

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) It is widely believed that there are several reasons for business growth and expansion for a merged company. Explain at least three such reasons for business growth and expansion which may be achieved by a merged company. (9 marks)
- (b) A company is over-capitalised due to rights issue, bonus issue and allotment of shares to the shareholders of transferor companies. Its share prices have plunged due to floating shares and do not represent its fair value in the market. The management is now thinking to take some corrective measures. The company has sufficient liquid cash at its disposal. State briefly the corrective measures. (6 marks)
- (c) In a scheme of reconstruction, a company may, if its memorandum of association permits, carry out reconstruction following the procedure laid down under section 494, by incorporating a new company specifically for that purpose.
In the given case, the new company bears features which are substantially the same as of the earlier company.
But the shareholders of a transferor company objected to the scheme of reconstruction that the directors were actuated by sinister motive by doing so.
Is the objection sustainable if the objecting shareholders fulfil the formalities of minimum percentage for doing so ? State your answer with case law. (5 marks)
- (d) What is 'strategic planning' ? State its salient features. (5 marks)

Answer 1(a)

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.

Operating Economics

A combination of two or more firms may result in reduction of costs due to operating economies. A combined firm may avoid overlapping of function and facilities. Various functions may be consolidated and duplicate channels may be eliminated by implementing an integrated planning and control system.

The merger of Sundaram Clayton Ltd. (SCL) with TVS Suzuki Ltd. (TSL) was motivated by operating economies and by virtue of this, TSL became the second largest producer of two wheelers. TSL needed to increase its volume of production but also needed a large manufacturing base to reduce its production costs. Large amount of funds would have been required for creating additional production capacity. SCL was also required to upgrade its technology and increase its production. Both the firms' plants were closely located offering various advantages, the most versatile being the capability to share common research and development facilities.

Diversifying the Portfolio

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

Financial Benefits

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

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.

Answer 1(b)

Some of the corrective measures for over capitalization includes the following:

- (a) Buy back of its own shares.
- (b) Paying back surplus share capital to shareholders.
- (c) Repaying of loans to Financial Institutions, Banks, Fixed deposit of Public if any.
- (d) Redemption of debentures, bonds etc.
- (e) Redemption of preference shares, if any.

Answer 1(c)

A company may, if its memorandum of association permits, carry out reconstruction following the procedure laid down in Section 494 of the Companies Act, 1956 by incorporating a new company specifically for that purpose.

This is a well recognised method of reorganisation and restructuring of a company. Where the shareholders of a company approve of such a method of reconstruction or reorganisation of a company, it cannot be said that the directors of the company were actuated by any sinister motive in doing so. [*United Bank of India Ltd. v. United India Credit & Development Co. Ltd. (1977) 47 Comp. Cas. 689 (Cal.)*]

A conjoint reading of sections 391 and 393 makes it clear at once that the Company Court which is called upon to sanction a scheme has not merely to go by the *ipse dixit* of the majority of the shareholders or creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the court has to consider the pros and cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it does not violate any public policy.

No court of law would ever countenance any scheme of compromise or arrangement arrived at between the parties and which might be supported by the requisite majority if the court finds that it is an unconscionable or an illegal scheme or is otherwise unfair or unjust to the class of shareholders or creditors for whom it is meant. It is right to say that once the scheme gets sanctioned by the court it would bind even the dissenting minority shareholders or creditors. Therefore, the fairness of the scheme qua them also has to be kept in view by the Company Court while putting its seal of approval on the concerned scheme. *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, (1996) 87 Com Cases 792 at 812 (SC).

Answer 1(d)

Strategic planning is a management tool, used to help an organisation do a better job to assess and adjust the organisation's direction in response to a changing environment. It is a disciplined effort to produce fundamental decisions and actions that shape and

guide as to what an organisation is, what it does, and why it does, with a focus on the future at the same time.

Strategic planning enables management to improve the chances of making decisions which will stand the test of time, and revising the strategy on the basis of monitoring the progress of R&D and the changes in product-market conditions. A strategic plan is visionary, conceptual and directory in nature.

