

CORPORATE RESTRUCTURING AND INSOLVENCY

Time allowed: 3 hours

Maximum marks: 100

NOTE : All references to sections relate to the Companies Act, 1956 unless stated otherwise.

PART — A

(Answer Question No.1 which is COMPULSORY and ANY THREE of the rest from this part.)

Question 1

- (a) The position of capital and reserves as on 31st March, 2009 of Matrix Ltd. are given below :

	Rs.
Equity shares (Fully paid-up of face value Rs.10 each)	1,00,00,000
Equity shares (Rs.5 is paid-up on face value of Rs.10 each)	1,00,00,000
Equity shares with differential voting rights (Fully paid-up of face value of Rs.10 each)	1,00,00,000
Preference shares (Fully paid-up of Rs.100 each)	1,00,00,000
Free reserves	7,50,00,000

The managing director of Matrix Ltd. wanted to place proposal before the Board for buy-back of its 100% preference share capital. You, as a Company Secretary, advise your managing director on the following issues :

- (i) Maximum limit upto which Board can approve buy-back of shares.
 - (ii) Maximum limit upto which shareholders can approve buy-back of shares.
 - (iii) Maximum limit upto which company can buy-back its own shares.
 - (iv) The situation in which further offer of buy-back can be given by the company within a period of 365 days. (2 marks each)
- (b) State whether the following statements are correct or incorrect citing relevant provisions of the law:
- (i) the scheme of arrangement is to be passed at a meeting with the support of majority in number and three-fourths in value of those present and voting. The creditors or members who are present at the meeting but remain neutral or abstain from voting will be counted in ascertaining the majority in number or value.
 - (ii) A person who is a transferee of certain shares (yet to be registered) can seek to modify a scheme of arrangement of the company concerned approved by the court.
 - (iii) A private limited company can amalgamate with a public limited company within few days after its incorporation.
 - (iv) Court has power to disapprove the scheme of arrangement on the grounds of mismanagement of affairs of the company and withholding of material information from the shareholders and creditors.
 - (v) Court can modify the scheme of arrangement filed before it on its own.
 - (vi) Section 394 does not cast an obligation on the court to satisfy the

presence of 'public interest' if the scheme is duly approved by the shareholders and creditors of the companies concerned. (2 marks each)

- (c) *Though the terms 'diminution of share capital' and 'reduction of capital' look synonymous, but sometimes diminution of share capital does not amount to reduction of capital. Briefly explain the circumstances when such exercises do not fall within the purview of 'reduction of capital' and procedure of reduction of capital under section 100 is not to be followed. (5 marks)*

Answer 1(a)

- (i) According to the proviso to Section 77A[2] of the Companies Act, 1956, the Board can authorize buy back of securities not exceeding 10% of total paid up equity capital and free reserves of the Company. The above limit states the quantum of fund required to be bought back with the approval of the Board.

The total paid up equity capital of the company excluding the preference shares is Rs.3,00,00,000.

The maximum amount upto which board can approve buy back is 10% of total paid up equity capital and free reserve which is 10% of (Rs.3,00,00,000 + Rs.7,50,00,000) = Rs. 1,05,00,000.

- (ii) According to Section 77A(2)(b) and (c) of the Companies Act, 1956, shareholders by passing Special resolution can approve buy back upto 25% of paid up capital and free reserves. The paid up capital shall include preference capital, if any.

In the given question, shareholders can approve 25% of the paid up capital and free reserves i.e. 25% of Rs.11,50,00,000/- (Rs3,00,00,000 + Rs. 1,00,00,000+ Rs.7,50,00,000) = Rs. 2,87,50,000.

- (iii) A company can buy back upto 25% of the total paid up capital and free reserves (Section 77A(2)(c)]. Further, buy back of equity shares in any financial year should not exceed 25% of the total paid up equity capital of the Company. However, company is free to buy back its entire preference capital during the financial year subject to overall limit of 25% of the total paid up capital and free reserves.

Hence, in the given question maximum buy back of equity shares should be limited to 25% of the total paid up equity capital of Rs. 3, 00, 00,000 which is Rs.75, 00,000.

- (iv) Once the buyback has been made with the authorization of the Board and not that of the shareholders, no further, offer for buy back of any securities can be made without the consent of shareholders accorded by Special Resolution within 365 days reckoned from the date of the offer [Section 77A(2)- second proviso).

However, shareholders can make further offer of buy back within a period of 365 days provided the aggregate of authorization does not exceed the limit prescribed in 77A [2] [c].

