

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) (i) ABC Ltd. has 700 creditors (in number) representing total value of Rs.100 crore as per its balance sheet. In a creditors meeting called under section 391 for considering proposed scheme of amalgamation with XYZ Ltd., out of total 700 creditors, only 150 creditors representing value of Rs.45 crore were present. Out of said 150 creditors present at the said meeting, only 140 creditors representing value of Rs.40 crore voted in favour of the resolution, while 10 creditors representing value of Rs.5 crore cast their dissenting vote against the scheme. Whether the motion proposing the scheme of amalgamation should be treated as approved or not ? Explain with reference to relevant provisions of law and case law, if any. (5 marks)
- (ii) In a scheme of arrangement made under section 391, a company proposes to transfer one of its undertakings to its subsidiary and also to reduce its share capital. Is the scheme valid ? Explain with relevant provisions of law and relevant cases. (5 marks)
- (b) State whether the following statements are true or false citing briefly relevant provisions of the law :
- (i) There is a bar on a company amalgamating with a newly incorporated company.
- (ii) A non-profit making company licensed under section 25 can be merged with a profit making company.
- (iii) High Court can sanction a scheme of merger of a sick industrial company when a revival scheme is pending before BIFR.
- (iv) An appeal can be preferred to the Supreme Court of India against the order passed under section 391/394 sanctioning a scheme of amalgamation.
- (v) The court can modify 'transfer date' proposed in a scheme of amalgamation. (2 marks each)
- (c) Explain the provisions relating to buy-back of shares through book-building route. (5 marks)

Answer 1(a)(i)

Yes, the motion proposing the scheme of amalgamation shall be treated as passed.

According to Section 391 (2) of the Companies Act, 1956, the resolution relating to the approval of amalgamation has to be approved by a twin majority i.e.

- A simple majority of members or creditors, as the case may be, who are present and voting at the general meeting, whether in person or through proxy; and

- A majority representing three-fourths in value of the votes of or the value of debt of, members or creditors, respectively, present and voting either in person or by proxy.

In the given case, out of 150 creditors who were present and voting, 140 have voted in favour which means that the first of the twin criteria has been satisfactorily met. In terms of value, those who voted in favour were commanding a value of Rs. 40 Crores as against the value of those who voted against who commanded a value of Rs.5 Crores. In other words, more than three-fourths in value of the votes of the creditors present and voting have voted in favour indicating clearly that the second of the twin criteria has also been satisfactorily met. Thus the resolution approving the amalgamation has been duly passed in accordance with the requirements of Section 391(2) of the Companies Act, 1956.

A full bench of the Punjab and Haryana High Court in *Hind Lever Chemicals Limited and Another* [2005] 58 SCL 211 (Punj&Har) held that in our view, the language of Section 391(2) of the Act is totally unambiguous and a plain reading of this provision clearly shows that the majority in number by which a compromise or arrangement is approved should represent three-fourth in value of the creditors/shareholders who are 'present and voting' and not of the total value of the shareholders or creditors of the company.

Similarly, in *Re: Kirloskar Electric Company Ltd.*, [2003] 116 Com Cas 413 (Kar), the Karnataka High Court held that the three-fourth majority required under sub-section (2) of Section 391 of the Act was of the value represented by the members who were not only present but who had also voted. In fact, it went a step further to hold that the creditors who were present and had even voted but whose votes had been found to be invalid, could not be said to have voted because casting an invalid vote is no voting in the eyes of law. Thus, it was held that "the proper construction to be placed in calculating whether any resolution is approved or passed by a three-fourth majority present and voting necessarily mean the value of the valid votes and out of the same whether the resolution has been passed with three-fourth the majority".

Also in *Hindustan General Electric Corporation Ltd. in re.* (1959) 29 Comp Case 46 (Cal.); the Hon'ble Court has held that in determining whether a resolution has been passed by the requisite majority or not, the members remaining neutral or absenting from the voting need not to be counted. The same view has also been upheld in *Kaveri Entertainment Ltd., in re* (2003) 117 Comp. Case 245 (Bom).

Answer 1(a)(ii)

Yes, the scheme is a valid scheme and is well within the scope of Section 391 read with Section 394 of the Act. In *Larsen & Toubro Limited* In re [2004] 60 CLA 335 (Bom) [2004], the Mumbai High Court held that a composite scheme could be made involving de-merger, of one of the undertakings of the transferor company and for the transfer of the demerged undertaking to a subsidiary company and for the reduction in the capital of the transferor-company. The Court ruled that the word arrangement is not specifically defined under the Act. It has a wide range and ambit. It includes restructuring of capital, reduction of capital and demerger. The scheme of arrangement having the ingredients of demerger and reduction of share capital and scheme of arrangements with the concerned companies and trust, cannot be said to be beyond the purview of sections of the Companies Act.

Answer 1(b)(i)

False : The Hon'ble Gujarat High Court in *Re: Apco Industries Ltd.* (1996) 86 Comp Cas 457 (Guj.) has held that there is no bar to a company amalgamating with a fifteen-day old company having no assets and business.

Answer 1(b)(ii)

True, amalgamation of a company licensed under Section 25 of the Companies Act with a commercial, trading or manufacturing company could be sanctioned under Section 391/394. (*Re. Sir Mathurdas Vissanji Foundation* (1992) 8 CLA 170(Bom.) *Re: Walvis Flour Mill Company P. Ltd.* (1996) 23 CLA 104]. 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. Case 291 (Bom.).

Answer 1(b)(iii)

False, in similar matter of *Tata Motors Ltd. v. Pharmaceuticals Products of India Ltd. and Another* (2008) 144 Comp. Case 178 (SC), it was held High Court cannot sanction scheme proposed under section 391/394 of the Act during the pendency of the revival scheme before BIFR under SICA. In terms of Section 26 of SICA, a company court did not have jurisdiction to entertain any application of a sick industrial company for merger under s.391 to 394 of the Companies Act 1956, while the matter was pending before the BIFR or the AAIFR.

Similarly in *Ashok Organic Industries Ltd v. ARCIL*, [2008]114 Comp Cas 144 (Bom), the Bombay High Court held that once the Industrial Company makes a reference under Section 15 of the SICA, the Company Court would have no jurisdiction for sanctioning the scheme of arrangement of compromise with its creditors and shareholders and neither will it have jurisdiction to take cognisance of such an application during the pendency of the reference.

Answer 1(b)(iv)

True, as per the existing provisions of the Companies Act, 1956, an appeal can be preferred to the Supreme Court of India against the order passed under Section 391/394 sanctioning a scheme of amalgamation.

Answer 1(b)(v)

True, the Hon'ble Supreme Court in *Marshal Sons & Co. (India) Ltd. v. ITO* (1977) 1 Comp LJ P. 1, observed that it is true that while sanctioning the scheme, it is open to the Court to modify the said date. But when the Court does not prescribe any specific date, the date specified in the scheme is "the transfer date".

Answer 1(c)**Buy Back through Book Building Route**

A company can buy back its securities through the book building process as provided

under Securities and Exchange Board of India (Buy Back of Securities) Regulations, 1998 which is as under:

1. (a) The special resolution as in Regulation 5 or 5A, should specify the maximum price at which the buy back will be made.
- (b) The company should appoint a merchant banker.
- (c) A public announcement as referred to in Regulation 8 shall be made atleast 7 days prior to the commencement of the buy back.
- (d) Subject to the provisions of Sub- clauses (i) and (ii), the provisions of Regulation 10 regarding escrow account are applicable –
 - (i) The deposit in the escrow account should be made before the date of the public announcement.
 - (ii) The amount to be deposited in the escrow account should be determined with reference to the maximum price as specified in the public announcement.
- (e) A copy of the public announcement must be filed with SEBI within two days of the announcement along with the fees specified in Schedule IV to the Regulations. The public announcement shall also contain the detailed methodology of the book building process, manner of acceptance, format of acceptance to be sent by the security holders pursuant to public announcement and details of bidding centers.
- (f) The book building process should be made through an electronically linked transparent facility.
- (g) The number of bidding centers should not be less than thirty and there should be atleast one electronically linked computer terminal at all the bidding centers;
- (h) The offer for buy back should be kept open to the security holders for a period of not less than fifteen days and not exceeding thirty days.
- (i) The merchant banker and the company should determine the buy back price based on the acceptances received and the final buy back price which should be the highest price accepted should be paid to all the holders whose securities have been accepted for the buy back.
2. The provisions of Regulation 9(5) pertaining to verification of acceptances and the provisions of Regulation 11 pertaining to opening of special account and payment of consideration are applicable mutatis mutandis.

Question 2

- (a) *Reduction of capital is one of the modes of re-organisation of capital structure of the company and to a certain extent it can be done without the sanction of the court. Explain with relevant provisions of the law.* (7 marks)
- (b) *Strategy is the very soul of any action and activity. Briefly define the strategy with 5Ps of Henry Mintzberg.* (4 marks)

- (c) *In a scheme of compromise, arrangement, reconstruction or amalgamation, various types of approvals are required. Describe briefly such approvals.*

(4 marks)

Answer 2(a)

A company may reorganize its capital in different ways which may include: (a) reduction of paid-up capital; (b) conversion of one type of shares into another; (c) conversion of shares into debentures. There may be many other ways and manner of re-organization of capital. Re-organization of share capital may be proposed between the company and its creditors or class of creditors or members or class of members and requires confirmation of CLB under Section 391. Reduction of capital means reduction of issued, subscribed and paid up capital of the company. Section 100 provides for the reduction of share capital, if the articles of the company so authorize with the confirmation of the Court.

However in following cases, reduction of share capital can be made without sanction of court.

(a) *Surrender of Shares*

This means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to reduction of capital. But if, under any arrangement such shares instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad v. Equity Insurance Company Limited (1948) 18 Com Cases 309: AIR 1948 Oudh 197*]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted for further liability on shares.

The Companies Act contains no provisions for surrender of shares. Thus surrender of shares is valid only when Articles of Association provide for the same and:

- (i) Where forfeiture of such shares is justified; or
- (ii) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. However, in the case of forfeiture it is at the initiative of the company and in the case of surrender it is at the initiative of member or shareholder.

(b) *Forfeiture of Shares*

A company may if authorized by its articles, forfeit shares for non- payment of calls and the same will not require confirmation of the court.

Where the power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised bona fide and in the interest of the company.

(c) *Diminution of Capital*

Where the company cancels shares which have not been taken or agreed to be taken by any person. [Section 94(1)(3)]

- (d) Redemption of redeemable preference shares
- (e) Purchase of shares of a member by the company under Section 402.
- (f) Buy back of its own shares under Section 77A
- (g) Reduction of capital when company is defunct.

