CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

Corporate restructuring is a collective term for a variety of different business transactions. Mergers, amalgamations, acquisitions, compromises, arrangement or reconstruction are all different forms of corporate restructuring exercises in the corporate world. Corporate restructuring might result in changes like change in share capital or capital structure, change of shareholders, change of control, change of business, change of operating entities, etc. Corporate restructuring serves different purposes for different companies at different points of time. It may take up various forms. The purpose of each of these restructuring activities is different but each one of them is targeted to rebuild or rearrange the corporate structure.

A company may grow his business either by internal expansion or by external expansion. In the case of internal expansion, a company grows gradually overtime in the normal course of the business, through acquisition of new assets, replacement of the technologically obsolete equipments and the establishment of new lines of products. But in external expansion, a firm acquires a running business and grows overnight through corporate restructuring.

Corporate Restructuring is a non-recurring exercise for an organisation but it has a lasting impact on the business and other concerned agencies due to its numerous considerations and immense advantages viz., improved performance, better corporate governance etc. The regulatory provisions and the multitude of judicial and unresolved issues enunciate that the professionals dealing with restructuring should possess unequivocal and explicit knowledge of the objective approach and perspective of the subject.

Companies use restructuring as a business strategy to ensure their long-term viability. Shareholders or creditors might force a restructuring if they observe the company's current business strategies as insufficient to prevent a loss on their investments. The nature of these threats can vary, but common catalysts for restructuring involve a loss of market share, the reduction of profit margins or decline in the power of their brand. Other motivators of restructuring include the inability to retain talented professionals and major changes to the marketplace that directly impact the corporation's business model.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read along with the original Bare Acts, Rules, Regulations, Case Law, Student Company Secretary e-bulletin and Chartered Secretary published by the Institute as well as recommended readings.

This Study Material is based on the provisions which are notified under Companies Act, 2013 and Insolvency and Bankruptcy Code, 2016. The amendments made up to 30th June, 2019 have been incorporated in this study material. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore, advised to refer to the website of the Institute for updation of the study material.

Although care has been taken in publishing this study material, yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the Student Company Secretary e-bulletin. In the event of any doubt, students may write to the Directorate of Professional Development, Perspective Planning and Studies in the Institute for clarification at academics@icsi.edu.

Relevance of the subject for the profession

Corporate restructuring as a business re-organisation tool holds lot of scope and potential as an area of practice. Corporate restructuring is been growing day by day and becoming a useful tool to overcome difficult times for the troubled businesses or the business who aspire to grow at a faster pace using the ample growth opportunities available in the global market. But it being a complex and technical area require lot of know-how of legal, financial, taxation, management and other related areas. These complexities require involvement of professionals to seamlessly conduct the corporate restructuring exercise.

The subject is inherently technical and is subjected to constant refinement through new legislations, rules and regulations made thereunder, court decisions on specific legal issues and corporate business dynamics. In Indian scenario various regulatory approvals and compliances are required to complete a scheme of arrangement, therefore, it becomes necessary for professionals to constantly update with the various legislative changes made as well as judicial pronouncements rendered from time to time by referring to the law/professional journals. This study aims to provide an in-depth understanding of all aspects and intricacies of law and practical issues affecting and arising out of Corporate Restructuring, Valuation as well as Insolvency.

The role of professionals becomes more relevant in the wake of cross-border mergers and takeovers since legal and taxation requirements vary from one nation to another. Corporate restructuring involves decision on various technical and legal aspects such as valuation of organizations involved in restructuring process, swap ratio of shares if any, legal and procedural aspects with regulators such as Registrar of Companies, Tribunal, etc., optimum tax benefits after merger, human and cultural integration, stamp duty cost involved, etc. All these activities requires professionals including business experts, Company Secretaries, Chartered Accountants, HR professionals, etc., who have a role to play in various stages of restructuring process.

Since corporate restructuring activities in India are primarily governed by the Companies Act, 2013, SEBI, FEMA and other allied laws which are expert areas for a Company secretary, it is an emerging area of practice for Company Secretaries to help companies in carrying out restructuring practices. Company Secretaries have in-depth knowledge of provisions of Companies Act, rules and regulations, NCLT rules, valuation and allied areas affecting the compromise and arrangement and other regulatory and compliance requirements as per prevailing law.

It is an area of specialization where the stakeholders expect the Company Secretaries to be experts. The study will enable students/members to acquire competence and professional skills to develop themselves into 'Corporate Managers' / 'Corporate Advisors'.

Hybrid Subject – Corporate Restructuring, Insolvency, Liquidation & Winding-Up is a hybrid subject which require expertise and integrated application of several core areas such as Company Law, Securities Laws, Insolvency Law, FEMA, etc. and ancillary areas such as Accounts, Finance, Taxation, Business and Financial Management, etc.

Broad Orientation

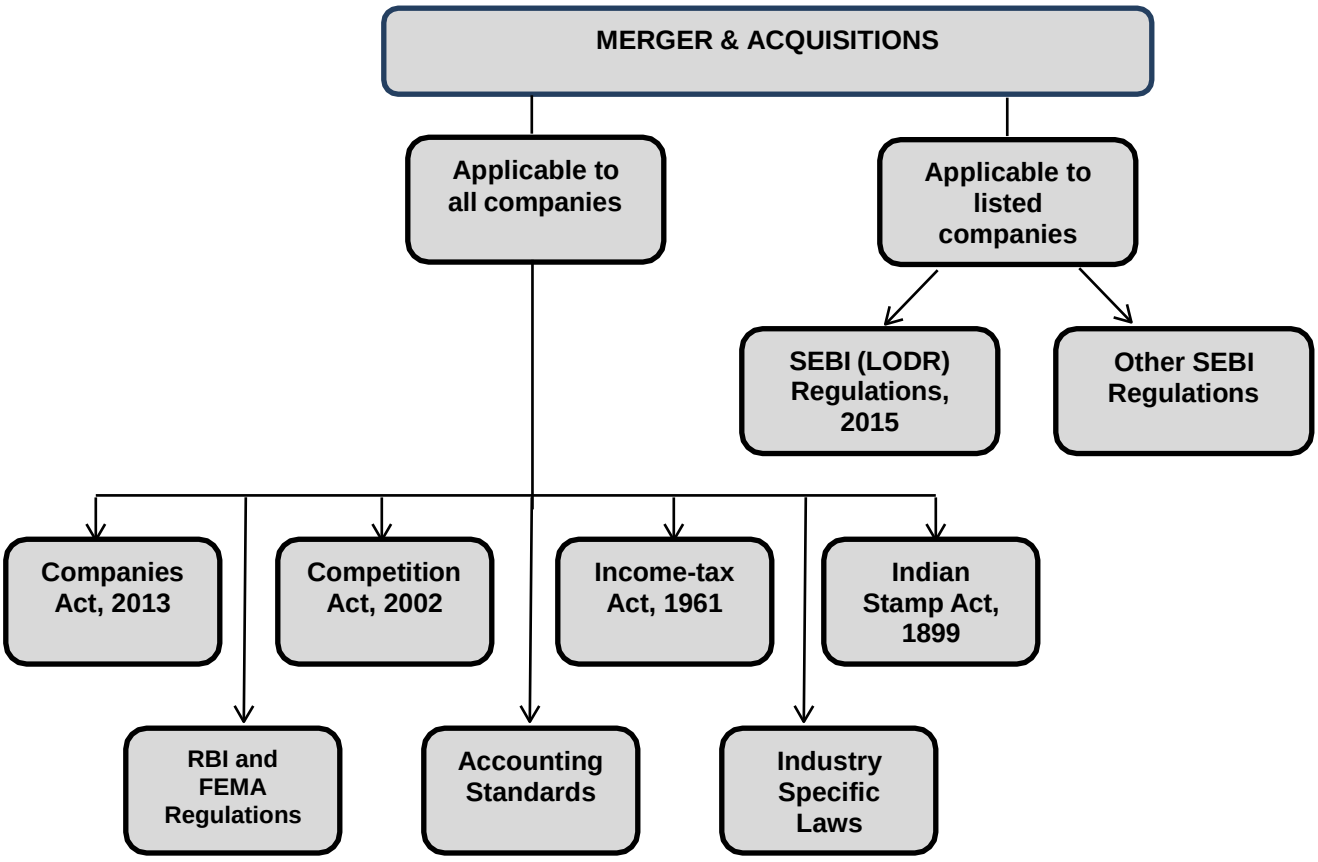
Expert Knowledge - comprehending, integrating and advising to resolve complex issues/problems, and decision making.

Guidance on how to study the subject

Corporate Restructuring, Insolvency, Liquidation & Winding-Up is a technical subject which require in-depth knowledge of both law and procedures. Students may follow these steps to study the subject:

1. Focus on understanding concepts and principles;
2. Students should develop art of reading, interpreting and understanding the law.
3. Students should read the relevant sections of the bare acts for basic understanding of the underlying law.
4. To study practical problems, judicial pronouncements, case studies, compliance requirements, etc. for understanding practical aspects and intent of law.
5. To study Act, Rules, Regulations, Notifications, Clarifications, Removal of Difficulties Orders, Guidelines, circulars, forms, etc.
6. To study Institutes publications such as Chartered Secretary, Student Company Secretary e-bulletin for recent updates.
7. To visit websites of regulatory bodies for the recent amendments/notifications/orders, etc.

LEGAL FRAMEWORK



PROFESSIONAL PROGRAMME

Module 2

Paper 5

CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

SYLLABUS

Objective

Part I: To provide expert knowledge of legal, procedural and practical aspects of Corporate Restructuring, Merger& Acquisitions, Insolvency, Liquidation & Winding-up.

Part II: To acquire knowledge of the legal, procedural and practical aspects of Insolvency and its resolution.

Detailed Contents

PART I- Corporate Restructuring (50 Marks)

1. Types of Corporate Restructuring: Key definitions, Compromises, Arrangements, Mergers & Amalgamations; Demergers & Slump Sale, Business Sale; Joint Venture, Strategic Alliance, Reverse Merger Disinvestment; Financial Restructuring (Buy-back, Alteration & Reduction).

2. Acquisition of Company/ Business: Acquisition of Company; Takeover of Listed Companies (i) Legal Framework (ii) Process & Compliances; Cross Borders Takeovers – Procedure.

3. Planning & Strategy: Case Studies pertaining to Merger, Amalgamation, Restructuring; Funding for M&A, Studies of Judicial pronouncements; Planning relating to acquisitions & takeovers; Protection of minority interest; Succession Planning; Managing Family Holdings through Trust.

4. Process of M&A transactions: Key Concepts of M&A**;** Law & Procedure; M&A Due Diligence; M&A Valuation; M&A Structure finalization; Post transaction integration.

5. Documentation–Merger & Amalgamation: Drafting of Scheme; Drafting of Notice and Explanatory Statement; Drafting of application & Petition.

6. Valuation of Business and Assets for Corporate Restructuring: Type of Valuations; Valuation Principles & Techniques for Merger, Amalgamation, Slump Sale, Demerger; Principles & Techniques of Reporting; Relative valuation and Swap ratio.

7. Accounting in Corporate Restructuring: Concept and Accounting Treatment: Methods of Accounting for Amalgamations - AS-14/ IndAS 103; Treatment of Reserves, Goodwill; Pre-Acquisition & Post-Acquisition Profit; Accounting in Books of Transferor and Transferee; Merger and De-Merger; Acquisition of Business and Internal Reconstruction.

8. Taxation & Stamp Duty aspects of Corporate Restructuring: Capital Gain; Set-off and carry forward under section 2(14) of Income Tax Act; Deemed Dividend; Payment of Stamp Duty on scheme, payment of stamp duty on movable and immovable properties.

9. Competition Act: Regulation of combinations under the competition Act, Kinds of combinations, Exempted combinations, Concept of relevant market and its importance, Determination of combinations and any appreciable adverse effect, Role of CCI.

10. Regulatory approvals of scheme: From CCI, Income Tax, Stock Exchange, SEBI, RBI, RD, ROC, OL and Sector Regulators such as IRDA, TRAI, etc.

11. Appearance before NCLT / NCLAT.

12. Fast Track Mergers: Small companies, Holding and wholly owned companies

13. Cross Border Mergers

Case Laws/Case Studies/Practical Aspects

LESSON WISE SUMMARY

CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

PART I- CORPORATE RESTRUCTURING

Lesson 1: Types of Corporate Restructuring

Corporate restructuring is an inorganic growth strategy of redesigning one or more aspects of a business. Restructuring typically occurs as a result of business analysis that shows a need for greater efficiency to complete tasks. Sometimes a particular segment of the business will start to fail, and the company will need to reallocate resources in order to support it. Sometimes a business may have expanded too much, and needs to refocus on its core abilities. At other times a business may need to restructure its financial position in order to continue making profits. Often, restructuring plans are necessary simply to meet the constantly changing demands of technology that competitors are embracing, survive a currently adverse economic weather, or poise the corporation to move in an entirely new trend. Some of common ways to carry our Restructuring process are mergers/amalgamations, acquisitions/takeovers, divestitures/demergers, slump sale, business sale; joint venture, strategic alliance, financial restructuring (buy-back, alteration & reduction). This lesson covers the concept of corporate restructuring, its importance, historical background, available tools and emerging trends in restructuring strategies, etc.

Lesson 2: Acquisition of Company/ Business

An acquisition is a situation whereby one company purchases most or all of another company's shares in order to take control. An acquisition occurs when a buying company obtains more than 50% ownership in a target company. Corporate Sector is an attractive medium for carrying on business as it offers a lot of benefits. Raising money from public has its own positive features and it helps setting up big projects. When promoters of a company desire to expand, they take a quick view of the industrial and business map. If they find there are opportunities, they will always yearn for capitalizing such opportunities. Compared to the efforts required, cost and time needed in setting up a new business, it would make sense to them to look at the possibilities of acquiring an existing entity. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 prescribes disclosure requirements, open offer thresholds and other procedural aspects to takeover. This lesson covers the meaning, concept, objectives of takeover, procedural requirements as to takeover of listed/unlisted companies, takeover defenses etc.

Lesson 3: Planning & Strategy

In order to make a merger work, it is pertinent to have a sound strategic planning so that maximum benefit is taken out from the merger. The company doing the acquisition must evaluate the performance, market position, cash flows, future opportunities, technology, regulatory issues of the target company to fix the right price for the deal. It is important to identify synergy between the two companies. Most prominently, the strategy must lay out the business drivers of the merger and factor in all the risks associated with the merger. Once the basic strategy is in place, then the acquiring company must look at the finances. Financing the deal can be done from myriad sources like cash, own accruals, debt, public and private equities, minority investments, etc. One must evaluate the cost of the fund depending on the needs and the amount of returns that the deal can fetch in the medium to long-run. This lesson covers the planning and strategy, purchase and protection of minority interests, succession planning and the funding process for mergers and acquisitions.

Lesson 4: Process of Merger & Acquisition transactions

Strategic decision of merger/amalgamation by the transferor/transferee company require compliance with a number of regulations viz., the Companies Act, 2013, National Company Law Tribunal Rules, 2016, Income Tax Act, 1961, The Indian Stamp Act, 1899, The Competition Act, 2002 etc. Due Diligence and Valuation are two most important aspects. Mergers and amalgamations involves conducting of various meeting including board/general meetings, obtaining of various approvals from regulators like Stock Exchanges, National Company Law Tribunal (NCLT) , Ministry of Corporate Affairs (ROC/RD), drafting of documents such as preparation of scheme, notices/explanatory statements, filing of various documents including e- forms with ROC, filing of scheme of amalgamation with NCLT, etc. This lesson covers the regulatory framework, interpretations of provisions in the Companies Act relating to merger/amalgamation, different approvals, steps involved, integration not only of the financials, accounting and software but also of the human and cultural integration and judicial pronouncements, etc.

Lesson 5: Documentation – Merger & Amalgamation

Mergers and acquisitions require a lot of legal documentation, hence drafting skills of an expert level is required. Besides that, a lot of coordination is required with statutory authorities and the same requires a lot of planning and patience at the Company Secretary's end. It's a wholesome procedure which demands not only internal coordination with team members, but also good liasoning skills with external parties. Proper understanding of documents required and skill to prepare them is an essential element for achieving desired results. Every professional involved in merger and amalgamation documentation should possess necessary expertise to draft the scheme along with attachments required in order to streamline the process of submission of petition and its approval. Company Secretary being an expert in drafting has an edge over others, to grab the ample opportunities available in this area of work. The study lesson covers the documentation involved, points to be factored while drafting such documents and general provisions under the Companies Act, 2013 and NCLT Rules with respect to mergers and amalgamations.

Lesson 6: Valuation of Business and Assets for Corporate Restructuring

Valuation is one of the most important factor in determining the accurate and realistic value of companies in mergers and acquisitions. Circumstances requiring valuation are discussed. Valuation provides a useful base to establish a price for the property. The main objective in carrying out a valuation is to conclude a transaction in a reasonable manner without any room for any doubt or controversy about the value obtained by any party to the transaction. There are various methodologies for valuing a business, all having different relevance depending on the purpose of valuation. These methodologies include asset based approach, earnings based approach and market based approach. Besides regulatory aspects also impact valuation. For example there are regulatory prescriptions for valuation of shares under SEBI (SAST) Regulations, 2011, SEBI (ICDR) Regulations, 2018, SEBI (Share Based Employee Benefits) Regulations, 2014, FEMA/Consolidated FDI Policy, Income Tax Act, 1961, etc. This lesson covers the meaning, purpose and methods of valuation, the regulatory aspects of valuation, etc.

Lesson 7: Accounting in Corporate Restructuring — Concept and Accounting Treatment

There are many accounting issues involved in the merger and acquisition. The main issues like accounting by acquirer, valuation of goodwill and reserve of the Target Company and accounting method. Accounting standard (AS-14) prescribes for accounting and disclosure requirements of merger and acquisition. According to AS14 amalgamation may be either in the nature of merger or in the nature of purchase. IND-AS 103 deals with meaning of business, business combination. According to IND-AS 103, business combination is accounted applying acquisition method. This lesson covers various developments happening in M&A

accounting, concepts of demerger and internal reconstruction and also major difference between IND-AS 103 and IFRS 103.

Lesson 8: Taxation & Stamp Duty aspects of Corporate Restructuring

In any corporate restructuring financial, taxation and stamp duty aspects play a pivotal role in accepting or rejecting a deal. Often a restructuring though operationally and technically viable may fail due to taxation and other issues. Taxation and stamp duty aspects will have regulatory scrutiny also. Capital Gain; Set-off and carry forward; Deemed Dividend; Payment of Stamp Duty on scheme, payment of stamp duty on movable and immovable properties are important considerations. Financial aspects of merger denote financial benefits. Stamp duty and taxation aspects are closely linked to the financial aspects. Similarly, the incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. Taxation aspects of merger includes aspects such as carry forward of losses after merger. This lesson covers the regulatory aspects and court decisions as to the stamp duty aspects of mergers, tax advantage on mergers, etc.

Lesson 9: Competition Act

Competition law being an economic legislation regulates merger (called combinations) deals with threshold limits (domestic/cross border), notice to Competition Commission of India etc. The lesson covers Regulation of combinations under the competition Act, Kinds of combinations, Exempted combinations, Concept of relevant market and its importance, determination of combinations and any appreciable adverse effect, Role of CCI. It is of utmost importance for Company Secretaries to have thorough knowledge of the precedents, orders and decisions made by the overseas contemporary authorities as well as the leading decisions of the Commission. It is worth highlighting that the filing process is not easy; rather, parties need to be well-prepared and carefully assess all possible market definitions. Role of professionals is important in advising the Board of directors about competition aspects of proposed merger and acquisition, filing before the Commission and representing the case where the Commission deems it necessary to give an opportunity of being heard to the parties to the combination before deciding the case. This lesson covers basics about combinations, their regulation and thresholds, etc. as specified in the Competition Act, 2002.

Lesson 10: Regulatory approvals of scheme

Corporate restructuring is an inevitable event in life of a corporate in dynamic and fast changing environment. Regulatory regime for mergers and acquisitions in India require approvals from CCI, Income Tax, Stock Exchange, SEBI, RBI, RD, ROC, OL and Sector Regulators such as IRDA, TRAI, etc. The merger and takeover involves various issues and compliance not even of the Companies Act, 2013, but from the other Regulators also depending upon the nature of business of the company and sector under which it is operating. From this point of view it becomes necessary for a student of professional programme to know various procedural aspects, regulatory approvals required to complete these events. It is to be noted in corporate world such professionals having an expertise in these procedural aspects are in great demand. This lesson covers the various approval required in case of merger/amalgamation, acquisition/ takeovers, etc.

Lesson 11: Appearance before NCLT / NCLAT

Basic framework before NCLT governed by the Companies Act, 2013, National Company Law Tribunal Rules, 2016, National Company Law Appellate Tribunal Rules, 2016, Companies (Compromise, Arrangements and Amalgamations) Rules, 2016is discussed in this lesson. Constitution of NCLT provides various opportunities for professionals to appear and represent before the Tribunal in case of mergers /

amalgamation / demerger / reduction of share capital, winding-up proceeding, oppression and mismanagement, conversion of a company from public to private, etc. Practicing Company Secretaries render services in preparing schemes, appearing before NCLT/NCLAT for approval of schemes and post-merger formalities. The comprehensive reading of corporate laws and ample amount of relevant training empowers the Company Secretaries to have edge over other professionals to deal with procedural and/ or practical oriented matters/ issues pertaining to Companies Act. This lesson covers the basic requirements and skills, Scope for PCS under NCLT, Dress Code, Etiquettes, Court craft to appear and represent before NCLT/NCLAT.

Lesson 12: Fast Track Mergers

Introduction, applicability and procedure for Fast track mergers under Section 233 of the Companies Act, 2013, Rule 25 of Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 and related concepts of small company are covered in this lesson. Company Secretary plays an important role in the restructuring process and often advises his/her clients as to the procedure to be adopted, forms to be filed, etc. Hence, it is important for them to learn the basic concepts of what is a fast track merger, to whom does it apply, how can it be invoked, what are the requisite steps and which forms are required to be filed.This lesson covers about concept of fast track merger, procedure involved in fast track merger, etc.

Lesson 13: Cross Border Mergers

Conceptual understanding of cross border mergers including the need for the introduction of outbound mergers, the legal provisions to be invoked and used, valuation issues pertaining to Cross Border Mergers, the tax/accounting implications, how to assess if a merger would be beneficial or not and the post-merger evaluation of a firm. Section 234 of the Companies Act, 2013 and Rule 25A of the Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 which provide for the basic legal framework involved in cross border mergers is discussed. This lesson covers concept of cross border mergers, legal framework surrounding cross border mergers, concepts of inbound and outbound mergers, risks and benefits associated with a cross border merger, etc.

LIST OF RECOMMENDED BOOKS AND OTHER REFERENCES

Corporate Restructuring, Insolvency, Liquidation & Winding-up

Recommended Readings and References

1.	Relevant Bare Acts	
2.	A. Ramaiya	Guide to Companies Act, Lexis Nexis Butterworths, Wadhwa, Nagpur
3.	M.C. Bhandari	Guide to Company Law Procedures, Lexis Nexis Butterworths Wadhwa Nagpur
4.	Taxmann	Master Guide to Companies Act 2013 & Company Rules
5.	S K Kataria	The Companies Act, 2013 with Rules and Ready Referencer by Bloomsbury Publication
6.	Sridharan and Pradhan	Guide to Takeovers and Mergers by Wadhwa & Co.
7.	ICSI	Handbook on Mergers Amalgamations and Takeovers.
8.	K.R. Sampath	Mergers/Amalgamations, Takeovers, Joint Ventures, LLPs and Corporate Restructure, Snow White Publications
9.	S. Ramanujam	Mergers et al, Lexis Nexis Butterworths Wadhwa Nagpur
10.	Ray	Mergers and Acquisitions Strategy, Valuation and Integration, PHI

Important Websites:

(a) www.mca.gov.in

(b) www.sebi.gov.in

(c) www.nclt.gov.in

(d) www.nclat.nic.in

(e) www.ibbi.gov.in

(f) www.rbi.org.in

(g) www.finmin.nic.in

(h) www.drt.gov.in

(i) www.dipp.nic.in

ARRANGEMENT OF STUDY LESSONS

Module 2 – Paper 5 - Corporate Restructuring, Insolvency, Liquidation & Winding-up

Lesson No.	*Lesson Title*
	PART I- Corporate Restructuring
1.	Types of Corporate Restructuring
2.	Acquisition of Company/ Business
3.	Planning & Strategy
4.	Process of M&A transactions
5.	Documentation–Merger & Amalgamation
6.	Valuation of Business and Assets for Corporate Restructuring
7.	Accounting in Corporate Restructuring—Concept and Accounting Treatment
8.	Taxation & Stamp Duty aspects of Corporate Restructuring
9.	Competition Act
10.	Regulatory approvals of scheme
11.	Appearance before NCLT / NCLAT
12.	Fast Track Mergers
13.	Cross Border Mergers

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

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Lesson 1
Types of Corporate Restructuring

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Meaning of Corporate Restructuring
- Historical Background
- Need & Scope of Corporate Restructuring
- Various Modes of Restructuring
- Commonly applied tools of Corporate Restructuring
- Planning, formulation and execution of various Restructuring Strategies
- Financial Restructuring
- Reduction of capital
- Buy-back

LEARNING OBJECTIVES

Corporate restructuring is a corporate action taken to significantly modify the structure or the operations of a company. It can be driven by external factors requiring change in the organizational structure or business model of a company, or it can be driven by the necessity to make financial adjustments to its assets and liabilities. There are many tools and strategies for carrying out Corporate Restructuring such as amalgamations, mergers, demergers, reverse mergers, takeovers, acquisitions, joint ventures, disinvestments, buy-back of shares, etc.

