

## 8. Compromise, Arrangements and Amalgamation of the companies

### Meaning

- 'Compromise' denotes an agreement between two or more persons for the ascertainment of their rights when there is some question in controversy between them or some difficulty in the enforcement of their rights.
- Arrangement involves a readjustment of the rights and liabilities of the members or creditors or any class of them. A few example of arrangement are as follows:
  - a. Issue of fully paid up share to pay off debentures.
  - b. Creditors agreeing to waive a part of their dues.
  - c. Preference shareholders surrendering their right or arrears of dividend.
  - d. Exchange of company's assets for shares in a newly formed company.
- Reconstruction implies that substantially the same business shall be carried on by substantially the same persons. As such, the same company comes in a new form with the same members and creditors.
- Under an amalgamation, assets of the two companies become vested in one company which has as its shareholders all or substantially all the shareholders of the two companies.
  - ✓ Amalgamation involves a merger of two or more companies by any of the following methods:
    - a. By consolidation of undertaking of two company.
    - b. By acquisition of a controlling interest in the share capital of a company by another company.
    - c. By acquisition of a controlling interest in the share capital of both companies by a new company.
  - ✓ Amalgamation can be effected by
    - a. Following the procedures as specified in section 391 to 394.
    - b. A takeover bid as specified u/s 395.
    - c. An order of the central government u/s 396.
  - ✓ Amalgamation can be resorted to for the following purposes
    - i. To effect economies
    - ii. To avail tax concession and benefits
    - iii. To revive a sick unit
    - iv. To diversify or expand business
    - v. To eliminate competition
    - vi. To make full use of the unutilized capacity
    - vii. To mobilize resources or improve cash flow
    - viii. To acquire assets at discount

### Procedure for Compromise or arrangement (Sect 391 to 393)

#### I. Application to the court

To make a compromise or arrangement, an application shall be made to the court. The application shall describe the scheme of the arrangement and the parties between whom it is prepared.

### ***Parties to compromise***

- a. Between a company and its creditors or any class of them; or
- b. Between a company and its members or any class of them.

### ***Application by whom***

- a. The company
- b. Any creditor of the company
- c. Any member of the company
- d. The liquidator of the company

## **II. Direction for holding the meeting**

On an application made by the company, the court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the court.

## **III. Notice to the central government**

The court shall give notice of every application seeking a compromise or arrangement to the CG.

## **IV. Information about compromise or arrangement**

### ***Notice to contain specified particulars***

- a. *Where a meeting of creditors or members is called, the notice given to them must contain,*
  1. the terms of the compromise or arrangement
  2. An explanatory statement explaining the effect of the C o A.
  3. A statement explaining any material interest of the directors, MD, or Director or manager of the company.
  4. If the debenture holders are also affected by the schemes, the interest of the trustees should also be similarly disclosed.
- b. Every notice calling the meeting which is given by advertisement shall contain the above particulars. Otherwise such notice must mention that the explanations are available at the company's office and the explanations shall be furnished FOC.

## **V. Approval of the scheme by creditors or members**

A scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting but remain neutral are not counted.

## **VI. Court to be satisfied that scheme is *bond fide***

*Bond fide* means it contain the following particulars

1. Compliance with statutory provisions
  2. Disclosure of material facts
  3. Fair representation of affected classes at meeting
  4. Scheme should be fair and reasonable
- If the scheme is not *bond fide* but intends to cover the misdeeds of delinquent directors then the court shall not sanction the scheme.
- It might be possible to find faults in a scheme, but that would not be sufficient ground to reject it.

## **VII. Sanction of the scheme**

On the sanction of the scheme, it shall be binding on –

- a. The creditors or members or any class of them; or
- b. The company or the liquidator of the company, if company is being wound up.

## **VIII. Filing of the order of the court with the registrar.**

The scheme becomes effective only after a certified copy of the order is filed with the registrar. Until such filing, the sanctioned scheme remains dormant and no creditor or member can enforce any right under the scheme.

## **IX. Copy of court's order to be annexed to memorandum**

After the certified copy of the scheme is filed with the registrar, the company shall annex to every copy of memorandum, a copy of such scheme. This is to ensure that any person who deals with the company will have the notice of the scheme.

## **X. Supervision and modification of the scheme**

The court has the power to modify or vary the sanctioned scheme so that it becomes workable. If it becomes unworkable even after honest efforts, the court may order the winding up of the company. The court may ask for a report on the working of the scheme and on consideration of such report, may give such directions as it thinks fit.

## **Power of the High Court (Section 392)**

1. Power to give direction to the company
2. Power to stay any suit or proceedings
3. Power to order winding up

If after sanctioning the scheme, the court is satisfied that the sanctioned scheme has become unworkable even after honest effort, the court may wind up the company. The power can be exercised *suo moto* or on the application of the company or its directors or any person interested in the affairs of the company.

4. Power to supervise and modify the scheme

## **Reconstruction or amalgamation by sale of undertaking (Section 394)**

Important

Procedures for reconstruction or amalgamation are as follows:

1. Application to the court

*Contents of application*

- a. Purpose of compromise or arrangement
- b. Transfer of understanding etc.

2. Order of the court

- i. The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company. However, the order of the court cannot provide automatic transfer of contracts of person service. Therefore, the workers of the transferor company can lawfully refuse to join the service in the transferee company. In such a case, the workers shall be entitled to compensation for premature termination of service.
- ii. The allotment by the transferee company of any shares, debentures, policies, or other like interests as provided by the scheme.

