

ARBITRATION, COMPROMISES, ARRANGEMENTS AND RECONSTRUCTIONS
SECTIONS 391 – 396 A)

compromise or arrangements with creditors and members (Section 391)

Problem 1

Alpha Ltd. and Beta Ltd. entered into a scheme of amalgamation by which Alpha Ltd. Would transfer its entire undertaking to Beta Ltd. However, the Central Government raised an objection that unless the objects clause of the companies are similar, and memorandum empowers to do so, the scheme of amalgamation cannot be permitted. Is the contention of the Central Government correct?

Solution

- The power to amalgamate may flow from the memorandum or it may be acquired by resorting to the statute. Section 17 of the Companies Act, 1956 indicates that a company which desires to amalgamate with another company will take necessary steps to come before a court for alteration of its memorandum in aid of such amalgamation.
- The statute confers a right on a company to alter its memorandum in aid of amalgamation with another company. The provisions contained in sections 391 to 396 and 494, illustrate instances of statutory power of amalgamating a company with another company without any specific power in the memorandum. [*Hari Krishna Lokia (v) Hoolungooree Tea Co. Ltd.*,].
- Section 391 is not only a complete system, but it is in the nature of a single window clearance system to ensure that parties are not put to avoidable, unnecessary and cumbersome procedure for making repeated applications to court for various alterations and changes. What is to be seen is the overall fairness and feasibility of scheme of amalgamation and there need not be any 'unison of objects of both transferor and the transferee company. [*R Morarjee Gokuldas & Co.*,].
- To amalgamate with another company is the power of the company and not an object of the company. [*Re. Hari Krishna Lohia*,].
- Irrespective of the objects clause, the court is empowered to sanction scheme of amalgamation provided it does not prejudice the interest of the public. Therefore, based on the above judicial rulings, the contention of the central government is not correct. [*Golkunda Engg. Enterprises Ltd (v) the G. V. Ltd, 1997J.*

Problem 2

Overambitious Limited became sick. The shareholders and creditors of the company passed resolutions in meetings convened by the company approving a scheme of reconstruction of the company. The scheme provides for sale of vacant land and utilisation of the sale proceeds for payment of outstanding wages, sales tax dues and repayment of part of the loan taken from the bank. The unsecured creditors will have to forego 50% of their claims against the company and receive debentures for the balance

amount. Advise the directors about the steps to be taken to give effect to the proposed scheme inspite of objections raised by a few shareholders and creditors. (May, 2003)

Solution

- The scheme provides for sacrifice on the part of creditors as they have to forego 50% of the amount due to them and accept debentures for the balance amount. The scheme also provides for sacrifice by members .
- The company is sick and therefore it can be considered as a company liable to be wound up within the meaning of section 390(a) of the Companies Act, 1956. The proposed scheme involves as a compromise or arrangement with members and creditors and it attracts section 391. While the company or any creditor or member can make application to the court under section 391, it is usual for the company to make an application. On such application, the court may order that a meeting of creditors and/or members be called and held as per directions of the court (Section 391(1)).
- Company must arrange to send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise or arrangement explaining its effect. Material interest of directors, M.D, or manager of the company in the scheme and the effect of scheme on their interest should be fully disclosed (Section 393(1)(a)).
- Advertisement issued by the company must comply with the requirements of Section 393(2).
- At the meetings convened as per directions of the court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting (either in person or proxy if allowed) must agree to compromise or arrangement.
- Thereafter the company must present a petition to the court for confirmation of the compromise or arrangement .
- The notice of application made by the company will be served on the Central Government and the Court will take into consideration representation, if, any made by the Central Government (Section 394A).
- The Court will sanction the scheme, if it is satisfied that the company has disclosed all material facts relating to the company e.g. latest financial position, auditor's report on accounts of the company, pendency of investigation of company, etc.
- Copy of Court order must be filed with the Registrar of Companies and then only the order will come into effect (Section 391(3)).
- Copy of court order must be annexed to every Memorandum of Association issued thereafter. (Section 391(4)).
- If the court sanctions the scheme, it will be binding on all members and creditors even those who were dissenting (Section 391(2)). (*S.K. Gupta vs K.P. Jain*).