The salient features of strategic planning are as under:

1. It involves participation of responsible persons at different levels, either directly or indirectly (shared ownership).
2. It is a key ingredient of effective management.
3. It prepares the firm not only to face the future but also to shape the future in its favour.
4. It is based on quality data.
5. It accepts accountability to the community.
6. It helps to avoid haphazardous response to environment.
7. It ensures optimum leveraging of firm's resources at every opportunity.

Question 2

- (a) *Can a lending bank file an appeal/revision application for modification of sanctioned scheme of amalgamation on the basis of the fact that there is a provision in the loan agreement executed between the company and the bank requiring prior approval of the bank before undertaking any steps for amalgamation or reconstruction ? Explain. (4 marks)*
- (b) *Acquirer, target company and merchant banker are duty bound to comply with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 both in letter and spirit. Explain, with relevant provisions of law, consequences in case of violation of provisions of the SEBI regulations. (4 marks)*
- (c) *State, with reasons in brief, whether the following statements are true or false :*
 - (i) *Provisions of the Specific Relief Act, 1963 override the provisions of sections 391 and 392.*
 - (ii) *A scheme, apparently made to merge the profit making company with a loss making company and to take tax advantage, is a valid scheme.*
 - (iii) *Amalgamation between two banking companies is governed solely by the Companies Act, 1956.*
 - (iv) *The transferee company after effecting merger is able to charge to profit and loss account the expenditure incurred wholly and exclusively for the purposes of amalgamation.*
 - (v) *Persons acting in concert (PAC) are individuals/company(ies)/any other legal entities who are acting together for an uncommon objective.*
 - (vi) *Under the SEBI (Substantial Acquisition of Shares and Takeovers)*

Regulations, 1997, it is a voluntary requirement to appoint a merchant banker for acquisition of shares.

- (vii) *The shares of a target company are deemed as 'frequently traded' for pricing purpose if the annualised trading turnover in those shares is more than 5% (by number of shares). (1 mark each)*

Answer 2(a)

In the matter of *Ramco Super Leathers Ltd. v. Dhanalakshmi Bank Limited (2009) Madras High Court*. It was held as follows:

The provisions of Section 391 of the Companies Act 1956 did not mandate holding of the meeting of the creditors in a scheme of arrangement between the company and its members and equally a meeting of the members in a scheme of arrangement between the company and its creditors. Though no specific provision had been made for ascertaining the wishes of the creditors in a scheme of arrangement between the company and its members, the court was entrusted with the duty to ascertain whether the scheme would affect the interest of the creditors to such an extent that the holding of their meeting was essential, and if the court, in appraisalment of the facts and circumstances, opined that the interest of the creditors would be adversely affected if the scheme was approved, then it had to refuse to sanction the scheme since what was involved was public interest.

The banking institutions from which the appellant-company availed different kinds of loan facilities were nationalised banks and also public sector undertaking. Hence, if any loss occasioned to these institutions, it would ultimately affect the public interest.

In the instant case having flouted the binding clauses in the agreement creating the charge and having kept the creditors under darkness as to the entire proceedings of the scheme despite their request for the consortium meeting and also having not placed before the court all material facts, which would enable the court to or not to approve the scheme and all the more when it was apparently clear that the scheme of amalgamation, if approved, would certainly affect the public interest, naturally the secured creditors should have been heard before approval.

The high court refused to interfere with the original order modified by the single judge that the approval to the scheme would be valid and effective subject to the approval by the secured creditors.

Answer 2(b)

Penalty for non-compliance of the provisions of SEBI (Substantial Acquisition of Shares & Takeover) Regulations, 1997, are covered under Regulation 45.

As per regulation 45, failure to carry out obligations under this regulations, may result in the following consequences:

1. The acquirer or any person acting in concert faces the consequences of the escrow amount being forfeited besides penalties.
2. The Board of Directors of Target Company shall be liable for action in terms of regulation and Act.