- iii. The court may order that any legal proceeding filed against the transferor company shall be continued against the transferee company
  - iv. Court will not make such an order unless it receives a report from the official liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or public interest.
  - v. The provision to be made for any person who dissents from the compromise or arrangement.
3. Filing of order of the court  
*Within 30 days* from the date of the order, a certified copy of the order shall be filed with the registrar by every company in relation to which the order is made.
4. Duties of the court before making order  
 The duties of the court U/S 394 are onerous and have to be carefully performed. The duties of the court are as follows:
- a. Compliance of statutory provisos: i.e 391, 393, 394A and 394
  - b. Meeting held properly: the court must be satisfied that an Extraordinary GM was convened under the directions of the court. The holding of EGM cannot be dispensed with on the ground that the shareholders have unanimously approved merger at an ordinary meeting.
  - c. Notice to the CG:
  - d. Scheme should be *bond fide*
  - e. Amalgamation must be in public interest.
  - f. Valuation of shares
  - g. Satisfaction report to the registrar

### **Reconstruction by sale of shares/takeover of a company (Sec 395)**

- An amalgamation of two companies required to follow section 391 to 394. However the prescribed procedure is very cumbersome and time consuming. Instead of following court procedure, section 395 enables a company to acquire the share of another company. The acquisition of share in the transferor company enables the transferee company to exercise control over the former. This process is commonly known as 'take-over'
- Procedure for take-over
  - 1. The offer to acquire a share
    - ✓ The transferee company makes an offer to the shareholder of the transferor company to acquire the share at a specified price. The offer also state the date by which the offer is to be accepted. Offer remains valid for 4 months only. There may be separate offers for the different class of companies.
  - 2. The acceptance of the offer
    - ✓ The shareholder of the transferor company may accept the offer. The transferee company must get acceptance of 90% of the shareholders before the expiry of the offer.
    - ✓ The transferee company's already holding is ignored in calculating the 90%.
    - ✓ Where separate offers have been made, this section can be invoked only in respect of that class for which 90% acceptance has been received.

3. Transferee Company's right to acquire the share of dissenting shareholders.
    - ✓ Meaning of dissenting shareholder
      - a. who has refused to transfer his shares to the transferee company; or
      - b. who has not given his assent to the scheme (inaction also amount to dissent)
    - ✓ Where 90% acceptances have been received, the transferee company may give notice to one or more dissenting shareholders that it desires to acquire the shares. Such notice is to be given *within 2 months* of the expiry of the offer.
  4. Dissenting shareholders' application to the court.
    - ✓ When the transferee company gives a notice to the dissenting shareholders, they may make an application to the court praying that acquisition of their shares should not be permitted, in spite of the fact that the scheme has been approved by 90% in value of the shares.
  5. Acquisition of shares of dissenting shareholders
    - ✓ Where the court allows the application of dissenting shareholders, the transferee company shall not be entitled to acquire the shares if the dissenting shareholders.
    - ✓ If application is rejected or not made by the dissenting shareholder that the transferee company becomes entitled as well as bound to acquire the shares of the dissenting shareholders.
    - ✓ Terms : as per the original offer which applies to other shareholder
    - ✓ If the dissenting shareholder does not voluntarily transfer the share, the company may appoint a person to execute such transfer.
    - ✓ Money received by the transferee company is kept in separate bank account for distribution to dissenting shareholders.
- Situation where transferee company already holds more than 10% of shares  
 For such situation advantage of section 395 cannot be availed unless all the following condition satisfied:
1. The offer is made to the remaining holders of shares
  2. The offer is accepted by the shareholders holding at least 90% of value of shares
  3. The shareholders accepting the offer are not less than 3/4 in number of the holders of such shares.

### **Amalgamation of companies in public interest (Section 396)**

Usually, the procedure prescribed in the Act for amalgamation of companies leads o prolonged delays, therefore the power has been conferred on the CG to order amalgamation of two or more companies in public interest. Following procedure shall be adopted for speedy process:

1. Preparation of draft order of the scheme
2. Determination of compensation
3. Appeal against award of compensation
4. Preconditions for making an order of amalgamation
  - a. Amalgamation in public interest
  - b. Consideration of objections and notification in the scheme
  - c. No pending appeal against compensation

5. Order of amalgamation
  - a. Constitution etc. of new company
  - b. Legal proceedings
  - c. Other measures
6. Parliamentary control: the order of the CG directing the amalgamation shall be place in both the house of parliament.

### **Arrangement with the creditors by a company in voluntary liquidation (Sec 517)**

Section 517 provides the opportunity to a company to enter into a arrangement with its creditors even though it is about to be, or in the course of being, wound up. Procedure is as follows:

#### **1. Requirement of section 517**

- a. The scheme of arrangement must be sanctioned by a SR of the company.
- b. The scheme must also be agreed by 3/4<sup>th</sup> in number and value of the creditor.
- c. Any creditor or contributory may, within 3 weeks from the completion of arrangement, appeal o the courts against the scheme.
- d. On an appeal made to the court, the courts shall have the power to amend, vary, conform or set aside the arrangement.

#### **2. Procedure**

- a. The draft scheme of arrangement shall be considered and approved by BOD.
- b. The company shall apply to court for direction to convene the meeting of the members and creditors.
- c. A GM of the company shall be held and the SR approving the scheme of arrangement shall be passed.
- d. A meeting of creditors shall be held whereat the scheme shall be agreed to buy 3/4<sup>th</sup> in number and value of the creditors.
- e. The company shall approach the court for approval of the scheme.
- f. On receipt of the court's order, the company shall file a certified copy of the court's order with the registrar.