Answer 2(b)

Strategy is the very soul of any action and activity and should be omni-present and therefore every executive and owner needs to be a 'strategist'. Henry Mintzberg enunciated 5 Ps of strategy which are as follows namely:

- 1 A Plan i.e. Strategy is consciously intended course of action which a firm chooses to follow after careful deliberations on the various options available to it.
- 2 A Ploy i.e. it is specific maneuver which intends to outwit an opponent or a competition. It is a trick, devise, a scheme or deception to gain advantageous position before engaging into the combat of marketing warfare.
3. A Pattern i.e. it is not one decision and one solitary action; it stands for a stream of decisions and actions to guide and tend the future course of the enterprise until it reaches its predetermined corporate objectives.
4. A Position i.e. it is a means of locating the firm in an environment full of external factors, pulls and pushes.
5. A Perspective i.e. it is an ingrained way of preceding the world around the organization and its business operations.

Answer 2(c)

In a scheme of compromise or arrangement, following types of approvals are required to be obtained by the transferor and transferee companies:

- (i) *Approval of the Boards of each of the Companies* : This is the first step to carry out amalgamation. Approval authorizes the director/company secretary to do everything for this purpose.
- (ii) *Approval of Shareholders/Creditors* : This approval is to be obtained at specially convened meetings as per Court's directions under Section 391(1) of the Companies Act. However, if all members consent in writing, this can be dispensed with. The unsecured / sundry creditors meetings are dispensed with subject to certain conditions.
- (iii) *Approval of Stock Exchange* : In case of companies listed with recognized stock exchange(s), a no-objection certificate under Clause 24(f) of the listing agreement is to be obtained atleast one month prior to filing it with High Court.
- (iv) *Approval from Financial Institutions/Lending Banks/Debenture trustees etc.* : If

the company has borrowed funds from the above lenders, approval is necessary from the lender and debenture trustees.

- (v) *Approval from the land holders* : If the land on which the factory is situated is the lease-hold land and the terms of the lease deed so specifies, the approval from the lessor will be needed.
- (vi) *Approval from Reserve Bank of India* : If amalgamation results to issuance of shares/cash option to the non-resident Indians, the amalgamated company has to obtain permission from Reserve Bank of India under Foreign Exchange Management (Transfer or issue of security by a person Resident outside India) Regulations, 2000.
- (vii) *Approval of Central Government under MRTP Act* : The Monopolies and Restrictive Trade Practices Act, 1969 is on the verge of being phased out with the passing of the Competition Act, 2002. Under the Competition Act, regulation of combinations as provided under Sections 5 and 6 of the Act would also be required to be complied by companies, if applicable. Under the Competition Act, 2002, reference must be made to the Competition Commission of India in certain cases depending upon the post merger size of the assets or business.
- (viii) *Sanction of the respective High Courts* : Both amalgamated/resulting companies and amalgamating companies are required to seek approval from the respective High Court(s) in which their registered offices are situated.

Question 3

- (a) *In a buy-back of securities, a company has to pay stamp duty under the Indian Stamp Act, 1899 for physical shares. Do you agree ? Explain. (5 marks)*
- (b) *In an open offer in terms of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, what message is conveyed by the SEBI by way of 'disclaimer clause' to the shareholders of the target company ? (5 marks)*
- (c) *What do you mean by 'hostile takeover' ? Why these types of takeovers are resorted to and by whom, and what is the objective of the acquirer ? (5 marks)*

Answer 3(a)

Any transfer of shares is liable for stamp duty under the Indian Stamp Act, 1899 vide entry No.62 in the Schedule I. For completion of transfer of shares, a company is required to register the shares in the name of the transferee. But purchase of own shares by a company cannot be registered in the name of the company. These shares are supposed to be mandatorily extinguished and the capital stands reduced to that extent. They cannot keep the bought back shares as "Treasury Stock" for reissue though such things are permissible in some western countries.

As per provisions of the Companies Act, 1956 and relevant rules, the bought back shares must be extinguished within 7 days from the closure date of said buy back and it should not be treated as "Release" under Article 55 of the Indian Stamp Act. Hence, no registration of such shares takes place in the name of the company.

The names of the members/shareholders from whom the shares are bought back, have to be struck off from the register of members of the company. Therefore, buy-

back cannot be considered as transfer and stamp duty would not be payable in a case where buy-back of shares takes place in physical form even if the shares are accompanied by an application form for transfer of shares in favour of the company.

Answer 3(b)

The message conveyed by SEBI by way of 'disclaimer clause' to the shareholders of the target company are as follows:

- (i) The purpose of the disclosure made in the letter is to facilitate the shareholders to take a decision in an informed way.
- (ii) The disclosures made in letter are generally adequate and are in conformity with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- (iii) It shall not be deemed or construed that SEBI has approved or cleared or vetted the offer letter.
- (iv) SEBI does not take any responsibility either for the truthfulness or correctness of for any statement, for financial soundness of Acquirer, or of Persons Acting in Concert, or of Target Company, whose shares are proposed to be acquired or for the correctness of the statements made or opinions expressed in the Letter of Offer.
- (v) While the acquirer is primarily responsible for the correctness, adequacy and disclosure of all relevant information in the letter of offer, the Merchant Banker is expected to exercise due diligence to ensure that acquirer(s) duly discharges its responsibility adequately.

Answer 3(c)**Hostile Takeover**

When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management, such acts of acquirer are known as 'hostile takeover'. Such takeovers are hostile on the management and are thus called hostile takeover.

This type of takeover action preferred by a competitor or a cash rich acquirer to take control over the targeted company against the wish of the existing management and controlling persons of the target company.

This type of takeover is primarily aimed for:

- (i) Elimination of competition or dilution of the degree of competition on the product/service market on the whole.
- (ii) Gaining reign/leadership in prices of the product sold/services rendered.
- (iii) Brand orientation.
- (iv) Building up or broadening the monopolistic or oligopolistic route in product market by the acquiring entity.

However Hostile Takeover is not a prohibited or illegal activity. When shares of a

company are listed in a recognized stock exchange, shares are available for being bought by anybody. Therefore acquisition per se, though hostile, cannot be banned. On the other hand, the regulations incorporate strict rules for regulating such takeover attempts so to make the process transparent and afford opportunity to a competitive process and protects interests of the investors.

Question 4

- (a) *Good Value Ltd. (GVL) is contemplating acquisition of Fair Value Ltd. (FVL). GVL has 3,00,000 equity shares and FVL has 2,00,000 equity shares and the market value of shares are Rs.30 and Rs. 20 and EPS is Rs.4 per share and Rs. 2.25 per share respectively. It is proposed to give one share of GVL to the shareholder of FVL for their two shares in FVL. Based on the above information, you are required to —*
- calculate EPS after the merger/acquisition of the company; and*
 - show the impact on EPS for the shareholders of both the companies.*
- (5 marks)
- (b) *X, an acquirer, fails to fulfil the offer obligation towards shareholders of target company who have lodged their shares with the acquirer. What are the remedies available to a merchant banker for discharge of the obligations especially towards shareholders who have participated in the offer as well as to deal with the escrow account ?*
- (5 marks)
- (c) *State whether any stamp duty is payable on transfer of properties under the order of amalgamation. Briefly comment with relevant case law.*
- (5 marks)

Answer 4(a)

(i) Calculation of EPS after merger/acquisition of the company

Total earnings after merger and acquisition:-

GVL	FVL	Total Earnings
3,00,000 x 4	2,00,000 x 2.25	
= Rs. 12,00,000	Rs. 4,50,000	Rs. 16,50,000

Total number of equity shares after acquisition:-

GVL	3,00,000
FVL (2,00,000 x 1/2)	1,00,000
Total no. of shares after acquisition	<u>4,00,000</u>

$$\begin{aligned}
 \text{EPS after merger} &= \frac{\text{Total earnings after acquisition}}{\text{Total number of shares after acquisition}} \\
 &= \frac{16,50,000}{4,00,000} \\
 &= \text{Rs. 4.125}
 \end{aligned}$$

(ii) Impact of EPS for the shareholders of both the companies

GVL	Rs.
Earnings before acquisition	12,00,000
[3,00,000 x 4]	
Earnings after acquisition	12,37,500
[3,00,000 x 4.125]	
Increase in earnings after acquisition	<u>37,500</u>
Net increase in EPS after merger	= <u>37,500</u>
	3,00,000
	= 0.125
 FVL	 Rs.
Earnings before acquisition	4,50,000
[2,00,000 x 2.25]	
Earnings after acquisition	4,12,500
[*1,00,000 x 4.125]	
Net decrease in earnings	<u>37,500</u>
Net decrease in EPS after merger	= <u>37,500</u>
	1,00,000
	= 0.375

(*being the shares held by shareholders of FVL in GVL after merger)

Therefore, there is an increase of Rs. 37,500 in total earnings of GVL and decrease of Rs. 37,500 in total earnings of FVL after merger.

Answer 4(b)

The Merchant Banker is entitled to ensure realization of Escrow Account by way of foreclosure of deposit, invocation of bank guarantees and sale of the shares (if any) and distribute the proceeds after deduction of expenses, if any, of the merchant banker and the registrars to the offer in following ways:

- (i) One third of amount to the target company.
- (ii) One third to regional stock exchanges where it is listed, for credit of the investor protection fund or any other similar fund for investor education, research, grievance redressal and similar such purposes as may be specified by SEBI.
- (iii) One third to be distributed on pro-rata basis among the shareholders who have accepted the offer.

The Merchant Banker is required to ensure that the rejected documents which are kept in the custody of the Registrar/Merchant Banker are sent back to the shareholder through Registered Post.

Answer 4(c)

Yes, stamp duty is payable on transfer of properties under the order of amalgamation.

In a landmark decision of Hon'ble Bombay High Court in *Li Taka Pharmaceuticals v. State of Maharashtra* (1996) 8 SC 102 (Bom.), it was held that:

- (i) An amalgamation under the order of the Court under Section 394 of the Companies Act, is an instrument under the Bombay Stamp Act;
- (ii) States are well within their jurisdiction when they levy stamp duty on instrument of amalgamation;
- (iii) Stamp duty would be levied not on the gross assets transferred but on the "undertaking", when the transfer is on a going concern basis, i.e. on the assets less liabilities. The value for this purpose would thus be the value of shares allotted. This decision has been accepted in the Act and now stamp duty is leviable on the value of shares allotted plus other consideration paid.