3. The intermediary (which includes merchant banker) would face suspension or cancellation of registration as member of stock exchange.
4. For any mis-statement to the shareholders or for concealment of material information required to be disclosed to the shareholders, the acquirers or the directors where the acquirer is a body corporate, the directors of the target company, the merchant banker to the public offer and the merchant banker engaged by the target company for independent advice would be liable for action in terms of the regulations and the Act.
5. The penalties stated above may include:
 - (i) Criminal prosecution under section 24 of the SEBI Act.
 - (ii) Monetary penalties under section 15H of the SEBI Act.
 - (iii) Directions under section 11B of the SEBI Act.
 - (iv) Directions under section 11(4) of the Act;
 - (v) Cease and desist order in proceedings under section 11D of the Act;
 - (vi) Adjudication proceedings under section 15HB of the Act.

Answer 2(c)

- (i) **False.** Provisions of the Specific Relief Act does not override the provision of section 391 & 392 of the companies act. In case of *Divya Vasundhara Financier Limited v. KN Samant (1990) 69 Comp. Cases*, it was held that the court while passing an scheme of arrangement under section 391 can also pass order of eviction against a person who prima facie does not have any right, title or interest in the property by issuing suitable directions.
- (ii) **True.** In case of *Bihari Mills Ltd. (1985) Comp Cas Guj.*, it appeared to the court that the scheme was by way of, what is known as commercial world as a reverse takeover which means that a profit making company merges itself into a loss making company for the purpose of having advantage for tax purpose of examining that the scheme is not that reason against public interest and for evasion of taxes. On the facts court found that the scheme was bona fide commercial nature, reasonable and fair.
- (iii) **False.** Amalgamation of one banking company with another banking company is governed by the provisions of Banking Regulation Act, 1949. Section 44A of the Banking Regulation Act, 1949 provides for procedure of amalgamation of two banking companies.
- (iv) **False.** Section 35DD of Income Tax Act, 1961 provides that, expenditure, wholly and exclusively for the purposes of amalgamation, the assessee is only allowed a deduction of an amount equal to 1/5th of such expenditure for each of the 5 successive previous years in which the amalgamation takes place.
- (v) **False.** Persons acting in concert (PAC) are acting for common objectives. As per SEBI(Substantial Acquisition of shares and takeovers) Regulations 1997, person acting in concert comprises persons who, for a common objective or

purpose of substantial acquisition of shares or voting rights or gaining control over the target company, pursuant to an agreement or understanding (formal or informal), directly or indirectly co-operate by acquiring or agreeing to acquire shares or voting rights in the target company or control over the target company.

- (vi) **False.** It is a mandatory requirement to appoint category I merchant banker who is not associate of or group of acquirer or target company.
- (vii) **True.** Shares shall be deemed to be infrequently traded if on the stock exchange, the annualised trading turnover in that share during the preceding six calendar months prior to the month in which the public announcement is made is less than five per cent (by number of shares) of the listed shares. Thus if turn over is more than 5% by number of such shares, it is deemed as frequently traded.

Question 3

- (a) *By analysing a balance sheet of Aadarsh Ltd., it was found that there are plethora of reserves in the balance sheet for the year ended 31st March, 2009, and the reserves are summarised below :*

- (i) *Investment fluctuation reserve*
- (ii) *Statutory reserve*
- (iii) *Securities premium account*
- (iv) *General reserve*
- (v) *Foreign currency fluctuation reserve*
- (vi) *Dividend equilisation reserve*
- (vii) *Dividend redemption reserve (preference shares)*
- (viii) *Capital, redemption reserve.*

Now, the Chairman of Aadarsh Ltd. asks you as a Company Secretary to know which of the above reserves can be utilised for the proposed buy-back of shares of the company. Advise. (4 marks)

- (b) *A company wants to demerge its unrelated business to a newly formed company with a purpose of selling the demerged company. However, the company presented a scheme of arrangement/demerger before the court and fixed an 'appointed date' before incorporation of the new company to which unrelated business will go. The Central Government raised objection that the 'appointed date' (i.e., on which date all assets and liabilities will transfer to the demerged company) cannot be transferred before the incorporation of the resulting company. Is the objection of the Central Government sustainable ? State your answer with case law.* (4 marks)
- (c) *Regulation 22 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 puts certain obligations upon the acquirer. At the same time, the duty of SEBI is to issue directions only. An aggrieved person applied to the court for writ of mandamus to SEBI to conduct enquiry for irregularities committed by the acquirer. Will the petitioner succeed ? State with relevant case law.* (4 marks)