Problem 3

A scheme of reconstruction of Southern Stone Company Limited was, approved by its shareholders and creditors in their meeting and resolutions to that effect were passed. Afterwards a few shareholders and creditors of the company raised objections against the said arrangements of reconstruction. The entire paid up capital of the company was wiped out by the accumulated losses. Advise the Directors of the said company about the steps to be taken to give effect to the proposed scheme under the Companies Act, 1956. (CA Final, New Course, May 2010)

Ans-

- The Company is a sick company and therefore can be considered as a company liable to be wound up with the meaning of Section 390 of the companies Act, 1956.
- The proposed scheme involves a compromise or arrangement with members and creditors and attracts Section 391 of the said Act. An application be submitted before the High Court under Section 391 of the said Act.
- On such application the court may order that a meeting of creditors and/or members be called and held as per the directions of the court.
- The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise explaining its effects.
- At the meetings convened as per directions of the court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting must agree in compromise or arrangements.
- Thereafter the company must present a petition to the court for confirmation of the compromise or arrangement.
- The notice of application made by the company will be served on the Central Government and the court will take into consideration representation, if any, made by the Central Government (Section 394A).
- The court will sanction the scheme, if satisfied, after consideration of all relevant matters. Copy of order issued by the court must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to memorandum of Association issued thereafter.
- The scheme sanctioned by the court shall be binding on all members and creditors even on those who were dissenting.

Problem 4

HPC Ltd. for a number of years was in various types of business. In order to exit from its non core business, its management decided to hive off the business of Food Processing by demerging the said business with an associate company, namely, BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 1956, the steps the management should take to give effect to the proposed demerger (November 2005)

Solution

HPC Ltd. can demerge its food processing business with an associate company, BCD Ltd. By obtaining the approval of Court . for this purpose, HPC Ltd. is required to take the following steps:

- HPC Ltd., known as “Transferor Company” for this purpose, has to prepare a scheme under which its properties and liabilities in respect of food processing business will be transferred to BCD Ltd., known as “Transferee Company” for this purpose. Such scheme must contain the consideration for transfer, known as “Exchange Ratio”.
- An application under Section 391(1) of the said Act must be made to Court for an order convening meetings of creditors and/or members.
- Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of Court. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.
- To hold the said meetings and pass necessary resolution approving the scheme subject to the confirmation of Court. It may be noted that the resolution must be passed by a majority in number representing $\frac{3}{4}$ in value of the members/creditors as required under Section 391(2) of the said Act.
- Thereafter, HPC Ltd. is required to move to Court jointly with BCD Ltd. for approval of the scheme disclosing all material facts relating to the Company. (Proviso to section 391(2). Court as required under section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the Scheme
- On receipt of Court’s order, HPC Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by Court. [(Section 394(3)]. This is very important since the non-filing of the order with ROC would make the approval order ineffective.

Problem 5

Solution the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956:

- (i) Whether companies being amalgamated must be companies registered in India.**
- (ii) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the court? Is the scheme to be approved by preference shareholders?**
- (iii) When will the court order dissolution of the transferor company? (May, 2000)**

Solution

- (i) A scheme of compromise or arrangement may provide for amalgamation of companies under Section 394 of the Companies Act, 1956. Section 394(4)(b) defines the ‘transferee’ and ‘transferor’ companies. While the ‘transferee company’ does not include any company other than a company within the

meaning of the Companies Act, 1956 the transferor company includes anybody corporate whether a company within the meaning of the Companies Act or not. Hence the scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

- (ii) Majority in number representing three-fourths in value of members or class of members, as the case may be, present and voting either in person or by proxy, where proxies are allowed must approve the scheme or arrangement providing for amalgamation of companies [Section 391(2)].

Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration. As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.

- (iii) The scheme may provide for the dissolution, without winding up, of any transferor company [Section 394(1)].

The Court shall not order dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second proviso to Section 394(2)].

