to Division Bench in O.S.A. 152 and 153/96. Madras High court directed advertisements in newspapers calling for objections and Court allowed the alternative prayer i.e. non implementation of the scheme reading sections 391(3) and 394(3) together in regard to the order not having come into effect.