

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) "As per provisions of the Companies Act, 1956, there is no difference between a merger and a reverse merger. But in common parlance, it means rightward and leftward, i.e., totally opposite to one another, but ultimate objective remains the same, i.e., revival of business of unhealthy company and enjoying tax benefits." Discuss it in practical scenario. What are the social objectives to provide tax incentives with reference to section 72A of the Income-tax Act, 1961 ? (10 marks)
- (b) State whether the following statements are true or false citing relevant provisions of the law :
- (i) Reorganisation of capital through a scheme of compromise or arrangement under section 391 can cover reorganisation of reserves and surplus.
 - (ii) Amalgamation cannot be sanctioned by the court when the transferee company's objects do not cover business of the transferor company which the former proposes to carry on after the amalgamation.
 - (iii) Any dissenting shareholder may apply to the court to seek an order to the effect that the scheme shall not be binding on him despite that it has been accepted by 90% of the shareholders.
 - (iv) Where a large number of creditors have not been given the notice, the scheme cannot be considered by the court for its sanction even if it has been passed by a three-fourths majority of the creditors who attended the meeting.
 - (v) The books and papers of a company which has been amalgamated with or whose shares have been acquired by another company shall not be disposed of without the prior permission of the Central Government.
 - (vi) A public offer once made shall be withdrawn when the statutory approvals required have been refused.
 - (vii) A promoter of the company may within three working days from the date of creation of pledge on shares of that company held by him, inform the details of such pledge of shares to that company. (1 mark each)
- (c) What are the broad principles that can be considered by the court while sanctioning the scheme of compromise or arrangement ?

(4 marks)

(d) "Strategies exist at several levels in any organisation." Comment. (4 marks)

Answer 1(a)

Reverse merger takes place when a healthy company merges with a financially weak company. However, in the context of the Companies Act, there is no distinction between a merger or a reverse merger because in either case one company merges with another company irrespective of the fact whether the merging or the amalgamating company is financially weaker or stronger.

Reverse merger like any amalgamation or merger is carried out through the High Court route under the provisions of Sections 391 to 394 of the Companies Act, 1956. However, if one of the companies in this exercise is a sick industrial company, its merger or reverse merger should also comply with the provisions of SICA and must take place through BIFR. On the reverse merger of a sick industrial company becoming effective, the name of the sick industrial company may be changed to that of the healthy company and the transferee company becomes entitled to the benefit of carry forward and set off of the accumulated losses and unabsorbed depreciation of the transferor company.

Section 72A was introduced in the Income Tax Act, 1961, to save the Government from the social costs in terms of loss of national output/production and loss of employment, and also to relieve the Government of the uneconomical burden of taking over and running sick industrial units.

Answer 1(b)

- (i) **True.** Reorganization of capital through a scheme of compromise or arrangement under section 391 can cover reorganization of reserve and surplus besides reorganization of share capital, as reserves and surpluses is part of shareholders' funds.
- (ii) **False.** There need not be unison or identity between objects of transferor company and transferee company. Companies carrying entirely dissimilar businesses can amalgamate. [*Re: PMP Auto Inds Ltd.* (1994) 80 Comp Cas 291 (Bom); *Re: EITA India Ltd.* (ibid); *Re: Mcleod Russel (India) Ltd.* (1997) 13 SCL 126(Cal)].
- (iii) **True.** Section 395 of the Companies Act, 1956 empowers dissenting shareholder to apply to the Court to seek an order to the effect that the scheme shall not be binding on him despite that it has been accepted by 90% shareholders.
The mere fact that the overwhelming majority of shareholders had accepted the offer as fair does not necessarily establish that an action of a dissentient shareholder alleging that the offer was unfair stands no prospect of success. Such action may not be as obviously unsustainable as to amount to an abuse of process. *Britol Ltd.*, Re, 1990 BCLC 70 (CA).
- (iv) **True.** Where a large number of creditors have not been given the notice, the scheme can not be considered by the Court for its sanction even if it has been passed by three-fourths majority of the creditors who attend the meeting.