Question 5

- (a) (i) *The court has fixed meeting of equity shareholders of Rim Zim Ltd. on Tuesday, the 9th June, 2009 at Broadway Hotel, 3, Osaka Street, Mumbai for considering the proposed scheme of amalgamation with Jhil Mil Ltd. and appointed Kabir as Chairman and Mrs. Noori as alternate Chairperson of the meeting. As a Company Secretary of Rim Zim Ltd., draft the notice of the meeting.* (7 marks)
- (ii) *After meeting of equity shareholders of Rim Zim Ltd., the proposed scheme of amalgamation of Rim Zim Ltd. with Jhil Mil Ltd. was passed. Draft the Chairman's report for onward submission to the court.* (4 marks)
- (b) *Briefly explain with relevant provisions of the Companies Act, 1956 as to when the scheme of amalgamation would become effective.* (4 marks)

Answer 5(a)(i)**Form No. 36**

IN THE HIGH COURT OF JUDICATURE AT _____
(ORIGINAL JURISDICTION)

In the matter of Companies Act, 1956

And

In the matter of Scheme of Amalgamation of Rim Zim Ltd. with Jhil Mil Ltd. Rim Zim Ltd., an existing company under Companies Act, 1956 and having its registered office at _____

Company Application No. _____ of 200 _____

Rim Zim Ltd., Applicant

Notice Convening Meeting

To

Equity Shareholders

TAKE NOTICE that by an order made on _____ day of _____ 200__, the

Court has directed that a meeting of the equity shareholders of the company be held at Broadway Hotel, 3, Osaka Street, Mumbai on Tuesday, the 9th day of June 2009 at _____AM/PM, for the purpose of considering and, if thought fit, approving with or without modification, the Scheme of Amalgamation proposed to be made between the Applicant Company and Jhil Mil Ltd.

TAKE FURTHER NOTICE that in pursuance of the said order, a meeting of the equity shareholders of the Applicant Company will be held at Broadway Hotel, 3, Osaka Street, Mumbai on Tuesday, the 9th day of June 2009 at _____AM/PM which 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 quorum of the meeting shall be five members present in person or by proxy.

The Court has appointed Mr. Kabir as the Chairman of the said meeting and Mrs. Noori as alternate Chairperson of the meeting.

A copy of each of the Scheme of Amalgamation, the statement under Section 393 of the Companies Act, 1956 and a form of proxy and attendance slip are enclosed.

Dated this _____ day of 200 _____

Sd/-

For Rim Zim Ltd.

XYZ

Company Secretary

Note : All alterations made in the form of Proxy should be initialled.

Answer 5(a)(ii)

Form No. 39

IN THE HIGH COURT OF JUDICATURE AT _____

(ORIGINAL JURISDICTION)

In the matter of Companies Act, 1956

And

In the matter of scheme of Amalgamation of Rim Zim Ltd. with Jhil Mil Ltd.

Rim Zim Ltd., an existing company under Companies Act, 1956 and having its registered office at _____

Company Application No. _____ of 200 _____

Rim Zim Ltd., Applicant

Report by Chairman

I, Kabir, Advocate, the person appointed by this Hon'ble Court to act as Chairman of the meeting of the equity shareholders of the above named company, summoned by notice served individually upon them and by advertisement dated the day of..... 200....., and held on the 9th day of June 2009, at Broadway Hotel, 3, Osaka Street, Mumbai, do hereby report to this Hon'ble Court as follows :

1. The said meeting was attended by.....equity shareholders personally holding.....value of shares and equity shareholders holding..... value of shares have attended the said meeting through proxy.
2. The scheme of amalgamation was read out and explained by me to the meeting and questions raised were answered satisfactorily. The equity shareholders of the said company have approved the scheme of amalgamation submitted to the meeting and agreed thereto.
3. The said meeting was unanimously of the opinion that the scheme of amalgamation should be approved and agreed to/or. The result of the voting of the meeting are attached as per annexure A showing names and addresses of the equity shareholders, value of equity shares held by them, number of votes, approved or disapproved.

Dated this_____ day of 200_____

Sd/-

Kabir

Chairman appointed for the meeting

(Annexure A)

Answer 5(b)

According to the provisions of Section 391(3) and 394(3) of the Companies Act, 1956, certified copy of the order passed by the Court shall be filed with the concerned Registrar of Companies. This is required to be filed with e-form 21 which is required to be filed within thirty days of the making of the order. Date of completion of the last of the required approvals shall be treated as effective date for the scheme of amalgamation.

PART B

(Answer ANY TWO questions from this part)

Question 6

- (a) Explain 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) Define 'securitisation' and explain the objectives of securitisation. (4 marks)
- (c) What do you mean by 'non-performing assets' under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ? (4 marks)

Answer 6(a)

Under section 13 of the Securitization and Reconstruction of Financial assets and Enforcement of Security Interest Act, 2002(hereinafter Securitization Act), secured creditor can enforce his security interest without intervention of the Court, on default in repayment of instalments, and non compliance with the notice of 60 days after the declaration of the loan as a non-performing asset. Secured creditors have been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustees appointed by any Bank or Financial Institution or Securitization or reconstruction company or any other trustee holding securities on behalf of bank or financial institution in whose favour security interest is created for due repayment by any borrower of any financial assistance. In case of the default in repayment of installment by the borrower and debts becoming NPA, the secured creditor has two options. It can either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act.

Section 13(4) of the Act empowers the recourse to one more of the following measures, after giving proper notice, for the recovery of the secured debts, namely:

- Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;
- Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset;
- Appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- Require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

In cases of joint financing under consortium or multiple lending arrangements if 75% of the secured creditors in the value agree to initiate recovery action the same is binding on all secured creditors.

In case of a company under liquidation, the amount realized from the sale of the secured assets is to be distributed in accordance with the provisions of Section 529A of the Companies Act, 1956. If the company is being wound up after the commencement of this Act, the secured creditor of such company, who opts to realize its security instead of relinquishing its security and proving its debts under proviso to Sub-section (1) of Section 529 of the Companies Act, may retain the sale proceeds of its secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of Section 529A of that Act. In case, dues of the secured creditors could not be satisfied in full, secured creditor may file application before DRT for recovery of balance amount. Secured creditor is also entitled to proceed against the guarantor or sell the pledged assets for its recovery.

Answer 6(b)

According to Section 2(1) (z) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, "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. "Securitisation company" means any company formed and registered under the Companies Act, 1956 for the purpose of securitization [Section 2(1)(za)].

Securitisation 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 stated securitisation 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. The most important, however, is the 'guarantees of credit quality'.

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(c)

According to Section 2 (1) (o) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest 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.

In *Srinivas Rice & Floor Mill v. Authorized Officer, State Bank of India*, [2008] 81 SCL 66 (AP), the AP High Court held that there is no statutory format, express or by necessary implication, that require the Banks to follow a particular or formal procedure or require a formal declaration as a condition precedent to classification of debt as "NPA". What section 13(2) r/w Section 2(1)(o) requires is a classification of a debt by a bank as 'NPA' within the legislative guidelines spelt out in the definition of NPA.

Question 7

- (a) *What do you understand by 'sick industrial company' ? Explain the immunities provided to a sick industrial company under the Sick Industrial Companies (Special Provisions) Act, 1985. (7 marks)*
- (b) *Though, UNCITRAL Model Law is not a substantive law, yet it recommends protection to creditors and other interested persons. Briefly describe what are the protections provided under the UNCITRAL Model Law. (4 marks)*

- (c) *The main objective of asset reconstruction company (ARC) is to act as an agent for banks and financial institutions. Briefly explain with the relevant provisions of law. (4 marks)*

Answer 7(a)

According to Section 3(1)(o) of the Sick Industrial Companies (Special Provisions) Act, 1985, "sick industrial company" means an industrial company (being a company registered for not less than five years), which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Explanation : For the removal of doubts, it is hereby declared that an industrial company existing immediately before the commencement of the Sick Industrial Companies (Special Provisions) Amendment Act, 1993 registered for not less than five years and having at the end of any financial year accumulated losses equal to or exceeding its entire net worth, shall be deemed to be a sick industrial company.

Immunities to a sick industrial company has been granted under the provisions of Section 22 of the SICA, 1985. This Section provides that in certain circumstances, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof and no suit for the recovery money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of BIFR or, as the case may be, the Appellate Authority.

Section 22 of SICA has two limbs. The first part enacts that "no proceeding for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof ... shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority." The second part which is independent of the first part declares that "no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority."

The protection under Section 22 of SICA is a superior protection as it operates notwithstanding anything contained in the Companies Act, 1956, or any other law or the memorandum and articles of association of the industrial company or any other instrument having effect under the said Act or other law.

The above protection is available in respect of an industrial company when an inquiry under Section 16 is pending in relation to the said industrial company or when any scheme referred to under Section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under Section 25 relating to an industrial company is pending.

BIFR may by order declare with respect to the sick industrial company concerned that the operation of all or any of the contracts, assurances of property, agreements, settlements, awards, standing orders or other instruments in force, applicable to the sick industrial company in question shall remain suspended or that all or any of the rights, privileges, obligations, and liabilities accruing or arising thereunder before the

said date, shall remain suspended or shall be enforceable with such adaptations and in such manner as may be specified by BIFR. Provided that such declaration shall not be made for a period exceeding two years which may be extended by one year at a time so, however, that the total period shall not exceed seven years in the aggregate. Any such declaration is valid and is protected notwithstanding anything contained in the Companies Act, 1956, or any other law or agreement or instrument or any decree or order of a court, Tribunal, officer or other authority or of any submission, settlement or standing order.

Section 22 does not grant immunity against the criminal proceedings against the company or its directors.

The apex court in *Maharashtra Tubes Limited v. State Industrial and Investment Corporation of Maharashtra Limited* [1993] 78 Comp Cas 803 (SC) held that the idea underlying Section 22(1) of SICA is that every such action (against the company or its guarantors for recovery of money or enforcement of security) should be frozen unless expressly permitted by the specified authority until the investigation for the revival of the industrial undertaking is finally determined. The apex court in *Patheja Bros. Forgings and Stamping v. ICICI Limited* AIR 2000 CLC 1492: (2000) 4 Comp LJ 9 (SC) held that the words Section 22 are clear and unambiguous and that they provide that no suit for the enforcement of a guarantee in respect of any loan or advance granted to the concerned industrial company will lie or can be proceeded with without the consent of BIFR or the appellate authority. When the words of a legislation are clear, the court must give effect to them as they stand and cannot demur on the ground that the legislature must have intended otherwise.

Answer 7(b)

Under the UNCITRAL Model Law, foreign creditors have the same rights regarding the commencement of and participation in a proceeding under the laws of the enacting state relating to insolvency as creditors in the state. The Model Law contains following provisions for protection of the creditors (in particular local creditors), the debtors and other affected persons:

1. 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);
2. the court may subject the relief it grants to conditions it considers appropriate; and
3. 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 the above 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).

Further, the Model Law states that the courts that recognize Foreign Proceeding may, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant necessary interim or other relief as stipulated thereunder.

Answer 7(c)

Assets Reconstruction Company (ARC) means a company incorporated under the provisions of Companies Act, 1956 for the 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 the ARC is to work as an agent of the banks and or financial institutions for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers' assets taken over by the banks or financial institution, to act as receiver of properties of any bank or financial institution or to carry on such ancillary or incidental business with the prior approval of RBI whenever 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.