Problem 6

M/s Over-ambitions Consultants Ltd. had, in course of its operations over the years, acquired various other ventures like plantations and tourism businesses. With a view to consolidate its core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise briefly the steps the management should take to achieve the purpose of demerger. (November, 2001)

Solution

M/s Over Ambitions Constructions Ltd. can achieve its purpose of hiving off its plantations and tourism business activity by demerger process by obtaining the approval of the High Court as provided in Section 394 of the Companies Act, 1956. The following steps are to be taken by M/s Over Ambitions Consultants Ltd.,

- (1) Prepare a draft scheme .
- (2) An application under section 391(1) must be made to the Court for an order convening meetings of creditors and/or members.
- (3) Notice of the meeting must be sent to members/creditors as per the court's directions, The notice must be accompanied by a statement under section 393(1) setting forth the terms of the compromise or arrangement and explaining its effects etc.

- (4) To hold the general meeting and pass that resolution approving the draft scheme of amalgamation subject to confirmation of the high court. Resolution must be passed by a majority in number representing 3/4th in value of the members as required under section 391.
- (5) To move the High Court jointly with transferee company for approval of the scheme and for the purpose to supply it with material facts . The court shall give notice of the application to the Central Government and shall take into consideration the representation, if any, made by the Government before passing any order. (Section 394A).
- (6) On receipt of the court's order, file the certified copy of the order, with the Registrar of Companies within 30 days after the making of the order [Section 394(3)]. Otherwise, it would not be effective.
- (7) To proceed to effect the scheme as per the scheme of amalgamation approved and the directions given by the High Court.

Problem 7. *M/s FMCG Ltd. proposes to acquire the majority shares of M/s Slow Industries Ltd. by way of Amalgamation. Briefly enumerate the steps that should be taken by the Transferee Company to achieve the objective under the Companies Act, 1956. (November, 2002)*

Solution

FMCG LTD., the transferee company should take the following steps to achieve the objective of acquiring the majority shares of Show Industries Ltd. They are:

- (i) to check up whether the memorandum of association of the transferee company contains the power of amalgamation. If not, to take steps to alter the objects clauses suitably to acquire the said power.
- (ii) to prepare the draft scheme of amalgamation including the exchange ratio and get it approved by a meeting of the Board of Directors.
- (iii) to apply to the High Court for direction to convene the general meeting by way of Judges' summons as provided in Companies (Court) Rules 1959.
- (iv) to send notice of general meeting to every member alongwith the details of the scheme of amalgamation.
- (v) to hold the general meeting and to pass the resolution approving the draft scheme of amalgamation subject to the confirmation of the High Court. The resolution is to be passed by a majority in number representing 3/4th in value of the members as required by Section 391.
- (vi) to move the High Court for approval of the scheme. (vii) on receipt of the court order, to file the certified copy thereof to the Registrar of Companies within 30 days after making the order. [Section 394(3)].
- (viii) A copy of the order of the court to be annexed to every copy of the memorandum issued after the certified copy of the order has been filed with the Registrar. (ix) To effect the scheme of amalgamation as per the scheme approved and the directions given by the High Court and to allot shares of the transferee company to the shareholders of transferor company i.e., Slow Industries Ltd.

Problem 8. *ABC Company Limited was amalgamated with and merged in XYZ Company Limited. Some workers of ABC Company Limited refuse to join as workers of XYZ Company Limited and claim compensation for premature termination of service. XYZ Company Limited resists the claim on the ground that their services are transferred to XYZ Company Limited by the order of amalgamation and*

merger and, therefore, the workers must join service of XYZ Company Limited and cannot claim any compensation. Examine whether the workers' contention is correct. (November, 2003)

Solution. An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of personal service, which are in their nature, incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other.

In *Nokes vs. Doucaster Amalgamated Collieries Ltd.*, the House of Lords categorically stated that the workers are not furniture and their services cannot be transferred without their consent. Therefore, the workers of ABC Co. Ltd will succeed against XYZ Co. Ltd.

Problem 9

Examine with reference to the provisions of the Companies Act, 1956 the validity of the following:

- (i) A scheme provides for Amalgamation of a 'Foreign Company' with a Company Registered under the Companies Act, 1956.***
- (ii) The statement forwarded with the notice convening a meeting of its members pursuant to Court's Direction Under Section 391 contains only 'Exchange Ratio' without details of its calculation.***
- (iii) At the time of filing of the petition for Amalgamation, the object clause of both the transferor and Transferee Companies does not contain power to Amalgamate. (May, 2004)***

Solution

According to Section 394(4)(b),

- ❑ Transferee company does not include any company other than a company within the meaning of this Act;
- ❑ Transferor company includes any body corporate, whether a company within the meaning of this Act or not.