Notice of the meeting should be sent under certificate of posting to the creditors/ members of the company, at their last known addresses at least twenty-one

clear days before the date fixed for the meeting. The notice must be accompanied by a copy of the scheme for the proposed compromise or arrangement and of the statement required to be furnished under Section 393 setting forth the terms of the proposed compromise or arrangement explaining its effects and an explanatory statement in terms of the provision of clause (a) of Sub-section (1) of Section 393 of the Companies Act.

- (v) **True.** As per Section 396A of the Companies Act, 1956, the books and paper of a company which has been amalgamated with or whose shares have been acquired by another company shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the first mentioned company or its amalgamation or the acquisition of its shares.
- (vi) **True.** As per Regulation 27 of SEBI (Substantial Acquisition of Share and Takeover) Regulations, 1997 no public offer, once made, shall be withdrawn except when the statutory approval required have been refused; the sole acquirer, being a natural person, has died; and there are such circumstances which in the opinion of SEBI merits withdrawal.
- (vii) **False.** As per Regulation 8A of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 a promoter of the company may within 7 working days from the date of creation of pledge on shares of that company held by him, inform the details of such pledge of shares to the company.

Answer 1(c)

Broad Principles evolved by Courts in Sanctioning the Scheme

- (a) The resolutions should be passed by the statutory majority in accordance with Section 391(2) of Companies Act, at a meeting(s) duly convened and held. The court should not usurp the right of the members or creditors;
- (b) Those who took part in the meetings are fair representative of the class and the meetings should not coerce the minority in order to promote the adverse interest of those of the class whom they purport to represent;
- (c) The scheme as a whole, having regard to the general conditions and background and object of the scheme, is a reasonable one; it is not for court to interfere with the collective wisdom of the shareholders of the company. If the scheme as a whole is fair and reasonable, it is the duty of the court not to launch an investigation upon the commercial merits or demerits of the scheme which is the function of those who are interested in the arrangement;
- (d) There is no lack of good faith on the part of the majority;
- (e) The scheme is not contrary to public interest;
- (f) The scheme should not be a device to evade law.

Answer 1(d)

Strategies exist at several levels in any organisation – ranging from the over all business (or group of business) to individuals working in it. Strategies can be visualised to operate at three different levels viz. Corporate level, divisional or business level and operational or functional level.

Corporate Level Strategy

Corporate strategy is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily influenced by investors in the business and acts to guide strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a “mission statement”.

Divisional/Business Level Strategy

Strategies at divisional levels are sub-strategies. They emanate from grand strategies and they have to necessarily devolve from the grand strategies. They have to operate within the framework of the grand strategy. They have market orientation because sub-strategies deal with the current and future product lines and current and future markets including overseas businesses.

Operational Strategy

Sub-strategies that are undertaken at the operational or functional level target the departmental or functional aspects of the operations. Operational strategy is concerned with how each part of the business is organized to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people etc. Success of grand strategies is largely dependent upon the successful implementation of strategic decisions regarding activities at the operational level.

Question 2

- (a) *New Ltd., the transferee company having paid-up share capital of 1,00,000 equity shares of ₹10 each, fully paid-up, at ₹10,00,000 and Old Ltd., the transferor company having paid-up capital of 50,000 equity shares of ₹10 each, fully paid-up, at ₹ 5,00,000, out of which, 10,000 equity shares were held by New Ltd. (the transferee company). The Hon'ble High Court passed the scheme of amalgamation with a swap ratio of 1:1. How many new shares of New Ltd. are to be issued to the public shareholders of Old Ltd. ? Show calculations.*
- (7 marks)*
- (b) *Is it possible at the instance of Hon'ble High Court to approve a scheme of amalgamation/arrangement without convening a meeting of shareholders and creditors ? If possible, state the circumstances and alternatives.*
- (5 marks)*
- (c) *On which grounds/compliances, amalgamation between holding and subsidiary companies be exempted from payment of stamp duty under the Indian Stamp Act, 1899 in case of order made by court under sections 391-394 ?*