- (d) *State government has power to impose stamp duty on transfer of properties under the order of amalgamation. Briefly comment with case law. (3 marks)*

Answer 3(a)

Aadarsh Ltd., can utilize the following reserves for the proposed buy-back of shares:

- (i) Investment fluctuation reserve
- (ii) Securities premium account
- (iii) General reserve
- (iv) Foreign currency fluctuation reserve (provided it is not in the nature of provision)
- (v) Dividend equalization reserve.

Answer 3(b)

Appointed date means the date for identification of assets and liabilities of existing company for transfer to new company. This identification is done on the basis of the audited balance sheet of the existing company for the financial year.

In the case of *HCL Hewlett-Packard Ltd.*, the Central Government had raised the objection in approving of the scheme of arrangement for spin-off the company's division with new company that the "appointed date" under the scheme for transfer of division was falling prior to incorporation of new company. The court over ruled the objection by distinguishing the "appointed date" from "effective date". This appointed date is relevant for fixation of the share valuation/share exchange rate which the company would offer to the existing shareholders after bifurcation and spinning off of the divisions.

All the assets are sought to be transferred to the new company as were on the 'appointed date'. The appointed date is to be distinguished from the 'effective date', which was the date on which all consents and approvals required under the scheme were to be obtained and transfer effected. Hence, objection that the appointed date under the scheme is falling prior to incorporation of new company is not sustainable, and the scheme was approved.

Answer 3(c)

In a similar case, 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 Damanis 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. The acquirer and the persons acting in concert with him are jointly and severally responsible for fulfilment of obligations under the regulations.

Answer 3(d)

The Supreme Court has held in *Hindustan Lever v. State of Maharashtra* (2004) CLC 166 : (2004) 1 Comp LJ 148 (SC), that the amalgamation scheme sanctioned by the court would be an "Instrument", within the meaning of Section 2(i) of the Bombay Stamp Act, 1958, which transfers the properties from the transferor company to the transferee company and the State Legislature has the legislative competence to impose stamp duty on the order of amalgamation passed by a court. Further, it was held that the word "*inter vivos*" appearing in Section 5 of the Bombay Stamp Act, in the context of Section 394 of the Companies Act would include within its meaning a transfer between two 'juristic persons' or a transfer in which a 'juristic person' is one of the parties.

Question 4

- (a) *What are the safeguards incorporated in the takeover process so as to ensure that shareholders get their payments under the offer/receive back their share certificates ?* (4 marks)
- (b) *Can the Central Government amalgamate two companies in the public interest? Explain with the relevant provisions of law and process.* (4 marks)
- (c) *What should be the minimum price for creeping acquisition ? Explain with relevant provisions of law.* (4 marks)
- (d) *Can an acquirer withdraw the offer once made ? Give reasons.* (3 marks)

Answer 4(a)

Regulation 28 requires the acquirer to open an escrow account as a security for performance of his obligations in terms of the public offer. The merchant banker is required to confirm that the financial arrangements are in place for fulfilling the obligations. The amount will be refunded or used for timely fulfilment of the obligations and forfeited if offer is not completed. This is a strong deterrent against frivolous takeover offers and secures interest of the public shareholders. The acquirer can exercise the option of tendering bank guarantee or approved securities in escrow account instead of cash. Similarly, approved securities with appropriate margins are to be deposited with the merchant banker with the authority to realize the value of such escrow account, by sale or otherwise and if any deficit occurs, the merchant banker shall be liable to make good such deficit. If the acquirer deposits cash with a scheduled bank, acquirer has to authorize the bank to act on any instructions given by merchant banker in respect of said account. SEBI has been empowered to forfeit the escrow account, either in full or in part in the event of non-fulfilment of obligations by the acquirer.