According to the definition of 'body corporate' in Section 2(7), it includes a company incorporated outside India.

As per Section 390(a), for purposes of Section 391, 'Company' means 'any company liable to be wound up'.

A foreign company having a place of business in India (i.e. a 'foreign company' within the meaning of Section 591) can be wound up as an 'unregistered company' under Section 582(b) read with Section 583 and 584. Hence, a scheme providing for amalgamation of a foreign company as a transferor company can be sanctioned by the court.

Statement under section 393: Every notice sent to members or creditors to convene a meeting pursuant to High Court's (NCLT) directions under Section 391 must be accompanied by a statement setting forth the terms of compromise or arrangement and explaining its effects and material interests of directors and effect thereof on the scheme (Section 393(1)). But the statement required under Section 393 is different from one required.

The 'statement' required under Section 393 is different from the 'explanatory statement' required under Section 173. The former does not ordain disclosure of all material facts [*Re. Tata Gil Mills Co. Ltd.*].

The statement should contain the exchange ratio. But it is not necessary to give details thereof, nor is it necessary to circulate the valuation report to shareholders (*Hindustan Lever Employees' Union v. Hindustan Lever Ltd*).

Hence the statement containing only exchange ratio without giving details of calculation of exchange ratio is valid.

Power to amalgamate: It has been held in various cases that where there is a statutory provision dealing with the amalgamation of companies, no special power in the object clause of the memorandum of association of a company is necessary for its amalgamating with its company [*Hari Krishna Lohia v. Hoolungoree Tea Company*]. Hence the objects in the memorandum of association of the transferor company or transferee company need not contain power to amalgamate.

Problem 10

Solution the following explaining the relevant provisions of the Companies Act, 1956:

- (1) Whether the Companies being amalgamated must be Companies registered under the Companies Act, 1956.***
- (2) Whether the Companies seeking sanction of the court for a scheme of amalgamation must have specific power to amalgamate in the object clause of their Memorandum of Association.***

(CA Final, New Course, November 2009)

Solution

(1). Amalgamation: A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferor' and 'transferee' companies.

- ❑ Transferee company does not include any company other than a company within the meaning of this Act;
- ❑ Transferor company includes any body corporate, whether a company within the meaning of this Act or not.

According to the definition of 'body corporate' in Section 2(7), it includes a company incorporated outside India.

Hence transferor company may be a company incorporated outside India, but transferee company must be a company incorporated under the Companies Act, 1956.

(2) Usually the Memorandum of Association of a company contains in its object clause the power to amalgamate. But, in a number of cases it has been held that it is not necessary to have in the memorandum of association a specific power to amalgamate with another company.

The provisions of Section 391/394 of the Companies Act, 1956 indicate the scope of the statutory power for amalgamating a company with another company despite the absence of any specific enabling provision in their memoranda. (*Aimco Pesticides Ltd, Feedback Reach Consultancy Pvt Ltd., Sir Matturdas Vissaiji Foundation in re*). Hence even companies not having specific power to amalgamate in their Memoranda can seek sanction of the Court for a scheme of amalgamation.

Problem 11

The shareholders and creditors of Wagonbound Company Limited, in meeting convened for approval of a scheme of reconstruction of the company, passed resolutions. The scheme of reconstruction provided for the following:

- (i) Sale of vacant land and appropriation of proceeds for payment of outstanding wages, tax dues and repayment of loan.*
- (ii) Unsecured creditors to forego 40% of their claims against the company and receive debentures for the balance amount. A few share holders and creditors raised objections against the said arrangements. Advise the directors about the steps to be taken to give effect to the proposed scheme under the Companies Act, 1956. (May 2009)*