The speed of business dynamics demands the business organizations not only to revamp their internal business strategies like effective market expansion, increased customer base, product diversification and innovation etc., but also expects the corporate to devise inorganic business strategies that results in faster pace of growth, effective utilization of resources, fulfillment of increasing expectations of stakeholders. These restructuring strategies may work positively for the businesses both during the business prosperity and troubled times.

This lesson would help you in understanding the concept of corporate restructuring, its importance, historical background, available tools & emerging trends in restructuring strategies, etc.

INTRODUCTION

Corporate Restructuring is an expression that connotes a restructuring process undertaken by business enterprise. It is the process of redesigning one or more aspects of a company. Hence, Corporate Restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives. A business may grow over time as the utility of its products and services is recognized, but it is a long drawn process. It may also grow through an inorganic process, symbolized by an instantaneous expansion in work force, customers, infrastructure resources and thereby an overall increase in the revenues and profits of the entity.

Restructuring as per Oxford dictionary means reorganization of a company with a view to achieve greater efficiency and profit, or to adapt to a changing market**.** According to Peter F Drucker, the management guru, the greatest change in corporate culture and the way business is being conducted, is the strategic intervention and relationship based not on ownership, but on partnership.

Corporate restructuring play a major role in enabling enterprises to achieve economies of scale, global competitiveness, right size, reduction of operational costs and administrative costs.

During the past decade, corporate restructuring has increasingly become a staple of business and a common phenomenon around the world. Unprecedented number of companies across the world have reorganized their divisions, restructured their assets and streamlined their operations in a bid to spur the company performance. The suppliers, customers and competitors also have an equally profound impact while working with a restructured company.

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Corporate restructuring is an inorganic growth strategy.

HISTORICAL BACKGROUND

The concept of merger and acquisition in India was not popular until the year 1988. During that period a very small percentage of businesses in the country used to come together, mostly into a friendly acquisition with a negotiated deal. The key factor contributing to fewer companies involved in the merger was the regulatory and prohibitory provisions of MRTP Act, 1969. According to this Act, a company or a firm has to follow a burdensome procedure to get approval for merger and acquisitions.

The year 1988 witnessed one of the oldest business acquisitions or company mergers attempt in India. It is the well-known ineffective unfriendly takeover bid by Swaraj Paul to overpower DCM Ltd. and Escorts Ltd. Further to that many other non-resident Indians had put in their efforts to take control over various companies through their stock exchange portfolio.

Before 1991 Indian economy was closed economy. Various licenses and registration under various enactments were required to set-up an industry. Due to restrictive government policies and rigid regulatory framework there existed very limited scope for restructuring. However, after 1991, the main thrust of Industrial Policy, 1991 was on relaxations in industrial licensing, foreign investments, and transfer of foreign technology, etc. With the economic liberalization, globalization and opening-up of economies, the Indian corporate sector started restructuring businesses to meet the opportunities and challenges.

In the era of hyper competitive capitalism and technological change, industrialists realized that restructuring perhaps is the best route to reach a size comparable to global companies so as to effectively compete.

NEED AND SCOPE

Corporate Restructuring is concerned with arranging the business activities of the Corporate as a whole so as to achieve certain pre-determined objectives at corporate level. Objectives may include the following:

- To enhance shareholders value
- Orderly redirection of the firms activities
- Deploying surplus cash from one business to finance profitable growth in another
- Exploiting inter-dependence among present or prospective businesses
- Risk reduction
- Development of core-competencies
- To obtain tax advantages by merging a loss-making company with a profit-making company
- To have access to better technology
- To become globally competitive
- To increase the market share

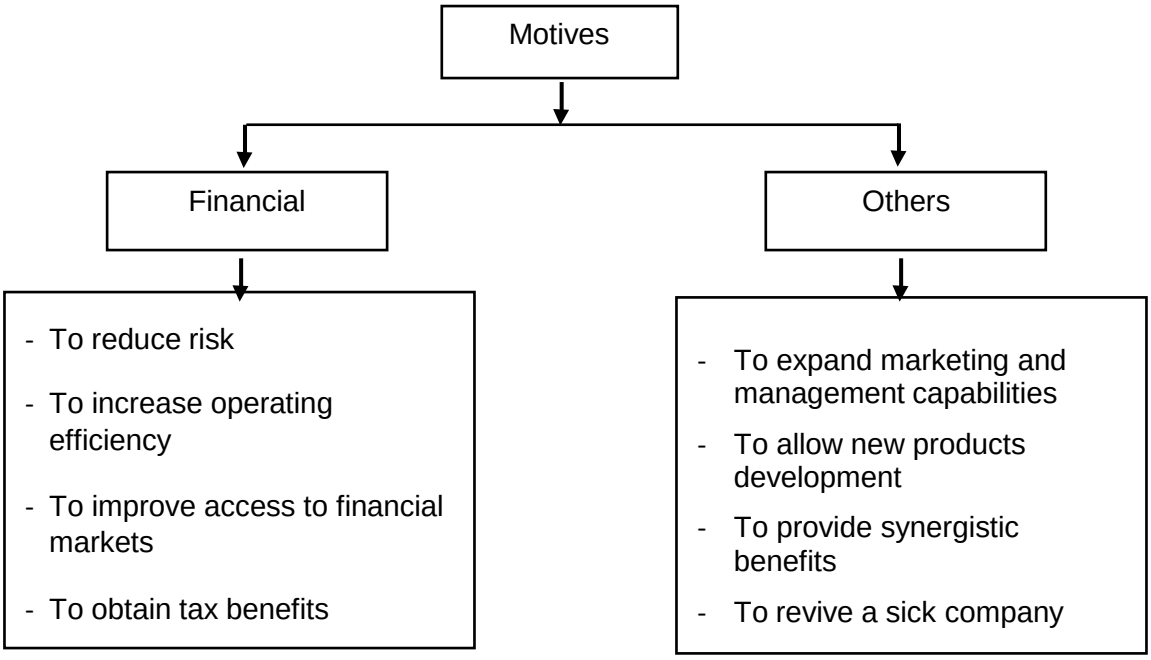
Restructuring aims at improving the competitive position of an individual business and maximizing its contribution to corporate objectives. It also aims at exploiting the strategic assets accumulated by a business i.e., monopolies, goodwill, exclusivity through licensing, etc. to enhance the competitiveness advantages. Thus, restructuring helps in bringing an edge over competitors.

In highly competitive world, cost cutting and value addition are very important to get highlighted.

Corporate Restructuring : an Example

ABC Limited has surplus funds but it is not able to consider any viable projects. Whereas XYZ Limited has identified viable projects but has no money to fund the cost of the project. The merger of ABC Limited and XYZ Limited is a mutually beneficial option and would result in positive synergies for both the Companies.

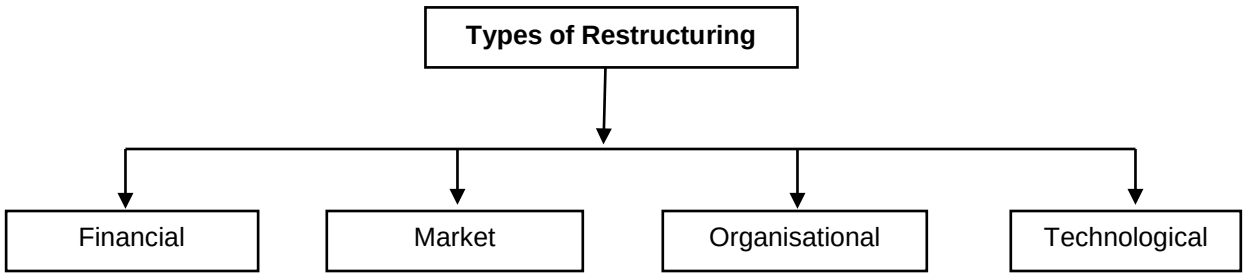
Motives behind Corporate Restructuring



Recent Mergers and Acquisitions

Acquirer	Target Company	Deal Size	Comments
Flipkart	Myntra	USD300 mn	Acquisition led to scripting of largest ecommerce stories
Asian Paints	Ess Ess Bathroom products	Undisclosed	To be one stop provider in home décor space
RIL	Network 18 Media & Investments	`4000 Cr.	78% shares were taken over by RIL
Merck	Sigma	USD17 bn	Acquisition to boost lab supply business of Merck
Sun Pharma	Ranbaxy	USD4 bn	Increased presence in global and domestic markets
TCS	CMC		Merger to consolidate IT business
Tata Power	PT Arutmin Indonesia	`47.4 bn	Purchase 30% stake
Groupe Lactalis	Tirumala Milk	USD275 mn	Lactalis entry into India
CSP CX	Aditya Birla Minacs	USD260 mn	Aditya Birla's exit from IT industry
Thomas Cook	Sterling India	` 870cr	Entry into hospitality business
Yahoo	Bookpad	USD15mn	First acquisition made by Yahoo
Kotak Bank	ING Vyasa	USD2.4bn	All shares deal
Ola Cabs	Taxi for sure	USD 200mn	Acquisition of competitor

TYPES OF RESTRUCTURING



I. FINANCIAL RESTRUCTURING

Financial restructuring deals with restructuring of capital base and raising finance for new projects. Financial restructuring helps a firm to revive from the situation of financial distress without going into liquidation.

Financial restructuring is done for various business reasons:

- Poor financial performance
- External competition

- Erosion or loss of market share
- Emerging market opportunities

It involves Equity Restructuring like buy-back, Alteration/Reduction of capital and Debt Restructuring like restructuring of the secured long-term borrowing, long-term unsecured borrowings, Short term borrowing which are explained in detail in further later.

II. Market and Technological Restructuring

Market Restructuring involves decisions with respect to the product market segments where the company plans to operate on its core competencies and technological restructuring occurs when a new technology is developed that changes the way an industry operates. This type of restructuring usually affects employees, and tends to lead to new training initiatives, along with some layoffs as the company improves efficiency. This type of restructuring also involves alliances with third parties that have technical knowledge or resources.

Indian technology major Tata Consultancy Services Limited has embarked upon the process of restructuring and focusing on three core areas Cloud, agile and automation. The restructuring plan of the company focuses on the manufacturing capacity and on product, technical and technological, financial, employment, organizational, purchasing and management restructuring activities.

Disney's global technology group, parks-and-resorts division is undergoing a reorganization which results in some employees losing their jobs. It is eliminating some positions and replacing them with others that help the company reach more long-term technology goals.

Joint Venture, Strategic Alliances, Franchising are some of the examples of market and technological restructuring which are explained in detail subsequently.

III. Organisational Restructuring

Organizational Restructuring involves establishing internal structures and procedures for improving the capability of the personnel in the organization to respond to changes. These changes need to have the cooperation of all levels of employees. Some companies shift organizational structure to expand and create new departments to serve growing markets. Other companies reorganize corporate structure to downsize or eliminate departments to conserve overheads.

LEGAL FRAMEWORK OF CORPORATE RESTRUCTURING

Corporate Restructuring in India is governed by the following Acts, Rules, etc.:

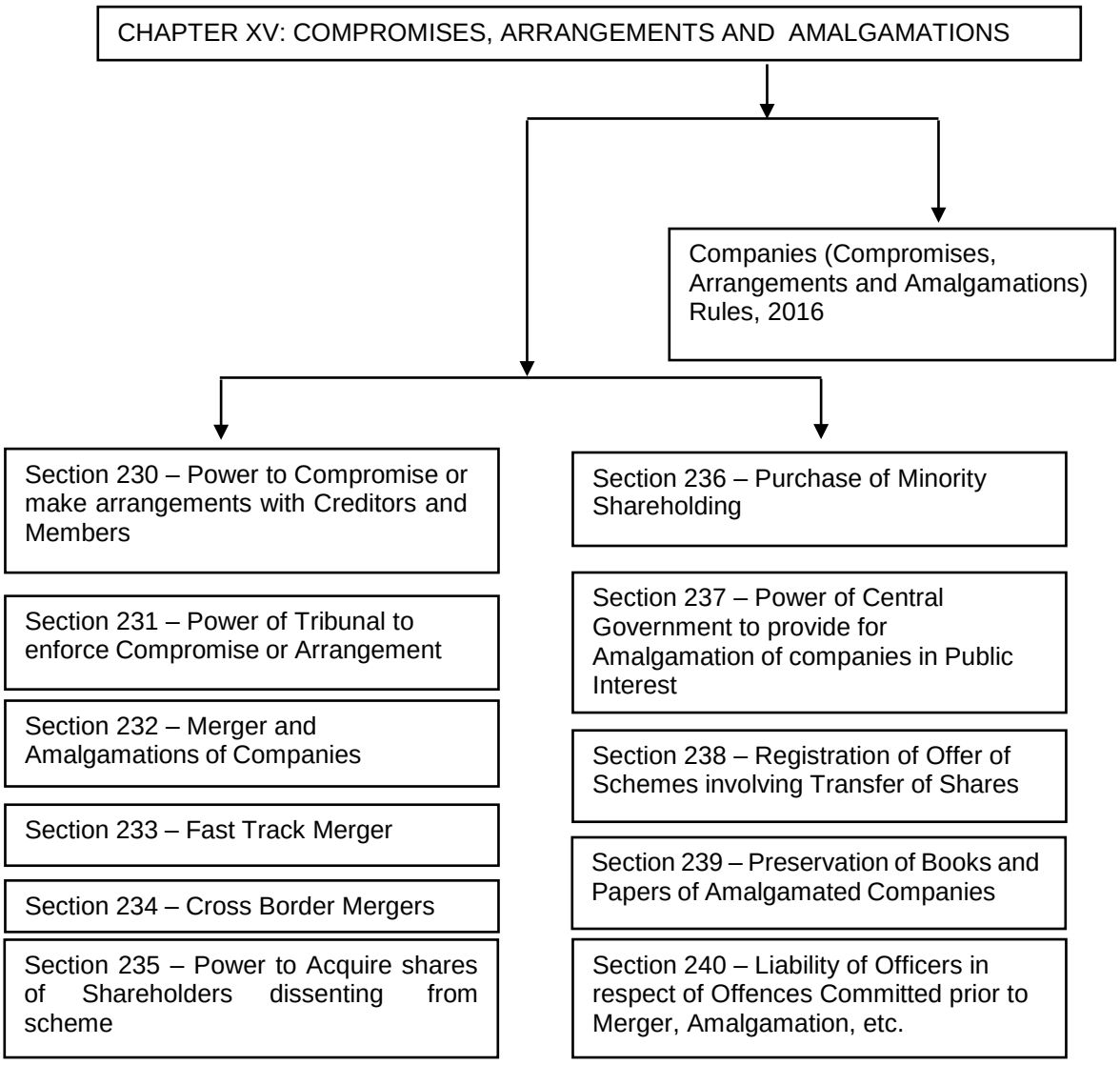
- Chapter XV of The Companies Act, 2013 (the Act)
- Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016
- Income Tax Act, 1961
- Accounting Standards
- Foreign Exchange Management Act,1999
- Competition Act, 2002
- Intellectual Property Rights
- Indian Stamp Act, 1899
- State Stamp Acts
- Insolvency and Bankruptcy Code, 2016

Ministry of Corporate Affairs (MCA) vide notification no. S.O. 3677(E) dated December 7, 2016 notified sections 230 [except sub section (11) and (12)], and sections 231 to 240 [except section 234 which provides merger with foreign company] of the Act, related to compromises, arrangements, and amalgamations effective from 15.12.2016.

MCA vide notification dated 14th December, 2016 notified The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 effective from 15th December, 2016. Consequently, w.e.f. 15.12.2016 all the matters relating to Compromises, Arrangements, and Amalgamations are being dealt with as per provisions of Companies Act, 2013 and the Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016.

MCA vide notification dated 13th April, 2017 notified Section 234 of the Act which deals with merger or amalgamation of a company with foreign company effective from 13th April, 2017.

Corporate Restructuring related matters including mergers, demergers, capital reductions, etc. are to be filed before and dealt by National Company Law Tribunal (NCLT) bench exercising respective territorial jurisdiction.



MOST COMMONLY APPLIED TOOLS OF CORPORATE RESTRUCTURING

Mergers/Acquisitions And Amalgamation

Mergers and Acquisitions (M&A) are transactions in which the ownership of companies, other business organizations or operating units are transferred or combined. As an aspect of strategic management, M&A allow enterprises to grow, shrink, and change the nature of the business or competitive position. It refers to the consolidation of two companies.

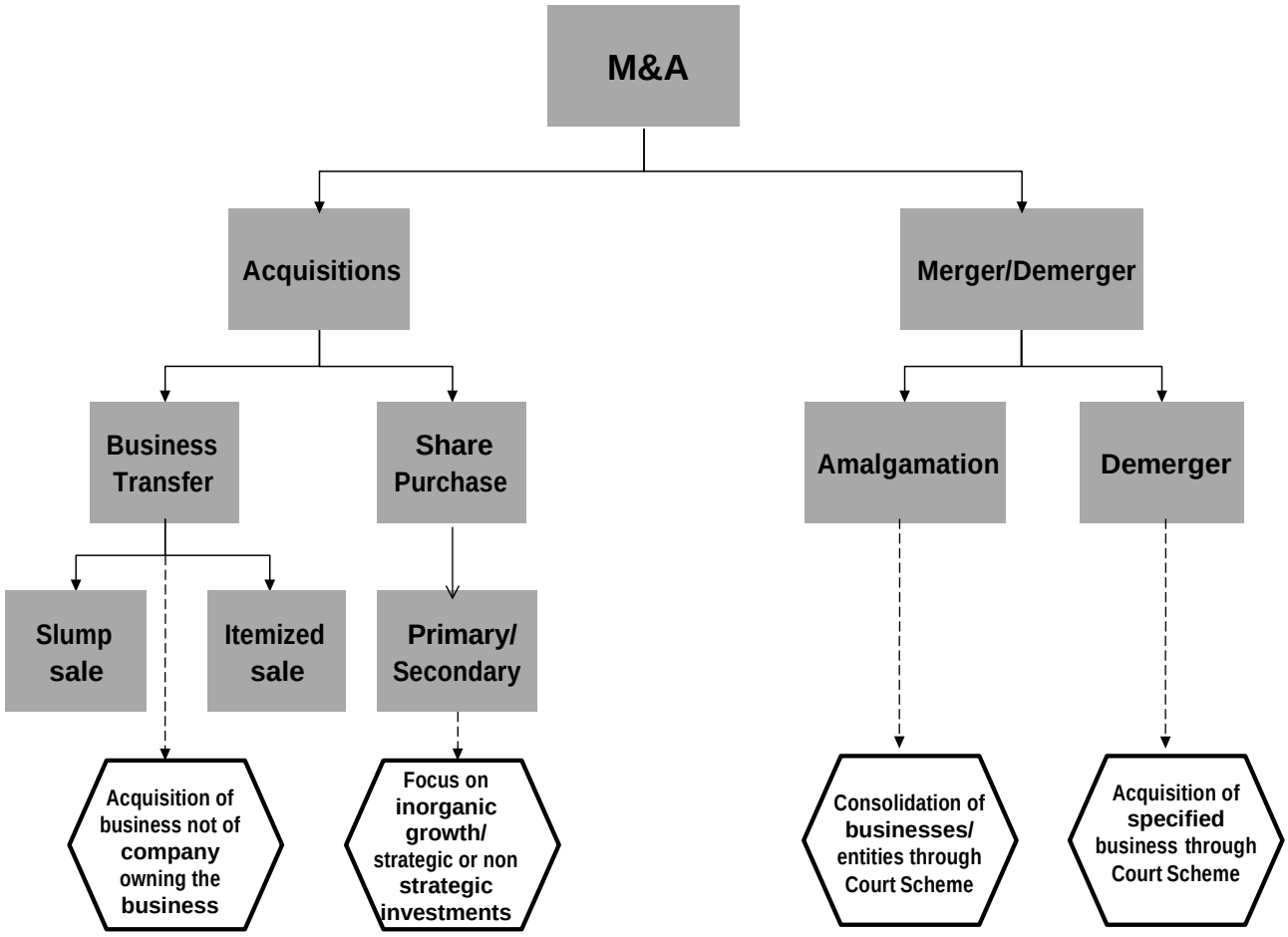
The reasoning behind M&A is that two separate companies together create more value compared to being on an individual stand. With the objective of wealth maximization, companies keep evaluating different opportunities through the route of merger or acquisition.

Section 232 of the Act deals with the mergers and amalgamation of companies and Section 234 of the Act which deals merger or amalgamation of a company with a foreign company.

Reasons for Mergers & Acquisitions

Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

- Becoming bigger: Many companies use M&A to grow in size and leapfrog their rivals. While it can take years or decades to double the size of a company through organic growth, this can be achieved much more rapidly through mergers or acquisitions.
- Preempted competition: This is a very powerful motivation for mergers and acquisitions, and is the primary reason why M&A activity occurs in distinct cycles.
- Domination: Companies also engage in M&A to dominate their sector. However, since a combination of two behemoths would result in a potential monopoly, such a transaction would have to face regulatory authorities.
- Tax benefits: Companies also use M&A for tax purposes, although this may be an implicit rather than an explicit motive.
- Economies of scale: Mergers also translate into improved economies of scale which refers to reduced costs per unit that arise from increased total output of a product.
- Acquiring new technology: To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.
- Improved market reach and industry visibility: Companies buy other companies to reach new markets and grow revenues and earnings. A merger may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.



M&A take place:

- by purchasing assets
- by purchasing common shares
- by exchange of shares for assets
- by exchanging shares for shares

M&A include a number of different transactions such as:

1. Mergers
2. Acquisitions
3. Amalgamation
4. Consolidations
5. Tender offers
6. Purchase of assets

7. Management buy-out

1. Mergers

The term merger and amalgamation has not been defined under the Act. M&A is often known to be a single terminology. However, there is a thin difference between the two. 'Merger' is the fusion of two or more companies, whereby the identity of one or more is lost resulting in a single company whereas 'Amalgamation' signifies the blending of two or more undertaking into one undertaking, blending enterprises loses their identity forming themselves into a separate legal identity.

There may be amalgamation by the transfer of two or more undertakings to a new or existing company. 'Transferor company' means the company which is merging also known as amalgamating company in case of amalgamation and 'transferee company' is the company which is formed after merger or amalgamation also known as amalgamated company in case of amalgamation.

A merger is a legal consolidation of two entities into one entity which can be merged together either by way of amalgamation or absorption or by formation of a new company. The Board of Directors of two companies approve the combination and seek shareholders' approval. After the merger, the acquired company ceases to exist and becomes part of the acquiring company. Some recent examples are acquisition of eBay India by Flipkart, Vodafone-Idea merger and Axis Bank's acquisition of freecharge.

TYPES OF MERGERS

a) HORIZONTAL MERGER

Horizontal Merger is a merger between companies selling similar products in the same market and in direct competition and share the same product lines and markets. It decreases competition in the market.The main objectives of horizontal merger are to benefit from economies of scale, reduce competition, achieving monopoly status and control of the market.

Examples:

Facebook's acquisition of Instagram in 2012 for a reported $1 billion. Both Facebook and Instagram operated in the same industry and were in similar production stages in regard to their photo-sharing services. Facebook, looking to strengthen its position in the social media and social sharing space, saw the acquisition of Instagram as an opportunity to grow its market share, increase its product line, reduce competition and access potential new markets.

b) VERTICAL MERGER

Vertical Merger is a merger between companies in the same industry, but at different stages of production process. In another words, it occurs between companies where one buys or sells something from or to the other.

To illustrate, suppose XYZ Ltd. produces shoes and ABC Ltd. produces leather. ABC has been XYZ's leather supplier for many years, and they realize that by entering into a merger together, they could cut costs and increase profits. They merge vertically because the leather produced by ABC is used in XYZ's shoes.

c) CONGLOMERATE MERGER

Conglomerate merger is a merger between two companies that have no common business areas**.** It refers to the combination of two firms operating in industries unrelated to each other. The business of the target company is entirely different from the acquiring company. The main objective of a conglomerate merger is to

achieve big size e.g., a watch manufacturer acquiring a cement manufacturer, a steel manufacturer acquiring a software company, etc.

d) CONGENERIC MERGER

Congeneric merger is a merger between two or more businesses which are related to each other in terms of customer groups, functions or technology e.g., combination of a computer system manufacturer with a UPS manufacturer.

2. ACQUISITION

Acquisition occurs when one entity takes ownership of another entity's stock, equity interests or assets. It is the purchase by one company of controlling interest in the share capital of another existing company. Even after the takeover, although there is a change in the management of both the firms, companies retain their separate legal identity. The companies remain independent and separate; there is only a change in control of the companies. When an acquisition is 'forced' or 'unwilling', it is called a takeover.