Answer 1(b)

- (i) **Incorrect.** The creditors or members who are present at the meeting but remain neutral or abstain from voting will not be counted in ascertaining the majority in number or value. The language in Section 391(2) requires the

counting of those who are present and voting, cumulatively. This was the legal position obtained from the decision in the case of *Re, Hindustan General Electric Corporation*, AIR 1959 Cal 679 at 681.

- (ii) **Correct.** As regards the modification of a scheme, an application can be made by any person interested. 'Any person interested' should not be confined to creditor or member or liquidator of the company. Accordingly, any person who has obtained a transfer of shares in the company but has not yet been registered as a member is also to be included therein. [*K K Gupta v. K P Jain* (1978) 48 Comp. Cases 342 : AIR 1979 SC 734].

Therefore, a person who is a transferee of certain shares (yet to be registered) can seek to modify a scheme of arrangement of the company concerned approved by the Court.

- (iii) **Correct.** In *Electricals (P) Ltd.* (1996) 22 CLA 274 (Guj.) it was held that there can be no objection to a private limited company having its assets revalued by an expert and then amalgamating with a public limited company within a few days after its incorporation.
- (iv) **Correct.** In the case of *J S Davar v. Dr. S V Marathe* AIR 1967 Bom 456 (DB), it was decided that if the object of the scheme is to prevent investigation or there is failure in the management of the affairs of the company or disregard of law or withholding of material information from the meeting etc. the court will not sanction the scheme..
- (v) **Incorrect.** In the absence of any consent on the part of any of the parties who entered into a scheme, especially on the part of the creditors, it is not open to the court to impose conditions or modifications of its own. [*Mihirendra Kishore Dutt v. Brahmanbaria Loan Co. Ltd.*, (1935) 5 Com Cases1, 6 : AIR 1934 Cal 816].
- (vi) **Incorrect.** It was held in the case of *Union of India v. Ambalal Sarabhai Enterprises Ltd.*, (1984) 55 Com Cases 623, 645 (Guj) that consideration of public interest must not be ignored while sanctioning a scheme. Further, it was observed by the Judges of Supreme Court that in *Hindustan Lever Employees Union v. Hindustan Lever Ltd.*, (1995) 83 Com Cases 30 that the company court has to apply its mind to the public interest involved in the merger. Further, a scheme which is valid and good may yet be bad if it is against public interest.

Answer 1(c)

Though the terms 'diminution of share capital' and 'reduction of capital' look synonymous, but sometimes diminution of share capital does not amount to reduction of capital. In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

- (i) Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 94(1)(e)];
- (ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 80;
- (iii) Where the company buys-back its own shares under Section 77A of the Act.

In the above mentioned situations, the procedure for reduction of capital as laid down in Section 100 of the Companies Act, 1956 is not attracted.

Question 2

- (a) *Good Luck Ltd. (GCL), a listed company, holds 100% equity of C&S India Ltd. C&S India Ltd. holds 15% stake in C&S USA Ltd. as on 31st March, 2009. Due to poor performance of C&S USA Ltd., Board of directors of GCL and C&S USA Ltd. in their meeting held on 20th May, 2009 had approved merger of C&S USA Ltd. with GCL with effect from 1st April, 2009. The scheme of merger was filed with the Hon'ble High Court of Delhi pursuant to sections 391-394. The Registrar of Companies has raised objections that sanction of the scheme of merger would result in the buying back by the GCL of shares of its subsidiary C&S USA Ltd. and would thereby violate the provisions of sections 42 and 77. Give your comments whether the objection raised by the Registrar of Companies is sustainable in the court of law. (5 marks)*
- (b) *Define 'corporate restructuring'. What are the various kinds of restructuring? (5 marks)*
- (c) *ABC Ltd. proposes to amalgamate with BCD Ltd. In this context, explain how to go about for convening the meeting of the creditors or class of creditors in terms of court's order. (5 marks)*

Answer 2(a)

In the case of *Himachal Telematics Ltd. v. Himachal Futuristic Communications Ltd.* (1996) 86 Comp Cas 325 (Del) a scheme of amalgamation was to be undertaken. However, the transferee company had a subsidiary which was holding shares of the transferor company. An objection was raised that the sanction of the scheme of amalgamation would result in the buying back by the transferee company of shares of its subsidiary and would thereby violate the provisions of Sections 42 and 77 of the Act. Dealing with the argument regarding violation of Section 77, it was held that no violation would result as a consequence of sanctioning the scheme of amalgamation as the transferee company was not buying any of its own shares. However the overall requirement to be satisfied prior to sanctioning a scheme of arrangement would be that the proposed scheme of compromise and arrangement should not be violative of any provision of law. [*Miheer H Mafatlal v Mafatlal Industries Limited* AIR 1997 SC 506.]