Solution

- The provisions contained in sections 391 to 394 of the Companies Act, 1956 are applicable to Wagonbound Company Limited as it can be considered as a company liable to be wound up within the meaning of Section 390 of the Companies Act, 1956.
- The proposed scheme involves a compromise or arrangement with members and creditors and it attracts section 391 of the said Act. While the company or any creditor or member can make application to the Court under Section 391, it is usual for the company to make an application. On such application the Court/Board may order that a meeting of creditors and/or members be called and held as per the directions of the Court/Board.
- The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise or arrangement explaining its effect. Material interest of directors, Managing Director or manager of the company in the scheme and the effect of scheme on their interest should be fully disclosed (Section 393).
- At the meetings convened as per directions of the Court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting must agree to compromise or arrangement. Thereafter the company must present a petition to the Court for confirmation of the compromise or arrangement.
- The notice of application made by the company will be served on the Central Government and the Court will take into consideration representation, if any, made by the Central Government (Section 394A).
- The Court will sanction the scheme, if satisfied, after considering all relevant matters.
- Copy of order issued by the Court must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to every Memorandum of Association issued thereafter.
- The scheme sanctioned by the Court shall be binding on all members and creditors even those who were dissenting.

Problem 12

Sunrise Company Limited was merged with Moonlight Company Limited on account of amalgamation. Some workers of sunrise Company Limited refused to join as workers of Moonlight Company Limited and claimed compensation on the ground of premature termination of their services. Moonlight Company Limited resists the claim of the workers on the ground that their services have been transferred to Moonlight Company Limited in view of the order of amalgamation and merger and hence the workers must join the service of Moonlight Company Limited and cannot claim any compensation. State the powers of the court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 1956. Decide whether the contention of the workers is justified. (November 2008)

Solution

While sanctioning the scheme of amalgamation, the Court under Section 394 of the Companies Act, 1956 may make provision for all or any of the following matters:

- I. The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company.
- II. The allotment by the transferee company of any shares, debenture etc, in that company which under the scheme are to be allotted by that company to any person.
- III. The continuation of any legal proceedings by or against any transferor and transferee company.
- IV. The dissolution, without winding up of any transferor company.
- V. The provisions to be made for any persons who within such time and in such manner as the court directs, dissent from the scheme of amalgamation.
- VI. Such incidental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out. An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of personal service which are in their nature incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other.

In *Nokes vs. Doucaster Amalgamated collieries Ltd. (1940 (3) all 2k 549)* the House of Lords clearly stated that the workers are not furniture and their services can not be transferred without their consent. Thus the contention of the workers of Sunrise Company Limited against the Moonlight Company Limited is correct and justified.

Problem 13

HPC Ltd. for a number of years was in various types of business. In order to exit from its noncore business, its management decided to hive off the business of food processing by demerging the said business with an associate company, namely BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 1956, the steps the management should take to give effect to the proposed demerger. (May 2008)

Solution

HPC Ltd. can demerge its food processing business with an associate company, BCD Ltd. By obtaining the approval of Court as provided in Section 394 of the Companies Act, 1956. For this purpose, HPC Ltd. is required to take the following steps:

- a) HPC Ltd., known as “transferor Company” for this purpose, has to prepare a scheme under which its properties and liabilities in respect of food processing business will be transferred to BCD Ltd., known as “Transferee Company” for this purpose. Such scheme must contain the consideration for transfer, known as “Exchange Ratio”.
- b) An application under Section 391(1) of the said Act must be made to Court for an order convening meetings of creditors and / or members.
- c) Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of Court. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.
- d) To hold the said meetings and pass necessary resolution approving the scheme subject to the conformation of Court. It may be noted that the resolution must be passed by a majority in number representing 3/4th in value of the members / creditors as required under Section 391(2) of the said Act.
- e) Thereafter, HPC Ltd. is required to move to Court jointly with BCD Ltd. For approval of the scheme disclosing all material facts relating to the Company. [Proviso to Section 391(2)], the High Court as required under Section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the scheme.
- f) On receipt of Court order, HPC Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by Court [Section 394(3)]. This is very important since the non- filing of the order with ROC would make the approval order ineffective.
- g) proceed to give effect to the scheme as approved by Court in the manner as directed by it.