Recent examples:

- Snapdeal and Freecharge ($400 million)
- Flipkart and Myntra ($300 to 330 million)
- Ola and TaxiForSure ($200 million)

Difference between a Merger and an Acquisition:

Merger	Acquisition
A merger occurs when two separate entities, usually of comparable size, combine forces to create a new, joint organization in which both are equal partners	An acquisition refers to the purchase of one entity by another (usually, a smaller firm by a larger one)
Old company cease to exist and a new company emerges	A new company does not emerge
It requires two companies to consolidate into a new entity with a new ownership and management structure	It occurs when one company takes over all of the operational management decisions of another
It the takeover is friendly, it is called merger	If the takeover is hostile, it is called as an acquisition

From a commercial and economic point of view, both types of transactions generally result in the consolidation of assets and liabilities under one entity, and the distinction between a "merger" and an "acquisition" is less clear. A transaction legally structured as an acquisition may have the effect of placing one party's business under the indirect ownership of the other party's shareholders, while a transaction legally structured as a merger may give each party's shareholders partial ownership and control of the combined enterprise.

Contemporary corporate restructurings are usually referred to as merger and acquisition (M&A) transactions rather than simply a merger or acquisition. The practical differences between the two terms are slowly being

eroded by the new definition of M&A deals. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

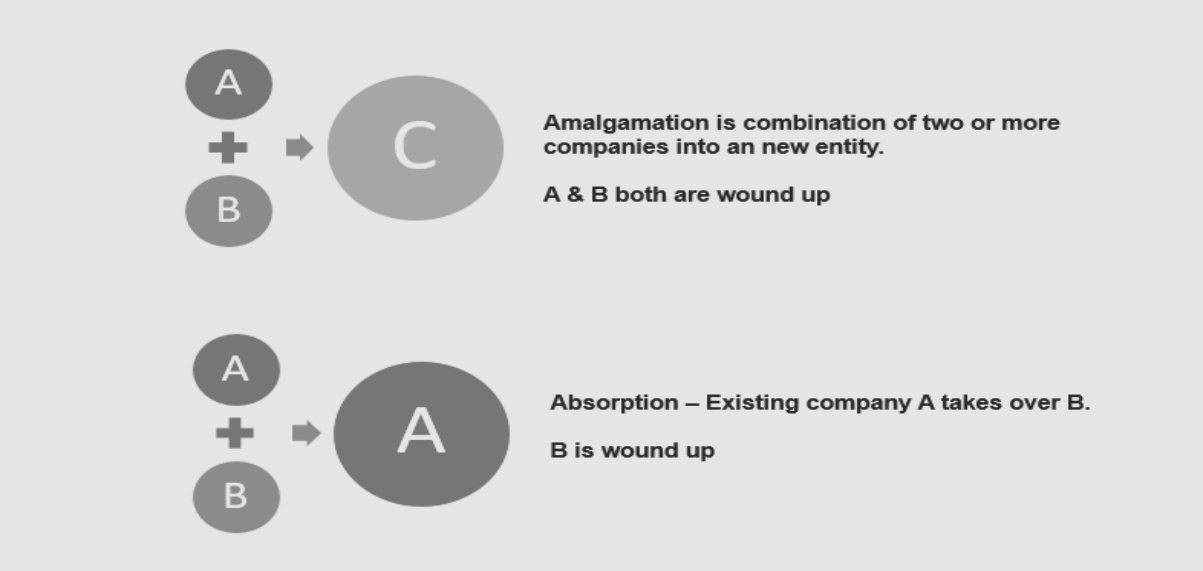
A stock swap occurs when shareholders' ownership of the target company's shares are exchanged for shares of the acquiring company as part of a merger or acquisition. During a stock swap, each company's shares must be accurately valued in order to determine a fair swap ratio.

3. AMALGAMATION

Amalgamation is defined as the combination of one or more companies into a new entity. It includes:

(i) Two or more companies join to form a new company

(ii) Absorption or blending of one by the other



Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or amalgamated company. In other words, property, assets, liabilities of one or more companies is taken over by another or are absorbed by and transferred to an existing company or a new company.

Therefore, the essence of amalgamation is to make an arrangement thereby uniting the undertakings of two or more companies so that they become vested in, or under the control of one company which may or may not be the original of the two or more of such uniting companies.

The word “amalgamation” is not defined under the Act whereas section 2(1B) of Income Tax Act, 1961 defines Amalgamation as:

“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 the amalgamating company or companies and the company with which they merge or which is formed as a 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-fourths 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.

Amalgamation includes absorption. The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 14 on Accounting for Amalgamations.

Illustration

Process	Result
Existing companies A and B are wound-up and a new company C is formed to takeover the businesses of A and B	Amalgamation
Existing company A takes over the business of another existing company B which is wound-up	Absorption
A new Company X is formed to take over the business of an existing company Y which is wound-up.	External reconstruction

Reasons for Amalgamation:

(a) To acquire cash resources

(b) To eliminate competition

(c) Tax savings/advantages

(d) Economies of large scale operations

(e) To Increase shareholders value

(f) To reduce the degree of risk by diversification

(g) Managerial effectiveness

(h) To achieve growth and financial gain

(i) Revival of weak or sick company

(j) Survival

(k) Sustaining growth

4. CONSOLIDATION

A consolidation creates a new company. Stockholders of both companies approve the consolidation, and subsequent to the approval, receive common equity shares in the new firm.

Example:

In 1998 Citicorp and Traveler's Insurance Group announced a consolidation, which resulted in Citigroup.

5. TENDER OFFER

One company offers to purchase the outstanding stock of the other firm at a specific price. The acquiring company communicates the offer directly to the other company's shareholders.

Example: Johnson & Johnson made a tender offer in 2008 to acquire Omrix Biopharmaceuticals for $438 million.

6. ACQUISITION OF ASSETS

In a purchase of assets, one company acquires the assets of another company. The company whose assets are being acquired, obtain approval from its shareholders. The purchase of assets is typical during bankruptcy proceedings, where other companies bid for various assets of the bankrupt company, which is liquidated upon the final transfer of assets to the acquiring firm(s).

7. MANAGEMENT BUYOUT

A management buyout (MBO) is a transaction where a company's management team purchases the assets and operations of the business they manage. MBO is appealing to professional managers because of the greater potential rewards from being owners of the business rather than employees.

According to global consultancy giant Grant Thornton, the overall deal activity -- including both mergers and acquisitions and PE (private equity) -- was about $59 billion in the January-November period of 2017, a 9 per cent rise from the previous year 2016.

RECENT MERGERS AND ACQUISITIONS IN INDIA

Vodafone India and Idea Cellular

Vodafone India and Idea Cellular decided to merge and form country's largest telecom operator `Vodafone India Ltd.' worth of more than $23 billion with a 35 per cent market share and it is the top M&A deal of 2017-18.

Vodafone and the Aditya Birla Group will have a joint control of this combined company. Combining the Vodafone and idea customers, the merged entity is the biggest telecom company in India.

The merged entity have over 408 million customers, nearly 42% customer market share (CMS) and nearly 33% revenue market share (RMS), leaving it stronger placed to take on competitive pressures triggered by Jio, with 160 million subscribers and over 16% CMS and 15.3% RMS. Airtel has a CMS of 29.5% and an RMS of 31.5%.

The Idea-Vodafone merger has been cleared by the stock exchanges, Securities and Exchange Board of India, Competition Commission of India, foreign direct investment clearance from the department of industrial policy and promotion, approval given by DoT as licensor and the merger after approval of NCLT is complete in August 2018.

Flipkart and eBay

Indian e-commerce major Flipkart acquired the Indian wing of eBay. The transaction was announced in April 2017 and completed in August 2017. eBay and Flipkart have also entered into an agreement for cross-border sale. In exchange of equity stake in Flipkart, eBay had made cash investment of $500 million and sold its eBay.in business to Flipkart.

As a result, Flipkart customers get expanded product choices with the wide array of global inventory

available on eBay while eBay customers will have access to a more unique Indian inventory from Flipkart sellers.

DEMERGER

It is a business strategy in which a single business is broken into components, either to operate on their own, to be sold or to be dissolved. A demerger allows a large company, such as a conglomerate, to split off its various brands to invite or prevent an acquisition, to raise capital by selling off components that are no longer part of the business's core product line, or to create separate legal entities to handle different operations.

Demerger is an arrangement whereby some part / undertaking of one company is transferred to another company which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company.

The contracts relating to the demerged undertaking would get automatically transferred to the resulting company, unless the underlying contract has stipulated specific restrictions. A demerged company is said to be one whose undertakings are transferred to the other company, and the company to which the undertakings are transferred is called the resulting company. It is a process of reorganizing a corporate structure whereby a capital stock of a division or subsidiary of corporation or of a newly affiliated company is transferred to the stakeholders of existing company.

Demerger under Section 2(19AA) of the Income tax Act, 1961 means the transfer, pursuant to a scheme of arrangement under section 230 to 232 of the Act, by a demerged company of its one or more undertakings to the resulting company in such a manner that:-

(i) 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 demerger;

(ii) All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) The property and the liabilities of the undertaking or undertakings, being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

(v) The shareholders holding not less than three-fourth in value of shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger; otherwise than as a result of the acquisition of the property or assets of the demerged or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis

(vii) Demerger in accordance with the conditions notified under Section 72A(5) of Income Tax Act, 1961.

“Undertaking” includes any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

"Liabilities" referred to in sub-clause (ii), shall include:

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

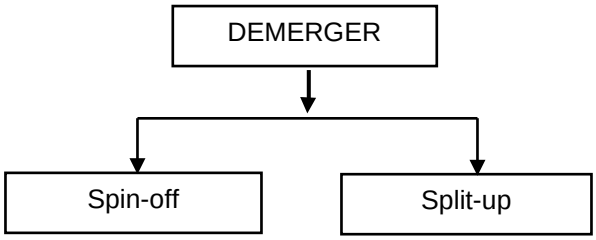
As per provisions of Section 72A(4) of Income Tax Act, 1961, in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall

(a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set-off in the hands of the resulting company;

(b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set-off in the hands of the demerged company or the resulting company, as the case may be.

Examples:

- Reliance Industries demerged to Reliance Industries and Reliance Communications Ventures Ltd, Reliance Energy Ventures Ltd, Reliance Capital Ventures Ltd, Reliance Natural Resources Ltd.
- In April 2018, Whitbread plc. announced to de-merge Costa Coffee from their stable of businesses.
- Pfizer sold their infant nutrition business to Nestle.



Types of Demerger

1. Divestiture

Divestiture means selling or disposal of assets of the company or any of its business undertakings/divisions, usually for cash (or for a combination of cash and debt). It is explained in detail in further.

2. Spin-offs

The shares of the new entity are distributed to the shareholders of the parent company on a pro-rata basis. The parent company also retains ownership in the spun-off entity. Spin-offs have two approaches that can be followed. In the first approach, the company distributes all the shares of the new entity to its existing shareholders on a pro rata basis. This leads to the creation of two different companies holding the same

proportions of equity as compared to the single company existing previously. The second approach is the floatation of a new entity with its equity being held by the parent company. The parent company later sells the assets of the spun off company to another company.

3. Splits/divisions

Splits involve dividing the company into two or more parts with an aim to maximize profitability by removing stagnant units from the mainstream business. Splits can be of two types, Split-ups and Split-offs.

Split-ups: It is a process of reorganizing a corporate structure whereby all the capital stock and assets are exchanged for those of two or more newly established companies resulting in the liquidation of the parent corporation.

Split-offs: It is a process of reorganizing a corporate structure whereby the capital stock of a division or subsidiary of corporation or of a newly affiliated company is transferred to the stakeholders of the parent corporation in exchange for part of the stock of the latter. Some of the shareholders in the parent company are given shares in a division of the parent company which is split off in exchange for their shares in the parent company.

4. Equity Carve-Outs

Equity carve-outs are referred to a percentage of shares of the subsidiary company being issued to the public. This method leads to a separation of the assets of the parent company and the subsidiary entity. Equity carve outs result in publicly trading the shares of the subsidiary entity.

Examples:

1. India's largest engineering and construction company Larsen and Toubro Ltd (L&T) adopted "asset-light strategy" by separating business units into independent subsidiaries by selling a stake in businesses. The company, which is considered a corporate proxy for the broader economy, divested its assets as a way to generate capital for investing in fresh projects.
2. In January 2017, the Government of India divested 10 per cent stake in Coal India Limited through the offer-for-sale (OFS) route at Rs.358 per share and brought its holding down to 79.65 per cent.

SLUMP SALE

The transfer of the undertaking concerned as going concern is called "Slump sale". Slump sale is one of the methods that are widely used in India for corporate restructuring where the company sells its undertaking. The main reasons of slump sale are generally undertaken in India due to following reasons:

- It helps the business to improve its poor performance.
- It helps to strengthen financial position of the company.
- It eliminates the negative synergy and facilitates strategic investment.
- It helps to seek tax and regulatory advantage associated with it.

Section 2 (42C) of the Income Tax Act, 1961, recognizes 'Slump-sale' as a transfer of an 'undertaking' i.e. a part or a unit or a division of a company, which constitutes a business activity when taken as a whole. It is a transfer of one or more undertakings as a result of sale for a lump sum consideration, without values being assigned to the individual assets and liabilities in such sale. Sale includes transfer of an asset from one person to another for some consideration, where consideration can be in kind or cash.

'Undertaking' shall include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

The term 'sale' is not defined in the Income Tax Act, 1961. The term "Sale" is defined in the Section 4 of the Sales of Goods Act, 1930. Sale is a contract whereby the seller transfers the property in goods to a buyer for a price.

In *CIT v R.R. Ramkrishna Pillai (66 ITR 725*), the Supreme Court made the clear distinction between sale and exchange. In this case, the assessee was carrying on the business and had transferred the assets of the business to a company in consideration for the allotment of the shares of that company. The issue was whether it was exchange or sale because on that basis the transaction will be identified as slump sale. The Supreme Court held that where the assets are transferred for money consideration and the liability of consideration so determined is discharged by any mode whether money or other assets then the said transaction is sale.

In that case, there are in truth two transactions, one transaction of sale and the other of contract under which the shares are allotted in satisfaction of the liability to pay the price. However where the assets are transferred for a consideration of another asset other than money the said transaction is exchange. On the basis of this distinction the Supreme Court held that transfer of assets in consideration for the allotment of shares of that company is 'exchange' and not sale.

The Act does not define a slump sale but has included in its ambit slump sale by way of section 180(1) and provides for the procedure and approval required for selling, leasing or disposing of the whole or substantially whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any such undertakings.

"Undertaking" means an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year.

"Substantially the whole of the undertaking" in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

BUSINESS SALE/DIVESTITURE

Divestiture means selling or disposal of assets of the company or any of its business undertakings/ divisions, usually for cash (or for a combination of cash and debt) and not against equity shares to achieve a desired objective, such as greater liquidity or reduced debt burden. Divestiture is normally used to mobilize resources for core business or businesses of the company by realizing value of non-core business assets.

For example: XYZ Ltd. is the parent of a food company, a car company, and a clothing company. If XYZ Ltd. wishes to go out of the car business, it may divest the business by selling it to another company, exchanging it for another asset, or closing down the car company.

Reasons for Divestitures

- Huge divisional losses
- Continuous negative cash flows from a particular division
- Difficulty in integrating the business within the company
- Unable to meet the competition

- Better alternatives of investment
- Lack of technological upgradations due to non-affordability
- Lack of integration between the divisions
- Legal pressures

E.g. Nestle is selling its US chocolate business, which includes brands such as BabyRuth, Butterfinger, and Crunch to Ferrero for $2.8 billion. The deal is part of Nestle's strategy to sell underperforming brands and refocus on healthier products and fast-growing markets.

JOINT VENTURE

A joint venture (JV) is a business or contractual arrangement between two or more parties which agree to pool resources for the purpose of accomplishing a specific task may be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. Company enters into a joint venture when it lacks required knowledge, human capital, technology or access to a specific market that is necessary to be successful in pursuing the project on its own.

For example, A Ltd. may own technology, manufacturing and production facilities that B Ltd. needs to create and ultimately distribute a new product. A joint venture between the two companies gives B Ltd. access to the equipment without purchasing or leasing it, while A Ltd. is able to participate in production of a product without incurring costs to develop. Each company benefits when the joint venture is successful, and neither is left to complete the project alone.

TYPES OF JOINT VENTURES

(a) Equity-based joint ventures is a type of joint venture in which two or more parties set-up a separate legal company to act as the vehicle for carrying out the project. This new company would usually be located in the same country as one of the two partner companies, with the purpose of mutually establishing an activity with its own objectives: marketing and distribution, research, manufacturing, etc. It benefits foreign and/or local private interests, or members of the general public through capital.

(b) Non-equity joint ventures also known as cooperative agreements, seek technical service arrangements, franchise, brand use agreements, management contracts, rental agreements, or one-time contracts, e.g., for construction projects, non-equity arrangements in which some companies are in need of technical services or technological expertise than capital. It may be modernizing operations or starting new production operations.

Example:

- Vistara airlines is an Indian Joint Venture with a foreign company. Vistara is the brand name of Tata SIA Airlines Ltd, a JV between India's corporate giant Tata Sons and Singapore Airlines (SIA).
- Tata Starbucks Pvt. Ltd is a joint venture of Tata with Starbucks Corporation, USA which runs a chain of Starbucks brand coffee shops across India.

STRATEGIC ALLIANCE

Nike, the world's largest producer of athletic foot-wear, does not produce a single shoe. Boeing, the giant aircraft company, makes little more than cockpits and wing bits. These organizations, like a number of other businesses nowadays, have created strategic alliances with their suppliers to do much of their actual production for them.

A strategic alliance is an arrangement between two companies that have decided to share resources to undertake a specific, mutually beneficial project. It is an excellent vehicle for two companies to work together profitably. It can help companies develop and exploit the unique strengths. Organizations get an opportunity to widen customer base or utilize the surplus capacity.

E.g. Etihad Airways, based in Abu Dhabi, has completed an investment in India's Jet Airways. This alliance will provide considerable benefits for both carriers, as it opens Etihad to 23 cities in India, and offers Jet Airways passengers connection possibilities to the US, Europe, Middle East and Africa that were previously unavailable.

ICICI Bank and Vodafone India entered into a strategic alliance to launch a unique mobile money transfer and payment service called 'm-pesa'.

REVERSE MERGER

A reverse merger is a merger in which a private company becomes a public company by acquiring it. It saves a private company from the complicated process and expensive compliance of becoming a public company. Instead, it acquires a public company as an investment and converts itself into a public company.

However, there is another angle to the concept of a reverse merger. When a weaker or smaller company acquires a bigger company, it is a reverse merger. In addition, when a parent company merges into its subsidiary or a loss-making company acquires a profit-making company, it is also termed as a reverse merger.

The reason for reverse merger are:

- To carry forward tax losses of the smaller firm, this allows the combined entity to pay lower taxes. Tax savings under Income Tax Act, 1961.
- Economies of scale of production
- Marketing network
- To protect the trademark rights, licence agreements, assets of small/loss making company

Examples:

1. Merging of Oil exploration company Cairn India with parent Vedanta India
2. In 2002 Merging of ICICI with its arm ICICI Bank. The parent company's balance sheet was more than three times the size of its subsidiary at the time. The rational for the reverse merger was to create a universal bank that would lend to both industry and retail borrowers.
3. Merging of Godrej Soaps, profitable and with a turnover of `437 crore with loss-making Gujarat Godrej Innovative Chemicals with a turnover of `60 crore, the resulting firm was named Godrej Soaps.

FINANCIAL RESTRUCTURING

Corporate financial restructuring is any substantial change in a company's financial structure, or ownership or control, or business portfolio, designed to increase the value of the firm, i.e., debt and equity restructuring. Internal reconstruction of a company is the simplest form of financial restructuring. Under this, various liabilities are reduced after negotiating with various stakeholders such as banks, financial institutions,

creditors, debenture holders and shareholders. It deals with the restructuring of capital base and raising finance for new projects.

DEBT RESTRUCTURING

It involves a reduction of debt and an extension of payment terms or change in terms and conditions, which is less expensive. It is nothing but negotiating with bankers, creditors, vendors. It is the process of reorganizing the whole debt capital of the company. It involves the reshuffling of the balance sheet items as it contains the debt obligation of the company. Debt capital of the company includes secured long term borrowing, unsecured long-term borrowing, and short term borrowings.

- Restructuring of the secured long-term borrowing for improving liquidity and increasing the cash flows for a sick company and reducing the cost of capital for healthy companies. Restructuring of the unsecured long-term borrowings.
- Restructuring of the long-term unsecured borrowings can be in form of public deposits and/or private loans (unsecured) and privately placed, unsecured bonds or debentures.
- Restructuring of other short-term borrowings: the borrowings that are very short in nature are generally not restructured these can indeed be renegotiated with new terms. These types of short-term borrowings include inter-corporate deposits clean bills & clean overdraft.
- Best method for corporate debt restructuring is Debt-equity swap. In the case of an debt-equity swap, specified shareholders have right to exchange stock for a predetermined amount of debt (i.e. bonds) in the same company. In debt-equity swap debt /bonds are exchanged with shares/stock of the company.

CASE STUDY

Gammon India Ltd. invoked the Strategic Debt Restructuring (SDR) mechanism in the 2015-2016. A total of 16 banks, led by ICICI Bank, decided to convert a part of their loan into 63.07 per cent equity. The SDR Scheme, an improved version of the erstwhile Corporate Debt Restructuring, or CDR, mechanism, wherein lenders have sweeping powers to throw out managements of companies whose assets have turned bad. However, the bankers could not find a buyer for the entire Gammon India and instead decided to restructure it into three parts - Power Transmission & Distribution (T&D), Engineering, Procurement & Construction (EPC), and the residual business. The Thailand-based GP Group has acquired the EPC assets while Ajanma Holdings bought stake in the T&D business.

Gammon India is one among two dozen companies where bankers have invoked the SDR Scheme, to make the process of debt recovery faster and smoother. The list includes Alok Industries, Usher Agro, Diamond Power, Monnet Ispat, Jaiprakash Power and IVRCL.

EQUITY RESTRUCTURING

It is a process of reorganizing the equity capital. It includes a reshuffling of the shareholders capital and the reserves that are appearing on the balance sheet. Restructuring equity means changing how the firm's residual cash flows are divided and distributed among the firms shareholders, with the goal of increasing the overall market value of the firms common stock. Restructuring of equity and preference capital becomes complex process involving a process of law and is a highly regulated area.

The following comes under equity restructuring:

- Alteration of share capital
- Reduction of share capital

- Buy-back of shares

ALTERATION OF SHARE CAPITAL

The capital of a company is separated into units of a fixed denomination and such unit is a share. A share means a share in the share capital of a company and includes stock as defined under Section 2(84) of Companies Act, 2013. Alteration of share capital means, increase or decrease in or rearrangement of share capital as permitted in Articles of Association. An increase or decrease in the share capital of a company may be carried out as and when the company requires thus leading to an alteration in the company's share capital.

According to section 61 of the Companies Act, 2013 a limited company having a share capital derives its power to alter its share capital through its articles of association. As per the section the company may alter its memorandum in its general meeting to—

1. increase its authorised share capital by such amount as it thinks expedient;
2. consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.

   The proviso to Section 61(1)(b) clarifies that No consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner. (This Proviso notified w.e.f. 01-06-2016)
3. convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
4. sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
5. cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled. The cancellation of shares shall not be deemed to be a reduction of share capital.

If a company increases its capital beyond the amount of authorised capital, it shall increase its authorised capital by the amount of new shares. Section 2(8) of the Companies Act 2013, defines that "Authorised capital" or "nominal capital" means such capital which is authorized by the memorandum of a company to be the maximum amount of share capital of the company.

If consolidation and division, results in changes in the voting percentage of shareholders, it shall be approved by the Tribunal.

Legal Provisions

- Section 61 to 64 read with Section 13 and 14 of the Companies Act, 2013
- Companies (Share Capital and Debentures) Rules, 2014.
- National Company Law Tribunal Rules, 2016

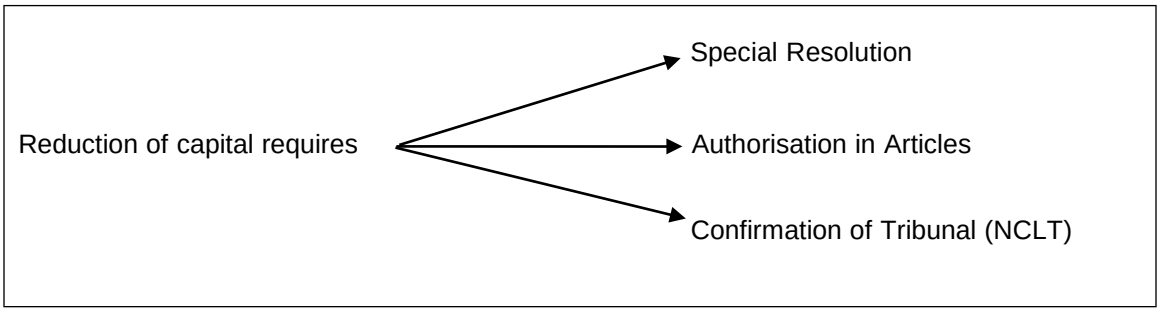
REDUCTION OF SHARE CAPITAL

Capital Reduction is the process of decreasing a company's shareholder's equity through share cancellations

and share repurchases. The reduction of share capital means reduction of issued, subscribed and paid up share capital of the company. In simple words it can be regarded as 'Cancellation of Uncalled Capital' i.e. part of subscribed share capital. The act of capital reduction is enacted by reducing the amount of issued share capital in a response to a permanent reduction in a company's operations or a revenue loss that cannot be recovered from a company's future earnings.