Question 8

- (a) *State the World Bank principles for effective insolvency and creditor rights systems. (7 marks)*
- (b) *On 2nd December, 1983, winding-up order was passed in respect of Heaven Ltd. On 1st December, 1989, official liquidator of Heaven Ltd. (in liquidation) initiated misfeasance proceedings against the promoter directors of the company. Directors pleaded that proceedings should be quashed being time barred. Briefly explain with support of relevant case laws, period of limitation for initiating misfeasance proceedings under the Companies Act, 1956. (4 marks)*
- (c) *Can an Indian court pass an order of amalgamation that has the winding-up effect in respect of the foreign company? Support your answer with relevant case law. (4 marks)*

Answer 8(a)

The World Bank Principles for effective insolvency and creditor rights system have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems that are fundamental to a sound investment climate, and to promote commerce and economic growth. Efficient, reliable and transparent creditor rights and insolvency systems are of key importance for reallocation of productive resources in the corporate sector, for investor confidence and forward looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales.

The Principles emphasize contextual, integrated solutions and the policy choices involved in developing those solutions. The Principles highlight the relationship between

the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements (Part A). The Principles also outline key features and policy choices relating to the legal framework for risk management and informal corporate workout systems (Part B), formal commercial insolvency law frameworks (Part C) and the implementation of these systems through sound institutional and regulatory frameworks (Part D).

The principles have broader application beyond corporate insolvency regimes and creditor rights. The Principles are designed to be flexible in their application, and do not offer detailed prescriptions for national systems. The Principles embrace practices that have been widely recognized and accepted as good practices internationally. As legal systems and business and commerce are evolutionary in nature, so too are the Principles, and it is anticipated that these will continue to be reviewed going forward to take account of significant changes and developments.

Answer 8(b)

No, proceedings are not time barred. In a similar case of *Ajay G Podar V. Official Liquidator Of JS & WM & Ors.* (2008) 85 CLA 398 (SC), Hon'ble SC has held that section 543(2) of the Companies Act, 1956 deals with the limitation of applications/claims including misfeasance proceedings and prescribes five (5) years period of limitation from the date of the winding up order for filing an application under section 543 (1). However, section 458A of the Companies Act, 1956 provides for the concept of computation of the limitation period. Section 458A being a non obstante clause exclude the period starting from commencement of winding up proceedings till the date on which winding up order is passed and a period of one (1) year thereafter. In view of the above, misfeasance proceedings filed by the Official Liquidator are well within limitation period.

Answer 8(c)

Yes, Indian Court can pass an order of amalgamation that has the winding up effect in respect of the foreign company. Section 390 of the Companies Act, 1956 provides definition and interpretation aid for sections 391 to 393 of the Act. In the case of *Bombay Gas Co. Pvt. Ltd. v. Regional Director* (1996) 21 CLA 269 (Bom.), it was held that Section 390(a) is applicable to a company incorporated outside India. If court has jurisdiction to wind up such a company on any of the grounds specified in the Act, court has jurisdiction to sanction scheme of amalgamation if a company incorporated outside India is a transferor-company.

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) State whether the following statements are correct or incorrect citing briefly relevant provisions of the law :
- (i) Court cannot refuse to sanction a scheme of arrangement which has been approved by majority of shareholders/creditors of the companies concerned.
 - (ii) Court would not insist on prior approval of stock exchange(s) while sanctioning a scheme of arrangement.
 - (iii) The word 'amalgamation' or 'merger' is not defined anywhere in the Companies Act, 1956.
 - (iv) The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 also apply to acquisition of global depository receipts (GDRs) or American depository receipts (ADRs).
 - (v) Filing of draft letter of offer with SEBI should be deemed or construed as conclusive evidence that the same has been vetted or approved by SEBI.
 - (vi) An offer made by the acquirer can be withdrawn unconditionally at any time without any demur or resistance of any party since the acquirer is at liberty to withdraw his offer.
 - (vii) The order of court sanctioning the scheme of arrangement is final and effective. Companies need not do any thing thereafter in respect of courts sanction. (2 marks each)
- (b) Distinguish between 'management buy-out' and 'management buy-in'. (3 marks)
- (c) A company whose shares were listed on a stock exchange for 3 months as on the relevant date made preferential allotment at Rs. 100 per share. On completing the period of 6 months of being listed on the stock exchange, the company recomputed the share price based on the guidelines issued by SEBI in this respect and price of share so recomputed came to Rs.150 per share. The company demanded additional amount of Rs. 50 per share from the allottees of shares. Is the action of the company justified ? Give reasons. (4 marks)
- (d) Grow Well Ltd. wants to adopt strategic planning to ensure its growth in the present day highly competitive scenario. As part of the management team, you are assigned with the role of highlighting the essential features such a planning should have. Suggest the features which you consider are vital for any strategic planning. (4 marks)

Answer 1(a)(i)

Statement is correct.

When a scheme of compromise/arrangement is sound not opposed to public policy and does not violate any law/statute and nature justice and is supported by majority of shareholders/creditors, the Court would sanction the scheme under Section 391 of the Companies Act, 1956.

Answer 1(a)(ii)

Statement is correct.

However, pursuant to clause 24 of the listing agreement, all listed companies shall have to file scheme/petition proposed to be filed before any Court/Tribunal under Sections 391, 394 and 101 of Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal.

Answer 1(a)(iii)

Statement is correct.

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'.

Answer 1(a)(iv)

Statement is partially correct.

It applies to the acquisition of Global Depository Receipts or American Depository Receipts provided as long as they are converted into shares carrying voting rights.

Answer 1(a)(v)

Statement is incorrect.

Filing of draft Letter of Offer with SEBI should not in any way be deemed or construed that the same has been cleared, vetted or approved by SEBI. The Letter of Offer is submitted to SEBI for a limited purpose of overseeing whether the disclosures contained therein are generally adequate and are in conformity with the Takeover Regulations.

Answer 1(a)(vi)

Statement is incorrect.

As per Regulation 27, no public offer, once made, shall be withdrawn except when:

- (a) the statutory approval(s) required have been refused;
- (b) the sole acquirer, being a natural person, has died; and
- (c) there are such circumstances which in the opinion of SEBI merits withdrawal.

Answer 1(a)(vii)

Statement is incorrect

Unless the copy of order is filed with ROC within 30 days from the Court's Order, the scheme can not be treated as effective.

Answer 1(b)

Management buy out – This situation occurs when the existing operating management and/or investors wish to buy the whole business, a division of the business or perhaps a product line. Specific financing is often provided by venture capitalists. In a management buy out, shareholders must be extra vigilant. The managers involved are of course looking to secure the best deal for themselves and this could lead them to withhold certain information from the shareholders. Shareholders often seek independent advice in these circumstances.

Management buy in - This is the situation when a group of managers from outside the business wish to buy into the business and run it, or buy into a division of the existing company.

Answer 1(c)

The action of the company is justified. Chapter XIII of SEBI (Disclosure and Investor Protection) Guidelines, 2000 clearly provided the rules regarding the price at which shares be issued on a preferential basis. The action of the company is in tune with those guidelines and hence correct as Chapter XIII, specially provides that where the equity shares are listed for less than six months, on completing a period of six months of being listed on a stock exchange, the company shall recompute the price of the shares in accordance with the provisions mentioned above and if the price at which shares were allotted on a preferential basis under clause was lower than the price so recomputed, the difference shall be paid by the allottees to the company.

Answer 1(d)

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 draws from both intuition and logic.
6. It accepts accountability to the community.
7. It helps to avoid hazardous response to environment.
8. It ensures optimum leveraging of firm's resources at every opportunity.

Question 2

(a) *“Section 391 is a boon to the corporate restructuring.” Critically examine the statement and discuss the relevant provisions relating to corporate restructuring. (8 marks)*

(b) *Will the court sanction a scheme of amalgamation where companies to the*

scheme tend to reshuffle their objects clause in the memorandum of association? Support your answer with case law. (4 marks)

- (c) *Relax Movies Ltd. is going for takeover of another company. Your advice is sought whether the company has to go for mandatory bidding. Advise with reference to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (3 marks)*

Answer 2(a)

Section 391 of the Companies Act, 1956 is a boon to corporate restructuring. This section along with Section 394, has proved to be a major legislative blessing for corporate restructuring in a variety of ways, such as amalgamation (merger) of two or more companies, demerger, division or partition of a company into two or more companies, hiving off a unit, as well as a compromise with the members or creditors of a company or an arrangement with respect to the share capital, assets or liabilities of the company etc.

It has been held in several cases that Section 391 is a 'complete code' or 'single window clearance system', and that the Court has been given wide powers under this section, to frame a scheme for the revival of a company. Being a complete code, the Court can, under this 'section', sanction a scheme containing all the alterations required in the structure of the company for the purpose of carrying out of the scheme.

Section 391 contemplates a compromise or arrangement between a company and its creditors or any class of them, or its members or any class of them, and provides machinery whereby such a compromise or arrangement may be binding on dissentient persons by an order of the Court. [*Oceanic Steam Navigation Co. In re.* (1939) 9 Comp. Cas. 229 (Ch.D)].

Answer 2(b)

Court will sanction the scheme if alteration of the memorandum is by reshuffling of the Objects Clause by shifting Other Objects to Main Objects, if transferee company has complied with provisions of Section 149(2A) [*Re: Rangkala Investments Ltd.* (1996) 1 Comp LJ 298 (Guj)].

Answer 2(c)

Takeovers usually take place when shares are acquired or purchased from the shareholders of a company at a specified price to the extent of at least controlling interest in order to gain control of that company. A person may acquire the voting shares of a listed company. A company may acquire shares of an unlisted company through what is called the acquisition under Section 395 of the Companies Act, 1956. Where the shares of the company are closely held by a small number of persons, a takeover may be effected by agreement with the holders of those shares. However, where the shares of a company are widely held by the general public, it involves the process of mandatory bidding as set out in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

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;
- (d) for acquiring control over a company.

Question 3

- (a) *Whether in a scheme of arrangement the meeting of shareholders and creditors can be dispensed with ? Supplement your answer with the help of case law.*
(4 marks)
- (b) *Whether non-compliance with the disclosure and related requirement is a violation of the SEBI Takeover Code ? Give your answer by referring to case law.*
(4 marks)
- (c) *Explain whether the transferee company is required to increase its authorised share capital by following the procedure laid down in the Companies Act, 1956 even though after amalgamation its authorised share capital is sufficient to issue shares to the shareholders of transferor company.*
(4 marks)
- (d) *Briefly state whether permission of the Reserve Bank of India is necessary for the compromise and arrangement of non-banking finance company (NBFC) with a bank.*
(3 marks)

Answer 3(a)

Members' and creditors' approval to the scheme of amalgamation is sine qua non for Court's sanction. Without that the Court cannot proceed. This approval is to be obtained at specially convened meetings held as per court's directions [Section 391(1)]. However, the court may dispense with meetings of members/creditors. Normally, creditors' meetings are dispensed with subject to certain conditions. For instance, members' meeting may be dispensed with if all the members' individual consent is obtained.