Problem 14

A scheme of amalgamation was approved by overwhelming majority of members of both the merging companies. The exchange ratio was fixed by a firm of reputed Chartered Accountants. When the scheme of amalgamation was awaiting sanction of the court, a small group of members of one of the merging companies raised objection on the ground that the exchange ratio was unfair. Examine with reference to decided case law whether the objection is likely to be sustained. What would be your solution in case similar objection was raised by the Central Government? (CA Final, New Course, November, 2008)

Solution

Exchange Ratio:

- Courts leave the aspect of share valuation to expert valuers and shareholders. Unless the person who challenges the valuation satisfies the court that the valuation is grossly unfair, the court will not disturb the scheme (*Piramal Spg Vs Weaving Mills Ltd*). In this case the valuation is confirmed to be fair by eminent firm of auditors and is also confirmed by majority of members.
- The objection of the some by small group of shareholders cannot be sustained as held in *Hindustan Lever Employees. Union Vs Hindustan Lever Ltd*. Section 394A of the Companies Act, 1956 requires the Court to give notice of every application made to it under Section 391 or 394 to the Central Government.
- The Court should take into consideration the representations if any made to it by that Government before passing any order.
- The role played by the Central Government is that of an impartial observer who acts in public interest and advises the Court (tribunal) whether it is or it is not feasible for the two companies to amalgamate (*Ucal Fuel Systems Ltd Sure*).
- But the court is not bound to accept the views of the Central Government. Thus objection of the Central Government as regards valuation of shares was rejected by the Court (Tribunal), in the face of views expressed by two independent chartered accountants (*M.G Investments & Industrial Co. Ltd Vs New Shorrock spinning & Mgf Co. Ltd*).
- Hence even in the case of representation bay Central Government, unless that Government establishes that the exchange ratio was unfair and not in public interest, the court will refuse to interfere

Problem 15

With a view to boost the share values, the Central Government wants to amalgamate two Public Limited Companies into a single company. The Government and Public Financial Institutions have substantial interest in both the companies. The two companies are in the business of tourism and running several hotels which are not making good profits and consequently the share prices are depressed. Examine the powers of the Central Government to amalgamate the two companies in public interest. (May, 2002)

Solution

- According to section 396 (1) of the Companies Act, 1956 where the Central Government is satisfied that it is essential in public interest that the two public limited companies should amalgamate the said Government may by order notified in the Official Gazette, provide for the amalgamation of the said two companies into a single company with such constitution; with such property, powers, rights interest, authorities and privileges and with such liabilities duties and obligations as may be specified in the order.
- This power of Central Government is notwithstanding anything contained in sections 394 and 395 of the Act that deal with amalgamation and reconstruction of companies.

- The Central Government has also the power to pass and provide for any consequential incidental and supplementary provisions in connection with the amalgamation including the confirmation by or against the transferee company of any legal proceedings pending by or against any transferor company.
- Any member or creditor who is aggrieved by the order of the amalgamation resulting in any financial loss is entitled to compensation which will be assessed by such authority as may be prescribed.
- Any person aggrieved by the order of compensation can file an appeal to the Company Law Board within 30 days of the publication of the order of compensation.
- Any order passed by the Central Government under this section can be made only where the draft copy thereof is sent to both the companies who have right to make an appeal and the same has been either disposed of or no appeal has been filed within the time provided thereof.
- The Central Government has duty to make such modifications in the light of any suggestions and objections received.
- All copies of the orders made under this section shall be laid before both the Houses of Parliament as soon as the same has been made.

Problem 16

X Ltd. and Y Ltd. are two listed companies engaged in the business of telecommunication. The companies are not making profits and as such their share's market prices have gone down. A substantial portion of their share capital is held by Central Government as well as some Public Financial Corporations. In order to increase the share value, the Central Government wants to amalgamate the aforesaid two companies into a single company.

Examine the powers of Central Government to amalgamate the two companies in public interest as per the provisions of the Companies Act, 1956. (May 2007)

Solution

- According to section 396 (1) of the Companies Act 1956 where the Central Government is satisfied that it is essential in public interest that two public limited companies should amalgamate the said Government may, by order notified in the Official Gazette, provide for the amalgamation of the said two companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.
- This power of Central Government is notwithstanding anything contained in section 394 and 395 of the Act that deal with amalgamation and reconstruction of companies.
- The Central Government has also the power to pass and provide for any consequential, incidental and supplementary provisions in connection with the amalgamation including the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company.

- Any member or creditor who is aggrieved by the order of the amalgamation resulting in any financial loss is entitled to compensation, which will be assessed by such authority as, may be prescribed.
- Any person aggrieved by the order of compensation can file an appeal to the Company Law Board within 30 days of the publication of the order of compensation.
- Any order passed by the central government under this section can be made only where the draft copy thereof is sent to both the companies who have right to make an appeal and the same has been either disposed of or no appeal has been filed within the time provided thereof .
- The Central Government has duty to make such modifications In the light of any suggestions and objections received.
- All copies of the orders made under this section shall be laid before both the houses of parliament as soon as the same has been made.