Answer 4(b)

Section 396 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate. If the

Government is so satisfied, it may pass an order providing for the amalgamation of those companies into a single company.

The Central Government may exercise the power under section 396, of its own motion without any application being received from the companies wanting to amalgamate. There is no bar to the exercise of that power by the Government on such application.

The order of the Central Government under this section may provide for amalgamation of companies into a single company with such constitution, such property, powers, rights, interests, authorities and privileges; and such liabilities, duties, and obligations as may be specified in the order. The order passed by the Government must be published in the Official Gazette.

If the Government decides to order amalgamation of companies under this section, it must ensure that the following requirements are complied with in regard to the proposed order:

- (a) a copy of the proposed order has been sent in draft to each of the companies concerned;
- (b) the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and
- (c) the Central Government has considered, and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof. [Section 396(4)].

Copies of every order made under this section shall, as soon as may be after it has been made, be laid before both Houses of Parliament. [Section 396(5)].

Answer 4(c)

As per Section 20A of Substantial Acquisition of Shares and Takeovers (SAST) Regulations, 1997, an acquirer who has made a public offer and seeks to acquire further shares under sub-regulation (1) of regulation 11 shall not acquire such shares during the period of 6 months from the date of closure of the public offer at a price higher than the offer price.

Answer 4(d)

As per Regulation 27 of SEBI Substantial Acquisition of Shares and Takeovers (SAST) Regulations the offer once made cannot be withdrawn except in the following circumstances:

1. Statutory approval(s) required have been refused;
2. The sole acquirer being a natural person has died;
3. Such circumstances as in the opinion of the Board merits withdrawal.

Question 5

(a) Describe any three of the following :

- (i) Cross border takeover
- (ii) Demerger by agreement
- (iii) Non-performing assets
- (iv) Accounting Standard-14.

(3 marks each)

(b) Distinguish between any two of the following : .

- (i) 'Reduction of capital' and 'diminution of capital'.
- (ii) 'Split-off and 'split-up',
- (iii) 'Mandatory bid' and 'competitive bid'.

(3 marks each)

Answer 5(a)(i)**Cross border takeover**

Cross border takeovers are takeovers beyond national territory. 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.

Companies go in for international acquisitions for a number of strategic or tactical reasons such as the following :

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

Answer 5(a)(ii)**Demerger by agreement**

Demerger by agreement : A demerger may be affected by agreement where the

demerged company spins off its specific undertaking to a resulting company, formed with another name in such a manner that –

1. 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.
2. All the liabilities relatable to the said undertaking, being transferred by the demerged company, immediately before the demerger, becomes the liabilities of the resulting company by virtue of the demerger.
3. The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportional basis.

Answer 5(a)(iii)

Non-performing assets

Non-performing assets means an asset or account of a borrower which has been classified by a bank or financial institution as sub-standard, doubtful or loss assets:

- In case such bank or financial institution is administered or regulated by an authority or body established 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.
- In any other case, in accordance with the directions or guidelines relating to asset classifications issued by the Reserve Bank.

Answer 5(a)(iv)

Accounting Standard-14

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.

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

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

Answer 5(b)(i)

‘Reduction of capital’ and ‘diminution of capital’

Reduction of Capital means reduction of issued, subscribed and paid up capital of the Company. Section 100 provides for reduction of share capital, if there is an enabling provision in the Articles of Association of the company. A company may resort to reduction of capital to restructure its capital to clean balance sheet by reducing business losses, heavy capital expenditures etc. The company need to seek confirmation of the Court to reduce its capital. There are following ways to reduce capital of the company, namely:

1. By reducing or extinguishing the liability of members in re. of uncalled or unpaid capital;

2. By paying off or returning paid up capital not wanted for the company;
3. By conditional pay off of un paid capital;
4. By combination of any of the above method;
- 5.. By writing off or cancelling the capital lost or unrepresented by assets of the company.

In following cases diminution of Capital shall not mean reduction of capital such as

1. Cancellation of shares which have not been taken or agreed to be taken by any person under section 94(l)(e);
2. Redemption of redeemable preference shares u/s 80;
3. Buy back of shares u/s 77A of the Act.