(3 marks)

Answer 2(a)

Total paid up capital in New Ltd. (Transferee company) (1,00,000 equity shares of ₹ 10 each)	₹ 10,00,000
Total paid up capital in Old Ltd. (Transferor company) (50, 000 equity shares of ₹ 10 each)	₹ 5,00,000
Holdings by New Ltd. in Old Ltd. (10,000 equity shares of ₹ 10 each)	₹ 1,00,000
Net number of shares to be issued by New Ltd. to the Public holders of Old Ltd.	
Total shares of Old Ltd.	50,000
Less : Shares held by New Ltd.	10,000
	<u>40,000</u>

Swap ratio being 1:1, 40,000 new equity shares to be issued by the New Ltd. for the public shareholders in the Old Ltd.

Answer 2(b)

In *Re Feedback Reach Consultancy Services (P) Ltd.* (2003) 52 CLA 260: (2003) CLC 498: (2003) 42 SCL 82: (2003) 115 Comp Cas 897 (Del). Court held that where the written consent to the proposed scheme is granted by all the members and secured and unsecured creditors, separate meeting of members and secured and unsecured creditors can be dispensed with.

Answer 2(c)

Amalgamation between Holding and Subsidiary Companies — Exemption from payment of Stamp Duty in a case:

- (i) where at least 90 per cent of the issued share capital of the transferee company is in the beneficial ownership of the transferor company, or
- (ii) where the transfer takes place between a parent company and a subsidiary company one of which is the beneficial owner of not less than 90 per cent of the issued share capital of the other, or
- (iii) where the transfer takes place between two subsidiary companies each of which not less than 90 per cent of the share capital is in the beneficial ownership of a common parent company:

Provided that in each case a certificate is obtained by the parties from the officer appointed in this behalf by the local Government concerned that the conditions above prescribed are fulfilled.

Therefore, if property is transferred by way of order of the High Court in respect of the Scheme of Arrangement/Amalgamation between companies which fulfill any of the above mentioned three conditions, then no stamp duty would be levied provided a certificate certifying the relation between companies is obtained from the officer appointed

in this behalf by the local Government (generally this officer is the Registrar of Companies).

However, stamp being a state subject, the above would only be applicable in those states where the State Government follows the above stated notification of the Central Government otherwise stamp duty would be applicable irrespective of the relations mentioned in the said notification.

Question 3

- (a) *Where an acquirer/company intends to takeover another company through acquisition of 90% or more in terms of its paid-up equity share capital, in such circumstances, what type of handicap/plight is suffered by the miserable minority shareholders? What are the possible ways of exit from such miserable situation and get a win-win position for the acquirer/company and the minority shareholders? What are the safeguards/uniqueness of using the procedure? (Detail procedure of section 395 not required.)* (8 marks)
- (b) *Buy-back of securities by a cash-rich company is so far used as a potential weapon for capital restructuring and increasing shareholders value. But companies are restricted to use this procedure under some circumstances. State the situation and circumstances.* (7 marks)

Answer 3(a)

When one Company has been able to acquire more than 90% control in another Company, the shareholders holding the remaining control in the other Company are reduced to a miserable minority. They do not even command a 10% stake so as to make any meaningful utilization of the power. Such minority can not even call an extraordinary general meeting under Section 168 of the Act nor can they constitute a valid strength on the grounds of their proportion of issued capital for making an application to Company Law Board under Section 397 and 398 of the Act alleging acts of oppression and/or mismanagement. Hence the statute itself provides them a meaningful exit route.

When a Company intends to take over another Company through acquisition of 90% or more in value of the shares of that Company, the procedure laid down under Section 395 of the Act could be beneficially utilized.