The need of reducing share capital arise in following situations:

- Returning of surplus to shareholders;
- Eliminating losses, which may be preventing the payment of dividends;
- As part of scheme of compromise or arrangements



Legal Provisions

- Section 66 of the Companies Act, 2013; Reduction by way of cancellation of shares
- Rule 2 to 6 of the National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016
- SEBI (LODR) Regulations, 2015.

Examples:

- The shares of face value of INR 125 each of which INR 100 paid, the company may reduce them to INR 100 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of INR 25 per share.
- The shares of face value of INR 100 each fully paid-up is represented by INR 75 worth of assets. In such a case, reduction of share capital may be effected by cancelling INR 25 per share and writing off similar amount of shares.
- The shares of face value of INR 100 each fully paid-up reduced to face value of INR 75 each by paying back INR 25 per share.

Modes of Reduction of Capital

A company limited by shares or a company limited by guarantee and having a share capital may, if authorised by its articles, by special resolution, and subject to its confirmation by the Tribunal on petition, reduce its share capital in any way and in particular:

(a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or

(b) either with or without extinguishing or reducing liability on any of its shares,—

(i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

(ii) pay off any paid-up share capital which is in excess of the wants of the company,

alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

Reduction of capital without sanction of the Tribunal

The following are cases which amount to reduction of share capital but where no confirmation by the Tribunal 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. 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 Co. Ltd., (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 provision 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 company and in the case of surrender it is at the initiative of member or shareholder.

(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 Tribunal.

(c) Diminution of capital – Where the company cancels shares which have not been taken or agreed to be taken by any person.

(d) Redemption of redeemable preference shares.

(e) Buy-back of its own shares.

Creditors' right to object to reduction

After passing the special resolution for the reduction of capital, the company is required to apply to the Tribunal by way of petition for the confirmation of the resolution under Section 66 of the Companies Act, 2013. Where the proposed reduction of share capital involves either (i) diminution of liability in respect of unpaid share capital, or (ii) the payment to any shareholder of any paid-up share capital, or (iii) in any other case, if the Tribunal so directs, the following provisions shall have effect:

The creditors having a debt or claim admissible in winding-up are entitled to object. To enable them to do so, the Tribunal will settle a list of creditors entitled to object. If any creditor objects, then either his consent to the

proposed reduction should be obtained or he should be paid off or his payment be secured. The Tribunal, in deciding whether or not to confirm the reduction will take into consideration the minority shareholders and creditors.

The Tribunal shall give notice of every application made to it under sub-section (1) of section 66 to the Central Government, Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice:

Provided that where no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

There is no limitation on the power of the Court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured [British and *American Trustee and Finance Corpn. v. Couper*, (1894) AC 399, 403: (1991-4) All ER Rep 667].

When exercising its discretion, the Tribunal must ensure that the reduction is fair and equitable. In short, the Court shall consider the following, while sanctioning the reduction:

(i) The interests of creditors are safeguarded;

(ii) The interests of shareholders are considered; and

(iii) Lastly, the public interest is taken care of.

Confirmation and registration

Section 66(3) of the Companies Act, 2013 states that if the Tribunal is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been determined, discharged, paid or secured, it may confirm the reduction of share capital on such terms and conditions as it deems fit.

Section 66(4) of the Companies Act, 2013 states that the order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be published by the company in such manner as the Tribunal may direct.

Section 66(5) of the Companies Act, 2013 states that the Company shall deliver a certified copy of Tribunal order confirming the reduction together with the minutes giving the details of the company's

(a) amount of share capital;

(b) number of shares into which it is to be divided;

(c) amount of each share; and

(d) amount, if any, at the date of registration deemed to be paid-up on each share,

to the Registrar within 30 days of receipt of the order of Tribunal who will register them. The reduction takes effect only on registration of the order and minutes, and not before. The Registrar will then issue a certificate of registration which will be a conclusive evidence that the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The Memorandum has to be altered accordingly.

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*].

Liability of members in respect of reduced share capital

On the reduction of share capital, a member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

If, however the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim—

(a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding-up on the day immediately before the said date; and

(b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

Penalties

If any officer of the company

(a) Knowingly conceals the name of any creditor entitled to object to the reduction;

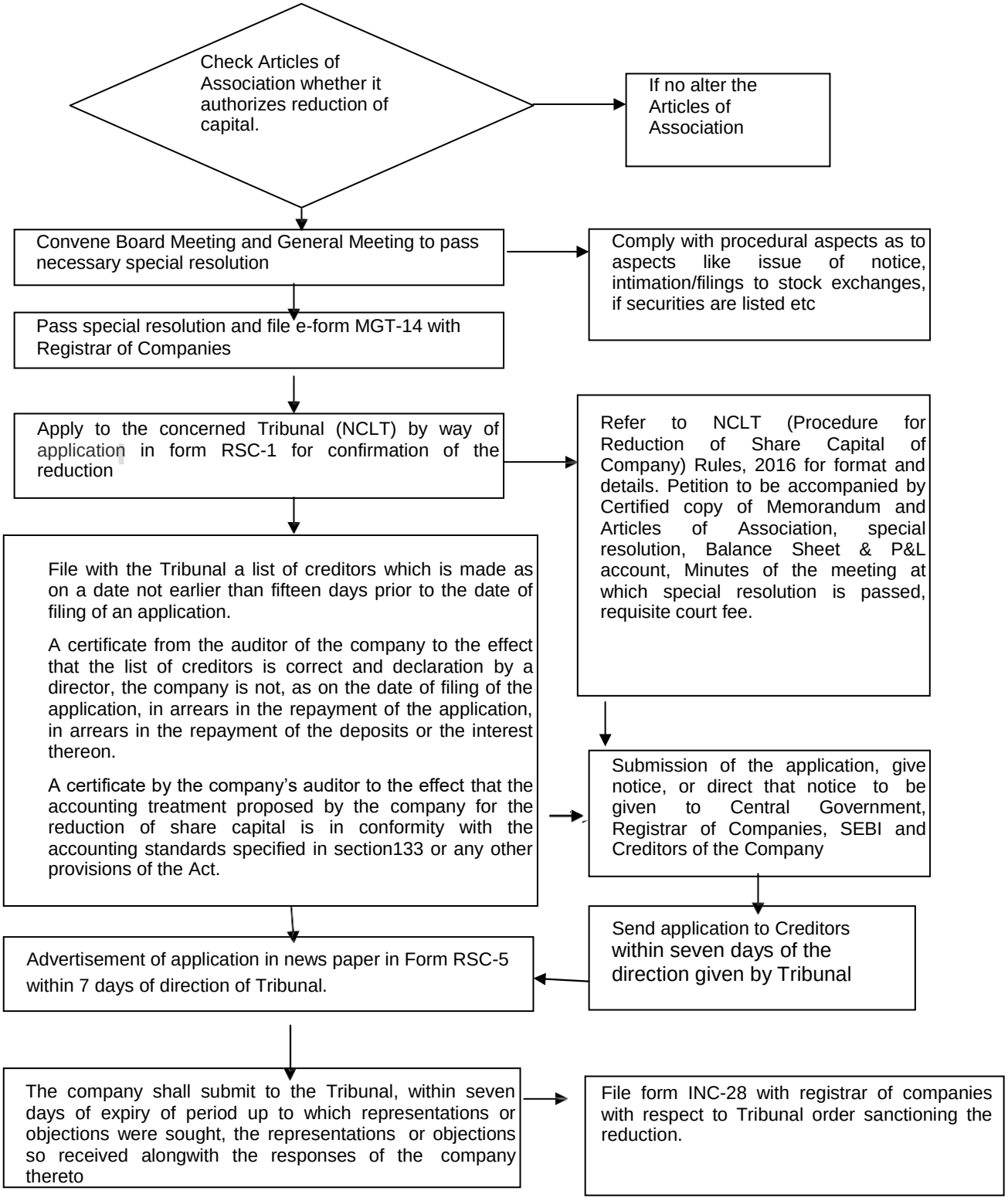
(b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

(c) abets or is privy to any such concealment or misrepresentation as aforesaid,

he shall be liable under section 447.

If a company fails to comply with the provisions of sub-section (4) of section 66, it shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees.

Procedure for reduction of capital – a Flow Chart



Reduction of capital and Scheme of Compromise and Arrangement

Arrangement includes 'a reorganisation of share capital of the company' and reorganisation can involve reduction of share capital. However, as part of the scheme of compromise or arrangement, distinct formalities as prescribed under section 100 do not have to be observed [*Maneckchowk and Ahmedabad Mfg. Co.Ltd., Re (1970) 2 Comp LJ 300 (Guj); also Vasant Investment Corporation Ltd. v. Official Liquidator (1981) 51 Comp Cas 20 (Bom); Mcleod & Co.Ltd. v. S.K. Ganguly (1975) 45 Comp Cas 563 (Cal)*]. It may however be noted that, in all such cases involving reduction of share capital in the scheme of compromise or arrangement, the petition seeking confirmation of the Tribunal with respect to the scheme must also expressly mention that the company is also seeking, at the same time, the confirmation of the Tribunal with respect to the reduction of share capital, and that, while seeking the consent of the members to the scheme, the consent of the members with respect to the reduction of share capital had also been obtained.

The power of Tribunal to give to creditors an opportunity of raising objections to the reduction of capital is discretionary. In an appropriate case, for example, where the interests of creditors are duly and fully protected, the Tribunal may exercise its discretion against calling upon the creditors to raise objections.

BUY-BACK

According to Section 68(1) of the Companies Act, 2013, a company whether public or private, may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

The term Buy-back has two meanings. Firstly, when a person sells shares or any specified securities and then buys again according to a fixed agreement, the buying back by a company of its shares/securities from an investor who put venture capital up for the formation of the company.

Secondly, buying of its own stock from open market in order to reduce the number of outstanding shares. It is one of the prominent modes of capital restructuring. It is a corporate action in which a company buys back its shares from the existing shareholders usually at a price higher than market price. When it buys back, the number of shares outstanding in the market reduces. By reducing the number of shares outstanding in the market, buy-backs increase the proportion of shares a company owns.

Prior to insertion of Sec 77A of Companies Act, 1956, capital restructuring was achieved through capital reduction which is cumbersome procedure. Buy-back should not be used for improving controlling interest of the promoters group. Promoters group controlling increases consequent to the buy-back. However improvement of controlling interest may occur as a natural consequence of the Buy-back strategy. Good corporate management should always aim at creation and enhancement of shareholders value.

Modes of Buy-Back

(1) Tender Offer

In tender offer, the company makes an offer to buy a certain number of shares/securities at a specific price

directly from security holders on proportionate basis. Share buyback ensures all shareholders are treated equally, however small they are.

(2) Open Market Purchase

In open market purchase, the company acquires a certain number of shares. Fixes a price cap and buy for any price up to the upper limit. Most companies prefer the open market route. The biggest difference between the two - tender offer and open market purchase- is that the price in the tender route is fixed.

Buy-back from open market can be made through :

- Book Building Process
- Stock exchange

Advantages of buy-back

- It is an alternative mode of reduction in capital without requiring approval of the National Company Law Tribunal
- To improve the earnings per share
- To improve return on capital, return on net worth and to enhance the long-term shareholders value
- To provide an additional exit route to shareholders when shares are undervalued or thinly traded
- To enhance consolidation of stake in the company
- To prevent unwelcome takeover bids
- To return surplus cash to shareholders
- To achieve optimum capital structure
- To support share price during periods of sluggish market condition
- To serve the equity more efficiently.

Legal Framework for Buy-back

- Companies Act, 2013
- Companies (Share Capital and Debentures) Rules, 2014.
- Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018.

EXAMPLES:

In the year 2017, Infosys decided to utilize cash reserves of USD 6 billion either through share buy-back or generous dividend. Cognizant and TCS announced mega buy-back offers worth USD 3.4 billion and `16,000 crore, respectively, to return surplus cash to shareholders. HCL Technologies also approved a buy-back of up to 3.50 crore shares worth `3,500 crore.

Procedure for Buy-back

Authorisation

The primary requirement is that the articles of association of the company should authorise buy-back. Incase, such a provision is not available, it would be necessary to alter the articles of association to authorise buy-back. Buy-back can be made with the approval of the Board of directors at a meeting and/or

by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy-back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

Quantum of Buy-back

(a) Board of directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and such buyback has to be authorized by the board by means of a resolution passed at the meeting.

(b) Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company. In respect of any financial year, the shareholders can approve by special resolution up to 25% of total equity capital in that year.

Post buy-back debt-equity ratio

The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back should not be more than twice the paid-up capital and its free reserves i.e. the ratio shall not exceed 2:1. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

All the shares or other specified securities for buy-back are to be fully paid-up.

Buy-back by listed/unlisted companies

The buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

The buy-back in respect of shares or other specified securities other than listed securities is in accordance with such rules made under Chapter IV of the Companies Act, 2013.

Time gap

No offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

Explanatory statement

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of shares or securities intended to be purchased under the buy-back;

(d) the amount to be invested under the buy-back; and

(e) the time-limit for completion of buy-back.

Buy-back Procedure for Private & Unlisted Public Companies

Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014

According to Rule 17(2) the company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in Form No. SH-8, along with the fee as prescribed. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

Filing Declaration of Solvency with SEBI/ROC [Rule 17(3)]

When a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution or board resolution as the case may be, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board (in case of listed companies), a declaration of solvency in Form No. SH-9 signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit as specified in said form.

Dispatch of letter of Offer [Rule 17(4)]

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

The letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document; [Rule17(10)]

Validity [Rule 17(5)]

The offer for buy-back shall remain open for a period of not less than15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

Acceptance on proportional basis [Rule 17(6)]

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

Time limit for verification [Rule 17(7)]

The company shall complete the verifications of the offers received within 15 days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from the date of closure of the offer.

Payment of consideration/returning of share certificates

The company shall within seven days of the time limit of verification:

(a) make payment of consideration in cash to those shareholders or security holders whose securities have been accepted, or

(b) return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

Separate Account [Rule 17(8)]

The company shall immediately after the date of closure of the offer, open a separate bank account and deposit there in, such sum, as would make-up the entire sum due and payable as consideration for the shares tendered for buy-back.

The company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration only by way of cash. [Rule17 (10)]

Other conditions [Rule 17(10)]

The rules further provide that the company shall ensure that—

(a) the company shall not withdraw the offer once it has announced the offer to the shareholders;

(b) the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying back its shares; and

(c) the company shall not utilize the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities for the buy-back.

Time limit for completion of buy-back [Section 68(4)]

Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

Methods of buy-back [Section 68(5)]

The buy-back may be —

(a) from the existing shareholders or security holders on a proportionate basis;

(b) from the open market;

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Extinguishment of securities bought back [Section 68(7)]

When a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

Prohibition of further issue of shares or securities [Section 68(8)]

When a company completes a buy-back of its shares or other specified securities it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Register of buy-back [Section 68(9)]

When a company buys back its shares or other specified securities , it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

According to the rules the register of shares or securities bought back shall be maintained in Form SH-10, at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. Entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose. [Rule 17(12)].

Return of buy back [Section 68 (10)]

A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board (incase of listed companies) a return containing such particulars relating to

the buy-back within thirty days of such completion, as may be prescribed.

The company shall file with the Registrar, and in case of a listed company with the Registrar and the SEBI, a return in the Form No. SH-11 along with the 'fee'. There shall be annexed to the return filed with the Registrar in Form No. SH-11, a certificate in Form No. SH-15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and rules made thereunder. [Rule 17(13) and Rule 17(14)]

Penal Provisions [Section 68 (11)]

If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Transfer to and application of Capital Redemption Reserve Account (Section 69)

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Circumstances prohibiting buy back (Section 70)

No company shall directly or indirectly purchase its own shares or other specified securities—

(i) through any subsidiary company including its own subsidiary companies;

(ii) through any investment company or group of investment companies; or

(iii) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92 (Annual Return), 123 (Declaration of Dividend), 127 (punishment for failure to distribute dividend) and section 129 (Financial Statement) of the Companies Act, 2013.

INCOME TAX ASPECTS

Section 46A of the Income-tax Act, 1961 provides that any consideration received by a security holder from any company on buy back shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the security holder as capital gains.

The computation of capital gains shall be in accordance with the provisions of Section 48 of the Income-tax Act, 1961.

In respect of Foreign Institutional Investors (FIIs), as per the provisions of Section196D (2) of the Income Tax Act,1961 no deduction of tax at source shall be made before remitting the consideration for equity shares tendered under the offer by FIIs as defined under Section 115AD of the Income Tax Act,1961. NRIs, OCBs and other non-resident shareholders (excluding FIIs) will be required to submit a No Objection Certificate (NOC) or tax clearance certificate obtained from the Income Tax authorities under the Income Tax Act. In case the aforesaid NOC or tax clearance certificate is not submitted, the company should deduct tax at the maximum marginal rate as may be applicable to the category of shareholders on the entire consideration amount payable to such share holders.

BUY-BACK PROCEDURE FOR LISTED SECURITIES

In exercise of powers, SEBI notified Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018 w.e.f. September 11, 2018. Notification No. SEBI/LAD-NRO/GN/2018/32. All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations, 2018, in addition to the provisions of the Companies Act, 2013. These regulations broadly cover the following aspects:

1. Special resolution and its additional disclosure requirements.
2. Methods of buy back including buy back through reverse book building, from existing shareholders through tender offer, etc.
3. Filing of offer documents, public announcement requirements.
4. O ffer procedure/opening of escrow account, etc.
5. General obligations of company, merchant banker, etc.

Special Resolution and its additional disclosure requirements (Regulation 5)

Sub-regulation (iv) of Regulation 5 of the Regulations, lays down that for the purposes of passing a special resolution the explanatory statement to be annexed to the notice for the general meeting shall contain disclosures as specified in Schedule I to the Regulations.

Sub-regulation (v) provides that a copy of the above resolution passed at the general meeting shall be filed with SEBI and the stock exchanges where the shares or other specified securities of the company are listed, within seven days from the date of passing of the resolution.

In case of Board approval

Regulation 5(vii) of the Regulations, provides that a company, authorized by a resolution passed by the Board of Directors at its meeting to buy back its shares or other specified securities, shall file a copy of the resolution, with the SEBI and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

Disclosures under Schedule I (Contents of Explanatory Statement)

An explanatory statement containing full and complete disclosure of all the material facts and the following disclosures prescribed in Schedule I of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders' approval:

(i) Date of the Board meeting at which the proposal for buy back was approved by the Board of Directors of the company;

(ii) Necessity for the buy back;

(iii) Maximum amount required under the buy back and its percentage of the total paid up capital and free reserves;

(iv) Maximum price at which the shares or other specified securities are proposed be bought back and the basis of arriving at the buy back price;

(v) Maximum number of securities that the company proposes to buy back;

(vi) Method to be adopted for buy back as referred in sub-regulation (iv) of regulation 4;

(vii) (a) the aggregate shareholding of the promoter and of the directors of the promoters, where the promoter is a company and of persons who are in control of the company as on the date of the notice convening the General Meeting or the Meeting of the Board of Directors;

(b) aggregate number of shares or other specified securities purchased or sold by persons including persons mentioned in (a) above from a period of six months preceding the date of the Board Meeting at which the buy back was approved till the date of notice convening the general meeting;

(c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;

(viii) Intention of the promoters and persons in control of the company to tender shares or other specified securities for buy-back indicating the number of shares or other specified securities, details of acquisition with dates and price;

(ix) A confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institutions or banks;

(x) A confirmation that the Board of Directors has made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(a) that immediately following the date on which the General Meeting or the meeting of the Board of Directors is convened there will be no grounds on which the company could be found unable to pay its debts;

(b) as regards its prospects for the year immediately following that date that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and

(c) in forming their opinion for the above purposes, the directors shall take into account the liabilities as if the company were being wound up under the provisions of the Companies Act, 1956 or Companies Act or the Insolvency and Bankruptcy Code, 2016 (including prospective and contingent liabilities);

(xi) A report addressed to the Board of Directors by the company's auditors stating that–

(a) they have inquired into the company's state of affairs;

(b) the amount of the permissible capital payment for the securities in question is in their view properly determined; and

(c) the Board of Directors have formed the opinion as specified in clause(x) on reasonable grounds and that the company will not, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.

METHODS OF BUY-BACK

According to Regulation 4 of the Regulations, a company may buy back its own shares or other specified securities by any one of the following methods:

(a) from the existing shareholders or other specified securities holders on a proportionate basis through the tender offer;

(b) from the open market through:

(i) book-building process

(ii) stock exchange

(c) from odd-lot holders.

It may be noted that no offer of buy back for 15% or more of paid up capital and free reserves, shall be made from the open market.

In terms of Regulation 4(vii), a company shall not make any offer of buy-back within a period of one year reckoned from the date of expiry of buy-back period of the preceding offer of buy-back, if any.

Regulation 4(vi) does not permit buy-back through negotiated deals (of and on stock exchange), private arrangement, spot transactions.

Buy-back from existing security-holders through tender offer

According to Regulation 6 of the Regulations, a company may buy-back its securities from its existing security-holders on a proportionate basis in accordance with the provisions of the Regulations. It may be noted that fifteen per cent of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders.

Additional Disclosures (Regulation 5(iv)(c))

In addition to disclosure required under Schedule I following additional disclosures are required to be made to the explanatory statement:

(a) the maximum price at which the buy-back of shares or other specified securities shall be made and whether the Board of Directors of the company is being authorized at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;

(b) if the promoter intends to offer their shares or others pacified securities, the quantum of shares or other specified securities proposed to be tendered, and the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back including information of number of shares or other specified securities acquired, the price and the date of acquisition.

Public announcement and Filing of offer documents (Regulation 7 & 8)

The company which has been authorized by a special resolution or a resolution passed by the Board of Directors at its meeting shall make a public announcement within two working days from the date of resolution in at least one English National Daily, one Hindi National Daily and a Regional language daily all with wide circulation at the place where the Registered office of the company is situated and shall contain all the material information as specified in Schedule II.

A copy of the public announcement along with the soft copy, shall also be submitted to the Board simultaneously through a merchant banker.

The company shall within five working days of the public announcement file with the Board a draft-letter of offer, along with soft copy, containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

The Board may give its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer. In the event the Board has sought clarifications or additional information from the merchant banker to the buy back offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

In the event the Board specifies any changes, the merchant banker to the buyback offer and the company shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

The company shall file along with the draft letter of offer, a declaration of solvency in the prescribed form and in a manner provided in section 68(6) of the Companies Act, 2013.

Offer Procedure (Regulation 9)

(1) A company making a buyback offer shall announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buy-back offer.

(2) The letter of offer along with the tender form shall be dispatched to the security holders who are eligible to participate in the buy back offer, not later than five working days from the receipt of communication of comments from the Board.

(3) The date of the opening of the offer shall be not later than five working days from the date of dispatch of letter of offer.

(4) The acquirer or promoter shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism as specified by the Board.

(5) The offer for buy back shall remain open for a period of ten working days.

(6) The company shall accept shares or other specified securities from the security holders on the basis of their entitlement as on record date.

(7) The shares proposed to be bought back shall be divided in to two categories; (a) reserved category for small shareholders and (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.

(8) After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by security holders in that category and thereafter from security holders who have tendered over and above their entitlement in other category.

Escrow account

Regulation 9(xi) & (xii) of the Regulations provides that-

(a) the company shall, as and by way of security for performance of its obligations under the Regulations, on or before the opening of the offer, deposit in an escrow account the sum as

specified in clause (b);

(b) the escrow amount shall be payable in the following manner:

(i) if the consideration payable does not exceed `100 crores—25 per cent of the consideration payable;

(ii) if the consideration payable exceeds `100 crores—25 percent upto `100 crores and10 percent thereafter;

(c) the escrow account referred to above shall consist of:

(i) cash deposited with a scheduled commercial bank, or

(ii) bank guarantee in favour of the merchant banker, or

(iii) deposit of acceptable securities with appropriate margin, with the merchant banker, or

(iv) a combination of (i),(ii) and (iii) above;

(d) where the escrow account consists of deposit with a scheduled commercial bank, the company shall while opening the account, empower the merchant banker to instruct the bank to make payment for the amount lying to the credit of the escrow account, as provided in the Regulations;

(e) where the escrow account consists of bank guarantee, such bank guarantee shall be in favour of the merchant banker and valid until thirty days after the expiry of buy-back period;

(f) where the escrow account consists of securities, the company shall empower the merchant banker to realize the value of such escrow account by sale or otherwise. If there is any deficiton realization of the value of the securities, the merchant banker shall be liable to make good any such deficit;

(g) in case the escrow account consists of bank guarantee or approved securities, these shall not be returned by the merchant banker till the completion of all obligations under the Regulations;

(h) where the escrow account consists of bank guarantee or deposit of approved securities, the company is also required to deposit with the bank in cash, a sum of at least one per cent of the total consideration payable, as and by way of security for fulfilment of the obligations under the Regulations by the company;

(i) on payment of consideration to all the security-holders who have accepted the offer and after completion of all the formalities of buy-back, the amount, guarantee and securities in the escrow, if any, should be released to the company;

(j) SEBI, in the interest of the security-holders, may, in case of non-fulfillment of obligations under the Regulations by the company forfeit the escrow account either in full or in part;

The amounts forfeited may be distributed pro rata amongst the security-holders who accepted the offer and the balance, if any, shall be utilized for investor protection.