Answer 5(b)(ii)

‘Split-off’ and ‘split-up’

In a split-off, some of the shareholders in the parent company are given shares in a division of the parent company, (usually a subsidiary) which is split-off in exchange for their shares in the parent company. It alters ownership proportions in both companies. Part of subsidiaries equity shares could also be sold of to public.

A corporate action in which a single company splits into two or more separately run companies. Shares of the original company are exchanged for shares in the new companies. This is an effective way to break up a company into several independent companies. After a split-up, the original company ceases to exist.

Answer 5(b)(iii)

‘Mandatory bid’ and ‘competitive bid’

Mandatory Bid: SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, requires conditional bidding for acquisition of certain level of holdings. Relevant Regulations are Regulation 10,11 and 12 of SEBI Substantial Acquisition of Shares and Takeovers (SAST) Regulations, 1997. A takeover bid is required to be made through newspaper announcement in the following cases namely: 1. acquisition of 15% or more shares or voting rights; 2. acquiring additional shares or voting rights to the extent of 5% of the voting right in any Financial year ending March 31, if such person already hold not less than 15% but not more than 55% of the shares or voting right in the company; 3. acquiring shares or voting rights along with person acting in concert to exercise more than 55% but less than 75% of the voting rights in a company; 4. acquiring control over a company.

Competitive Bid: According to Regulation 25 of the SAST, if any person wants to make a competitive bid, the same need to be made within 21 days of the public announcement of the offer made by the acquirer. Any competitive offer by the bidder shall be such number of shares which taken together with the shares held by person acting in concert, shall be at least equal to the holding of the first bidder.

PART B

(Answer **ANY TWO** questions from this part)

Question 6

- (a) *"A company is also a person in the eye of law and can be adjudged as insolvent."*
Comment. (5 marks)
- (b) *Is the Registrar of Companies capable of making a petition for winding-up of a company ? If so, on what grounds ?* (5 marks)
- (c) *Explain the immunities provided to a sick industrial company under the Sick Industrial Companies (Special Provisions) Act, 1985.* (5 marks)

Answer 6(a)

As a general rule of law, a company cannot be adjudged as insolvent like a person, but a company may be wound up if the company is unable to pay its debts.

Apart from that, if the members of a company desire that the company should be dissolved or if it becomes insolvent or is otherwise unable to pay its debts or if for any reason it seems desirable that it should cease to exist, it may wound up.

Therefore, it is obvious that a company may be wound up even when it is perfectly solvent, e.g. for purpose of reconstruction. Further more, a company can never be declared as bankrupt, although it is unable to pay its debts.

Answer 6(b)

The Registrar may, with the previous sanction of the Central Government present a petition for winding up of a company but only on the following grounds, namely:

- (i) if default is made by the company in delivering the statutory report to him or in holding a statutory meeting. It may be reiterated that on this ground no one except the Registrar or a contributory can petition;
- (ii) if the company does not commence its business within one year from its incorporation or suspends its business for a whole year;
- (iii) if it appears to him either from the financial condition of the company as disclosed in the balance sheet or from the report of a special auditor or an inspector that the company is unable to pay its debts;
- (iv) where the Registrar is authorized by the Central Government under Section 243 to present a petition for winding up;
- (v) where the number of members of the company has fallen below the statutory minimum; i.e., below seven in case of public company and below two in case of private company.
- (vi) where it is just and equitable that the company be wound up.

In all these cases the Registrar has to obtain previous sanction of the Central Government to the presentation of a petition. With regard to previous sanction, the

Central Government will not grant it to the Registrar to present petition for the winding up of a company without first giving the company an opportunity to make its representation, if any.

Answer 6(c)

Immunities to a sick industrial company has been granted under the provisions of section 22 of the SICA, 1985.