Section 395 lays down two safeguard in respect of compulsory acquisition of majority shares i.e. Firstly, the scheme requires approval of a large majority of shareholders and Secondly, the Court's has the discretion to prevent compulsory acquisition.

There have been occasions when the minority shareholders have raised objections and have succeeded in preventing the implementation of a scheme of arrangement. A lone minority shareholder of Tainwala Polycontainers Ltd. (TPL), Dinesh V Lakhani, had apparently forced the company to call off its merger plans with Tainwala Chemicals and Plastics (India) Ltd. (TCPL). Lakhani had opposed the proposed merger on several grounds including allegations of willful suppression of material facts and mala fide intention of promoters in floating separate companies (TPL and TCPL).

A division bench of the Bombay High Court had stayed the proposed TPL-TCPL merger. After almost two years of courtroom battle, the company decided to withdraw the amalgamation petition without citing any reasons.

Answer 3(b)**Restrictions on buy-back of shares in certain circumstances**

- A company should not buy-back its securities if default subsists in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan or interest payable thereon to any financial institution or bank. [Section 77B(1)(c)].

Deposits for this purpose include deposits under Section 58A read with Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975.

- Buy-back should not be made if a company has defaulted in relation to preparation and filing of its annual return. [Section 77B(2)].

However, such a company may buy-back its securities after the default has been rectified.

- Buy-back should not be made in the event of any default in relation to payment of dividend to any equity or preference shareholder. [Section 77B(2)].

Where a dividend has been declared by a company but has not been paid in accordance with the provisions of the Act, the company may buy-back its securities only after payment of dividend and interest thereon as per the provisions of the Act.

- Buy-back should not be made in the event of default in preparation of the annual accounts. [Section 77B(2)].

Where the report of the statutory auditors of the company contains a qualification that annual accounts are not prepared as per the accounting standards or otherwise are not in accordance with the provisions of

Section 211, the company cannot proceed to buy-back its securities.

- However, compounding of the aforementioned defaults or subsequent curing of the default may qualify as an enabling provision for buy-back.

- Buy-back should not be made by a company:

- (i) through any subsidiary company including its own subsidiary companies;
- (ii) through any investment company or group of investment companies. [Section 77B(1)(a) and (b)].

Question 4

- (a) *Explain discounted cash flow method of valuation of shares.* (6 marks)
- (b) *Draft a notice convening meeting of unsecured creditors in the case of scheme of compromise or arrangement, not being amalgamation.* (5 marks)
- (c) *Draft a suitable Board resolution for opening of escrow account.* (4 marks)

Answer 4(a)**Discounted cash flow valuation method**

Discounted cash flow valuation is based upon expected future cash flows and discount rates. This approach is easiest to use for assets and firms whose cash flows are currently positive and can be estimated with some reliability for future periods.

Discounted cash flow valuation, relates the value of an asset to the present value of expected future cash flows on that asset. In this approach, the cash flows are discounted at a risk-adjusted discount rate to arrive at an estimate of value. The discount rate will be a function of the riskiness of the estimated cash flows, with lower rates for safe projects and higher rate for riskier assets.

The discounted cash flow (DCF) model is applied in the following steps:

1. Estimate the future cash flows of the target based on the assumption for its post-acquisition management by the bidder over the forecast horizon.
2. Estimate the terminal value of the target at forecast horizon.
3. Estimate the cost of capital appropriate for the target.
4. Discount the estimated cash flows to give a value of the target.
5. Add other cash inflows from sources such as asset disposals or business divestments.
6. Subtract debt and other expenses, such as tax on gains from disposals and divestments, and acquisition costs, to give a value for the equity of the target.
7. Compare the estimated equity value for the target with its pre-acquisition stand-alone value to determine the added value from the acquisition.
8. Decide how much of this added value should be given away to target shareholders as control premium.

Answer 4(b)

In the High Court at....