Payment to the Security holders (Regulation 10)

Regulation lays down that—

1. The company shall immediately after the date of closure of the offer, open a special account with a SEBI registered banker to an issue and deposit therein, such sum as would, together with ninety percent of the amount lying in the escrow account make up the entire sum due and payable as consideration for the buy-back and for this purpose, may transfer the funds from the escrow account.

2. The company shall complete the verifications of offers received and make payment of consideration to those security holders whose offer has been accepted and return the remaining shares or other specified securities to the security holders within seven working days of the closure of the offer.

Extinguishing of bought-back securities (Regulation11)

The company shall extinguish and physically destroy the security certificates so bought back in the presence of a Registrar to issue or the Merchant Banker and the Statutory Auditor within fifteen days of the date of acceptance of the shares or other specified securities. The company shall also ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period.

The shares or other specified securities offered for buy-back if already dematerialised shall be extinguished and destroyed in the manner specified under the Securities and Exchange Board of India (Depositories and Participants) Regulations,1996, and the bye-laws, the circulars and guidelines framed thereunder.

The company shall, furnish a certificate to the Board certifying compliance as specified above and duly certified and verified by-

(i) the registrar and whenever there is no registrar by the merchant banker;

(ii) two directors of the company one of whom shall be a managing director where there is one;

(iii) the statutory auditor of the company,

The certificate shall be furnished to the Board within seven days of extinguishment and destruction of certificates.

The company shall furnish, the particulars of the security certificates extinguished and destroyed, to the stock exchanges where the shares of the company are listed within seven days in which the securities certificates are extinguished and destroyed. The company shall also maintain a record of security certificates which have been cancelled and destroyed as prescribed in the Companies Act.

Odd-lot Buy-back (Regulation 12)

Regulation12 states that the provisions pertaining to buy-back through tender offer as specified shall be applicable mutatis mutandis to odd-lot shares or other specified securities.

Buy-back from Open Market (Regulation 14 & 15)

Regulation 14 of the Regulations lays down that a buy-back of shares or other specified securities from the open market may be in any one of the following methods:

(i) Through stock exchange.

(ii) Book-building process.

The company shall ensure that at least 50% of the amount earmarked for buyback, as specified in resolutions (Board/special resolution) is utilized for buying back shares and other specified securities.

Buy-back through the stock exchange (Regulation 16 to 18)

Regulation provides that a company should buy-back its specified securities through the stock exchange as provided hereunder:

- the buy-back of securities should not be from the promoters or persons in control of the company;

- the company shall appoint a merchant banker and make a public announcement as referred to in Regulation 7 pertaining to tender offer;
- the public announcement shall be made within 2 working days from the date of passing special resolution;
- simultaneously with the issue of such public announcement, the company shall file a copy of the public announcement with the Board;
- the company shall submit the information regarding the shares or other specified securities bought-back, to the stock exchange on a daily basis in such form as may be specified by the Board and the stock exchange shall upload the same on its official website immediately;
- the company shall upload the information regarding the shares or other specified securities bought-back on its website on a daily basis;
- the buy-back offer shall open not later than seven working days from the date of public announcement and shall close within six months from the date of opening of the offer.
- the buy-back should be made only on stock exchanges having Nationwide Trading Terminal facility and only through the order matching mechanism except 'all or none' order matching system;
- the identity of the company as a purchaser would appear on the electronic screen when the order is placed.
- The company shall upload the information regarding the shares or other specified securities bought back, on its website on daily basis.

Buy–back of physical shares or other specified securities (Regulation19)

A company may buy-back its shares or other specified securities in physical form through open market method as provided hereunder:

(a) a separate window shall be created by the stock exchange, which shall remain open during the buy-back period, for buy-back of shares or other specified securities in physical form.

(b) the company shall buy-back shares or other specified securities from eligible shareholders holding physical shares through the separate windows specified in clause (a), only after verification of the identity proof and address proof by the broker.

(c) the price at which the shares or other specified securities are bought back shall be the volume weighted average price of the shares or other specified securities bought-back, other than in the physical form, during the calendar week in which such shares or other specified securities were received by the broker:

Provided that the price of shares or other specified securities tendered during the first calendar week of the buy-back shall be the volume weighted average market price of the shares or other specified securities of the company during the preceding calendar week.

Explanation: In case no shares or other specified securities were bought back in the normal market during calendar week, the preceding week when the company has last bought back the shares or other specified securities may be considered.

Escrow account for Open Market Buy-back through Stock Exchange (Regulation 20)

(1) The Company shall, before opening of the offer, create an escrow account towards security for

performance of its obligations under these regulations, and deposit in escrow account 25 per cent of the amount earmarked for the buy-back as specified in the resolutions.

(2) The escrow account referred to in sub-regulation (1) may be in the form of,—

(a) cash deposited with any scheduled commercial bank; or

(b) bank guarantee issued in favour of the merchant banker by any scheduled commercial bank.

(3) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the company shall while opening the account, empower the merchant banker to instruct the bank to make payment of the amounts lying to the credit of the escrow account, to meet the obligations arising out of the buy-back.

(4) For such part of the escrow account as is in the form of a bank guarantee:

(a) the same shall be in favour of the merchant banker and shall be kept valid for a period of thirty days after the expiry of buy-back period of the offer or till the completion of all obligations under these regulations, which ever is later.

(b) the same shall not be returned by the merchant banker till completion of all obligations under the regulations.

(5) W here part of the escrow account is in the form of a bank guarantee, the company shall deposit with a scheduled commercial bank, in cash, a sum of at least 2.5 per cent of the total amount earmarked for buy-back as specified in the resolutions as and by way of security for fulfillment of the obligations under the regulations by the company.

(6) The escrow amount may be released for making payment to the shareholders subject to at least 2.5% of the amount earmarked for buy-back as specified in the resolutions, remaining in the escrow account at all points of time.

(7) On fulfilling the obligation specified in Regulation15, the amount and the guarantee remaining in the escrow account, if any, shall be released to the company.

(8) In the event of non-compliance with regulation 15, the Board may direct the merchant banker to forfeit the escrow account except in cases where,-

a. volume weighted average market price (VWAMP) of the shares or other specified securities of the company during the buy-back period was higher than the buy-back price as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

b. inadequate sell orders despite the buy orders placed by the company as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

c. such circumstances which were beyond the control of the company and in the opinion of the Board merit consideration.

(9) In the event of forfeiture for non-fulfillment of obligations specified in sub regulation (8), the amount forfeited shall be deposited in the Investor Protection and Education Fund of Securities and Exchange Board of India.

Extinguishment of certificates (Regulation 21)

Subject to the provisions of sub-regulation (2) and sub regulation (3), the provisions of regulation 11

pertaining to extinguishment of certificates for tender offers shall apply for extinguishment of certificates.

(2) The company shall complete the verification of acceptances within fifteen days of the payout.

(3) The company shall extinguish and physically destroy the security certificates so bought back during the month in the presence of a Merchant Banker and the Statutory Auditor, on or before the fifteenth day of the succeeding month:

Provided that the company shall ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period.

Buy-back through book-building (Regulation 22)

A company can buy-back its shares or other specified securities through the book-building process as provided hereunder:

1. (a) The special resolution or the Board of Directors resolution, as the case may be, shall be passed in accordance with the Regulation 5.

   (b) The company should appoint a merchant banker and make public announcement.

   (c) A public announcement shall be made at least seven days prior to the commencement of the buy-back.

   (d) Subject to the provisions of Sub-clauses (i) and (ii), the provisions of Regulation 9 shall apply:

      (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 as specified in Schedule V to the Regulations. The Public announcement shall also contain the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the security holders pursuant to the public announcement and the details of bidding centres.

   (f) The book-building process should be made through an electronically linked transparent facility.

   (g) The number of bidding centres should not be less than thirty and there should be at least one electronically linked computer terminal at all the bidding centres.

   (h) The offer for buy-back shall 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 holders whose securities have been accepted for the buy-back.

   (j) The provisions of sub-regulation (ii) of regulation 10, pertaining to verification of acceptances and the provisions of regulation 10 pertaining to opening of special account and payment of consideration shall be applicable *mutatis mutandis*.

Extinguishment of certificates (Regulation 23)

The provisions pertaining to extinguishment of certificates for tender offer shall be applicable *mutatis mutandis.*

Obligations of the company (Regulation 24)

According to Regulation 24 of the Regulations, the company shall ensure that:

(a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material contains true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

(b) the company shall not issue any shares or other specified securities including by way of bonus till the date of expiry of buy-back period for the offer made under these Regulations;

(c) the company shall pay consideration only by cash;

(d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;

(e) the promoter or his/their associates shall not deal in the shares or other specified securities of the company in the stock exchange or off market, including inter-se transfer of shares among the promoters during the period “from the date of passing the resolution of the board of directors or special resolution, as the case may be, till the closing of the offer.

(f) the company shall not raise further capital for a period of one year from the expiry of buy-back period, except in discharge of its subsisting obligations.

No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act.

The company shall nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

The particulars of the said security certificates extinguished and destroyed should be furnished by the company to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates.

The company shall not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable.

The company shall issue, within two days of the expiry of buy-back period, a public advertisement in a national daily*, inter alia*, disclosing the following:

(i) number of securities bought;

(ii) price at which the securities were bought;

(iii) total amount invested in the buy-back;

(iv) details of the security-holders from whom securities exceeding one per cent of the total securities were bought-back; and

(v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Obligations of the merchant banker (Regulation 25)

Regulation 25 provides that the merchant banker shall ensure that:

(a) the company is able to implement the offer;

(b) the provision relating to escrow account has been complied with;

(c) firm arrangements for monies for payment to fulfil the obligations under the offer are in place;

(d) the public announcement of buy-back is made and the letter of offer has been filed in terms of the Regulations;

(e) the merchant banker should furnish to SEBI, a due diligence certificate which should accompany the draft letter of offer;

(f) the merchant banker should ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary.

(g) the merchant banker should ensure compliance of Section 68, 69 and 70 of the Companies Act, and any other applicable laws or rules in this regard has been made;

(h) upon fulfillment of all obligations by the company under the Regulations, the merchant banker should inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company and send a final report to SEBI in the specified form,within15 days from the date of expiry of the buy-back period.

Repeal and savings (Regulation 29)

The Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998, stands repealed from the date on which these Regulations came into force.

LESSON ROUND UP

- Corporate restructuring is a change in the business strategy of an organization resulting in diversification, closing parts of the business, etc. to increase its long-term profitability.
- It can be driven by external factors requiring change in the organizational structure or business model of a company, or it can be driven by the necessity to make financial adjustments to its assets and liabilities.
- Corporate Restructuring is an inorganic business strategy that results in faster pace of growth, effective utilization of resources, fulfillment of increasing expectations of stakeholders, managing competition, etc.
- Restructuring may be financial restructuring, technological, market and organizational restructuring.
- Corporate Restructuring process in India is governed by the Companies Act, 2013, Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 and various other laws.
- The most commonly applied tools of corporate restructuring are amalgamation, merger, demerger, acquisition, joint venture, disinvestments, etc.
- Corporate financial restructuring is any substantial change in a company's financial structure, or ownership or control, or business portfolio, designed to increase the value of the firm, i.e., debt and equity restructuring.
- Debt restructuring involves a reduction of debt and an extension of payment terms or change in terms and conditions, which is less expensive.
- Capital Reduction is the process of decreasing a company's shareholder's equity through share cancellations and share repurchases.
- According to section 61 of the Companies Act 2013 a company limited by shares or a company limited by guarantee and having a share capital may, if authorised by its articles, by special resolution, and subject to its confirmation by the Tribunal on petition, reduce its share capital.
- "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.

- According to Section 68(1) of the Companies Act, 2013 a company whether public or private, may purchase its own shares or other specified securities out of: (i) its free reserves; or (ii) the securities premium account; or (iii) the proceeds of any shares or other specified securities.
- When a company buys back its shares or other specified securities, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.
- Section 46A of the Income Tax Act, 1961 provides that any consideration received by a security holder from any company on buy back shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the security holder as capital gains.
- All the listed companies are required to comply with SEBI (Buy Back of Securities) Regulations, 2018, in addition to the provisions of the Companies Act, 2013.

GLOSSARY OF TECHNICAL WORDS

Corporate Restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Corporate restructuring is an inorganic growth strategy.

Merger is the fusion of two or more companies, whereby the identity of one or more is lost resulting in a single company.

Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or amalgamated company.

Acquisition occurs when one entity takes ownership of another entity's stock, equity interests or assets. It is the purchase by one company of controlling interest in the share capital of another existing company. Even after the takeover, although there is a change in the management of both the firms, companies retain their separate legal identity.

Demerger is an arrangement whereby some part / undertaking of one company is transferred to another company which operates completely separate from the original company.

Slump Sale is a transfer of one or more undertakings as a result of sale for a lump sum consideration, without values being assigned to the individual assets and liabilities in such sale.

Joint Venture (JV) is a business or contractual arrangement between two or more parties which agree to pool resources for the purpose of accomplishing a specific task may be a new project or any other business activity.

Reverse Merger is a merger in which a private company becomes a public company by acquiring it. It saves a private company from the complicated process and expensive compliance of becoming a public company.

Financial Restructuring is any substantial change in a company's financial structure, or ownership or control, or business portfolio, designed to increase the value of the firm, i.e., debt and equity restructuring.

LIST OF FURTHER READINGS

1. Guide to Companies Act by A Ramaiya, LexisNexis Butterworths
2. Master Guide to Companies Act 2013 & Company Rules by Taxmann
3. Mergers Acquisitions & Corporate Restructuring, 3rd Edition by Taxmann

4. The Companies Act, 2013 with Rules and Ready Referencer by S K Kataria, Bloomsbury Publication
5. Guide to Takeovers and Mergers by Sridharan and Pradhan, Wadhwa & Co.
6. Mergers, Acquisitions and Corporate Restructuring by C Krishnamurthi, SAGE Publications

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation.)

1. Define Corporate Restructuring.
2. Briefly discuss the scope and modes of Corporate Restructuring.
3. Describe about legal provisions of Corporate Restructuring in India.
4. Explain in detail the types of Merger.
5. Explain the acquisition of Flipcart and ebay.
6. What do you mean by Business Sale? Explain
7. What do you mean by 'buy-back' of shares or specified securities under the Companies Act, 2013? Explain the relevant provisions of the Act.
8. What are the different alternatives available to a public company for 'buy-back'?
9. Enumerate the provisions relating to Escrow account and offer procedure under SEBI (Buy- back of Securities) Regulations, 2018.
10. Discuss the obligations of Merchant Banker under SEBI (Buy-back of Securities) Regulations, 2018.

Lesson 2
Acquisition of Company/ Business

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Concept of Takeover
- Kinds of Takeover
- Legal aspects of Takeover
- Takeover of unlisted companies
- Takeover of listed companies
- Bailout Takeover and Takeover of sick units
- Takeover bids
- Takeover Defenses
- Cross Border Takeovers

LEARNING OBJECTIVES

Corporate Sector is an attractive medium for carrying on business as it offers a lot of benefits. Raising money from public has its own positive features and it helps setting-up big projects. When promoters of a company desire to expand, they take a quick view of the industrial and business map. If they find there are opportunities, they will always yearn for capitalizing such opportunities. Compared to the efforts required, cost and time needed in setting-up a new business, it would make sense to them to look at the possibilities of acquiring or taking over an existing entity.

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 prescribes disclosure requirements, open offer thresholds and other procedural aspects to takeover.

Cross Border Takeover is a much sought after term in recent years. Expansion and diversification are one of the primary reasons to cross the border as the domestic markets usually do not provide the desired growth opportunities.

After reading this lesson you will be able to understand the meaning, concept, objectives of takeover, procedural requirements as to takeover of listed/unlisted companies, takeover bids, takeover defences, Cross Border Takeovers, etc.

MEANING OF TAKEOVER

Takeovers and acquisitions are common occurrences in the business world. In some cases, the terms takeover and acquisition are used interchangeably, but each has a slightly different connotation. A takeover is a special form of acquisition that occurs when a company takes control of another company without the acquired firm's agreement. Takeovers that occur without permission are commonly called hostile takeovers. Acquisitions, also referred to as friendly takeovers, occur when the acquiring company has the permission of the target company's Board of directors to purchase and takeover the company. Acquisition refers to the process of acquiring a company at a price called the acquisition price or acquisition premium. The price is paid in terms of cash or acquiring company's shares or both.

As the motive is to takeover of other business, the acquiring company offers to buy the shares at a very high premium, that is, the gaining difference between the offer price and the market price of the share. This entices the shareholders and they sell their stake to earn quick money. This way the acquiring company gets the majority stake and takes over the ownership control of the target company.

An acquisition involves purchase of one entity by another (usually, a smaller firm by a larger one). A new company does not emerge from an acquisition; rather, the acquired company, or target firm, is often consumed and ceases to exist, and its assets become part of the acquiring company.

Acquiring an existing business enables a company to speed up its expansion process because they do not have to start from the very scratch. The target company is already established and has all the processes in place. The acquiring company simply has to focus on merging the business with its own and move ahead with its growth strategies.

Objects of Takeover

The objects of a takeover may *inter alia* include:

(i) To effect savings in overheads and other working expenses on the strength of combined resources;

(ii) To achieve product development through acquiring firms with compatible products and technological/manufacturing competence, which can be sold to the acquirer's existing marketing areas, dealers and end users;

(iii) To diversify through acquiring companies with new product lines as well as new market areas, as one of the entry strategies to reduce some of the risks inherent in stepping out of the acquirer's historical core competence;

(iv) To improve productivity and profitability by joint efforts of technical and other personnel of both companies as a consequence of unified control;

(v) To create shareholder value and wealth by optimum utilisation of the resources of both companies;

(vi) To achieve economies of scale by mass production at economical costs;

(vii) To secure substantial facilities as available to a large company compared to smaller companies for raising additional capital, increasing market potential, expanding consumer base, buying raw materials at economical rates and for having own combined and improved research and development activities for continuous improvement of the products, so as to ensure a permanent market share in the industry;

(viii) To achieve market development by acquiring one or more companies in new geographical territories or segments, in which the activities of acquirer are absent or do not have a strong presence.

Kinds of Takeover

Takeovers may be broadly classified into three kinds:

(i) Friendly Takeover: Friendly takeover is with the consent of taken over company. In friendly takeover, there is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company. This kind of takeover is done through negotiations between two groups. Therefore, it is also called negotiated takeover.

(ii) 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.

(iii) Bailout Takeover: Takeover of a financially sick company by a profit earning company to bail out the former is known as bailout takeover. There are several advantages for a profit making company to takeover a sick company. The price would be very attractive as creditors, mostly banks and financial institutions having a charge on the industrial assets, would like to recover to the extent possible.

Development of Takeover Regulations

The SEBI Act, 1992 empowered SEBI to make substantial acquisition of shares and takeovers a regulated activity for the first time. SEBI notified the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 in November 1994.

Being statutory in nature, violation of any of the provisions attracted several penalties. SEBI could initiate criminal prosecution under Section 24 of the SEBI Act, 1992, issue directions under the SEBI Act and could direct any person not to dispose off any securities acquired in violation of the regulations or direct him to sell shares acquired in violation of the Regulations or take action against the intermediary registered with SEBI. The SEBI Act, 1992 also empowered SEBI to initiate adjudications and to impose fines as penalties for certain violations of the Regulations.

SEBI acquired necessary expertise and insight into the complexities of a Takeover after implementing the same for 2 years and thereafter formed a Committee under the Chairmanship of Justice Bhagwati. The terms of reference of the Committee were:

- to examine the areas of deficiencies in the existing regulations; and
- to suggest amendments in the Regulations with a view to strengthen the Regulations and make them more fair, transparent and unambiguous and also protect the interest of investors and all parties concerned in the acquisition process.

The Committee submitted its report in January 1997 and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were notified on February 20, 1997. These Regulations primarily dealt with the issues such as consolidation of holdings, conditional offers, change in control, formation of a Takeover Panel, competitive offers and defined substantial quantity for the purpose of making a disclosure and for the purpose of making an open offer. Takeovers were for the first time regulated in India in full swing. However the various provisions were again subject to different interpretations and some of the provisions could not give the intended results.

With a view to address all the concerns raised by all concerned, the same committee was reconstituted to review the working of the regulations and to consider suitable suggestions for further refinement of the

Regulations in the light of the experience gained so far. The reconstituted Committee submitted its recommendations in 2002 and the Regulations went in for a major amendment in the year 2002.

In 2009, SEBI constituted a Takeover Regulation Advisory Committee (TRAC Committee) under the Chairmanship of Mr. C Achutan to review the Takeover Regulations of 1997. The committee submitted its report in 2010 and the Regulations, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 were notified on September 23, 2011, became effective from October 22, 2011. The major amendments/changes were:

1. Increase in trigger limit for open offer from 15% to 25%
2. Increase in statutory open offer size from 20% of share capital to 26% of total share capital of the company
3. Overhaul of exemptions from open offer:

   Exemptions have been further categorized into the following broad heads:

   a. Transactions, which trigger a statutory open offer due to substantial acquisition of shares/ voting rights, or due to change in control

   b. Transactions, which trigger a statutory open offer due to acquisition of shares/ voting rights exceeding prescribed thresholds, provided that there is no change in control.
4. Offer pricing: The new regulations brought in the concept of Volume Weighted Average Market Price.
5. Creeping acquisition: The New Regulations provided that an acquirer could make a creeping acquisition of 5% annually (between April 1 to March 31 of next year) to reach 75% stake such that the minimum public shareholding of 25% is maintained. The manner of computation of the 5% creeping acquisition limit has also been clarified.
6. Non Compete Fee : The provision of payment of non compete was done away with.
7. Recommendation of independent directors on the open offer to be published in the newspapers in which the detailed public statement was given.

The Regulations, further sought to include the various SAT judgements, informal guidance given and the experience gained from implementing the Takeover Regulations from the year 1994. They further sought to align itself with the Takeover Regulations as they exist in the rest of the world.

Legal aspects of Takeover

The legislations/regulations that mainly govern takeover are as under:

1. Companies Act, 2013
2. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (The Regulations)
3. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

As far as Companies Act, 2013 is concerned, the provisions of Section 186 apply to the acquisition of shares through a company. Section 235 and 236 of the Companies Act, 2013 lays down legal requirements for purpose of takeover of an unlisted company through transfer of undertaking to another company.

SEBI (SAST) Regulations, 2011 lays down the procedure to be followed by an acquirer for acquiring majority shares or controlling interest in another company.

As per Regulation 31A (8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, if any public shareholder seeks to re-classify itself as a promoter, such a public shareholder shall be required to make an open offer in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Exception from the applicability

The regulations shall not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue, on the institutional trading platform of a recognised stock exchange.

TAKEOVER OF UNLISTED COMPANIES

Section 236 of the Companies Act contains a compulsory acquisition mode for the transferee company to acquire the shares of minority shareholders of Transferor Company.

Where the scheme has been approved by the holders of not less than nine tenth (90%) in value of the shares of the transferor company whose transfer is involved, the transferee company, may, give notice to any dissenting shareholders that transferee company desires to acquire their shares. The scheme shall be binding on all the shareholders of the transferor company (including dissenting shareholders), unless the Tribunal orders otherwise (i.e. that the scheme shall not be binding on all shareholders).

Accordingly, the transferee company shall be entitled and bound to acquire these shares on the terms on which it acquires under the scheme (the binding provision).

The advantage of going through the route contained in Section 235 of the Companies Act is the facility for acquisition of minority stake. The transferee company shall give notice to the minority dissenting shareholders and express its desire to acquire their shares within a period of 4 months after making an offer as envisaged under Section 235 of the Act.

When a Company intends to takeover another Company through acquisition of 90% or more in value of the shares of that Company, the procedure laid down under Section 235 of the Act could be beneficially utilized. 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 minority. They do not even command a 10% stake so as to make any meaningful utilization of the power. Such minority cannot even call an extra-ordinary general meeting under Section 100 of the Act nor can they constitute a valid strength on the grounds of their proportion of issued capital for making an application to the Tribunal under Section 241 of the Act alleging acts of oppression and/or mismanagement. Hence the statute itself provides them a meaningful exit route.

The advantage of going through the route is the facility for acquisition of minority stake. But even without going through this process, if an acquirer is confident of acquiring the entire control, there is no need to go through Section 235 of the Act. It is purely an option recognized by the statute.

The merit of this scheme is that without resort to tedious court procedures the takeover is affected. Only in cases where any dissentient shareholder or shareholders exist, the procedures prescribed by this section will have to be followed. It provides machinery for adequately safeguarding the rights of the dissentient shareholders also.

Section 235 lays down two safeguard in respect of expropriation of private property (by compulsory acquisition of majority shares). First the scheme requires approval of a large majority of shareholders.

Second the Tribunal's discretion to prevent compulsory acquisition.