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

Answer 3(b)

No, there is no violation of takeover Regulations, the non-filing of resolution and non-disclosure of the pre-shareholding pattern and post-shareholding pattern cannot be

considered a violation of Takeover Code, but a short-coming or a lapse on the part of company would result in a breach, if there is an intention to do so. [*Ramesh Chandra Mansukhani NIR v. Adjudication Officer, SEBI (SAT)*].

Answer 3(c)

No. Since the authorized capital of the transferor company stands merged from the appointed date and transferred to and re-organised and re-classified as the authorized share capital of the transferee company and the combined share capital (authorized by articles) is sufficient to allot shares of the transferee company, the transferee company need not increase its authorized share capital. [*Motorola India (P) Ltd.*, in re 73 CLA 1].

Answer 3(d)

Section 44A of Banking Regulation Act, 1949 does not apply where NBFC is proposed to be merged with a Banking company. In case of *IndusInd Enterprises and Finance Ltd. v. IndusInd Bank Ltd. and (ICICI Ltd.)* Reported in 2002(3) COMP. L.J. 111, the contention that prior permission of RBI is necessary for the proposed amalgamation was rejected. However as per the recent RBI Notification, prior approval of RBI is necessary in cases of acquisition transfer of control of NBFCs' accepting deposits.

Question 4

- (a) Discuss 'funding through rehabilitation finance' as a source of funds for mergers/ takeovers. (6 marks)
- (b) Draft a suitable Board resolution with respect to takeover for the following :
 - (i) Appointment of a merchant banker,
 - (ii) Opening of an Escrow account. (3 marks each)
- (c) Can shareholders seek an amendment to the swap ratio in the scheme of merger? Supplement your answer by referring to case law. (3 marks)

Answer 4(a)

BIFR has been arranging such takeover from time to time in which creditor financial institutions and banks have been providing consortium financial packages in promoting mergers.

Merger or takeover may be provided for in a scheme of rehabilitation under the Sick Industrial Companies (Special Provisions) Act, 1985.

The Sick Industrial Companies (Special Provisions) Act, 1985 provides for reference to the Board for Industrial and Financial Reconstruction (BIFR) of a sick industrial company. Once a reference is made, BIFR will cause an enquiry, appoint an operating agency for determination of measures necessary for rehabilitation of the sick company, direct the preparation of a rehabilitation scheme, which may provide, inter alia, for

- (i) rehabilitation finance for the sick company;
- (ii) merger of the sick company with a healthy company or merger of a healthy company with the sick company;
- (iii) takeover of the sick company by a healthy company;
- (iv) such other preventive, ameliorative and remedial measures as may be appropriate.

The scheme is prepared by the operating agency, and after the same is sanctioned becomes operative and binding on all the concerned parties including the sick company and other companies – amalgamating, merging, the amalgamated or the merged companies.

Answer 4(b)(i)

Appointment of Merchant Banker

“RESOLVED THAT M/s being Category-I Merchant Banker be and is hereby appointed as Merchant Banker for aforesaid public offer, on the terms and conditions as contained in the draft letter of appointment placed before the meeting duly initialed by the Chairman for the purpose of identification, for making the public announcement of the takeover offer in the newspapers, forward the same to the Securities and Exchange Board of India, Stock Exchange(s) and to the target company and to draft the Letter of Offer to be sent to the shareholders of, target company in accordance with the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997”.

Answer 4(b)(ii)

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.”

Answer 4(c)

The exchange ratio is a matter of expert determination. It is the major ground on which the foundation of scheme of amalgamation is based and any change in the exchange ratio may vitiate the scheme. In this regard, a reference can be made to the decision of the Bombay High Court wherein it was held that swap ratio forms integral part of a scheme of amalgamation, and no shareholder can seek amendment to the swap ratio in a scheme of amalgamation. [*Dinesh Veajlal Lakhani v. Parke Davis (India) Ltd.* (2005) 66 CLA (Bombay)].

Question 5

- (a) *What are the safeguards incorporated in takeover process so as to ensure that shareholders get their payments under the offer or receive back their share certificates ?* (4 marks)
- (b) *Gopal has acquired shares in Aadil Ltd., but he is yet to be registered as a member. He has made an application to the court for modification in the scheme*

proposed under section 391. Is he entitled under the Companies Act, 1956 to move such an application ? (4 marks)

(c) *The capital structure of Johar Ltd. is as follows :*

- 5 lakh equity shares of Rs.10 each fully paid-up.
- 10 lakh equity shares of Rs.10 each on which Rs.5 is paid-up.
- Free reserves of Rs.3 crore.

The Board of directors of the company has passed a resolution authorising the buy-back of shares worth Rs.40 lakh for the financial year 2009-10. Is the Board of directors empowered to do so ? Give reasons. (4 marks)

(d) *Abhay Ltd. has filed a petition before the High Court of Bombay for sanction of a scheme of amalgamation with Gel Well Ltd., and the petition is posted for hearing, to Monday, the 8th March, 2010. The court has ordered to serve notice of the hearing of the petition on the creditors. As the Company Secretary of Abhay Ltd., draft the notice.* (3 marks)

Answer 5(a)

Safeguards provided to shareholders in Takeover process:

- (i) Acquirer, before making public announcement has to open an Escrow Account with a Commercial Bank or deposit a bank guarantee in favour of merchant banker.
- (ii) Merchant banker to confirm adequate financial arrangements.
- (iii) In case of failure of acquirer to make payment, merchant banker to distribute proceeds as under:
 - 1/3 of amount to target company.
 - 1/3 to regional SEs for investor fund.
 - 1/3 to be distributed on prorata basis among shareholders.

Answer 5(b)

Yes. Under Section 392(2), the court may on its own motion or on application of any person interested in the affairs can make an order for modification. Application can be made by any person interested, which included a person who has obtained a transfer of shares but yet to be registered as a member. It is not restricted to a creditor or liquidator of the company. [*K.K. Gupta v. K P Jain* (1979) 49 Company Cases 342: AIR 1979 SC 734].

Answer 5(c)

Board by passing a resolution can authorize the buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company [Proviso to section 77A(2)].

But the buy-back of equity shares in any financial year should not exceed 25% of the total paid-up equity capital of the company [Proviso to section 77A(2)(c)].

In this case

10% of paid-up equity share capital and free reserves = Rs.40,00,000 i.e. 10% of (Rs.50,00,000+Rs.50,00,000+Rs.300,00,000)

25% of paid-up equity capital + Rs.25,00,000 i.e. 25% of (Rs.50,00,000 + Rs.50,00,000).

So the Board is not empowered to buy-back shares worth Rs.40,00,000.

Answer 5(d)

IN THE HIGH COURT OF JUDICATURE AT MUMBAI

Ordinary Civil Jurisdiction

Company Petition No. _____ of _____

Company Application No. _____ of _____

In the matter of Sections 391 and 394 of the Companies Act, 1956

And

In the matter of Scheme of Amalgamation between ABC Ltd. and XYZ Ltd.

ABC Ltd. a company incorporated under the Companies Act, 1956, having its registered office at _____, Mumbai.

ABC Ltd. _____ Petitioner

Notice to Creditors

Please take notice that a petition under sections 391 and 394 of the Companies Act, 1956, for sanction of the Scheme of Amalgamation of the Petitioner Company with XYZ Ltd. was presented by the Petitioner Company on the _____ was admitted on the _____ day of _____, and the said Petition is fixed for hearing before the Learned Judge taking company matters on Wednesday the 8th day of March 2010 at _____ AM/ PM.

PART B

(Answer ANY TWO questions from this part.)

Question 6

- (a) *Laxmi Bank Ltd. has approached you for your professional advice about the rights available to it for enforcing the security interest under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. Highlight the rights and the advantages to the bank by resorting to that mode of recovery citing the relevant provisions of the said Act. (5 marks)*
- (b) *Kuber Bank Ltd. has obtained a decree from a civil court to recover an amount of Rs.20 lakh with 12% interest and the court has allowed it to proceed against the commercial building given as security for the loan. Can the decree be treated as a debt under the SARFAESI Act, 2002 ? Cite the relevant provisions of law in support of your answer. (5 marks)*

- (c) *Amir Bank has issued a bank guarantee for and on behalf of Madhuri Ltd., an industrial company in connection with loans granted to the company. The company became sick. While the proceedings before Board for Financial and Industrial Reconstruction (BIFR) is going on, the beneficiary of the bank guarantee invoked it and demanded payment from Amir Bank. The bank has sought your expert opinion in the matter. Give your opinion based on legal provisions and judicial decisions.* (5 marks)

Answer 6(a)**Enforcement of Security interest by a Creditors**

Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 provides for the enforcement of security interest by a secured creditor straight away without intervention of the court, on default in repayment of instalments, and non compliance with the notice of 60 days after the declaration of the loan as a non-performing asset. It must, however, be remembered that the classification of assets as non performing is not on the mere whims and fancies of the financial institutions. The Reserve Bank of India has a detailed policy providing guidelines or prudential norms in that regard.

The Secured Creditor has been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustee appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance.

The secured creditor has two options. It can either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act.

Section 13(4) of the Act empowers the recourse to one more of the following measures, after giving proper notice, for the recovery of the secured debts, namely:

- Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;
- Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured asset;
- Appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- Require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

Advantages

Bank can take possession of the security and sell it without the intervention of court.

As per section 15 of the Act –

On publication of the notice of taking over the management of the business of the borrower the directors of the company or administrators of the business deemed to have vacated their office.

Shareholders cannot pass resolutions or appoint directors without the consent of the bank.

No proceeding for winding up of the borrower company or the appointment of receiver shall lie in any court without the consent of the bank.

If any reference is pending, it shall abate if 75% of the secured creditors have taken measures to recover their secured debts.

Answer 6(b)

Section 2(1)(ha) of the SARFAESI Act defines that “debt” shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. As per Section 2(g) of the Act, “Debt” means any liability (inclusive of interest) which is claimed alleged as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgagee and subsisting on, and legally recoverable on, the date of the application.

So the decree can be treated as a debt.

Answer 6(c)

Section 22 of SICA, 1985 grants several immunities to a sick industrial company. One such immunity is that no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or proceed with further except with the consent of BIFR or its Appellate Authority.

The above protection is available in respect of an industrial company when an inquiry under Section 16 is pending in relation to the said industrial company or when any scheme referred to under Section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under Section 25 relating to an industrial company is pending.