Original jurisdiction

In the matter of the Companies Act, 1956

AND

In the matter of an application under Sections 391 (1), 393 and 394
of the Companies Act, 1956

AND

In the matter of ABC Ltd.....

Company Application No..... of 2012..

...Applicant(s)

Notice convening meeting of secured creditors

To

.....

.....

It may be noted that Hon'ble High Court by an order made on....(day), the..... day of.....2012.., has directed that a meeting of (here mention the class of creditors) of the company be held at..... on the....(day), of.....(month), 2012..., at..... o'clock for the purpose of considering, and if thought fit, approving (with or without modifications), the compromise or arrangement proposed to be made between the said company and (here mention the class of creditors or members with whom the compromise or arrangement is to be made) of the company.

Hence, the notice is hereby given that in pursuance of the said order, a meeting of (here mention the class of creditors or members of whom the meeting is to be held) of the company will be held at..... on.... day, the..... day of.... 2012, and you are requested to attend.

Take further notice that you may attend and vote at the said meeting in person or by proxy, provided that a proxy in the prescribed form, duly signed by you is deposited at the registered office of the company at.... not later than 48 hours before the meeting.

The court has appointed Shri and failing him Shri..... to be the chairman of the said meeting.

A copy each of the compromise or arrangement, the statement under Section 393 and a form of proxy is enclosed.

Dated this... day of..... 2012....

Chairman appointed for the meeting
(or as the case may be)

Answer 4(c)**Opening of Escrow Account**

"RESOLVED THAT an Escrow Account be opened with Bank and Rs.....be deposited in the said account.

RESOLVED FURTHER THAT M/s....., Merchant Banker, be and is hereby authorised to operate the above said account and the Bank be and is hereby authorised to act on the instructions given by M/s , Merchant Banker, in relation to operation of bank account."

RESOLVED FURTHER THAT Mr. , Director of the company, be and is hereby authorised to collect and communicate the same to.....Bank, the names and specimen signatures of the person authorised by M/s. , Merchant Banker, to operate the above said bank account."

Question 5

- (a) Define 'amalgamation' and 'merger' to qualify as an amalgamation for the purpose of income-tax. What are the conditions to be satisfied ? (5 marks)
- (b) "In valuation of shares and fixation of exchange ratio, the court cannot abdicate its duty to scrutinise the scheme with vigilance." Do you agree ? Support your answer with relevant case law. (5 marks)
- (c) What should be the minimum price for creeping acquisition ? (5 marks)

Answer 5(a)

The word 'amalgamation' or 'merger' is not defined anywhere in the Companies Act, 1956. However Section 2(1B) of the Income Tax Act, 1961 defines 'amalgamation' as follows:

"Amalgamation in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as amalgamating company or companies and the company with which they merge or which is formed as result of the merger, as the amalgamated company), in such a manner that?

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company."

Thus, for a merger to qualify as an 'amalgamation' for the purpose of the Income Tax Act, the above three conditions have to be satisfied. This definition is relevant inter alia for Sections 35(5), 35A(6), 35E(7), 41(4) Explanation 2, 43(1) Explanation 7, 43(6) Explanation 2, 43C, 47 (vi) & (vii), 49(1)(iii)(e), 49(2), 72A of Income Tax Act.

Answer 5(b)

The Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.* (1996) 4 Comp LJ 124 (SC) where it was held 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 recognised firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without

demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest.

Answer 5(c)

As per Regulation 20A of SEBI (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. However this condition shall not apply where the acquisition is made through the stock exchanges.