The following are the important ingredients of the Section 235 route:

- The Company, which intends to acquire control over another Company by acquiring share, held by shareholders of that another Company is known under Section 235 of the Act as the "Transferee Company".
- The Company whose shares are proposed to be acquired is called the "Transferor Company".
- The "Transferee Company" and "Transferor Company" join together at the Board level and come out with a scheme or contract.
- Every offer or every circular containing the terms of the scheme shall be duly approved by the Board of Directors of the companies and every recommendation to the members of the transferor Company by its directors to accept such offer. It shall be accompanied by such information as provided under the said Act. The circular shall be sent to the dissenting shareholders in Form No: CAA 14 to the last known address of the dissenting shareholder.
- Every offer shall contain a statement by or on behalf of the Transferee Company, disclosing the steps it has taken to ensure that necessary cash will be available. This condition shall apply if the terms of acquisition as per the scheme or the contract provide for payment of cash in lieu of the shares of the Transferor Company which are proposed to be acquired.
- Any person issuing a circular containing any false statement or giving any false impression or containing any omission shall be punishable with fine, which may extend to five hundred rupees.
- After the scheme or contract and the recommendation of the Board of Directors of the transferor Company, if any, shall be circulated and approval of not less than 9/10th in value of "Transferor Company" should be obtained within 4 months from the date of circulation. It is necessary that the Memorandum of Association of the transferee company should contain as one of the objects of the company, a provision to take over the controlling shares in another company. If the memorandum does not have such a provision, the company must alter the objects clause in its memorandum, by convening an extraordinary general meeting. The approval is not required to be necessarily obtained in a general meeting of the shareholders of the Transferor Company.
- Once approval is available, the 'Transferee Company' becomes eligible for the right of compulsory acquisition of minority interest.
- The Transferee Company has to send notice to the shareholders who have not accepted the offer (i.e. dissenting shareholders) intimating them the need to surrender their shares.
- Once the acquisition of shares in value, not less than 90% has been registered in the books of the transferor Company, the transferor Company shall within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration representing the price payable to them by the transferee Company.
- The transferee Company having acquired shares in value not less than 90% is under an obligation to acquire the minority stake as stated aforesaid and hence it is required to transfer the amount or other consideration equal to the amount or other consideration required for acquiring the minority stake to the transferor Company. The amount or consideration required to be so transferred by the transferee Company to the transferor company, shall not in any way, less than the terms of acquisition offered under the scheme or contract.
- Any amount or other consideration received by the Transferor Company in the manner aforesaid

shall be paid into a separate bank account. Any such sums and any other consideration so received shall be held by the transferor Company in trust for the several persons entitled to the shares in respect of which the said sums or other consideration were respectively received.

The takeover achieved in the above process through Section 235 of the Act will not fall within the meaning of amalgamation under the Income Tax Act, 1961 and as such benefits of amalgamation provided under the said Act will not be available to the acquisition under consideration. The takeover in the above process will not enable carrying forward of unabsorbed depreciation and accumulated losses of the transferor Company in the transferee Company for the reason that the takeover does not result in the transferor Company losing its identity.

Check-list

Transferor Company (Documents etc. involved in this process):

1. Offer of a scheme or contract from the transferee company
2. Minutes of Board meeting containing consideration of the offer and its acceptance or rejection
3. Notice calling general meeting
4. Form CAA 14 circulated to the members
5. Minutes of general meeting of the company containing approval of the offer by statutory majority in value and in numbers also, if required
6. Court order, if any
7. Register of Members
8. Notice sent by the transferee company to dissenting shareholders for acquiring their shares
9. Duly filled in and executed instrument(s) of transfer of shares held by the dissenting shareholders
10. Bank Pass Book or Statement of Account in respect of the amount deposited in the special bank account to be kept in trust for the dissenting shareholders
11. Annual Report

Transferee Company (Documents etc. involved in this process):

1. Minutes of Board meeting containing consideration and approval of the offer sent to the transferor company
2. Offer of a scheme or contract sent to the transferor company
3. Notice to dissenting shareholders if any, of the transferor company
4. Notice to the remaining shareholders of the transferor company, who have not assented to the proposed acquisition, if any
5. Form No: CAA14 received from the transferor company, which has been circulated to its members by that company
6. Minutes of general meeting of the company containing approval of the shareholders to the offer of scheme or contract sent to the transferor company
7. Court order, if any
8. Register of Investments

9. Duly filled in and executed instrument(s) of transfer for shares held by the dissenting shareholders
10. Balance Sheets showing investments in the shares of the transferor company

TAKEOVER OF LISTED COMPANIES

Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Therefore, before planning a takeover of a listed company, any acquirer should understand the compliance requirements under the Regulations and also the requirements under the SEBI (LODR) Regulations, 2015 and the Companies Act, 2013. There could also be some compliance requirements under the Foreign Exchange Management Act, 1999 if the acquirer were a person resident outside India.

As per Regulation 38, the listed entity shall comply with the minimum public shareholding requirements as specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulations) Rules, 1957 in the manner as specified by the Board from time to time. In other words, the listed entity shall ensure that the public shareholding shall be maintained at 25% of the total paid up share capital of the company failing which the company shall take steps to increase the public shareholding to 25% of the total paid up share capital by the methods as specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulations) Rules, 1957.

This provision shall not apply to entities listed on institutional trading platform without making a public issue.

DEFINITIONS

In order to understand the concept of the Regulations, it would be pertinent to go through some of the important definitions:

The term 'Takeover' has not been defined under the said Regulations; the term basically envisages the concept of an acquirer acquiring shares with an intention of taking over the control or management of the target company. When an acquirer, acquires substantial quantity of shares or voting rights of the target company, it results in the substantial acquisition of shares. Substantial is again not defined in the Regulations and what is substantial for one company may not be substantial for another company. It can therefore not be quantified in terms of number of shares.

1. Acquirer [Regulation 2(1)(a)]

"Acquirer" means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company;

2. Acquisition [Regulation 2(1)(b)]

"Acquisition" means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company;

It means that agreement to acquire the share or voting or control in a listed company without actual acquisition of share will also be treated as acquisition for the purpose of SEBI Takeover Regulations, 2011.

3. Control [Regulation 2(1)(e)]

"Control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including

by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:

Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;

4. Frequently Traded Shares [Regulation 2(1)(j)]

Frequently traded shares means shares of a target company, in which the traded turnover of any stock exchange during the twelve calendar months preceding the calendar month in which the public announcement is made is at least ten per cent of the total number of shares of such class of the target company.

Provided that where the share capital of a particular class of shares of the target company is not identical throughout such period, the weighted average number of total shares of such class of the target company shall represent the total number of shares.

5. Identified Date [Regulation 2(1)(k)]

Identified Date means the date falling on the tenth working day prior to the commencement of the tendering period, for the purposes of determining the shareholders to whom the letter of offer shall be sent.

6. Immediate Relative [Regulation 2(1)(l)]

Immediate relative means any spouse of a person, and includes parent, brother, sister or child of such person or of the spouse.

7. Maximum non Public Shareholding [Regulation 2(1)(o)]

Maximum permissible non-public shareholding means such percentage of shareholding in the target company excluding the minimum public shareholding required under the Securities Contracts (Regulation) Rules, 1957.

It means as per Rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 read with Regulation 38 of the SEBI (LODR) Regulations, 2015 every company shall ensure that at least 25% of each class or kind of equity shares issued by a listed company is held by public shareholders in order to remain continuously listed. Currently only Listed Public Sector Undertakings are exempted from this requirement and it is sufficient if the public shareholding is maintained at 10% of the paid up capital of such public sector enterprises, which are listed. Therefore the maximum permissible non-public shareholding in the general sense of the term is 75% of the total paid up equity capital of the company for any listed company, which is not a listed public sector undertaking.

8. Offer Period (Regulation 2(1)(p))

Offer Period means the period between the date of entering into an agreement, formal or informal, to acquire shares, voting rights in, or control over a target company requiring a public announcement, or the date of the public announcement, as the case may be, and the date on which the payment of consideration to shareholders who have accepted the open offer is made, or the date on which open offer is withdrawn, as the case may be.

9. Persons Acting in Concert (Regulation 2(1)(q))

Persons Acting in Concert means persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding,

formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

10. Promoter (Regulation 2(1)(s))

Promoter has the same meaning as in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and includes a member of the promoter group.

11. Promoter Group (Regulation 2(1)(t))

Promoter Group has the same meaning as in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

12. Shares (Regulation 2(1)(v))

Shares means shares in the equity share capital of a target company carrying voting rights, and include any security which entitles the holder thereof to exercise voting rights. For the purpose of this clause, shares will include all depository receipts carrying an entitlement to exercise voting rights in the target company.

13. "Target Company" (Regulation 2(1)(z))

"Target Company" means a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange;

14. "Tendering period" (Regulation 2(1)(za))

"Tendering Period" means the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations;

15. "Volume weighted average market price" (Regulation 2(1)(zb))

"Volume weighted average market price" means the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange;

16. "Volume weighted average price" (Regulation 2(1)(zc))

"Volume weighted average price" means the product of the number of equity shares bought and price of each such equity share divided by the total number of equity shares bought;

17. "Weighted average number of total shares" (Regulation 2(1)(zd))

"Weighted average number of total shares" means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighing factor.

TRIGGER POINTS UNDER TAKEOVER REGULATIONS

By trigger points, we mean the threshold levels upon reaching which, an acquirer, either on its own individual account or along with Persons Acting in Concert (PAC) acquiring shares or voting rights in a target company is required to make a public announcement for an open offer and comply with the other provisions of the Takeover Code with regard to an open offer.

These threshold levels are set in Regulation 3 of the SEBI (SAST) Regulations, 2011. In the following

paragraphs, the main points arising out of these regulations are discussed with illustrative examples.

Open offer thresholds

REGULATION 3(1): Substantial acquisition of shares or voting rights

As per Regulation 3(1) of the SEBI (SAST) Regulations, 2011, any acquirer can acquire shares or voting rights in a target company, which when taken together with the shares or voting rights held by him either individually or along with Persons Acting in Concert (PACs) with him entitles him / them to exercise 25% or more of the voting rights in such a target company, only after making a public announcement of an open offer in accordance with the provisions of the SAST Regulations. Suppose A Ltd is the target company listed on the BSE and the shareholding pattern as on April 25, 2015 is as under:

Name of the Shareholder	**Number of shares held (in number)**	**Percentage of voting rights (in %)**
A (promoter)	5000	50
B (Part of the Public)	500	5
Others (all constituting other Public Shareholders)	4500	45
Total Equity Share Capital	**10000**	**100**

On April 26, 2015 if B were to acquire 2000 shares by way of a Share Purchase Agreement with A, the promoter, his holding would increase to 2500 shares, which would be 25% of the voting rights of the company and he would therefore under Regulation 3(1) of the SEBI (SAST) Regulations, 2011 be under an obligation to make a public announcement in accordance with the SAST Regulations. He can proceed with the acquisition only by giving a public announcement of making an open offer for acquiring the shares from the shareholders of the target company.

REGULATION 3(2)

Regulation 3(2) of the SAST Regulations, stipulates that an acquirer, who along with persons acting in concert has acquired and holds 25% or more of the shares or voting rights in a target company, in accordance with the SEBI (SAST) Regulations, but less than the maximum permissible non-public shareholding which is normally 75% of the total paid up share capital of the company, can acquire additional shares or voting rights in a financial year in a target company, entitling them to exercise 5% of the voting rights. Any acquisition beyond 5% of the voting rights of the target company can be made only after making a public announcement of an open offer for acquiring shares of such a target company in accordance with the provisions of the target company.

Regulation 3(2) further stipulates that the acquirer shall not enter into any Share Purchase Agreement or acquire such number of shares, which when taken together with the shares already held by him along with the PACs would take the aggregate shareholding of the Acquirer and the PACs beyond the maximum permissible limit of non-public shareholding, which is normally 75% of the total paid up capital of the company.

The above provisions are explained with the following example:

Suppose A Ltd. is the target company listed on the BSE and the shareholding pattern as on April 25, 2015 is as under:

Name of the Shareholder	Number of shares held (in number)	Percentage of voting rights (in %)
A (promoter) along with PACs / persons belonging to the promoter group	5000	50
Others (all constituting other Public Shareholders)	5000	50
Total Equity Share Capital	**10000**	**100**

In the above example, if A, who is holding 50% of the voting rights of the company, which has been acquired in accordance with the provisions of the SEBI (SAST) Regulations, he can acquire another 5% of the voting rights in the financial year beginning April 01, 2015. This acquisition can be done either by himself or by the other members of the promoter group or partially by him and partially by the other members of the promoter group.

Regulation 3(3)

As per the provisions of Regulation 3(3) of the SEBI Takeover Regulations, when any person or entity acquires shares, if the individual shareholding of such an acquirer post such acquisition exceeds the threshold limit of 25% as laid down in Regulation 3(1) of the Takeover Regulations or the creeping acquisition limit of 5% in a financial year as laid down in Regulation 3(2) of the Takeover Regulations, that person or individual or entity would be under an obligation to make a public announcement of an open offer. This is irrespective of the aggregate shareholding of such an individual or an entity with persons acting in concert with him. This condition can be best understood with the following example:

Example

The Paid up Equity Share Capital of A Ltd is 10000 shares as on April 01, 2014

The promoters hold 4000 shares as on April 01, 2014, which is 40% as on April 01, 2014

The promoters comprise of three shareholders, A who holds 2200 shares (i.e. 22%), B who holds 1500 shares (i.e. 15%) and C who holds 300 shares (i.e. 3%).

The company makes a preferential allotment of 800 shares to A as a result of which the post issue shareholding of A would be 3000 shares.

Let us determine whether there would be a trigger using the methods enumerated in the previous pages:

(4800/10800)% - (4000/10000)% = 44.44% - 40% = 4.44%.

Since the acquisition by all the promoters together does not exceed 5% in a financial year there is no trigger. However we need to check what would be the post issue holding of A the allottee, who is currently holding 22% of the paid up capital of the company, with respect to the fully expanded capital which works out to 3000/11000 = 27.27%, by virtue of which he has crossed the initial threshold limit of 25% as stipulated in Regulation 3(1) of the Takeover Regulations. Therefore A has triggered the Code and is under an obligation to make an public announcement.

Regulation 3(4)

As per Regulation 3(4), any acquisition of shares made by the promoters of the target company in an offer made by them to the dissenting shareholders pursuant to an exit offer to be given to them in accordance with

Chapter VIA of the SEBI (ICDR) Regulations, 2009 shall not be treated as an acquisition under Regulation 3 of the SEBI (SAST) Regulations, 2011. In other words, this acquisition shall be exempt and shall not be required to make an open offer as mandated by the Regulations. As exit offer is made when the company which has made a public issue after April 01, 2014 wants to change the objects of the issue from the stated object in the Prospectus and seeks the approval of the shareholders for the same. In case there are dissenting shareholders the promoters and person in control of the company need to give an exit offer to these shareholders. Such acquisitions made pursuant to the offer shall be exempt from the requirement of making an open offer.

Regulation 4: Acquisition of control.

As per the provisions of Regulation 4 of the SEBI Takeover Regulations, 2011, an acquirer shall make a public announcement of an open offer for acquiring shares of a company, in case he / she acquires control of the target company either directly or indirectly. This is irrespective of the fact whether the acquisition of control is accompanied by acquisition or holding of shares or voting rights of the target company.

Regulation 5: Indirect acquisition of shares or control.

Regulation 5(1) of the Takeover Regulations, states that any acquisition of shares or voting rights in a target company or control over a company or any other entity which enables the person or persons acting in concert with him to exercise or direct the exercise of such percentage of voting rights or control over a target company, such acquisition would be deemed to have attracted the obligation of making a public announcement of an open offer. This is considered an indirect acquisition of shares or voting rights or control over a target company.

DELISTING AND THE TAKEOVER REGULATIONS

As per Regulation 7(4) and 7(5) of the SEBI (SAST) Regulations, 2011, in the event the shares accepted in an open offer by an acquirer taken together with the shares held by him along with persons acting in concert with him exceeds 75% or the maximum permissible non-public shareholding, the acquirer is required to bring down the non-public shareholding to the level specified and within the time period specified in the Securities Contracts (Regulation) Rules, 1957. The time period specified is 12 months from the expiry of the offer period. Further, the acquirer whose shareholding exceeds the maximum permissible non-public shareholding, following an open offer shall not be eligible to make a voluntary delisting offer under the SEBI (Delisting of Equity Shares) Regulations, 2009 unless a period of 12 months has elapsed from the date of expiry of the offer period. Hence it is evident that no voluntary delisting can be done unless the acquirer takes steps to reduce the non-public shareholding to a level within the permissible limit within 12 months of the completion of the offer period. The acquirer can make a voluntary delisting offer only after the expiry of 12 months.

The Regulations have however been recently amended and as per Regulation 5A, an acquiring who declares his intention to delist the company at the time of making the detailed public announcement, may delist the company in accordance with the provisions of the SEBI (Delisting of Equity Shares) Regulations, 2009 immediately, without waiting for the stipulated 12 month period. The Regulation reads as under:

Regulation 5A: Delisting offer

As per regulation 5A(1) of the SEBI Takeover Regulations, 2011 any acquirer who is desirous of delisting the company post the acquisition of the company due to a variety of reasons, may proceed to voluntarily delist the company under the SEBI Takeover Regulations, 2011 and the SEBI (Delisting of Equity Shares) Regulations, 2009. The following are the main points:

1. Acquirer to intimate the Board of Directors.
2. Board to consider the proposal for delisting.
3. Public announcement in case delisting offer fails.
4. File draft letter of offer with SEBI.
5. Minimum details in the tentative schedule of activity.
6. Competing Offer.
7. Withdrawal of shares tendered.
8. Option to tender shares in open offer.

Bombay Swadeshi Stores Ltd., is the only company to have availed this process till this date.

Regulation 6: Voluntary Offer

Any acquirer who either by himself or along with persons acting in concert with him hold shares or voting rights in the target company which entitles him to exercise 25% or more but less than the maximum permissible non-public shareholding, which is normally 75% of the total paid up capital of the company / voting rights of the company, such an acquirer is entitled to voluntarily make a public announcement for an open offer for acquiring shares in accordance with the Takeover Regulations. This is termed as voluntary offer and can be made without triggering / attracting the provisions of Regulation 3, 4 and 5 of the Takeover Regulations.

This provision is subject to the fact that in case the Acquirer or any person acting in concert with the Acquirer has acquired shares of the target company in the preceding 52 weeks without attracting the provisions of the Takeover Regulations, with regard to the obligation to make an open offer i.e. under an exemption, such an Acquirer is ineligible to make a voluntary open offer under the Takeover Regulations.

As per Regulation 6(2) and 6(3) the Acquirer is further prohibited from acquiring shares in any other mode, except in the voluntary open offer. The Acquirer and the persons acting in concert with him shall further not acquire any shares for a period of 6 months from the completion of the open offer, except through another voluntary open offer. The Acquirer can however make a competing offer during this period on any other person who is making an open offer for acquiring the shares of the target company. The Acquirer is further entitled to get shares in a bonus issue or acquire shares in a share split during this period of 6 months.

Regulation 6A - Prohibition by a wiful defaulter to make an open offer

As per the Takeover Regulations, a person who is a wilful defaulter shall not make a public announcement of an open offer or enter into any transaction which will create an obligation on him to make a public announcement. However he can make a competing offer, in respect of any offer that has been made by any other person.

PROCEDURE FOR MAKING AN OPEN OFFER

Manager to the open offer

The Acquirer shall before making a public announcement, appoint a merchant banker registered with the Board, who is not an associate of the acquirer, as the manager to the open offer. A Manager shall be termed as an Associate if either the merchant banker or the acquirer controls directly or indirectly through its subsidiary or holding company not less than 15% of the voting rights of the other or either of them directly or

indirectly by itself or in combination with other persons exercises control over the other or there is a common director excluding nominee director amongst the acquirer, its subsidiary or holding company and the merchant banker.

Public Announcement

The public announcement of the open offer for acquiring shares required under the Takeover Regulations shall be made by the acquirer through manager to the open offer.

Timing of the Public Announcement

The public announcement made on crossing the thresholds mentioned in Regulation 3 and on acquiring control under Regulation 4 shall be made in accordance with Regulation 14 and Regulation 15 of the Takeover Regulations. The Public Announcement shall be made on the date of agreeing to acquire shares or voting rights in, or control over the target company.

In case of market purchases, such a public announcement shall be made prior to placement of the purchase order with the stock broker to acquire the shares that would take the entitlement to voting rights beyond the stipulated thresholds.

In case of a voluntary offer under Regulation 6 of the Takeover Regulations, the public announcement shall be made on the same day as the date on which the acquirer takes the decision to voluntarily make a public announcement of an open offer for acquiring shares of the target company.

Offer Price

The open offer for acquiring the shares under regulations 3, 4, 5 or 6 of the Takeover Regulations, shall be made at a price which shall not be lower than the price arrived at in accordance with the provisions laid down in Regulation 8(2) or Regulation 8(3), as the case may be**.**

Direct Acquisition and Indirect Acquisition where the parameters set out under Regulation 5(2) are satisfied

In case the shares of the target company are acquired directly or indirectly, but all the parameters set out in Regulation 5(2) of the Takeover Regulations, are met, the offer price shall be the highest of the following:

(a) the highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer. This would be price agreed to be paid under a Share Price Agreement.

(b) the volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement; This would be applicable if there are several acquisitions by the acquirer during the 52 weeks preceding the public announcement and the volume weighted average price shall be calculated for all such acquisitions.

(c) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty six weeks immediately preceding the date of the public announcement. In this case the acquisition during the 26 weeks prior to the date of public announcement is taken and the actual price paid is considered.

(d) the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such

period, provided such shares are frequently traded. In order to arrive at this price, the first step is to determine if the shares are frequently traded or not. In case they are frequently traded, then the volume weighted average market price of such shares for a period of 60 trading days immediately preceding the date of public announcement is to be calculated.

(e) where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies. This provision would be applicable only if the shares are not frequently traded and regulation (d) above is not applicable.

SEBI may, if not satisfied with the valuation, at the expense of the acquirer, require valuation of the shares by an independent merchant banker other than the manager to the open offer or an independent chartered accountant in practice having a minimum experience of ten years.

(f) the per share value computed under sub-regulation (5), if applicable.

Indirect Acquisition where the parameters set out under Regulation 5(2) are not satisfied

As per Regulation 8(3) of the Takeover Regulations, in case of an indirect acquisition of shares or voting rights in, or control over the target company, where the parameter referred to in sub-regulation (2) of regulation 5 are not met, the offer price shall be the highest of:

(a) the highest negotiated price per share, if any, of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer,

(b) the volume-weighted average price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain,

(c) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain,

(d) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, between the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, and the date of the public announcement of the open offer for shares of the target company made under the Takeover Regulations,

(e) the volume-weighted average market price of the shares for a period of sixty trading days immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded, and

(f) the per share value computed under Regulation 8(5) of the Takeover Regulations.

Detailed Public Statement

Every acquirer shall after giving a Public Announcement, publish a detailed public statement through the

manager to the open offer not later than five w than five working days of the public announcement.

The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.

The Acquirer shall send a copy of the public announcement to SEBI and to the target company at its registered office within one working day of the date of the public announcement through the Manager to the Offer.

The detailed public statement pursuant to the public announcement shall be published in all editions of any one English national daily with wide circulation, any one Hindi national daily with wide circulation, and any one regional language daily with wide circulation at the place where the registered office of the target company is situated and one regional language daily at the place of the stock exchange where the maximum volume of trading in the shares of the target company are recorded during the sixty trading days preceding the date of the public announcement.

Letter of Offer

The Acquirer through the merchant banker shall within five working days from the date of the detailed public statement made file with SEBI a draft of the letter of offer containing such information as may be specified along with a non-refundable fee, by way of a banker's cheque or demand draft payable in Mumbai in favour of Securities and Exchange Board of India.

The Manger to the Open offer shall provide the soft copies of the Public Announcement, Detailed Public Statement and the Letter of Offer to SEBI and the same shall be uploaded on the website of SEBI.

SEBI shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by SEBI, it is deemed that SEBI does not have comments to offer.

Escrow Account

The acquirer, shall not later than two working days prior to the date of the detailed public statement of the open offer for acquiring shares, create an escrow account towards security for performance of his obligations and deposit in escrow account such aggregate amount as per the following scale:

Sl. No.	**Consideration payable under the Open Offer**	**Escrow Amount**
A	On the first five hundred crore rupees	an amount equal to twenty-five per cent of the consideration
B	On the balance consideration	Rupees 125 crores plus 10% of the balance consideration

Where an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

The consideration payable under the open offer shall be computed as shall be calculated with reference to the open offer price assuming full acceptances of the open offer, in case the offer is subject to differential

pricing, it shall be computed on the highest offer price, irrespective of the manner of payment of the consideration. If the offer price is revised the value of the escrow amount shall be computed on the revised consideration calculated at such revised offer price, and the additional amount shall be brought into the escrow account prior to effecting such revision.

The escrow account may be in the form of cash deposited with any scheduled commercial bank or a bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or by way of deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin. It shall be borne in mind that the cash or bank guarantee shall be only with a scheduled commercial bank and that of a co-operative bank shall not be accepted.