The protection under section 22 of SICA is a superior protection and has an overriding effect on any other law or any other instrument having effect under other laws.

So the beneficiary is not entitled to invoke the guarantee without the permission of the BIFR [*Maharashtra Tubes Ltd. v. State Industrial and Investment Corporation of Maharashtra Ltd. (SC)*, *Patheja Bros. Forgings and Stamping v. ICICI Ltd. (SC)*].

Question 7

- (a) *Explain the role of BIFR and the concerned High Court in winding-up of a sick industrial company mentioning the relevant provisions of the law and judicial decision(s).* (5 marks)
- (b) *There was an agreement between a company having its registered office at Delhi with its creditors having their office at Mumbai. It contained a clause that in case of dispute between them, only the courts in Mumbai will have the jurisdiction. On the basis of the clause, the creditors filed a winding-up petition before High Court of Bombay. The company has asked your professional opinion in the matter. How will you advise the company ?* (5 marks)
- (c) *Recovery Officer under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 has issued an order and the defendant wants to challenge the order. What will be your advice to the defendant based on the relevant provisions in the Act ?* (5 marks)

Answer 7(a)**Role of BIFR and concerned High Court**

- After making necessary inquiry under Section 16 and after giving an opportunity to all concerned parties, if BIFR is of the opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time and it is not likely to become viable in future and as such it is just and equitable to wind up the company, BIFR may record and forward its opinion to the concerned High Court.
- The High Court shall, on the basis of the opinion of the Board, order winding up of the sick industrial company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.
- For the purpose of winding up, the High Court may, with the consent of the operating agency, appoint any officer of the operating agency, as the liquidator and such officer, if appointed shall be deemed to be, and have all the powers of, the official liquidator under the Companies Act, 1956.
- When BIFR recommends the winding up of a sick industrial company pursuant to Section 20(1) of the SICA, 1985 and forwards its opinion to the connected High Court, the High Court is bound to order the winding up of the company on the basis of the opinion of BIFR.
- Once BIFR forwards its opinion to the connected High Court, the role of BIFR comes to an end in respect of the said sick industrial company.

Answer 7(b)

Only Delhi High Court where the registered office of the company is situated has jurisdiction in winding up, even if there is an agreement between the company and its

creditors that Mumbai courts will have jurisdiction in case of dispute between them and the company. Cases – *GTC Industries Ltd. v. Parasrampur Trading (All HC)*, *LKP Merchant Financing v. Arwin Liquid Gases (Guj)*.

Answer 7(c)

The defendant has to challenge the order of the Recovery Officer by way of appeal to the Debt Recovery Tribunal within 30 days on which a copy of the order is issued to him. The Tribunal may, after giving an opportunity to the appellant to be heard and after making such inquiry as it deems fit, confirm, modify or set aside the order of the Recovery Officer in exercise of his powers under section 25 to 28 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

Question 8

- (a) *The trade union of workers of a company has filed a winding-up petition of their company. State the legal position citing relevant case law. (5 marks)*
- (b) *Debt Recovery Tribunal (DRT) has passed an interim order attaching the property of the defendant. The defendant wants to challenge this order on the ground that DRT has no power to pass interim orders. Explain the legal provisions in this regard. (5 marks)*
- (c) *As the Company Secretary of a company, mention your duties in respect of compulsory winding-up. (5 marks)*

Answer 8(a)

Section 439 of the Companies Act, 1956 confers right upon certain persons to file a winding up petition. The said section does not authorize the workers to make a winding up petition. So the workers cannot make a winding up petition. (no locus standi)

But workers are entitled to be heard as interveners but not as parties. After the winding up order is made the workers may appeal against it. But once the order becomes final, the workers shall not participate in further proceedings [*National Textile Workers' Union v. P.R. Ramakrishnan (SC)*].

Answer 8(b)

The Debt Recovery Tribunals are empowered to pass interim orders whether by way of injunction or stay or attachment against the defendant to debar him from transferring, alienating or otherwise dealing with, or disposing of, any property and assets belonging to him without the prior permission of the tribunal. However, there are judgments of Supreme Court and the High Courts which have laid down the conditions which must be followed by the Tribunals before passing such orders.

Generally, they have to first hear the defendants before the orders are passed. The Tribunal should be satisfied by affidavit or otherwise that the defendant with the intent to obstruct or delay or frustrate the execution of any order for recovery of the debt that may be passed against him is about to dispose of the property, to remove it from the local jurisdiction of the Tribunal, likely to cause any damage to the property or create third party interest before passing the orders.

Answer 8(c)**Duties of the Secretary in respect of Compulsory Winding Up**

The duties of the Secretary in respect of compulsory winding up of the company may be enumerated as follows:

- (i) If the company itself makes the petition for compulsory winding up, the Secretary should help the directors in drawing up the petition.
 - (ii) He should see that a copy of winding up order, when passed by the Court is filed with the Registrar within 30 days of the making of the order.
 - (iii) He should help in preparation of the statement of affairs of the company in the prescribed form for submission to the Official Liquidator. He should see that it is properly verified by an affidavit.
 - (iv) He should give all necessary information to the Court, when called upon by it during the course of the winding up.
 - (v) He should see that all documents, correspondence etc., issued by the company during the period of winding up contain a statement that the company is being wound up.
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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 with in 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 Damani's 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 Damani's 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)

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. Dhanlakshmi 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.

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) Big Ltd. prepared a scheme of amalgamation and arrangement with Small Ltd. and Little Ltd. and the scheme has gone through the required formalities and court approved the scheme, in which the swap ratio was provided as under :

- (i) The transferor Company No.1 — Small Ltd. : The shareholders of Small Ltd. will get one equity share of ₹10 each of Big Ltd. for every 2 shares fully paid-up of Small Ltd.
- (ii) The transferor Company No.2 — Little Ltd. : The shareholders of Little Ltd. will get one equity share of ₹10 each fully paid-up for every 5 equity shares fully paid-up of Little Ltd.

There were no other types of shares in the companies on the record date fixed for swap ratio.

The capital structure of the transferee company (amalgamated company) and the transferor companies (amalgamating companies) was as under on appointed date, and there was no change in this regard upto date as aforesaid:

Particulars	Big Ltd.	Small Ltd.	Little Ltd.
Equity share capital (Nos.)	10,00,000	8,00,000	7,00,000
Fully paid-up equity share @ ₹10 each (₹)	1,00,00,000	80,00,000	70,00,000
Reserves and surplus (₹)	50,00,000	70,00,000	50,00,000
Total (₹)	<u>1,50,00,000</u>	<u>1,50,00,000</u>	<u>1,20,00,000</u>

Investments of Big Ltd. :

Equity shares of Small Ltd. of ₹10 each fully paid-up in Small Ltd. —

Equity shares (Nos.)	3,00,000
Nominal value (₹)	30,00,000
Paid-up value (₹)	30,00,000

Equity shares of Little Ltd. of ₹10 each fully paid-up in Little Ltd.

Equity shares (Nos.)	2,00,000
Nominal value (₹)	20,00,000
Paid-up value (₹)	20,00,000

As a Company Secretary and CFO of Big Ltd. (the transferee company), how would you deal with —

(i) *the issues for effecting the allotment of equity shares of Big Ltd. for which shareholders' approval was received under section 81(1A).*
(3 marks)

(ii) *the number of equity shares of Big Ltd. of ₹10 each fully paid-up to be issued to the shareholders of Small Ltd. and Little Ltd.*
(6 marks)

And also state that the total number of issued equity shares of Big Ltd. after such allotment.
(1 mark)

(b) *State whether the following statements are true or false citing briefly relevant provisions of the law :*

(i) *A company seeking amalgamation with another company, passed a resolution under section 391(2), as per direction of the court and did not file the same with the Registrar of Companies under section 192, on the plea that it is neither an ordinary nor a special resolution but an extra-ordinary resolution.*

(ii) *A company called a meeting of members of the company under direction of the court for amalgamation with another company and excluded the proxies for the purpose of counting quorum.*

(iii) *The date of agreement made by the merchant banker with the acquirer is treated as 'deemed date of offer' for the purpose of acquisition of shares and/or control in the target company.*

(iv) *The order sanctioning the scheme of amalgamation made by the court should be filed with the Registrar of Companies. If the order is not filed with the Registrar of Companies, it will not have any effect.*

(v) *Every notice of any meeting called as per orders of court under section 391 shall not include explanatory statement.*
(2 marks each)

(c) *Explain the circumstances where reduction of share capital is done without confirmation by the court.*
(5 marks)

Answer 1(a)(i)

After receiving the order from the Hon'ble Court, a copy of the court order be filed with ROC to make the merger effective in the eye of law.

A Board Resolution to be passed for allotment of equity shares of Rs.10 each fully paid up to the shareholders of the transferor companies and file the necessary e-forms (e-form 2) with Registrar of Companies.

The investment in the Small Ltd. and Little Ltd. to be written off and cancelled from the books of Big Ltd.

Answer 1(a)(ii)

The number of equity shares to be allotted to the shareholders of Small Ltd.

Paid up equity shares (Nos.)	8,00,000
Less : Cross holding (between transferor and transferee company - liable to be cancelled)	3,00,000
Net number of shares to be swapped	5,00,000
Swap ratio	1:2
New shares of Big Ltd. to be allotted	2,50,000 nos.

The number of equity shares to be issued to the shareholders of Little Ltd.

	<i>Little Ltd.</i>
No. of paid equity shares	7,00,000
Less : Cross holding between the transferor and transferee company	2,00,000
Net Shares to be swapped	5,00,000
Swap Ratio	1:5
Net share to be allotted	1,00,000

After the allotment, the total number of issued equity shares stands as under:

	<i>Nos.</i>
Big Ltd. No. of equity shares before merger	10,00,000
Allotted to shareholder of Small Ltd.	2,50,000
Allotted to shareholder of Little Ltd.	1,00,000
Total No. of issued shares	13,50,000

Answer 1(b)

- (i) **True.** A full bench of the Punjab and Haryana High Court in *Hind Lever Chemicals Limited and Another* [2005] 58S CL 211 (Punj. & Har.) held that the language of Section 391(2) of the Act is totally unambiguous and a plain reading of this provision clearly shows that the majority in number by which a compromise or arrangement is approved should represent three-fourth in value of the creditors/ shareholders who are 'present and voting' and not of the total value of the shareholders or creditors of the company. This is neither an ordinary resolution nor a special resolution within the purview of Section 189 of the Act. This is an extraordinary resolution. A copy of this resolution need not be filed with the Registrar of Companies under Section 192.
- (ii) **False.** Proxies are to be counted for the purpose of quorum for the meeting called under direction of the Court for amalgamation with another company.

In terms of Section 391, the resolution has to be approved by a majority of members representing three-fourths in value of the creditors or class of creditors or members or class of members as the case may be present and voting either in person or by proxy.