They include the followings namely: 1. no fresh proceeding and stay of existing proceedings for the winding up or for execution, distress or the like against the company'; 2. no enforcement of any security or guarantee given in relating to the sick industrial company. 3. no suit for recovery of money, stay on fresh or existing a properties of the industrial company or for appointment of receiver. Above protections/immunities are available to sick industrial company in the following circumstances namely-

1. an inquiry under section 16 is pending,
2. any scheme is referred under section 17 for preparation or consideration;
3. scheme is under implementation or
4. where an appeal is pending under section 25 of the Act.

The Sick industrial company fulfilling any of the above criterion becomes eligible for the protection, unless ordered by the BIFR otherwise. BIFR also have authority to pass an order and declare with respect to the sick industrial company that the operation of all or any contracts, awards, instruments etc shall remain suspended or that all or any rights, privileges, obligations and liabilities accruing or arising there under before the said date, shall remain suspended or shall be enforceable with such adaptations and in such a manner as may be specified by BIFR. Such declaration shall not be made for a period of two (2) years and may be extended for one (1) year at a time, for a total period of seven (7) years in aggregate. Immunities and protections have superseding effect against the provisions of, order made under and operation of the companies and other Act. However, section 22 does not grant immunity against the criminal proceedings against the company or its directors.

Question 7

- (a) *Briefly explain the mechanism for the enforcement of security interest by a secured creditor under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.* (7 marks)
- (b) *Briefly describe the role of professionals in the insolvency process.* (4 marks)
- (c) *Briefly describe the insolvency or bankruptcy laws as applicable in United States of America.* (4 marks)

Answer 7(a)

Under Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter Securitisation Act) Secured creditor can enforce his security interest without intervention of the court. Secured creditors have been defined to mean banks or financial Institutions or any consortium or group of

banks or financial institutions and includes debenture trustees appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding security on behalf of bank or financial institution in whose favour due interest has been created for repayment by any borrower of any financial assistance. In case of the default in instalment by the borrower and debts becoming Non-performing Asset (NPA)., Secured creditor has two options. It can, after giving opportunity to repay debts with interest and other charges, either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act. Section 13(4) prescribes the recourses, which secured creditor can invoke namely:

1. take possession of the secured assets of the borrower including right to transfer by way of lease, assignment, or sale for realizing the debts;
2. takeover the management of secured assets of the borrower including right to transfer by way of lease, assignment or sale;
3. appoint any person to manage the secured assets;
4. recover any actionable claims of the borrower for recovery of secured debts.

In case of joint or multiple lending arrangements, 75% of the secured creditors need to agree for the initiation of the aforesaid proceedings. In case of a company under liquidation, secured creditor either participate in the proceeding and recover after overriding preferential payment of workers or he may opt for retention of the sale proceed after depositing the workers dues under section 529A. In case, dues of the secured creditors could not be satisfied in full, secured creditor may file application before Debt Recovery Tribunal (DRT) for recovery of balance amount. Secured creditor is also entitled to proceed against the guarantor or sale of pledge assets for its recovery.

Answer 7(b)

The concept of insolvency practitioners was recommended by the Irani Committee. Currently the law does not support effective participation of professionals and experts in the insolvency process. Disciplines of chartered accountancy, company secretaryship, cost and work accountancy, law etc. can act as feeder streams, proving high quality professional for this new activity.

In fact private professionals can play a meaningful role in all aspects of process. Insolvency practice can also open up a new field of activity for service professionals while improving the quality of intervention at all levels during rehabilitation/ winding up/ liquidation proceedings. Law should encourage and recognize the concept of Insolvency Practitioners, Greater responsibility and authority should be given to them under the supervision of the Tribunal to maximize resource use and application of skills.

The committee observed that by incorporating this recommendation, there would be a revolutionary change in the Indian Insolvency System by bringing it at par with the international standards and provide opportunities to participate and perform various roles in the insolvency process.

Answer 7(c)

The US has parallel system of insolvency/bankruptcy laws, one at federal level and another at state level. Federal Law (Bankruptcy code) prohibits domestic or foreign

insurance companies, banks, saving/loan associations, small business investment companies and similar insured institutions from filing their bankruptcy application. Consequently, they can file their application under the concerned State Law. Bankruptcy code establishes mainly two types of cases namely:

1. liquidation or straight bankruptcy;
2. reorganisation or rehabilitative cases.