Answer 2(b)

The meaning of the term 'Corporate Restructuring' is quite wide and varied. Depending upon the requirements of a company, it is possible to restructure its business, financial and organizational transactions in different forms. Restructuring is a method of changing the organizational structure in order to achieve the strategic goals of the organization or to sharpen the focus on achieving them. The essentials of Corporate Restructuring are efficient and competitive business operations by increasing the market share, brand power and synergies. Simply stating, the expression 'Corporate Restructuring' implies restructuring or reorganizing a company or its business (or one of its businesses) or its financial structure, in such a way as to make it operate more effectively.

Restructuring may be of the following kinds:

Financial restructuring which deals with the restructuring of capital base and raising finance for new projects. This involves decisions relating to acquisitions,

mergers, joint ventures and strategic alliances.

Technological restructuring which involves, inter alia, alliances with other companies to exploit technological expertise.

Market restructuring which involves decisions with respect to the product market segments, where the company plans to operate based on its core competencies.

Organizational restructuring which involves establishing internal structures and procedures for improving the capability of the personnel in the organization to respond to changes. This kind of restructuring is required in order to facilitate and implement the above three kinds of restructuring. These changes need to have the cooperation of all levels of employees to ensure that the restructuring is successful.

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

Answer 2(c)

After receiving the court's order for convening the meeting of creditors or class of creditors as per section 391(1) of the Companies Act, 1956, the meetings are to be held as per directions of the Court under the chairmanship of the person appointed by the Court for the purpose. Normally, the Court appoints a Chairman and alternate Chairman of each meeting. The procedural aspects for convening the meeting of the creditors or class of creditors in terms of court's orders are as follows –

1. The notice and explanatory statement under Section 393 of the Companies Act, 1956 with the form of proxy and specimen advertisement in the newspapers as approved by the Court alone should be issued.
2. Notice shall be issued to all the creditors of the Company or a class of creditors as directed by the Court. Notice should be accompanied by approved draft of the explanatory statement and proxy form.
3. The advertisement of the meeting shall be given in the approved format in newspapers approved by the Court.
4. Keep the venue of the meeting ready for the event.
5. Usually the Court may appoint a chairman for the meeting. Otherwise the Court approves the chairman or any other named director to chair the meetings.
6. The quorum shall be as specified in the direction of the Court.
7. As per Companies Court rules, 1959, even the presence of a proxy is counted for quorum purposes.
8. The meeting shall commence at the appointed time.
9. A copy of the scheme; particulars of creditors, class-wise, copies of notices and other records, financial statements, value of debt due to a creditor should be kept ready.
10. Proper arrangements should be made for voting.
11. When a resolution is put to vote, proper count shall be taken of those who are present and voting.
12. Chairman shall ask the scrutinizer to submit a report on the result of voting and the value thereof.

13. Chairman shall prepare the minutes of the meeting and furnish a report to the Court.

Question 3

- (a) *In Broad Vision Ltd., two acquirers made open offer for acquisition of 20% of its equity capital — one made by Damania and another by British-American Tobacco Plc. UK (BAT Group). In this case, the petitioners sought a writ of mandamus directing SEBI to conduct investigation into violations and particularly under regulation 22 dealing with obligations of acquirer, and thereby to deny permission to the abovementioned two acquirers to proceed with their public offer.*

Will the petitioner get the remedy as applied before the High Court of the State where the registered office of the target company is situated ? Support your answer with justification and case law(s). (7 marks)

- (b) *A takeover bid may either be 'friendly' or 'hostile', it may also be mandatory, partial or competitive. Explain the three types of takeover bids with circumstances and purpose of such bids. (8 marks)*

Answer 3(a)

The High Court of Andhra Pradesh in the case of *M.V. Subramanyam v. Union of India* (2001) 33 SCL-III (A.P.) considered the open offer made by Damania and counter offer made by British American Tobacco P/c UK (BAT group) for acquisition of 20 percent of equity share capital of VST. In this case, the petitioners sought a writ of mandamus directing SEBI to conduct investigation into statutory violations and thereby deny permission to the two acquirers to proceed with public offer. It was held that Regulation 22 dealing with general obligations of acquirer was only directory in nature and there was no merit in contention that non-adherence to time schedule would invalidate letter of offer. It was further stated that the petitioners having failed to establish prejudice caused to shareholders in extending letters of offers or allowing acquirers to acquire would result in unforeseen circumstances, jeopardizing industrial growth or interest of shareholders, petitioners were disentitled to seek mandamus from court.

In view of the above, petitioners were disentitled/denied to seek mandamus from the High Court.