- (iii) **False.** The offer under SEBI (SAST) Regulations, 1997 is deemed to have been made on the date of publication of the public announcement in any of the newspapers.
- (iv) **True.** As per Section 391(3) of the Companies Act, 1956, the order made by the court under Sub-section (2) of Section 391 should be filed with the Registrar of Companies. If the order is not filed with the Registrar, the amalgamation ordered by the Court shall not have any effect.
- (v) **False.** Section 393(1) of the Companies Act, 1956 lays down that where a meeting of creditors or members or any class of them is called under Section 391:
 - (a) with every notice calling the meeting which is sent to a creditor or a member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effects and in particular, stating any material interests of the directors, managing director or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise and the effect on those interests, of the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons; and
 - (b) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

Answer 1(c)

Reduction of share capital without sanction of the Court

The following are cases which amount to reduction of share capital but where no confirmation by the Court is necessary:

- (a) *Surrender of shares* – “Surrender of shares” means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital.
- (b) *Forfeiture of shares* – A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Court, when it is re-issued.
- (c) *Diminution of capital* – Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 94(1)(3)].
- (d) Redemption of redeemable preference shares.

- (e) Purchase of shares of a member by the company under Section 402.
- (f) Buy-back of its own shares under Section 77A.

Question 2

- (a) *What is the difference between 'compromise' and 'arrangement' ?*
(5 marks)
- (b) *Explain briefly the procedure for making application to court under section 391 for directions to hold meetings of shareholders/creditors.*
(5 marks)
- (c) *What factors will you consider for valuation of shares in merger/amalgamation ?*
(5 marks)

Answer 2(a)**Difference between Compromise and Arrangement**

The meaning of the expression 'arrangement' as given under Section 390(b) of the Companies Act, 1956 includes reorganization of share capital of the company by consolidation of shares of different classes or division into different classes of shares or both. 'Compromise' presupposes the existence of a dispute which it seeks to settle. Nothing like that is implied in the 'arrangement' which has wider meaning than 'compromise'. An arrangement involves an exchange of one set of rights and liabilities for another. All modes of reorganizing the share capital, takeover of shares of one company by another including interference with preferential and other special rights attached to shares can form part of an arrangement proposed with members.

Answer 2(b)**Application to High Court seeking direction to hold meetings**

Rule 67 of the Companies (Court) Rules, 1959 lays down that an application under Section 391(1) of the Companies Act, 1956 for an order seeking direction for convening meeting(s) of creditors and/or members or any class of them shall be by way of Judge's summons supported by an affidavit. A copy of the proposed scheme should be annexed to the affidavit as an exhibit thereto. The summons should be moved ex parte in Form No. 33 of the Companies (Court) Rules, 1959. The affidavit in support of the application should be in Form No. 34.

Answer 2(c)

Determining the value of a business is a complicated and intricate process. Valuing a business requires the determination of its future earnings potential, the risks inherent in those future earnings. Strictly speaking, a company's fair market value is the price at which the business would change hands between a willing buyer and a willing seller when neither are under any compulsion to buy or sell, and both parties have knowledge of relevant facts.

Arriving at the transaction price requires that a value be placed on the company for sale. The process of arriving at this value should include a detailed, comprehensive analysis which takes into account a range of factors including the past, present, and

most importantly, the future earnings and prospects of the company, an analysis of its mix of physical and intangible assets, and the general economic and industry conditions.

The other salient factors include:

- (1) The stock exchange price of the shares of the two companies before the commencement of negotiations or the announcement of the bid.
- (2) Dividends paid on the shares.
- (3) Relative growth prospects of the two companies.
- (4) In case of equity shares, the relative gearing of the shares of the two companies.
(‘gearing’ means ratio of the amount of Issued preference share capital and debenture stock to the amount of issued ordinary share capital.)
- (5) Net assets of the two companies.
- (6) Voting strength in the merged (amalgamated) enterprise of the shareholders of the two companies.
- (7) Past history of the prices of shares of the two companies.

Merger and amalgamation deals can take a number of months to complete during which time valuations can fluctuate substantially. Hence provisions must be made to protect against such swings.

Question 3

- (a) *Sharad who is a promoter of Grow Good Ltd. holds 20% of paid-up share capital of the company. The shares of the company are listed on National Stock Exchange Ltd., Mumbai. Sharad would like to pledge his shares for obtaining loan. State the requirements for disclosure of pledged shares under the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009.* (8 marks)
- (b) *Explain the provisions relating to ‘escrow account’ under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.* (7 marks)

Answer 3(a)

Sharad has to comply with the following requirements :

Disclosure of pledged shares (Regulation 8A)

- (1) A promoter or every person forming part of the promoter group of any company is required to disclose details of shares of that company pledged by him, if any, to that company, within 7 working days from the date of creation of pledge on shares of that company held by him.

A promoter or every person forming part of the promoter group of any company shall, within 7 working days from the date of invocation of pledge on shares of that company pledged by him, inform the details of invocation of such pledge to that company.

Compliance requirements by Growgood Ltd.

- (2) The company shall disclose the information received as above (i.e. from Mr. Sharad) to all the stock exchanges, on which the shares of company are listed, within 7 working days of the receipt thereof, if, during any quarter ending March, June, September and December of any year,:-
- (a) aggregate number of pledged shares of a promoter or every person forming part of promoter group taken together with shares already pledged during that quarter by such promoter or persons exceeds twenty five thousand; or
 - (b) aggregate of total pledged shares of the promoter or every person forming part of promoter group alongwith the shares already pledged during that quarter by such promoter or persons exceeds one per cent. of total shareholding or voting rights of the company, whichever is lower.”

Answer 3(b)

Escrow Account

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 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 value of escrow amount shall be 25%, upto Rs.100 crores and 10% above Rs.100 crores, of the consideration payable under the public offer. In case the acquirer has made the offer subject to a minimum level of acceptance and he does not want to acquire minimum of 20% then he has to provide 50% of the consideration payable under the offer in cash in escrow account. The acquirer has the option of keeping differential pricing and if he so opts, he shall deposit in the escrow account, amount calculated with reference to highest price offered. In the event of upward revision of the offer, the acquirer is supposed to enhance the escrow value upto 10% of consideration payable upon such revision.

The acquirer can exercise the option of tendering bank guarantee or approved securities in escrow account instead of cash. Bank guarantee has to be executed by acquirer in favour of merchant banker and has to be valid atleast for a period commencing from the date of public announcement until 20 days after closure of the offer. 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. Merchant Banker is also prohibited from returning the bank guarantee or securities until all the obligations under the offer have been completed by the acquirer. In case, the acquirer offers bank guarantee or approved securities in the escrow account, he shall deposit with a bank atleast 1% of total consideration payable. 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.

Question 4

- (a) *Explain funding through swaps or stock to stock merger.* (5 marks)
- (b) *Draft a suitable Board resolution with respect to takeover for the following :*
- (i) *offer by offeror company; and*
 - (ii) *authorisation to invest in the shares of investee company.* (4 marks each)
- (c) *Sanction to the scheme of amalgamation can be refused by the court on the ground that the transferee company does not have sufficient authorised share capital on the appointed date. Do you agree ? Give reasons.* (2 marks)

Answer 4(a)**Funding through Swaps or Stock to Stock Mergers**

In stock swap mergers, or stock-for-stock mergers, the holders of the target company's stock receive shares of the acquiring company's stock. The majority of mergers during the past few years have been stock-for-stock deals. A merger arbitrage specialist will sell the acquiring company's stock short, and will purchase a long position in the target company, using the same ratio as that of the proposed transaction. (If the purchasing firm is offering a half share of its stock for every share of the target company, then the merger arbitrageur will sell half as many shares of the purchasing firm as he or she buys of the target company.

As with all mergers, stock swap mergers may involve event risk. In addition to the normal event risks, stock swap mergers involve risks associated with fluctuations in the stock prices of the two companies.

The terms of the deal involve an exchange of shares and are predicted on the prices of the two companies' stock at the time of the announcement, drastic changes in the shares prices of one or both of the companies can cause the entire deal to be re-evaluated. Merger arbitrageurs derive returns from stock swap mergers when the spread or potential return justifies the perceived risk of the deal's failing.

Answer 4(b)(i)**Offer by Offeror Company**

RESOLVED THAT an offer be made, to the persons who are the members of..... Ltd. as on....., for acquisition of..... equity shares of Rs. 10/- each representing a.....% of the total issued capital of the.....Ltd.

RESOLVED FURTHER THAT above said offer shall remain open till..... at a price of Rs. each.

RESOLVED FURTHER THAT shares be accepted even if such shares in aggregate are less than the limit mentioned above and in case shares offered exceed the limit, the company shall have an option to accept or reject the same in consultation with the concerned authorities and offer will be accepted according to the order in which they are received and full shareholding of the members accepting the offer be acquired subject to abovementioned limit."

Answer 4(b)(ii)**Authorisation to invest in the shares of investee company**

Board Meeting Resolution under section 372A of the Companies Act, 1956.

Resolved that pursuant to section 372A and other applicable provisions if any, of the Companies Act, 1956 and authorization given by the members of the company at their meeting held on unanimous consent of the Board of Directors be and is hereby given to invest upto equity shares of M/s. ABC Ltd. at a price of Rs..... each.

Answer 4(c)

No, Sanction to scheme of amalgamation cannot be refused on the ground that the transferee company does not have sufficient authorised capital on the appointed date. If the scheme is sanctioned, the transferee company can thereafter increase its authorised capital to give effect to the scheme [*Re: Mahavir Weaves Pvt. Ltd.* (1985) 83 Comp. Cas 180].

Question 5

- (a) *A company has passed a special resolution for 'reduction of capital' and effected the same and applied before the Registrar of Companies (ROC) for issuance of certificate confirming the reduction.*

The ROC issued certificate confirming the reduction. Subsequently, it was found that :

- (i) the company had no authority under its articles to reduce capital; and*
- (ii) the special resolution was invalid one.*

State with brief reasons separately in both the above circumstances, whether the reduction of capital would be allowed. (4 marks)

- (b) *It is a well known fact that to maximise the shareholders value, a company having surplus funds often induced to buy-back its own shares. What are common reasons which usually induces a company to resort to buy-back ?*

(5 marks)

- (c) *A listed company had drafted a special resolution to be passed through postal ballot to buy-back 25% of its paid-up equity share capital. As a Company Secretary, you are required to draft the explanatory statement to the proposed resolution. What factors will you consider to prepare the explanatory statement?*

(3 marks)

- (d) *A company whether listed or not is required to make a 'declaration of solvency' and has to submit to the appropriate authorities before making a buy-back of shares. In view of the statement, you are required to answer where the declaration of solvency is to be submitted in case of —*

- (i) A listed company.*
- (ii) An unlisted company.*
- (iii) A private limited company.*

(1 mark each)

Answer 5(a)**Conclusiveness of certificate for reduction of capital**

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd.*, (1903) 88 LT 792 (Ch D)]. Similarly, in a case where the special resolution for reduction was an invalid one, but the company had gone through with the reduction, the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook*, (1900) 2 QB 376].