Under liquidation, a trustee is automatically appointed by the office of the US Trustee. However, in reorganisation cases, debtor remains in possession of the business and manages its affairs as it did prior to filing of bankruptcy. A plan of reorganisation may be confirmed by the Bankruptcy court, subject to certain conditions/exception, in the following cases namely:

When creditors or equity holders of each class accept the plan by two third in value of the claim/equity and half of the claims/equity interest in number, or when at least one impaired class votes in favour of the plan and the plan is fair and equitable with respect to the remaining classes.

Question 8

- (a) *Though UNCITRAL Model Law is not a substantive law, yet it recommends protection to creditors and other interested persons. Briefly describe the protections provided under the UNCITRAL Model Law. (4 marks)*
- (b) *Main object of 'asset reconstruction company' (ARC) is to act as an agent for banks and financial institutions. Briefly explain with relevant provisions of law. (4 marks)*
- (c) *Can a company make winding-up petition ? If so, what is the procedure of making petition for winding-up ? (4 marks)*
- (d) *Define 'securitisation' and explain its motives. (3 marks)*

Answer 8(a)

UNCITRAL Model Law (hereinafter "the Model Law") in its preamble mention that objects of the Model Law is not to create substantive rights but to give general orientation for users of the Model Law and to provide effective mechanism to deal with cross border insolvency. Model Law contains following provisions for protection of the creditors, the debtors and other affected persons:

1. temporary relief upon application for recognition of a foreign proceeding or upon recognition, which is at the discretion of the Court, on being satisfied that interest of the creditors and other interested persons are adequately protected;
2. the court may grant relief subject to the conditions, as it thinks fit;
3. the Court may modify or terminate the relief granted, if so requested by a person affected thereby.

Model Law further provides that in case of actions are manifestly contrary to the public policy of the enacting state, the court may refuse taking any action under the Model Law.

Answer 8(b)

Reconstruction company means a company incorporated under provisions of Companies Act, 1956 for purpose of assets reconstruction.

The problem of non-performing loans created due to systematic banking crisis world over has become acute. Focused measures to help the banking systems to realise its NPAs has resulted into creation of specialised bodies called asset management companies which in India have been named asset reconstruction companies ('ARCs'). The buying of impaired assets from banks or financial institutions by ARCs will make their balance sheets cleaner and they will be able to use their time, energy and funds for development of their business. ARCs may be able to mix up their assets, both good and bad, in such a manner to make them saleable.

The main objective of asset reconstruction company ('ARC') is to act as agent for any bank or financial institution for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers' asset taken over by banks, or financial institution, to act as the receiver of properties of any bank or financial institution and to carry on such ancillary or incidental business with the prior approval of Reserve Bank wherever necessary. If an ARC carries on any business other than the business of asset reconstruction or securitisation or the business mentioned above, it shall cease to carry on any such business within one year of doing such other business.

Answer 8(c)**Winding up Petition by Company**

The company may make a petition through its directors with the authority of a special resolution passed at a general meeting. It may also, apply to liquidator if it is being wound up voluntarily. The directors may, on their authority present a petition on behalf of the company. However, when the ground for winding up is that the company has passed special resolution, the petition must be presented by the company itself.

Answer 8(d)

"Securitization" means acquisition of financial assets by any securitization company or reconstruction company from any originator, whether by raising of funds by such securitization 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)]. Securitization company means any company formed and registered under the Companies Act, 1956 for the purpose of securitization [Section 2(l)(Za)].

Securitization is the issuance of marketable securities backed not by the expected capacity to repay of a private corporation or public sector entity but by the expected cash flows from specific assets.

Simply stating securitization is the process by which the 'originators' of assets like loans which are illiquid are able to transfer such assets to a 'special purpose vehicle' (SPV), which in turn, issues tradable liquid securities to the investors. These transactions can be structured with a wide variety of 'credit enhancement' to make the deals attractive for investors.

There are two motives for securitization. One the securitized 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.