PART B

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

Question 6

(a) *“In the commercial and legal world, the terms ‘winding-up’ and ‘dissolution’ refer to same legal procedure and there are no fundamental differences between the two.” Do you agree with this statement ? Justify. (7 marks)*

(b) *Write notes on the following :*

(i) *Non-performing assets*

(ii) *Compromise through Lok Adalats. (4 marks each)*

Answer 6(a)

The terms “Winding up” and “Dissolution” are sometimes erroneously used to mean the same thing. But according to the Companies Act, 1956, the legal implications of these two terms are quite different and there are fundamental differences between them as regards the legal procedure involved. The main points of distinction are given below:

1. The entire procedure for bringing about a lawful end to the life of a company is divided into two stages – ‘winding up’ and ‘dissolution’. Winding up is the first stage in the process whereby assets are realised, liabilities are paid off and the surplus, if any, distributed among its members. Dissolution is the final stage whereby the existence of the company is withdrawn by the law.
2. The liquidator appointed by the company or the Court carries out the winding up proceedings but the order for dissolution can be passed by the Court only.
3. According to the Companies Act the liquidator can represent the company in the process of winding up. This can be done till the order of dissolution is passed by the Court. Once the Court passes dissolution orders the liquidator can no longer represent the company.
4. Creditors can prove their debts in the winding up but not on the dissolution of the company.
5. Winding up in all cases does not culminate in dissolution. Even after paying all the creditors there may still be a surplus; company may earn profits during the course of beneficial winding up; there may be a scheme of compromise with

creditors while company is in winding up and in all such events the company will in all probability come out of winding up and hand over back to shareholders/old management. Dissolution is an act which puts an end to the life of the company.

As such winding up is only a process while the dissolution puts an end to the existence of the company. Unless and until it has been set aside under Section 559 of the Act, it prevents any proceedings being taken against promoters, directors or officers of the company to recover money or property due or belonging to the company or to prove a debt due from the company. When the company is dissolved, the statutory duty of the liquidator towards the creditors and contributories is gone, but if he has committed without complying with the requirements of the Act, he is liable to damages to the creditors.

Answer 6(b)(i)

Non-Performing Assets

As per Section 2(1)(o) of the SARFESI Act, 2002 "Non-Performing Asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset—

- (a) in case such bank or financial institution is administered or regulated by an authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;
- (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank.

Answer 6(b)(ii)

Compromise through Lok Adalat

The concept of Lok Adalat is of recent origin and is set up under the Legal Service Authorities Act, 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. The advice was issued to clarify the doubt raised by banks whether, in view of the limitation of ceiling of Rs. 5 lakhs for disposal by Lok Adalats, they should participate in the Lok Adalats convened by various DRTs/ DRATs for resolving cases involving Rs. 10 lakhs and above.

Question 7

- (a) *Explain the procedure involved in the process of takeover of business of a borrower by the secured creditor under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. (7 marks)*

- (b) *Explain preferential payments in the process of winding-up.* (4 marks)
- (c) *Explain 'reference to the Board' under the Sick Industrial Companies (Special Provisions) Act, 1985.* (4 marks)

Answer 7(a)

Section 15 of the Securitisation Act provides for the manner and effect of takeover of management. When the management of business of a borrower is taken over by a secured creditor it can appoint as many persons as it thinks fit to be the directors, where the borrower is a company, or the administrators of the business of the borrower, in any other case. The secured creditor is required to publish a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated.

On the publication of the notice all persons who were directors of the company or administrators of the business, as the case may be, are deemed to have vacated their office. It also has the effect of termination of all contracts entered into by the borrower with such directors or administrators. As per Section 16 no compensation is payable to such a director or manager whose services are terminated.

Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower:

- It shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be director of the company;
- No resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
- No proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor;
- Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realization of his debt in full, restore the management of the business of the borrower to him.

Answer 7(b)

Section 530 of the Companies Act, 1956 provides that in winding up subject to the provisions of Section 529A, the following debts shall be paid in priority to all other debts:

- (a) all revenues, taxes, cesses and rates due from the company to the Central or State Government or to a local authority. The amount should have become due and payable within twelve months before the date of commencement of winding up. The amount imposed and demanded as advance-tax under Section 207 of the Income-tax Act, 1961, is a tax within the meaning of this clause but any amount due to the Government in relation to commercial transactions does not enjoy preferential right, as it is not tax or cess.
- (b) all wages or salary of any employee in respect of services rendered to the

company and due for a period not exceeding four months within twelve months before the relevant date. The amount to be paid as preferential payment must not exceed Rs. 20,000 in the case of each employee or workmen.