Answer 3(b)

A takeover bid may be a "friendly takeover bid" or a "hostile takeover bid". Bids may be mandatory, partial or competitive bids.

Mandatory Bid

This type of bid has arisen due to regulatory requirement. The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, require acquirers to make bids for acquisition of certain level of holdings subject to certain conditions. Regulations 10, 11 and 12 of the said Regulations contain necessary provisions. A takeover bid is required to be introduced through a public announcement through newspapers. Such requirements arise in the following cases:

- (a) for acquisition of 15% or more of the shares or voting rights;
- (b) for acquiring additional shares or voting rights to the extent of 5% of the

voting rights in any financial year ending on 31st March if such person already holds not less than 15% but not more than 55% of the shares or voting rights in a company;

- (c) for acquiring shares or voting rights, along with persons acting in concert to exercise more than 55% but less than 75% of voting rights in a company.

Partial Bid

Partial bid covers a bid made for acquiring part of the shares of a class of capital where the offeror intends to obtain effective control of the offeree through voting power. Such a bid is made for equity shares carrying voting rights. In other words, the offeror bids for the whole of issued shares of one class of capital in a company other than equity share capital carrying voting rights, partial bids come to the fore. Regulation 12 of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 qualifies partial bid in the form of acquiring control over the target company irrespective of whether or not there has been any acquisition of shares or voting rights in a company. For such acquisitions, it is necessary to make public announcement in accordance with the Regulations.

Competitive Bid

This type of a bid envisages the issue of a competitive bid so that when a bid is announced by a prospective acquirer, if any other person finds interest in acquiring the shares, such acquirer should offer a competitive bid, which can be made through public announcement by any person within 21 days of public announcement of the offer made by the acquirer. No person shall make a competitive bid for acquisition of shares of a financially weak company where once lead financial institution has evaluated the bid and accepted the bid of the acquirer who has made the public announcement in pursuance of Regulation 35 of SEBI Takeover Regulations, 1997.

Question 4

- (a) *According to the Companies Act, 1956, it is clearly understood that there is no difference between the terms 'merger' and 'reverse merger', both are the cases of amalgamation. But in common business parlance, both are quite different. Why is the amalgamation of a particular nature called 'reverse merger' and what are underlying circumstances and benefits for effecting a 'reverse merger'? Discuss. (7 marks)*
- (b) *Registrar of Companies (ROC) while going through the technical scrutiny of the annual report of Gemini Ltd. for the financial year ended on March, 2008 had observed certain irregularities or non-compliance of Schedule VI of the Companies Act, 1956 related to disclosure of 'interest accrued and due on secured loans' and asked information from the company under section 234. The Schedule 3 of the secured loan as given in the annual report of Gemini Ltd. as on 31st March, 2008 is as follows:*

Schedule 3 : Secured Loans	Rupees in Crores	
	As at 31-3-2008	As at 31-3-2007
<i>Debentures :</i>		
<i>10% Non-convertible debentures</i>	—	9.00
<i>From banks and financial institutions :</i>		
<i>Working capital loans</i>	241.00	243.00

Foreign currency loans	5.00	15.00
Rupee term loans	<u>581.00</u>	<u>517.00</u>
	<u>827.00</u>	<u>784.00</u>

ROC in its letter to Gemini Ltd. stated that "as per the provisions of section 211 read with Schedule VI, Part 1 to the Companies Act, 1956, interest accrued and due on secured loans should be included under the appropriate sub-heads under the head secured loans. But it was observed that the company has not separately disclosed the interest accrued and due on the secured loan and thereby violated the provisions of section 211 read with Schedule VI to the Companies Act, 1956. Explain."

Gemini Ltd. in its reply to ROC has given following facts:

"As per provisions of section 211 every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and shall, subject to the provisions of this section, be in the form set out in Part 1 of the Schedule VI to the Companies Act, 1956 or as near thereto as circumstances admit.

As far as not showing the interest accrued and due on secured loans under appropriate sub-head under the head secured loans, we would like to state that the same has been clubbed with secured loan under Schedule 3 of the annual report and we believe that the disclosure is as per the format set out in Part 1 of the Schedule VI or as near thereto and there is no violation of the provisions of section 211 read with Schedule VI to the Companies Act, 1956."

ROC has not agreed with the above views of the Gemini Ltd. and issued show cause notice for violation of section 211 read with Schedule VI to the Companies Act, 1956. In its show cause notice ROC has stated that "whereas during the course of technical scrutiny of the balance sheet as at 31st March, 2008, it has been observed that company has not separately disclosed the interest accrued and due on secured loans separately and as such the balance sheet is not drawn up in accordance with the requirements of provisions of section 211 read with Schedule VI to the Companies Act, 1956. Whereas in view of the above observations, the provisions of section 211 read with schedule VI to the Companies Act, 1956 have been contravened and every officer of the company who is in default have rendered themselves liable to be prosecuted under section 211(7) read with section 209(6).