Problem 17

ABC Ltd has made an offer to acquire all the equity shares of XYZ Ltd at a certain price. Members of the company who hold 90% of the shares of XYZ Ltd have accepted the offer. The remaining shares are held by 2 persons who do not agree to the deal. Explain the procedure to finalize the deal. State the steps to be taken to acquire the shares of dissenting shareholders? Also, state whether ABC Ltd can acquire all the shares in XYZ Ltd?

Solution

- Applying the provisions of section 395 of the Companies Act, 1956, ABC Ltd., can acquire all the shares of XYZ Ltd. including those held by 2 persons.
- It can acquire the shares held by 2 persons if no application is made to the court for avoiding the sale of their shares or if the court refused it accordingly.
- In *Bombay Gas Company (P) Ltd., vs. Central Government*, the Bombay High Court held that Section 394(4)(b) provides for amalgamation of a foreign country with the Indian company. The transferee company, however, cannot be a foreign country.
- The expression member is not only holders of equity shares but also preference shareholders who had to be taken into account and value of their shares be included. The scheme may provide for the dissolution without winding up of any transferor company [Section 394(i)].

Problem 18

A scheme of merger of DJA Company Limited with MRN Company Limited with approved by the shareholders at an extraordinary general meeting and the exchange ratio of 3 shares of MRN Company Limited for 20 shares in DJA Company Limited was approved. The proposal was also okayed by a lending financial institution which held 45% shares in DJA Company Limited. The valuation was carried out by one of the directors of DJA Company Limited, who was also a senior member of the

Institute of Chartered Accountants of India. The valuation was affirmed by three independent valuers nominated by the shareholders in general meeting. However, certain leasehold properties, under license, which were not transferable, were not taken into account in the valuation. While the scheme was awaiting the Court's sanction, it was challenged by certain shareholders on the ground that the exclusion of leasehold assets in the valuation, made the scheme Unfair' Decide giving reasons :

(i) Whether the contention of the shareholders is tenable ?

(ii) What factors would the court take into account in approving the exchange ratio?

Solution

(i)

- The contention of the shareholders in this case shall not be tenable. The court is not to disturb a scheme unless the person who challenges the valuation satisfies the court that the valuation arrived at was grossly unfair.
- Valuation in this case was approved by the shareholders and also okayed by the lending institution(s) which are usually well-informed and scrutinize the scheme with expert's eye and which are also presumed to act bonafide.
- In the similar case of *Tata Oil Mills Ltd. Re* (1994), the court held that the presumption of fairness was writ large on the face of the Scheme. The Court did not attach importance to the fact that certain leasehold assets and properties held under license were excluded from valuation. Such assets, the court said, were neither transferable nor heritable. They are in the nature of a personal privilege.
- The Supreme Court affirmed this decision in *Hindustan Lever Employees Union v, Hindustan Lever Ltd.*, (1994) and accepted the exchange ratio proposed. The Supreme Court found no objection to the valuation being done by one of the directors of TOMCO. His report did not show any prejudice and was also affirmed by the independent valuers. Supreme Court also enumerated all the possible methods of valuation such as, market price, book value and yield basis and pointed out that a combination of all or some of the methods, may have to be adopted in circumstances of a particular case.
- Thus based on the above explanation and the decisions given by the Supreme Court, it can be concluded that the contention of the shareholders that the exclusion of certain leasehold assets in the valuation has made the scheme unfair, shall not be tenable.

(ii) The court would take into account the following factors in determining the final share exchange ratio:

1. The past history of the prices of the shares of the companies.
2. The voting strength in the merged enterprise of the shareholders of the two companies.
3. The values of the net assets of the two companies.
4. The relative gearing of the shares of the two companies.
5. The cover for the present dividends of the two companies.
6. The relative growth prospects of the two companies.

7. The dividends presently paid on the shares of the two companies.
8. The stock exchange prices of the shares of the two companies before the commencement of negotiations or the announcement of the bid.