- (c) all accrued holiday remuneration becoming payable to any employee or in the case of his death to any other person in his right on termination of his employment before or by the effect of the winding up order or resolution.
- (d) unless the company is being wound up voluntarily only for the purpose of reconstruction or of amalgamation with another company in respect of all contributions payable during 12 months next before the relevant date, by the company as the employer of any persons, under the Employees State Insurance Act, 1948, or any other law for the time being in force.
- (e) unless as in (d) above or unless workmen's compensation insurance policy is taken, all sums due as compensation under the Workmen's Compensation Act, 1923.
- (f) all sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.
- (g) the expenses of any investigation held under Section 235 or Section 237 in so far as they are payable by the company.

Answer 7(c)

Under Section 15 of the SICA, 1985 where an industrial company has become sick, the Board of Directors of the company shall, within 60 days from the date of finalization of duly audited accounts of the company for the financial year at the end of which the company has become sick, make a reference to the Board (BIFR) for determination of measures to be adopted with respect to the company.

If the Board of Directors had sufficient reason even before such finalization to form opinion that the company had become a sick unit after the Board of Directors shall, within 60 days after it has formed such opinion, make a reference to the Board for determination of measures which shall be adopted in respect of the company.

Further, the Central Government or Reserve Bank or State Government or a public financial institution or a State level institution or a scheduled bank may provide sufficient reason that any industrial company has become sick industrial company, may make a reference to the Board for determination of measures which shall be adopted in respect of the company.

Question 8

- (a) *Briefly describe the protection provided to the creditors and other interested persons under the UNCITRAL Model Law.* (5 marks)
- (b) *"Asset reconstruction companies are public financial institutions." Comment.* (5 marks)
- (c) *Define 'financial asset' under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.* (5 marks)

Answer 8(a)

Article 22 of UNCITRAL Model Law provides protection of creditors and other interested persons

The Model Law contains following provisions to protect the interests of the creditors (in particular local creditors), the debtor and other affected persons:

- availability of temporary relief upon application for recognition of a foreign proceeding or upon recognition is subject to the discretion of the court; it is expressly stated that in granting such relief the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected (Article 22, paragraph 1);
- the court may subject the relief it grants to conditions it considers appropriate; and
- the court may modify or terminate the relief granted, if so requested by a person affected thereby (Article 22, paragraphs 2 and 3).

In addition to those specific provisions, the Model Law in a general way provides that the court may refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting State (Article 6).

Answer 8(b)**Assets Reconstruction Companies (ARCs) are public financial institutions.**

All the ARCs who have obtained certificate of registration from Reserve Bank to carry on the business of asset reconstruction, are public financial institution as defined under Section 4A of the Companies Act, 1956. This is a special status conferred by the Act on ARCs. The first proviso to Sub-section (3) of Section 67 of the Companies Act, 1956 permits a company to issue securities on a private placement basis upto 50 persons only. However, this proviso does not apply to a public financial institution. Therefore, the ARC can invite any number of qualified institutional buyers to subscribe to its debentures, bonds, units, etc., issued for financing the acquisition of assets of the defaulting borrowers of any bank/financial institution. It has to create a debentures redemption reserve for the redemption of debentures and adequate amount should be credited to such reserve from out of its profits every year until such debentures are redeemed, as provided in Section 117C of the Companies Act, 1956.

Answer 8(c)

"Financial asset" under Section 2(1)(l) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2012 means debt or receivables and includes—

- (i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or
- (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
- (iii) a mortgage, charge, hypothecation or pledge of movable property; or

- (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
 - (v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
 - (vi) any financial assistance;
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