Now in view of what is stated herein above, every officer in default of the company as the case may be are hereby called upon to show cause as to why legal action under section 211(7) read with section 209(6) should not be taken."

ROC has served notice in terms of section 51 to the Managing Director, Executive Director (Finance) and the Company Secretary.

You as the Vice-President and Company Secretary of the company, prepare a note for the Board on consequences of the situation and remedies, if any.

(8 marks)

Answer 4(a)

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.

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 of the Act 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. However the benefits of carrying forward of the losses and setting of against the profits of the merged entity is subject to conditions contained in section 72A of the Income Tax Act, 1961 read with Rule 9C of the Income Tax Rules. Therefore if the conditions cannot be complied with due to difficulties, companies may plan for a reverse merger such that the loss making company remains to exist even after the amalgamation. The healthy unit loses its name and surviving sick company retains its name. In the context of the Companies Act, 1956 there is no difference between a merger and a reverse merger. It is like any other amalgamation. A reverse merger is also carried out through the High Court route. However, where one of the merging companies is a sick industrial company in terms of the Sick Industrial Companies (Special Provisions) Act, 1985, such merger has necessarily to be through the Board for Industrial and Financial Reconstruction (BIFR). On the reverse merger becoming effective, the name and objects of the sick company (merged company) may be changed to that of the healthy company.

The underlying circumstances generally exist to effect a 'reverse merger' is as below:-

- (i) There is a financially weak company with substantial amount of loss. However, the company has technical competence, and/or brand value but it is financially unviable and needs a financier.
- (ii) A sick company referred under SICA, 1985 to the Board for Industrial Reconstruction (BIFR) for reconstruction of a company and the 'reverse merger' had been approved by BIFR.

The benefits of a reverse merger are as follows:

- The merged company can save income tax on its profit since the company can take advantage of carry forward losses of the loss-making company.
- The accumulated loss of financially weak company and unabsorbed depreciation shall be deemed as accumulated loss and unabsorbed depreciation of the merged company.
- The financially sound company can utilize the technical competence and/or brand value of the financially weak and/or sick company.
- Upon such merger, the merged company can adopt/change the name of the healthy (transferor company) company.

Answer 4(b)

The Board of Directors
Gemini Ltd.

The Schedule VI has categorically defined the sub-heads for the presentation of "SECURED LOANS" in the Balance Sheet (Horizontal Form). The sub-heads of "Secured Loans are given below:

1. Debentures

2. Loans and Advances from banks
3. Loans and advances from subsidiaries
4. Other Loans and advances

Further, in order to give more clarity in the presentation of "Secured Loans" under the above subheads, Part I also provide instructions for classification of liabilities which are as under:-

"Interest accrued and due on Secured Loans should be included under the appropriate subheads under the head "SECURED LOANS".

In the given case, the company has contravened the provisions of section 211 of Companies Act, 1956.

Consequences for contravention of Section 211 of the Companies Act 1956

If any such person as is referred to in sub-section (6) of section 209 fails to take all reasonable steps to secure compliance by the company, as respects any accounts laid before the company in general meeting, with the provisions of Section 211 and with the other requirements of this act as to the matters to be stated in the accounts, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees, or with both:

Persons referred under sub-section (6) of section 209

- where the company has a managing director or manager, such managing director or manager and all officers and other employees of the company; and
- where the company has neither a managing director nor manager, every director of the company

Remedy

The Company can make a compounding application under Section 621A to the Central Government.

Vice President & Company Secretary

Question 5

- (a) *In case of amalgamation, merger, arrangement, de-merger, etc., various courts have pronounced different opinions for valuation of shares of companies involved. In view of such pronouncements, state the principles for valuation with example of two cases. (Name of the case is not essential.)*
(7 marks)
- (b) *Comment on the following in the light of judicial pronouncements:*
 - (i) *Once the exchange ratio is determined by an independent expert in the field of valuation of securities and who has used his expertise to value the exchange ratio, then court has limited jurisdiction to substitute its exchange ratio.* (4 marks)
 - (ii) *In a scheme of arrangement by way of demerger — one of the unsecured creditors took an objection that it will amount to transfer of technology and thereby the terms of supply agreement will be violated. Is the objection maintainable?* (4 marks)

Answer 5(a)

PRINCIPLES FOR VALUATION OF SHARES IN TWO DIFFERENT SITUATIONS

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

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

- (1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.
- (2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company, then value is determined by reference to the dividends, if any, reflecting the profit earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making will ordinarily determine the value.
- (3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.
- (4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set back is temporary, then it is perhaps possible to take the estimate of the value of the shares before set back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.
- (5) Where the company is ripe for winding up, then the break-up value method determines what would be realised by that process.