In the event of the escrow account being created by way of a bank guarantee or by deposit of securities, the acquirer shall also ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.

Release of amount from Escrow Account

The manager to the open offer shall not release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, save and except for transfer of funds to the special escrow account as required under regulation 21 of the Takeover Regulations.

In the event of non-fulfillment of obligations under the Takeover Regulations, by the acquirer SEBI may direct the manager to the open offer to forfeit the escrow account or any amounts lying in the special escrow account, either in full or in part. The escrow account deposited with the bank in cash shall be released only in the following manner:

(a) the entire amount to the acquirer upon withdrawal of offer in terms of regulation 23 of the Takeover Regulations as certified by the manager to the open offer;

(b) for transfer of an amount not exceeding ninety per cent of the escrow account, to the special escrow account in accordance with regulation 21 of the Takeover Regulations;

(c) to the acquirer, the balance of the escrow account after transfer of cash to the special escrow account, on the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer;

(d) the entire amount to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments;

(e) the entire amount to the manager to the open offer, in the event of forfeiture for non-fulfillment of any of the obligations under these regulations, for distribution in the following manner, after deduction of expenses, if any, of registered market intermediaries associated with the open offer—

(i) one third of the escrow account to the target company;

(ii) one third of the escrow account to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009; and

(iii) one third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

Other Procedures

The acquirer, simultaneously with the filing of the draft letter of offer with SEBI shall send a copy of the draft letter of offer to the target company at its registered office address and to all the stock exchanges where the shares of the target company are listed.

On receipt of the observations from SEBI, the Acquirer through the Manager to the Offer, shall ensure that the letter of offer is dispatched to the shareholders whose names appear on the register of members of the target company as of the identified date, not later than seven working days from the receipt of comments from the Board. In case no comments / observations are received from SEBI, the letter of offer shall be dispatched within seven working days from the expiry of the period stipulated in sub-regulation (4) of regulation 16, which is 15 working days from the date of filing of the draft letter of offer with SEBI.

The acquirer shall disclose during the offer period every acquisition made by the acquirer or persons acting in concert with him of any shares of the target company in such form as may be specified, to each of the stock exchanges on which the shares of the target company are listed and to the target company at its registered office within twenty-four hours of such acquisition, and the stock exchanges shall forthwith disseminate such information to the public. However, the acquirer and persons acting in concert with him shall not acquire or sell any shares of the target company during the period between three working days prior to the commencement of the tendering period and until the expiry of the tendering period.

(a) Stock Exchange mechanism

The acquirer shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism as specified by SEBI.

SEBI has further mandated the following additional disclosures to be made in the Detailed Public Statement and the Letter of Offer:

- Name and address of the stock broker appointed by the Acquirer/Company;
- Name of the Stock Exchanges with nationwide trading terminals where the Acquisition Window shall be available including the name of the Designated Stock Exchange.
- Methodology for placement of orders, acceptances and settlement of shares held in dematerialised form and physical form
- Details of the special account opened with Clearing Corporation.

Pre Offer Advertisement

The acquirer shall issue an advertisement in such form as may be specified, one working day before the commencement of the tendering period, announcing

- the schedule of activities for the open offer or the revised schedule, if any
- the status of statutory and other approvals, if any, whether for the acquisition attracting the obligation to make an open offer or for the open offer,
- unfulfilled conditions, if any, and their status,
- the procedure for tendering acceptances and such other material detail as may be specified.

Such an advertisement shall be published in all the newspapers in which the detailed public statement pursuant to the public announcement was made and simultaneously sent to SEBI, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

Mode of Payment

The offer price may be paid either:

- in cash; or
- by issue, exchange or transfer of listed shares in the equity share capital of the acquirer or any person acting in concert with the acquirer; or
- by way of an issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not below investment grade as rated by a credit rating agency registered with SEBI; or
- by issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquirer listed shares in the equity share capital of the acquirer or any person acting in concert with the acquirer; or
- a combination of the mode of payment of consideration stated above.

As per the SEBI Takeover regulations, in case the shareholders have been provided with an option to accept payment in cash or by way of securities or by way of combination thereof, the pricing of the open offer may be different for each option. This shall however be subject to the compliance with the requirement of minimum offer price and further the Detailed Public Statement and Letter of Offer shall contain the justification for such differential pricing.

Completion of Acquisition

The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period.

However, if the offer is made pursuant to a preferential allotment, the offer shall be completed within the period as provided under sub-regulation (3) of regulation 74 of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

In case the acquirer deposits 100% of the consideration payable under the open offer in cash in the escrow account assuming full acceptance of the open offer, the parties to such agreement may after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.

The acquirer shall complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period.

Provided that in the event of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period, the Board may for reasons to be published, may grant an extension of time by such period as it may deem fit in the interests of investors in securities and the securities market.

WITHDRAWAL OF THE OFFER

An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances,—

(a) statutory approvals required for the open offer or for effecting the acquisitions attracting the

obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer.

Note: the statutory approval must be rejected and anticipation of rejection shall not be a ground for withdrawal of open offer.

(b) the acquirer, being a natural person, has died;

(c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

(d) such circumstances as in the opinion of the Board, merit withdrawal. In this case, SEBI shall pass a reasoned order permitting withdrawal, and such order shall be hosted by the Board on its official website.

In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days, make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer simultaneously with the announcement, inform in writing to SEBI, all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public and the target company at its registered office.

CONDITIONAL OFFERS

An acquirer may make an open offer conditional as to the minimum level of acceptance. Provided that where the open offer is pursuant to an agreement, such agreement shall contain a condition to the effect that in the event the desired level of acceptance of the open offer is not received the acquirer shall not acquire any shares under the open offer and the agreement attracting the obligation to make the open offer shall stand rescinded.

Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert with him shall not acquire, during the offer period, any shares in the target company except under the open offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.

COMPETING OFFERS

When a public announcement for acquiring shares of a target company in an open offer is made, any person, other than the acquirer who has made such public announcement, shall be entitled to make a public announcement of an open offer within fifteen working days of the date of the detailed public statement made by the acquirer who has made the first public announcement. The competing open offer shall be for such number of shares which, when taken together with shares held by such acquirer along with persons acting in concert with him, shall be at least equal to the holding of the acquirer who has made the first public announcement, including the number of shares proposed to be acquired by him under the offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.

No person shall be entitled to make a public announcement of an open offer for acquiring shares, or enter into any transaction that would attract the obligation to make a public announcement of an open offer for acquiring shares under the Takeover regulations, after the period of fifteen working days from the date of first public announcement and until the expiry of the offer period for such open offer.

Unless the open offer first made is an open offer conditional as to the minimum level of acceptances, no acquirer making a competing offer may be made conditional as to the minimum level of acceptances.

The schedule of activities and the tendering period for all competing offers shall be carried out with identical timelines and the last date for tendering shares in acceptance of the every competing offer shall stand revised to the last date for tendering shares in acceptance of the competing offer last made. Once a competing offer has been made, an acquirer who had made a preceding competing offer shall be entitled to revise the terms of his open offer provided the revised terms are more favourable to the shareholders of the target company. Further, the acquirers making the competing offers shall be entitled to make upward revisions of the offer price at any time up to three working days prior to the commencement of the tendering period.

All the provisions of the Takeover regulations shall apply to every competing offer.

EXEMPTIONS

Under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, an acquirer together with Persons Acting in Concert (PAC) are under obligation to make public announcement of an open offer pursuant to Regulation 3 and 4 of these regulations, in the event of their becoming entitled to exercise 25% or more of the voting rights in a target company. However, there are circumstances when such acquirers acting together with PAC are not under an obligation to make a public announcement of an open offer.

The exemptions available under the SEBI (SAST) Regulations are broadly of two types:

(i) GENERAL EXEMPTION – Regulation 10

(a) General Exemption – governed by Regulation 10 for which application need not be made to SEBI, but based on facts and circumstances of the case, the acquirer and the PAC have to take a view whether or not they are entitled to the exemption provided under Regulation 10 from complying with the regulations to make public announcement of open offer. In all such cases, the regulations require filing of reports with the Stock Exchange after the transaction has been completed. Filing of such report within the due date is a strict requirement, which if not fulfilled, will trigger an obligation to make public announcement of open offer.

Regulation 10 of the SEBI (SAST) Regulations, stipulates the various exemptions that would be automatically or generally available from the obligation of making a public announcement of an open offer under Regulation 3 and / or Regulation 4 of the SEBI Takeover Regulations, subject to fulfillment of necessary conditions. It is to be noted that that there are no exemptions from the compliance of Regulation 5 at any point in time.

Regulation 10(1)(a)

(1) The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 subject to fulfillment of the conditions stipulated therefore,—

(a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being,—

(i) immediate relatives;

(ii) persons named as promoters in the share holding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;

(iii) a company, its subsidiaries, its holding company, other subsidiaries of such holding

company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;

(iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement;

(v) shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company:

Provided that for purposes of availing of the exemption under this clause,—

(i) If the shares of the target company are frequently traded, the acquisition price per share shall not be higher by more than twenty-five per cent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed inter se transfer under sub-regulation (5), as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, and if the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than twenty-five per cent of the price determined in terms of clause (e) of sub-regulation(2) of regulation 8; and

(ii) the transferor and the transferee shall have complied with applicable disclosure requirements set out in Chapter V.

Analysis of the Regulation

Regulation 10(1) lays down certain circumstances which exempt an acquirer from making an open offer under Regulation 3 and Regulation 4 of the Takeover Regulations. As per ***Regulation 10(1)(a) any acquisition pursuant to inter-se transfer amongst qualifying persons are exempted. The qualifying persons are***

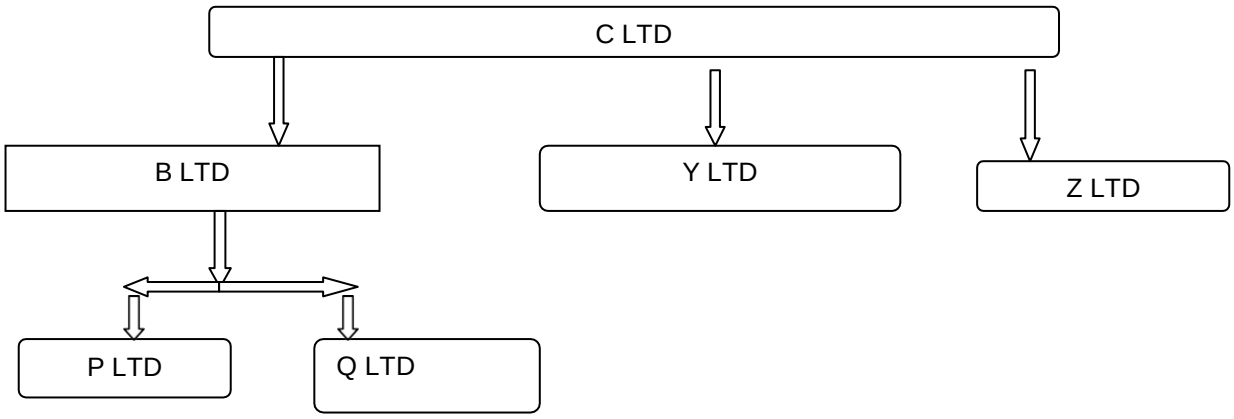
(i) Immediate relatives: Any inter-se transfer amongst persons who are immediate relatives would be exempted from the requirement of making an open offer. Hence with reference to the acquirer, any transfer from his spouse, children, parents, brother, sister, parents of his spouse and the brother / sister of his spouse is automatically exempted. However an inter-se transfer from a grandfather to his grandson or from an uncle to his nephew or his niece is not exempted, as they do not fall within the definition of immediate relatives within the meaning of Regulation. Similarly, any transfer from a person to his brother's wife or sister's husband is also not exempted automatically, for the same reason.

(ii) Inter-se transfers of shares amongst named promoters: Any inter-se transfer of shares amongst persons named as promoters in the shareholding pattern filed by the target company with the stock exchange in accordance with Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 or any filing made of the promoters' shareholding under the SEBI Takeover Regulations (i.e. Regulation 30 of the SEBI (SAST) Regulations, 2011 for a period of not less than 3 years prior to the proposed acquisition shall be exempted. In other words, in order to obtain an exemption, both the transferors and transferees must have held shares in the company as a promoter for a continuous period of 3 years prior to the date of the proposed acquisition.

(iii) (a)Inter se transfers amongst Holding, subsidiary and fellow subsidiary companies: Any inter-se transfer amongst a company and its subsidiaries, its holding company and its other holding company is exempted.

To explain this if in Target Company A Ltd., the shares are held by B Ltd., which is the subsidiary of C Ltd. C Ltd in turn has two other subsidiaries Y Ltd and Z Ltd. Further B Ltd in turn has a subsidiary P Ltd and Q Ltd . This is diagrammatically shown as under:

Shares of A Ltd., held by B Ltd



Any transfer of shares held by B Ltd in the target company to its holding Company C Ltd., or to its subsidiaries P Ltd or Q Ltd or to the other subsidiaries of its holding company Y Ltd and Z Ltd., would be exempted.

(iii)(b) Inter-se transfer to persons holding not less than fifty percent of the equity shares of a company

Any transfer amongst persons who hold not less 50% of the company which holds shares in the target company would be exempted from the requirement of making a public announcement for an open offer. This can be best explained with an example.

Example:

In target company, A Ltd., more than 25% (beyond the initial threshold as laid down under Regulation 3(1)) is held by a company Viz., B Ltd. How can these shares be transferred without attracting the provisions of the Takeover Regulations. One option available is to look at the shareholding pattern of B Ltd., and in this case if 75% of the share capital is held by C, then the shares of A Ltd., which is held by B Ltd. can be transferred to C, who holds more than 50% of itself.

(iii)(c) *Inter-se* Transfer to other companies in which such persons hold not less than 50% of the equity shares and their subsidiaries

Such Inter Se transfers are exempt, subject to the condition that control over such qualifying persons being exclusively held by the same persons.

Any inter se-transfer of shares to a company in which the same set of persons hold not less than 50% of the equity shares would be exempted from the requirement of making a public announcement for an open offer. This can be best explained with the following example:

Example:

35% of the paid up equity share capital of A Ltd., is held by B Ltd., which is promoted by A, B and C. They together hold 90% of the Share capital of B Ltd and also hold 65% of the share capital of C Ltd. If B Ltd., is desirous of transferring its entire shareholding in A Ltd., to C Ltd, the acquisition of 35% by C Ltd., would be automatically exempted from the provisions of Regulation 3 and 4 of the Takeover Regulations, with regard to the obligation to make the open offer, since the same set of persons hold more than 50% of the share capital of the companies B Ltd and C Ltd.

(iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement.

Any transfer of shares amongst persons who are acting in concert for a period of not less than 3 years before the transaction and the same has been disclosed in the shareholding patterns filed with the stock exchange under Regulation 31 of the SEBI (LODR) Regulations, 2015 would be exempted.

(v) shareholders of a target company who have been persons acting in concert

Any inter se transfer between PACI for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company.

In case the shareholders have been persons acting in concert for a period of not less than 3 years prior to the proposed acquisition of shares and their shareholding has been disclosed as such in the shareholding patterns filed with the stock exchange under Regulation 31 of the SEBI (LODR) Regulations, 2015, an inter-se transfer of shares to another company in which the same persons hold the share capital in the same proportion as that in which they hold shares in the target company would be exempted. This can be best explained by an example:

Example:

If the A B & C hold 10,000; 40,000 and 50,000 shares of Target Company A Ltd., and they are termed as PACs in the share holding pattern filed with the stock exchange. They are also the only shareholders of ABC Pvt Ltd., in which the share capital is 50,000 shares of Rs. 10 each. A B & C are desirous of transferring their shareholding in A Ltd., to ABC Pvt Ltd., This is automatically exempt only if the entire 50, 000 shares in ABC Private Ltd are held as A : 5,000 shares, B: 20,000 shares and C : 25,000 shares. In other words the entire share capital of ABC Pvt Ltd., must be held in the same proportion of 1:4:5 as that of their shareholding in the target company, in order that this inter-se transfer be automatically exempted.

Conditions to be satisfied for availing the exemption in case of inter-se transfers amongst qualifying persons:

Exemption under Regulation 10(1)(a)(i) to (v) would however be available only if the following conditions are also met by the transferor and the transferees.

The Conditions to be fulfilled for availing inter-se exemption are classified under two categories namely

(a) frequently traded shares

(b) Not frequently traded shares

1. If shares are frequently traded: In case the shares are frequently traded, the volume weighted

average market price for a period of 60 days prior to the date of prior intimation of the proposed inter-se transfer of shares is to be calculated and the acquisition price at which the inter se transfer is to be done shall not be more than 25% of the weighted average market price as calculated

2. If shares are not frequently traded: In case the shares are infrequently traded, the price at which the inter se transfer is to be done is to be calculated as per the parameters laid down in Regulation 8(2)(e) of the SAST Regulations and shall not be more than 25% of the price so calculated as per the parameters discussed.

Further the transferor and the transferee must have complied with the requirements of making disclosures under Regulation 29, 30 and 31 of the SAST regulations. In case both the conditions are not fulfilled and either of the conditions are not fulfilled, the exemption that would have been available automatically would not be available to the transaction.

Note: Prior intimation needs to be given to the stock exchange where the shares of the company are listed at least 4 working days before the transaction in all the above cases.

Regulation 10(1)(b)

Any acquisition in the ordinary course of business by—

(i) an underwriter registered with the Board by way of allotment pursuant to an underwriting agreement in terms of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(ii) a stock broker registered with the Board on behalf of his client in exercise of lien over the shares purchased on behalf of the client under the bye-laws of the stock exchange where such stock broker is a member;

(iii) a merchant banker registered with the Board or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of Chapter X B of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(iv) any person acquiring shares pursuant to a scheme of safety net in terms of regulation 44 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(v) a merchant banker registered with the Board acting as a stabilising agent or by the promoter or pre-issue shareholder in terms of regulation 45 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009; (This is normally done when the company opts for a Green Shoe Option in a Public issue of securities made in accordance with the SEBI (ICDR) Regulations, 2009.)

(vi) by a registered market-maker of a stock exchange in respect of shares for which he is the market maker during the course of market making;

(vii) a Scheduled Commercial Bank, acting as an escrow agent; and

(viii) invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee.

Any shares acquired in the ordinary course of business by the above category of persons is exempted from the requirement of making a public announcement for an open offer, pursuant to Regulation 3 and Regulation 4 of the SEBI Takeover Regulations.

Regulation 10(1)(c)

Acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement:

Provided that,—

(i) Both the acquirer and the seller are the same at all the stages of acquisition; and

(ii) Full disclosures of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.

In other words, if there is an Share Purchase Agreement to acquire shares and pursuant to the same, if the acquirer has made a public announcement, any acquisitions subsequently between the same seller and the acquirer would also be exempted from the requirement of making a public announcement, if such an intention and full disclosure of the same has been made in the public announcement and in the letter of offer.

Regulation 10(1)(d)

Acquisition pursuant to a scheme:

(i) made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) or any statutory modification or re-enactment thereto. In other words, any acquisition pursuant to a scheme sanction by the Hon'ble BIFR would be exempted from the applicability of these regulations from the requirement of making a public announcement.

(ii) of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign. In other words, any acquisition of shares pursuant to a scheme of amalgamation or merger or demerger or any reconstruction, involving the target company as a transferor company or transferee company, would be exempted, provided such a scheme is pursuant to an Order of the Court, under any Indian or Foreign Law.

(iii) of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a Tribunal or a competent authority under any law or regulation, Indian or foreign, subject to,

(A) the component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme and

(B) where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.

Regulation 10(1)(da)

Acquisition pursuant to a resolution plan approved under Section 31 of the Insolvency and Bankruptcy Code, 2016.

Regulation 10(1)(e)

Any acquisition pursuant to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002) would be exempted from the applicability of the provisions of Regulation 3 and Regulation 4 with regard to making a public announcement for an open offer.

Regulation 10(1)(f)

Any acquisition pursuant to the delisting offer made under the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009 would be exempted from the applicability of the provisions of Regulation 3 and Regulation 4 with regard to making a public announcement for an open offer.

Regulation 10(1)(g)

Any acquisition by way of transmission, succession or inheritance, would be exempted from applicability of the provisions of Regulation 3 and Regulation 4 with regard to making a public announcement for an open offer.

Regulation 10(1)(h)

Any acquisition of voting rights or preference shares carrying voting rights arising out of the operation of sub-section (2) of section 87 of the Companies Act, 1956 (1 of 1956), (now to be read as Section 47(2) of the Companies Act, 2013), would be exempted from applicability of the provisions of Regulation 3 and Regulation 4 with regard to making a public announcement for an open offer.

As per Proviso to Section 47(2) of the Companies Act, 2013, where dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have the right to vote on all resolutions placed before the company. In other words, these shareholders acquire voting rights which could lead to a situation that they may either exceed the threshold limit of 25% or the creeping acquisition limit of 5% in a financial year as stipulated under Regulations 3(1) and 3(2) respectively. This exemption was laid down by the SAT in the matter of *Weizmann Ltd.* v. *SEBI*.

Regulation 10(1)(i)

Conversion of debt into equity under Strategic Debt Restructuring Scheme **-** Acquisition of equity shares by the consortium of banks, financial institutions and other secured lenders pursuant to conversion of their debt as part of the Strategic Debt Restructuring Scheme in accordance with the guidelines specified by the Reserve Bank of India:

Provided that the conditions specified under sub-regulation (5) or (6) of regulation 70 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as may be applicable, are complied with.

Regulation 10(1)(j)

Increase in voting rights arising out of the operation of sub-section (1) of section 106 of the Companies Act, 2013 or pursuant to a forfeiture of shares by the target company, undertaken in compliance with the provisions of the Companies Act, 2013 and its articles of association.

Regulation 10(2)

The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India vide circular no. B.P.BC 15/21.04, 114/2001 dated August 23, 2001, or any modification or re-notification there to provided such scheme has been authorized by shareholders by way of a special resolution passed by postal ballot, shall be exempted from the obligation to make an open offer under regulation 3.

As per Regulation 10(2) of the SEBI Takeover Regulations, any acquisition of shares of a target company,

not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring (CDR) in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India vide circular no. B.P.BC 15/21.04, 114/2001 dated August 23, 2001, or any modification or re-notification thereto provided such scheme has been authorised by shareholders by way of a special resolution passed by postal ballot, shall be exempted from the obligation to make an open offer under regulation 3.

The following points are to be kept in mind while claiming an exemption when an acquisition is pursuant to a CDR Package:

(a) The Exemption is available only from the applicability of Regulation 3 of the SEBI Takeover Regulations and not Regulation 4. In other words if pursuant to the CDR Package, there is a change of control of the target company, no exemption would be available.

(b) The entire CDR package should be approved by the shareholders and not merely the additional allotment of shares pursuant to the CDR Package.

(c) Such shareholder approval should be obtained by the company by way of a postal ballot process and not physical voting.

Regulation 10(3)

An increase in voting rights in a target company of any shareholder beyond the limit attracting an obligation to make an open offer under sub-regulation (1) of regulation 3, pursuant to buy-back of shares shall be exempt from the obligation to make an open offer provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold referred to in sub-regulation (1) of regulation 3 within ninety days from the date of closure of the buy-back offer.

Regulation 10(4)

The following acquisitions shall be exempt from the obligation to make an open offer under sub-regulation (2) of regulation 3, i.e. the creeping acquisition of limit of 5% in a financial year. In other words, the following acquisitions would permit the shareholders who hold more than 25% but less than 75% of the paid up capital of the company to acquire more than 5% in a financial year beginning April 01.

(a) acquisition of shares by any shareholder of a target company, upto his entitlement, pursuant to a rights issue. In other words, any acquisition of shares in a target company upto a person's entitlement in a rights issue would be exempted from the applicability of Regulation 3(2).

(b) acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfillment of the following conditions,

(i) the acquirer has not renounced any of his entitlements in such rights issue;

(ii) the price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of:

(A) the volume weighted average market price of the shares of the target company during a period of sixty trading days ending on the day prior to the date of determination of the rights issue price, multiplied by the number of shares outstanding prior to the rights issue, divided by the total number of shares outstanding after allotment under the rights issue:

Provided that such volume weighted average market price shall be determined on the basis of trading on the stock exchange where the maximum volume of trading in the shares of such target company is recorded during such period; and

(B) the price at which the shares are offered in the rights issue, multiplied by the number of shares so offered in the rights issue divided by the total number of shares outstanding after allotment under the rights issue.

In other words, any acquisition of shares beyond a shareholders' entitlement would be exempted from the applicability of Regulation 3(2), provided the applicant is a shareholder and the shareholder has applied for his entire entitlement without renouncing even a single share and the price at which the application is made is not higher that the ex-rights price.

(ii) SPECIFIC EXEMPTION – Regulation 11

If the proposed transaction is not automatically exempted under the various categories mentioned in Regulation 10 discussed in the preceding paragraphs above and the acquirers are of the opinion that the transaction that they propose to enter into requires an exemption, the Acquirer must make an application to SEBI seeking exemption. It must however be noted that application shall be made before the transaction / acquisition is initiated. Post facto exemptions are not granted by SEBI.