Answer 5(b)

Good corporate governance calls for maximizing the shareholder value. When a company has surplus funds for which it does not have good avenues for deployment assuring an average return on capital employed and earnings per share, the company's financial structure requires balancing.

The reasons for buy-back may be one or more of the following:

- (i) to improve earnings per share;
- (ii) to improve return on capital, return on net worth and to enhance the long-term shareholder value;
- (iii) to provide an additional exit route to shareholders when shares are under valued or are thinly traded;
- (iv) to enhance consolidation of stake in the company;
- (v) to prevent unwelcome takeover bids;
- (vi) to return surplus cash to shareholders;
- (vii) to achieve optimum capital structure;
- (viii) to support share price during periods of sluggish market conditions;
- (ix) to service the equity more efficiently.

The decision to buy-back is also influenced by various other factors relating to the company, such as growth opportunities, capital structure, sourcing of funds, cost of capital and optimum allocation of funds generated.

Answer 5(c)

Whereas unlisted companies should obtain shareholders' approval by passing the special resolution only at a duly convened general meeting, listed companies should obtain such approval by postal ballot.

The notice containing the special resolution proposed to be passed should be accompanied by an explanatory statement stating:

- (a) all material facts, fully and completely disclosed;
- (b) the necessity for buy-back;

- (c) the class of security intended to be purchased under the buy-back;
- (d) the amount to be invested under buy-back; and
- (e) the time limit for completion of buy-back [Section 77A(3)].

Answer 5(d)

- (i) In the case of buy-back of listed securities, before making a buy-back, the company must file with the Registrar of Companies and SEBI, a declaration of solvency in the prescribed form.
- (ii) In the case of unlisted companies, a declaration of solvency has to be filed with Registrar of Companies before buy-back of shares.
- (iii) In the case of private Limited Companies, the Declaration of Solvency is to be filed with Registrar of Companies before buy-back of shares.

PART B

(Answer ANY TWO questions from this part.)

Question 6

- (a) *Immunity from certain litigations to 'sick company' is the purpose of the Sick Industrial Companies (Special Provisions) Act, 1985. Discuss with reference to the legal provisions of the Act.* (7 marks)
- (b) *Explain the composition of debt recovery tribunals and explain the procedure for appeal to Appellate Tribunal.* (8 marks)

Answer 6(a)

Immunity from Certain Litigations – Section 22

The protection under Section 22 of SICA is a superior protection as it operates notwithstanding anything contained in the Companies Act, 1956, or any other law or the memorandum and articles of association of the industrial company or any other instrument having effect under the said Act or other law. The above protection is available in respect of an industrial company when an inquiry under Section 16 is pending in relation to the said industrial company or when any scheme referred to under Section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under Section 25 relating to an industrial company is pending.

Where the management of the sick industrial company is taken over or changed in pursuance of any scheme sanctioned under Section 18, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof and no suit for the recovery money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of BIFR or, as the case may be, the Appellate Authority.

Further it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company and no

resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by BIFR.

Answer 6(b)

Composition of Tribunal

The Recovery of Debt Due to Banks and Financial Institutions Act, 1993 provides that a Tribunal shall consist of one person only, to be called the Presiding Officer, to be appointed, by notification, by the Central Government. The Central Government may also authorise the Presiding Officer of one Tribunal to discharge also the functions of the Presiding Officer of another Tribunal. Any person who is, or who has been, or is qualified to be, a District Judge may be appointed as the Presiding Officer, who shall, hold office for a term of five years from the date on which he enters his office or until he attains the age of sixty-two years, whichever is earlier.

The Central Government shall also appoint one or more Recovery Officers and such other officers and employees as the Government may think fit. The Recovery Officers and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer.

Appeal to the Appellate Tribunal

Section 20 of the Act provides that any person aggrieved by an order made, or deemed to have been made, by a Tribunal under this Act, may prefer an appeal to an Appellate Tribunal having jurisdiction in the matter. No appeal shall lie to the Appellate Tribunal from an order made by a Tribunal with the consent of the parties. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made, or deemed to have been made, by the Tribunal is received by him and it shall be in such form and accompanied by such fee as may be prescribed. Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

Question 7

- (a) *In a voluntary winding-up, all is left to the company, the contributories and the creditors to settle their affairs 'without intervention of the court as far as possible'. Can the court pierce the process, and what is its vested power to pierce the process, and when and where it is being exercised ? Briefly discuss all relevant aspects.* (5 marks)
- (b) *In consequence of winding-up of a limited company, a person becomes both contributory and a creditor almost for the same amount. The person made an application to the liquidator that the amount to be payable as 'contributory' may be set-off against his 'receivable' amount from the company. Shall the person get such relief ? If not, why and on what grounds ?* (5 marks)
- (c) *What is 'non performing asset' (NPA) under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ?* (5 marks)

Answer 7(a)

In voluntary winding up it is left to the company, the contributories and the creditors to settle their affairs without intervention of the Court as far as possible. However, the

Companies Act, 1956, contains certain provisions which provide a means of access to the Court with a view to speed up the liquidation proceedings and to overcome the difficulties that may arise in the course of liquidation. The Court will intervene in the voluntary winding up whenever it is satisfied that such an intervention will be just and beneficial. In appropriate cases the Court can be approached for compulsory winding up (Section 440) or winding up being conducted under the supervision of the Court (Section 522).

The Court is vested with the following powers in voluntary winding up:

- (i) To appoint the Official Liquidator or any other person as liquidator where no liquidator is acting [Section 515(1)].
- (ii) To remove the liquidator and appoint the Official Liquidator or any other person as liquidator on justifiable cause being shown [Section 515(2)].
- (iii) To determine the remunerations of liquidator when the Official Liquidator is appointed as a liquidator [Section 515(3)].
- (iv) To amend, vary, confirm or set aside the arrangement entered into between a company and its creditors on an appeal being made by any creditor or contributory within 3 weeks of the completion of the arrangement (Section 517).
- (v) On an application of the Liquidator or contributory or creditor:
 - (a) to determine any question arising in the winding up of a company [Section 518(1)(a)];
 - (b) to exercise, as respects the enforcing of calls, the staying of suits or other legal proceedings or any other matter, all or any of the powers which the Court might exercise if the company were being wound up by the Court [Section 518(1)(b)].
- (vi) To set aside any attachment, distress or execution started against the estate or effects of the company after the commencement of the winding up on such terms as it thinks fit on an application made by the liquidator, creditor or contributory if the Court is satisfied that it is just and beneficial to do so [Section 518(3) and (4)].
- (vii) To order public examination of any person connected with promotion or formation of a company or any officer connected with the affairs of the company in regard to matters of promotion or formation or conduct of the business of the company or as to his conduct or dealing as officer thereof. Such an examination can be ordered on a report of the liquidator where he is of the opinion that a fraud has been committed by the persons aforesaid in the formation or promotion of the company or in the conduct of its affairs [Section 519(1)].

Answer 7(b)

A person, who is both a contributory and a creditor of the company (in respect of dividends, profits or otherwise) cannot set off his debts against his liability for calls even if there is an express agreement to do so whether the call was made before or after winding up [*Rameshwar Prasad v. Simla Banking & Industrial Co. etc. Ltd.*, (1955) 25

Comp. Cas. 475]. The principle underlying denial of right of set off is that where a person entitled to participate in a fund is also bound to make a contribution in aid of that fund, he cannot be allowed to participate until he has discharged his obligation [*Re. Peruvian Railway Constructions Co.* (1915) 2 Ch. 442].

Answer 7(c)

Non-Performing Assets [Section 2(1)(o)]

SARFESI Act defines "Non-Performing Asset" as to mean 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.

Question 8

- (a) *What is the procedural requirement for recognition of 'foreign proceedings' under the UNCITRAL Model Law ?* (9 marks)
- (b) *Write short notes on the following :*
 - (i) *Lok Adalat*
 - (ii) *Committee of inspection*
 - (iii) *Corporate insolvency.* (2 marks each)

Answer 8(a)

Application for recognition of a foreign proceeding (Article 15)

Article 15 of UNCITRAL Model Law, defines the core procedural requirements for an application by a foreign representative for recognition. In incorporating the provision into national law, it is desirable not to encumber the process with additional requirements beyond these requirements. A foreign representative may apply to the court for recognition of the foreign proceeding in which the foreign representative has been appointed. An application for recognition shall be accompanied by:

- (a) A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; or
- (b) A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or
- (c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.

An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.

The court may require a translation of documents supplied in support of the application for recognition into an official language of State.

The Model Law presumes that documents submitted in support of the application for recognition need not be authenticated in any special way, in particular by legalization.

It further requires that an application for recognition must be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative. That information is needed by the court not so much for the decision on recognition itself but for any decision granting relief in favour of the foreign proceeding. In order to tailor such relief appropriately and make sure that the relief is consistent with any other insolvency proceeding concerning the same debtor, the court needs to be aware of all foreign proceedings concerning the debtor that may be under way in third States.

Answer 8(b)(i)

Lok Adalat

The concept of Lok Adalat received prominence due to need for speedy disposal of cases. The Lok Adalat as 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.

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.

Answer 8(b)(ii)

Committee of Inspection

In creditors Voluntary Winding Up, the creditors may appoint a Committee of Inspection consisting of not more than five members. If such a committee is appointed, the company may also at the same or any subsequent general meeting appoint such number of persons not exceeding five as they think fit to act as members of the committee. In any case, the creditors may resolve that all or any of the persons so appointed by the company ought not to be members of the committee of Inspection, whereupon the persons mentioned in the company's resolution shall not be qualified to act as members of the committee unless the Court otherwise directs. The Act provides that the powers and proceedings of such Committee of Inspection are the same as those of a Committee of Inspection appointed in a winding up by Court (compulsory winding up) and as provided in Section 465 (Section 503).

Answer 8(b)(iii)

Corporate insolvency

Company is a juridical person created under the Companies Act, 1956 and for all practical purposes, the law views a company to be a natural person so as to enable it to hold properties in its name and to be liable for the debts it had incurred. Just as a natural

person can become insolvent, a company can also become insolvent. A company is said to be insolvent when its liabilities exceed its assets which results in its inability to pay off the debts.

In all cases of insolvency of a company, the question is not whether the company can pay all its debts presently due or payable in future and continue to function, but whether it is able to meet its current demands and whether its existing and probable assets would suffice to meet future demands. When a company becomes insolvent it is either wound up or revived. When a company is wound up, its assets are realized and liabilities are paid off from the realisation in the manner provided in the Act.

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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