In the case of Carron Tea Co. Ltd. (1966) 2 Comp Cas 227 (Guj):

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

Answer 5(b)(i)

It was held by the Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* (1996) 4 Comp LJ 124 (SC) that once the exchange ratio of the shares of the

transferee company to be allotted to the holders of shares in the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies. It is also not feasible for the court to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio of the ground that it will be detrimental to their interest.

Answer 5(b)(ii)

The fundamental requirement under Section 391(2) of the Companies Act, 1956 is that the scheme of arrangement should be approved by a requisite majority of shareholders and creditors. The expression 'creditors' should include unsecured creditors too. If the requisite majority of creditors or shareholders had approved the scheme, it will be binding upon the dissentient shareholders or creditors too. An unsecured creditor may raise objections at the hearing of the petition for sanction of the scheme by the Court. SC in *J.K.(Bombay) P Ltd. v New Kaiser I Hind Spinning and Weaving Co Ltd.* [1970] 40 Company Cases 689 held that a scheme is statutorily binding even on the creditors and shareholders who dissented from or opposed to its being sanctioned. In *Sequent Scientific Ltd., In Re* and in *P.I. Drugs and Pharmaceuticals Ltd., in Re*, [2009] 151 Comp Cas 1 (Bom) the Bombay High Court held that the transferee company would step into the shoes of the successor in interest of the transferor company and would be bound by the terms and conditions of the supply agreement and is obliged to comply with the same in its letter and spirit in all respects. In this company Court accepted the contention of the Petitioner companies that the intervenor is neither a creditor nor a shareholder of the transferor company and intervenor cannot have any locus. But in the given question the objection has arisen from an unsecured creditor and he has locus to object.

PART—B

(Answer ANY TWO questions from this part.)

Question 6

- (a) What is meant by 'securitisation' under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)? What are the main motives of securitisation? (5 marks)
- (b) The Government of India is of the opinion that the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 would bring about a financial discipline and reduce burden of NPA's on banks and financial institutions.

The ICICI Bank initiated action under this Act against Mardia Chemicals Ltd. and the later, aggrieved by the Act, challenged the same on the grounds that the Act was loaded heavily in favour of lenders, giving little chance to the borrower to explain their views, therefore is not constitutional and pleaded the following against Union of India:

- (i) *There was no occasion to enact such a draconian legislation to find a short cut to realise NPA's without their ascertainment when there already existed the Recovery of Debts Due to Banks and Financial Institutions*

Act, 1993 (Recovery of Debts 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 of the SARFAESI Act, 2002 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% of the amount claim is deposited with the Debt Recovery Tribunal (DRT).*

State whether the Mardia Chemicals Ltd. will succeed on the stands taken by them. Give reasons. (10 marks)

Answer 6(a)

"Securitisation" means acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise [Section 2(1)(z) on Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002].

It is a process by which the owners of financial assets, such as loans which are illiquid, are able to transfer such assets to a 'special purpose vehicle' ('SPV'), which, in turn, issues tradable liquid securities to investors.

There are two motives for securitisation. One, the securitised assets go off the balance sheet of the originator and so the asset-base is pruned down to that extent, thereby reducing the regulatory capital requirements to support the assets. Second, the asset portfolio is liquidated, releasing cash, which in turn reduces the need for demand and time liabilities that are subject to statutory reserves.

Answer 6(b)

The Hon'able Supreme Court in the case of *Mardia Chemicals Ltd. v. UOI* [2004] 59 CLA 380 (SC) where the facts of the present case were similar held that though some of the provisions of the Act 2002 are a bit harsh for some of the borrowers but on those grounds the impugned provisions of the Act cannot be said to be unconstitutional in the view of the fact that the objective of the 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 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.

The Supreme Court further held as follows:

"Under sub-section (2) of Section 13 of the "The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest, Act, 2002" [SARFAESI Act] it is incumbent upon the secured creditor to serve 60 days notice before proceeding to take any of the measures as provided under sub-section (4) of

Section 13 of the Act. After service of notice, if the borrower raises any objection or places facts for consideration of the secured creditor, such reply to the notice must be considered with due application of mind and the reasons for not accepting the objections, howsoever brief they may be, must be communicated to the borrower."

After this landmark decision of the Supreme Court, sub-section (3A) was introduced under Section 13 of the SARFAESI Act. As per the mandatory concept of borrowers making a representation containing their objections to the enforcement action by the lenders which lenders had commenced by issuing the '60-days' demand notice under Section 13(2) of the SARFAESI Act. If the objections are not acceptable to the lenders, they have to communicate the reasons for non-acceptance of the objections within 1 week of the receipt of the objections.

The Supreme Court had further clarified in the above case that the reasons so communicated by the lenders shall only be for the purposes of the information/knowledge of the borrower without giving rise to any right to approach the DRT under Section 17 of the Act, at that stage.

Thereafter secured creditors are at liberty to proceed to take enforcement measures under Section 13(4) of the SARFAESI Act read with Security Interest (Enforcement) Rules, 2002 [Enforcement Rules].

If a borrower is aggrieved due to any enforcement measure initiated by a secured creditor under Section 13(4) of the SARFAESI Act, Section 17(1) of the SARFAESI Act enables the borrower to file an application before DRT. It is fairly clear that every single action such as possession, letting on lease, selling the secured assets or takeover of management or any other such major action falling under Section 13(4) is certainly liable to scrutiny.

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. Therefore the Court held this provision to be invalid and ordered that it was liable to be struck down.

Question 7

- (a) *There must be strong grounds for liquidating a company as it is the last resort to be adopted and mere allegations would not constitute just and equitable ground for winding-up of a company. Comment. (5 marks)*
- (b) *The Board of directors can refuse to file a petition for winding-up of a company on their own even though members have given authorisation for filing the petition by passing ordinary resolution. Comment. (5 marks)*
- (c) *What do you mean by 'Lok Adalat' under the Legal Services Authorities Act, 1987 and what is the purpose, scope and purview of the same? What is the need of setting-up of Lok Adalats? (5 marks)*

Answer 7(a)

In a petition for winding up under just and equitable clause the petitioner must convince the court not only that there are just and equitable grounds for winding up of the company but also that there is no alternative remedy open to him [Atul Drug House Ltd., In Re, (1971) 41 Com Cases 352 (Guj)].

Further, there must be strong grounds for liquidating a company as it is the last resort to be adopted and mere allegations would not constitute just and equitable ground for winding up of a company. It was held in the case of *K. Venkateshwara Rao v. Phoenix Share & Stock-brokers P. Ltd.*, (2002) 35 SCL 561 (Bom) that where the allegations made by the petitioner, such as non-receipt of notices, absence of minutes, siphoning off of funds and monetary mismanagement, which required deeper investigation under sections 397 and 398 and 402 by the Company Law Board, the Court said that there being the availability of a good remedy under sections 397 and 398, a petition for winding up was not maintainable.

Answer 7(b)

A company may itself present a petition for winding up of a company on any of the grounds mentioned in clauses (a) to (f) of section 433 of the Companies Act, 1956. While a special resolution to wind up enables a company to present a petition under clause (a), such a resolution is not necessary, where the company bases the petition on any of the grounds mentioned in clauses (b) to (f) of section 433 of the Act [*State of Madras v. Madras Electric Tramways Ltd.*, AIR 1956 Mad 131 : (1955) 25 Com Cases 378].

Further, without the authority of the general meeting the directors are not entitled to present a winding up petition in the name of the company. But where the directors have presented such a petition, it is open to general meeting of shareholders to ratify their action. So, in view of the above it seems that the Board of directors cannot refuse to file a petition for winding up if the members have authorized it by passing an ordinary resolution.

Answer 7(c)

The concept of Lok Adalat is of recent origin and is set up under the Legal Service Authorities Act, 1987 (39 of 1987). Where the borrower and the banker are not able to arrive at a compromise, bringing the case before the forum of Lok Adalat can be helpful. Experience has shown that in many cases, particularly where the amount is not large, Lok Adalat has been successful in bringing the borrower to terms by using some kind of social pressure.

The Reserve Bank has advised all scheduled commercial banks and all India financial institutions that they can take up the matter where outstandings are Rs. 10 lakhs and above with Lok Adalats organized by the Debt Recovery Tribunals/Debt Recovery Appellate Tribunals.

Lok Adalats are being organized at different places under the auspices of local judiciary and voluntary organizations with the object of speedy disposal of disputes of different kinds. Bank's claims against its borrowers are also being taken-up by such Lok Adalats. The Indian Banks Association (IBA) has considered the matter relating to participation by banks before Lok Adalats by which cases of banks are settled speedily and also saving legal charges.

Lok Adalats do not have statutory status, as judgements rendered by them do not take the form of a court decree so as to make it binding on the parties. If either of the parties does not give consent for settlement of dispute through Lok Adalat, the Lok Adalat cannot settle the matter.

If a settlement is arrived at, terms thereof are recorded by the Presiding Officer of the Lok Adalat and signed by the parties. If there is no settlement, the matter is left unresolved. While a Lok Adalat can take up all such disputes for consideration, which have not yet reached any court, pending civil suits are also referred to Lok Adalats for decision.

Question 8

- (a) *"It is cardinal principle of law that a person can be insolvent but a company cannot be adjudged insolvent." In the light of this statement, state the reasons why a company can't be adjudged insolvent but, it can be dissolved that too in case it is running in proper health and able to pay its obligation. Further, you are required to differentiate between the 'insolvency of an individual' and 'winding-up of a company' and their legal status during insolvency and winding-up process. (9 marks)*
- (b) *Write short notes on the following :*
- (i) *Cross border insolvency*
 - (ii) *Meaning of 'State' within the UNCITRAL Model Law*
 - (iii) *Requirements and stipulations to become a merchant banker of an acquirer for making a takeover bid. (2 marks each)*

Answer 8(a)

Winding up of a company is a process of putting an end to the life of a company.

Winding up is a process, in which assets of the company are disposed off and its dues are realized. After that its debt are paid off and collections are taken from its members in case of need. If any surplus is left, it is distributed among the members in accordance with their rights.

Prof. L C B Gower defined winding up of a company as the process whereby its life is ended and administered for the benefit of its creditors and members. An administrator called liquidator is appointed and he/she takes control of the company, collects its debts and finally distributes any surplus among the members in accordance with their rights.

The winding up of a company bears an analogy with the insolvency of a company. As a general rule in case of winding up if the members of a company desires that the company should be dissolved or it becomes insolvent or is otherwise unable to pay its debts, or if for any reason it seems desirable that it should cease to exist, it is wound up.

Therefore, in view of the above it is clear that a company may also be wound up even it is perfectly solvent, e.g. for the purpose of reconstruction etc.

Further more, a company can never be declared as insolvent although it is unable to pay its debts. It can only be wound up. Of course, some provisions of insolvency laws are made applicable to companies in liquidation i.e. section 442, 446, 477, 528 to 531 and 534 to 537 of the Companies Act, 1956.

The followings are differences between insolvency of an individual or a firm and winding up of a company:

- (i) In the case of insolvency of an individual, the whole of the insolvent's property is taken out of his hands and rests in the court or the official assignee.

On the other hand, in case of winding up, the property remains vested in the company, subject to its being administered for the purposes of winding up as the company retains its complete existence. Its legal death comes only when it is formally dissolved.

- (ii) In insolvency, an insolvent individual can obtain his discharge and continue living and working free from the burden of his debts. On the other hand, a company in liquidation cannot obtain its discharge and continue free from the burden of its debts. The liquidator winds up its affairs and then terminates it through dissolution.
- (iii) Although, in the administration of the assets of an insolvent company the insolvency rules apply, they are however, not identical with those of insolvency.
- (iv) For individual, administration of his/her property by the official assignee or the official receiver occurs only if he is declared an insolvent by the court. But the assumption of the director's powers by the liquidator occurs even if the company is fully solvent. Liquidation or winding up even of a solvent company can be proceeded with the aid of the court, as in voluntary winding up.

Legal status during insolvency and winding up

In case of winding up, the property and asset of the company belong to the company until dissolution takes place. 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. On the passing of the winding up order, a secured creditor could take action only if he chooses to stand outside the winding up. If a company is in winding up, official liquidator becomes the *custodia legis* of all properties. By virtue of Section 441 of the Companies Act, on the passing of a winding up order the winding up commences with retrospective effect from the date of presentation of the petition for winding up. By virtue of Section 445(3) of the Companies Act, the winding up order operates as a notice of discharge to officers, directors and employees of the company. The Board of Directors would cease to function.

On the other hand, in case of insolvency, the whole of the insolvent's property is taken out of his hands and rests in the court, under the provincial insolvency Act, 1920 or to the official assignee under the presidency towns Insolvency Act, 1909.

An individual after being declared an insolvent is not capable to sue or being sued by any other person.

Answer 8(b)

(i) **Cross border insolvency** issues arise when a non-resident is either a debtor or contributory or creditor of the insolvent Indian company. The other instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State, where the insolvency proceeding is taking place.

(ii) The word "**State**", as used in the preamble and throughout the UNCITRAL 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.

- (iii) Before making any public announcement of offer, for the purpose of making a

takeover the acquirer is required to appoint merchant banker in Category I holding a certificate of registration granted by the Board (SEBI), who is not an associate of or group of the acquirer or the target company. (Regulation 13 of Takeover Regulations)