The application for exemption shall be under Regulation 11(3) of the Takeover Regulations, and submitted along with a non-refundable fee of Rs.5,00,000 payable by way of direct online credit in bank account or a demand draft payable at Mumbai, favouring Securities and Exchange Board of India.

The application shall be supported by a duly sworn affidavit, giving details of the proposed acquisition and the grounds on which the exemption has been sought.

Under this regulation SEBI has powers to grant exemption from the strict compliance of procedural requirement in Chapter III and IV in the interest of investors in securities and the securities market.

The option of seeking specific exemption is available only in cases where the target company is a company in respect of which the Central Government or State Government or any other regulatory authority has superseded the board of directors of the target company and has appointed new directors under any law.

SEBI has to be satisfied that

a. the Board of Directors of such target company have formulated a plan which provides for transparent, open, and competitive process for acquisition of shares or voting rights in, or control over the target company to secure the smooth and continued operation of the target company in the interests of all stakeholders of the target company and such plan does not further the interests of any particular acquirer

b. the conditions and requirements of the competitive process are reasonable and fair

c. the processed opted by the board of directors of the target company provides for details including the time when the open offer for acquiring shares would be made, completed and the manner in which the change in control would be effected.

SEBI after affording reasonable opportunity of being heard to the applicants and after considering all relevant facts and circumstances shall pass a reasoned order either granting or rejecting the exemption or relaxation sought as soon as possible. It is also provided that SEBI may constitute a panel of experts to which the application for exemption may be referred for their recommendations, if considered necessary.

The order passed by SEBI granting exemption is hosted by SEBI on its official website www.sebi.gov.in.

OBLIGATIONS

Obligations of the Directors of the Target Company

The obligations of the directors of the target company are covered by Regulation 24 of the SEBI Takeover Regulations. As per the said Regulation, no person representing the acquirer or the person acting in concert with him shall be appointed as a director on the Board of Directors of the target company, either as an additional director or in a casual vacancy during the offer period. However if the acquirer has deposited 100% of the consideration payable in the escrow account, persons representing the acquirer can be appointed on the Board of Directors of the target company after expiry of the initial 15 working days from the date of publication of the Detailed Public Statement. Where the acquirer has specified conditions, in the agreement for the acquisition of shares, which attracted the obligation to make an open offer, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.

Where the open offer is a conditional offer, subject to the a minimum level of acceptance by the acquirer in the open offer, the acquirer and persons acting in concert shall regardless of the amount of cash deposited in the escrow account not be entitled to appoint any director representing the acquirer or any person acting in concert with him on the board of directors of the target company during the offer period. In other words, even if 100% of the consideration payable is deposited in cash in the escrow account and if the offer is a conditional offer, the acquirer shall not be entitled to appoint any director on the Board of Directors of the Target Company.

In case of a competing offer, irrespective of the amount of cash deposited in the escrow account, there shall be no induction of any new director to the board of directors of the target company. In other words, if the first acquirer has deposited 100% in cash in the escrow account and there is a competing offer, within the expiry of fifteen working days of the publication of the Detailed Public Statement, the first acquirer shall not be entitled to appoint any of his representatives on the Board of Directors of the Target Company.

However, in the event of death or incapacitation of any director, the vacancy arising there from may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

In the event the acquirer or any person acting in concert is already represented by a director on the board of the target company, such director shall not participate in any deliberation of the board of directors of the target company or vote on any matter in relation to the open offer. This normally happens when the existing promoters who are also promoters, trigger the code and make an open offer or if the acquirer has already triggered the obligation to make an open offer in the past, but has however failed to make an open offer. In such cases the acquirer or his representative might be on the Board of the target company. In such a situation, such directors representing the acquirer and the persons acting in concert with him shall not participate in any of the discussions pertaining to the open offer and a statement to this effect is normally included in the Letter of Offer.

Obligations of the Acquirer

The obligations of the directors of the target company are covered by Regulation 25 of the SEBI Takeover Regulations. The acquirer shall before making the public announcement of an open offer for acquiring shares under the SEBI Takeover Regulations, make firm financial arrangements for fulfilling the payment obligations under the open offer. The acquirer shall also ensure that he is in a position to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

The acquirer, as per the standard format of the Letter of Offer is required to declare his intention not to alienate any of the material assets of the target company of any of its subsidiaries by way of a sale, lease, encumbrance, except in the ordinary course of business. In case the acquirer has not declared such an intention in the detailed public statement and in the Letter of Offer, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period. In other words, he shall not be entitled to alienate any of the material assets of the target company of any of its subsidiaries by way of a sale, lease, encumbrance, except in the ordinary course of business for a period of two years from the date of expiry of the offering period. However, if the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall *inter alia* contain reasons as to why such alienation is necessary. It is normal practice therefore for the acquirer to make a declaration in the Detailed public statement and the Letter of Offer of his intention not to alienate any of the assets of the target company or its subsidiaries except with the approval of the shareholders by way of a special resolution through the postal ballot process for a period of two years from the expiry of the offering period.

The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary. SEBI may proceed against the acquirer in case of misstatements in the Letter of Offer and levy appropriate penalties.

The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period. In other words, once a public announcement has been given, the shares held by the acquirers and persons acting in concert shall not be sold to anybody either through the market or off market during the offer period.

The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations.

Obligations of the Target Company

Regulation 26 of the Takeover Regulations covers the obligations of the target company which assume significance since non-compliance of the obligations attracts penal action from SEBI. This would also be relevant from the point of defense strategies that can be adopted in case a hostile takeover has been made on the target company.

Once a public announcement has been made, the Board of Directors of the target company shall ensure that the business of the target company is conducted in the ordinary course of business during the offer period. The business shall be conducted in a manner which shall be consistent with the past practice and there shall be no deviations from the same.

During the offer period, unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement for the same the ordinary course of business. If a hostile takeover has been made and the target company would like to thwart this bid by adopting a “crown jewel” strategy wherein the company sells of its crown jewel and other properties to diminish its worth, it may not be possible to adopt this strategy since the regulation casts an obligation of the Board of Directors not to dispose of or enter into

any agreement to sell, transfer, encumber or dispose of any of its material assets, including a crown jewel. It may be mentioned that as per the Companies Act, 2013, the Board cannot sell the whole or substantially the whole of its undertaking without the permission of the shareholders in a general meeting. Any defense if at all can be used before the public announcement is made.

The Target Company shall not enter into any material borrowing which is not in the ordinary course of business. In other words, if the target company would like to make its business unattractive, by availing or entering into major loans / borrowing agreements, when a hostile bid has been made, this defense will not be available in view of this obligation cast on the target company.

The Target Company shall not issue or allot any authorised but unissued securities entitling the holder to voting rights. A target company is therefore prohibited from allotting a fresh issue of shares during the offer period, to which would entitle the holder to voting rights. However in the hostile bid for Kalindee Rail Nirman Ltd., by Jupiter Metal, the Board of Directors, approved the preferential allotement of 24.9% stake to Texmaco, which was a white Knight to counter the hostile takeover by Jupiter Metal. Texmaco make a competitive bid and after a price war, managed to acquire control of Kalinee Rail Nirman after an open offer at Rs.71 per share.

The Target Company's subsidiaries may (i) issue or allot shares upon conversion of convertible securities issued prior to the public announcement of the open offer, in accordance with pre-determined terms of such conversion, (ii) issue or allot shares pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies prior to the public announcement of the open offer; or (iii)issue or allot shares pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement of the open offer. In other words, if a document has already been filed with the ROC or a record date has already been announced before the open offer is announced, the target company is permitted to go ahead with its fund raising activities.

The target company cannot implement any buy-back of shares or effect any other change to the capital structure of the target company. This would again make one of the defense strategies available called as "Targeted Share Repurchase or Buyback", where the company increases the holdings of the existing promoters by announcing a buy-back of shares, thereby making the company unattractive to the raider. However this defense in not available in India and to Indian promoters, since a company is prohibited from making a buy-back or bring about any change to its capital structure once a public announcement has been made.

The target company is not permitted to enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, which is not in the normal course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person.

The target company cannot accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise.

In any general meeting of a subsidiary of the target company for considering the matters laid down in Regulation 26(2) of the Takeover Regulations, the target company and its subsidiaries, if any shall vote in a manner consistent with the special resolution passed by the shareholders of the target company.

The target company shall be prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period. In other words no bonus, dividend or any other restructuring activity shall be carried out by the target

company from three working days prior to the commencement of the tendering period until the expiry of the tendering period.

The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any, for registration of transfer of shares are pending with the target company. The acquirer shall reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.

Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations. The Committee shall be entitled to seek external professional advice at the expense of the target company. The committee of independent directors shall provide its written reasoned recommendations on the open offer to the shareholders of the target company and such recommendations shall be published in such form as may be specified, at least two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to SEBI, the stock exchanges where the shares of the target company are listed and the stock exchanges shall forthwith disseminate such information to the public and to the Manager to the Offer and if there is a competing offer to the manager to the open offer of every competing offer.

The board of directors of the target company shall facilitate the acquirer in verification of shares tendered in acceptance of the open offer.

The board of directors of the target company shall make available to all acquirers making competing offers, any information and co-operation provided to any acquirer who has made a competing offer.

Upon fulfillment by the acquirer, of the conditions required under these regulations, the board of directors of the target company shall without any delay register the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

As per Regulation 31A of the Listing Regulations, it is now a requirement to ensure that the reclassification of the acquirer as the new promoter is done only after the approval of the shareholders by way of a special resolution. Further it shall also be ensured that the exiting promoters do not hold more than 10% of the share capital of the target company.

Obligations of the Merchant Banker to the Open Offer

As per Regulation 27 of the Takeover Regulations, the Manager to the open offer shall ensure that the acquirer is able to implement the open offer and firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer. It shall be ensured by the Manager that the acquirer does not use borrowed funds to meet his obligations under the open offer.

The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under the takeover regulations.

The Manager to the Open offer furnishes to SEBI a Due Diligence certificate along with the Draft Letter of

Offer filed with SEBI. The Manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board. The Manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with the Takeover Regulations. The Manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.

The Manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements. The Manager shall also ensure that a Post Offer Advertisement is given after completion of all formalities.

DISCLOSURES

Chapter V of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 stipulate the provisions related to disclosures, namely Disclosure-related provisions (Regulation 28); Disclosure of acquisition and disposal (Regulation 29) Continual Disclosures (Regulation 30) and Disclosure of encumbered shares (Regulation 31).

Disclosure-related provisions (Regulation 28)

28. (1) The disclosures under this Chapter shall be of the aggregated shareholding and voting rights of the acquirer or promoter of the target company or every person acting in concert with him.

(2) For the purposes of this Chapter, the acquisition and holding of any convertible security shall also be regarded as shares, and disclosures of such acquisitions and holdings shall be made accordingly.

(3) For the purposes of this Chapter, the term “encumbrance” shall include a pledge, lien or any such transaction, by whatever name called.

(4) Upon receipt of the disclosures required under this Chapter, the stock exchange shall forthwith disseminate the information so received.

Disclosure of acquisition and disposal (Regulation 29)

29 (1) Any acquirer who acquires shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, aggregating to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in such form as may be specified.

(2) Any acquirer, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose every acquisition or disposal of shares of such target company representing two per cent or more of the shares or voting rights in such target company in such form as may be specified.

(3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company to,—

(a) every stock exchange where the shares of the target company are listed; and

(b) the target company at its registered office.

(4) For the purposes of this regulation, shares taken by way of encumbrance shall be treated as an acquisition, shares given upon release of encumbrance shall be treated as a disposal, and disclosures shall be made by such person accordingly in such form as may be specified:

Provided that such requirement shall not apply to a scheduled commercial bank or public financial institution as pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.

Continual disclosures (Regulation 30)

30 (1) Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

(2) The promoter of every target company shall together with persons acting in concert with him, disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

(3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the end of each financial year to,—

(a) every stock exchange where the shares of the target company are listed; and

(b) the target company at its registered office.

Disclosure of encumbered shares (Regulation 31)

31 (1) The promoter of every target company shall disclose details of shares in such target company encumbered by him or by persons acting in concert with him in such form as may be specified.

(2) The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares in such form as may be specified.

(3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to,—

(a) every stock exchange where the shares of the target company are listed; and

(b) the target company at its registered office.

TAKEOVER BIDS

"Takeover bid" is an offer to the shareholders of a company, who are not the promoters of the company or the sellers of the shares under an agreement, to buy their shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquiring sufficient number of shares to give the Offer or Company, voting control of the target company.

A takeover bid is a technique, which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

Type of takeover bids

A takeover bid may be a "friendly takeover bid" or a "hostile takeover bid". Bids may be mandatory/competitive bids.

Mandatory Bid

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, require acquirers to make bids for acquisition of certain level of holdings subject to certain conditions. A takeover bid is required to be made by way of a public announcement issued to the stock exchanges, followed by a Detailed Public Statement in the newspapers. Such requirements arise in the following cases:

(a) for acquisition of 25% 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 beginning April 01, if such person already holds not less than 25% but not more than 75% or 90% of the shares or voting rights in a company as the case may be;

(c) for acquiring control over a company.

DEFENSE STRATEGIES TO TAKEOVER BIDS

A hostile bid made directly to the shareholders of the target company with or without previous overtures to the management of the company has become a means of creating corporate combinations. Hence, there has been considerable interest in developing defense strategies by actual and potential targets. Defenses can take the form of fortifying oneself, i.e., making the company less attractive to takeover bids or more difficult to takeover and thus discourage any offers being made. Defensive actions are also resorted to in the event of perceived threat to the company ranging from early intelligence that an acquirer is accumulating shares.

I FINANCIAL DEFENSE MEASURES

1. Adjustments in Asset and Ownership Structure

Firstly, consideration has to be given to developing defense structures that create barriers specific to the bidder. These include purchase of assets that may cause legal problems, purchase of controlling shares of the bidder itself, and sale to their party of assets which made the target attractive to the bidder and issuance of new securities with special provisions conflicting with the aspects of the takeover attempt.

It must however be borne in mind that as per the Regulation 26(2) of the SEBI (SAST) Regulations, 2011, the target company cannot alienate its assets, make any material borrowings, issue any new shares with voting rights or terminate any material contract during the offering period (which commences once the public announcement is made) except with the approval of shareholders by way of a special resolution passed by Postal Ballot. Hence it would be almost impossible to bring about adjustments in Assets and Ownership structure in India.

(i) A second common method is to create a consolidated vote block allied with target management. Thus securities are issued through private placements to parties friendly or in business alliance with management or to the management itself. Moreover another method can be to repurchase publicly held shares to increase an already sizeable management block in place.

It must however be borne in mind that as per the Regulation 26(2) of the SEBI (SAST) Regulations, 2011, the target company cannot, issue any new shares with voting rights or terminate any material contract during the offering period (which commences once the public announcement is made) and can also not make a buy-back of shares from the public shareholders except with the approval of shareholders by way of a special resolution passed by Postal Ballot. Hence it would be almost impossible to bring about adjustments in Assets and Ownership structure in India. However in anticipation of a perceived threat of takeover, the management can issue shares or convertible

securities beforehand so that they can be converted once the public announcement for an open offer is made.

(ii) A third common theme has been the dilution of the bidders vote percentage through issuance of new equity shares. However, this option will not work in India due to the strict procedures laid down in Regulation 26(2) of the SEBI (SAST) Regulations, 2011.

(iii) The "Crown Jewel" Strategy

The central theme is this strategy is to divest the most coveted asset by the bidder, commonly known as the "crown jewel". Consequently the hostile bidder is deprived of the primary intention behind the takeover bid. A variation of the crown jewel strategy is the more radical "scorched earth approach", vide which approach, the target sells off not only the crown jewel, but also properties to diminish its worth. Such a radical step may however be self-destructive and unwise in the company's interest.

However as per the Companies Act, 2013, selling of whole or substantially the whole of its undertaking requires the approval of the shareholders in a general meeting by way of a special resolution and Regulation 26(2) of the SEBI (SAST) Regulations, 2011, the target company cannot alienate any of its material assets during the offering period (which commences once the public announcement is made) and can also not make a buy-back of shares from the public shareholders except with the approval of shareholders by way of a special resolution passed by Postal Ballot. Hence it would be almost impossible to use the "Crown Jewel" Strategy as a defense mechanism in India.

(iv) The Packman Defence

This strategy although unusual attempts to purchase the shares of the raider company. This is usually the scenario if the raider company is smaller than the target company and the target company has a substantial cash flow or liquidable asset.

Regulation 26(2) of the SEBI (SAST) Regulations, 2011, however prohibits the target company to enter into any agreement which is not in the ordinary course of business during the offering period (which commences once the public announcement is made) except with the approval of shareholders by way of a special resolution passed by Postal Ballot. Hence it would be almost impossible to use the "Packman Defense" Strategy as a defense mechanism in India.

(v) Targeted Share Repurchase or "Buy-back"

This strategy is one in which the management of the target company uses up a part of the assets fo the company on the one hand to increase its holding and on their hand it disposes of some of the assets that make the target company unattractive to the raider. The strategy therefore involves a creative use of buyback of shares to reinforce its control and detract a prospective raider. But "Buyback" would involve the use of the free reserves of the company and would be an expensive proposition for the target company. Further as per Regulation 26(2) of the SEBI (SAST) Regulations, 2011, the target company cannot implement a buy-back during the offer period except with the approval of shareholders by way of a special resolution passed by Postal Ballot. Hence it would be almost impossible to use this defense mechanism also in India.

(vi) Golden Parachutes

These are separation clauses of an employment contract that compensate managers who lose their jobs under a change of management scenario. The provision usually calls for a lump-sum payment or payment over a specified period at full and partial rates of normal compensation. Target

Companies invoke this provision and pay off a huge compensation to large number of employees so as to make themselves unattractive to the raider. However section 192 and Section 202 of the Companies Act, 2013 provide for compensation to be paid for loss of office only to a Managing Director, Whole Time Director or a Manager and not the entire senior management, as is the practice in the United States of America. Hence this defense mechanism is of no consequence in India.

II. ANTI TAKEOVER AMENDMENTS OR "SHARK REPELLANTS"

An increasingly used defense mechanism being used is anti-takeover amendments to the company's constitution or articles of association, popularly called as "shark repellants". This practice consists of changing the articles of associations, regulations, bye-laws, etc. to be less attractive to the raider / hostile bidder. This again may not work out in India as any change to the Articles of Association or the Memorandum of Association would require approval of the shareholders.

i. Supermajority Amendments

These amendments require shareholder approval by at least 2/3rds vote and sometimes as much as 90% of the voting power of outstanding capital for all transactions involving change of control. In most existing cases, however the super majority agreements have a board out clause which provides the board with the power to determine when and if the super majority provisions will be in effect. Pure or inflexible super majority provisions would seriously limit the management's scope of options and flexibility in takeover negotiations.

ii. Classified Boards

Another type of anti-takeover amendments provides for a staggered or classified board of directors to delay effective transfer and control in a takeover. The much touted management rationale in proposing a classified board is to ensure continuity of policy and experience in the USA. The legal position of such classified or staggered boards is quite flexible. An example is when a 9 member board may be divided into 3 categories, with only 3 members standing for election to a three year term each, such being the modalities of the retirement by rotation. Thus a new majority shareholder would have to wait for at least 2 AGMs to gain control of the Board of Directors. Section 152 of the Companies Act, 2013 warrants that 1/3rd of the directors whose office is determinable by retirement will retire. Therefore continuing the example of 9 directors, 3 can be made permanent directors by amending the Articles and therefore the acquirer would have to wait for at least 3 AGMs to gain control over the Board. However the company may by an ordinary resolution remove a director before the expiration of his period of officer. Thus any provision in the Articles of the Company or any agreement between the company and a director by which the director is rendered irremovable from office by an ordinary resolution would be void and contrary to the Act.

iii. Authorisation of Preferred Stock

The Board is authorised to create a new class of securities with special voting rights. This security, typically preferred stock may be issued to a friendly party in a control context. This is referred to as issuance of Shares with Differential Voting Rights, which is subject to restrictions under the Companies Act, 2013 and SEBI (ICDR) Regulations, 2009 and hence has been rendered unattractive over a period of time.

iv. Poison Pill Defenses

This is a controversial but popular defense mechanism. These pills provide their holders with special rights exercisable only after a period of time following the occurrence of a triggering event. These rights take several forms but all are difficult and costly to acquire control of the issuer or the target company. Poison pills

are generally adopted by the Board of Directors without shareholder approval. Usually the rights provided by the poison pill can be altered quickly by the Board or redeemed by the Company any time after they become exercisable following the occurrence of the triggering event. These provisions force the acquirer to negotiate directly with the target company's board and allow some takeover bids to go through. Many proponents of this mechanism argue that this enhances the ability of the Board of Directors to bargain for a fair price.

CROSS BORDER TAKEOVERS

Cross Border Takeover is a much sort after term in recent years. Competitiveness among the domestic firms forces many businesses to go global. There are various factors which motivate firms to go for global takeovers. Apart from personal glory, global takeovers are often driven by market consolidation, expansion or corporate diversification motives. Also, financial, accounting and tax related matters inspire such takeovers.

Expansion and diversification are one of the primary reasons to cross the border as the domestic markets usually do not provide the desired growth opportunities. Another main reason for cross border takeovers is to attain monopoly. Acquirer company is always on the lookout for companies which are financially vulnerable but have untapped resources or intellectual capital that can be exploited by the purchaser.

Global takeovers are complex processes. Despite some harmonized rules, taxation issues are mainly dealt within national rules, and are not always fully clear or exhaustive to ascertain the tax impact of a cross-border merger or acquisition. This uncertainty on tax arrangements sometimes require seeking of special agreements or arrangements from the tax authorities on an ad hoc basis, whereas in the case of a domestic deal the process is much more deterministic.

Gross-border takeover bids are complex transactions that may involve the handling of a significant number of legal entities, listed or not, and which are often governed by local rules (company law, market regulations, self-regulations, etc.). Not only a foreign bidder might be hindered by a potential lack of information, but also some legal complexities might appear in the merger process resulting in a deadlock, even though the bid would be 'friendly'. This legal uncertainty may result in a significant execution risk and act as a major hurdle to cross-border consolidation.

Going global is rapidly becoming Indian company's mantra of choice. Indian companies are now looking forward to drive costs lower, innovate speedily, and increase their international presence. Companies are discovering that a global presence can help insulate them from the vagaries of domestic market and is one of the best ways to spread the risks. Indian corporate sector has witnessed several strategic acquisitions. Tata Motors acquisition of Daewoo Commercial Vehicle Company, Tata Steel's acquisition of Singapore's NatSteel, Reliance's acquisition of Flag is the culmination of Indian Company's efforts to establish a presence outside India.

It is expected that the cross borders takeovers will increase in the near future. The companies will have to keep in mind that global takeovers are not only business proposals but also a corporate bonding for which both the entities have to sit and arrive at a meaningful and deep understanding of all the issues as mentioned above.

LESSON ROUND UP

- Takeover is a corporate device whereby one company acquires control over another company, usually by purchasing all or a majority of its shares.
- Takeovers may be classified as friendly takeover, hostile takeover and bailout takeover.
- Consideration for takeover could be in the form of cash or in the form of shares.
- The Takeover Regulations, 2011 became effective from October 22, 2011.
- The Regulations, provide certain events, on the happening of which the Acquirer is required to make a public announcement for acquiring the shares from the public shareholders of the company
- The Regulations provide for voluntary offer, competing offer and conditional offer.
- Regulation 10 and 11 provide for automatic exemptions and specific exemptions.
- The regulations provide a detailed procedure once the public announcement is made
- There are certain conditions when the open offer made can be withdrawn
- The Regulations also provide for obligations on the part of the target company, acquirers, board of directors of the target company and the merchant banker
- The Regulations also provide the situations in which the disclosures are to be made.
- Takeover bids may be mandatory, partial or competitive bids.
- Defense strategies to takeover bids are adopted by companies to counter takeover attempts.
- Competitiveness among the domestic firms forces many businesses to go global. There are various factors which motivate firms to go for Cross Border Takeovers.

GLOSSARY OF TECHNICAL WORDS

Acquirer means any person who, whether by himself, or through, or with persons acting in concert with him, directly or indirectly, acquires or agrees to acquire shares or voting rights in, or control over a target company. An acquirer can be a natural person, a corporate entity or any other legal entity.

Persons acting in Concert (PACs) are individual(s)/company (ies) or any other legal entity (ies) who, with a common objective or purpose of acquisition of shares or voting rights in, or exercise of control over the target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

Open Offer is an offer made by the acquirer to the shareholders of the target company inviting them to tender their shares in the target company at a particular price.

Voluntary Open Offer under Regulation 6, is an offer made by a person who himself or through Persons acting in concert ,if any, holds 25% or more shares or voting rights in the target company but less than the maximum permissible non-public shareholding limit.

Competitive Offer is an offer made by a person, other than the acquirer who has made the first public announcement. A competitive offer shall be made within 15 working days of the date of the Detailed Public Statement (DPS) made by the acquirer who has made the first PA.

Conditional Offer is an offer in which the acquirer has stipulated a minimum level of acceptance.

Offer Price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8.

Offer Period pertains to the period starting from the date of the event triggering open offer till completion of

payment of consideration to shareholders by the acquirer or withdrawal of the offer by the acquirer as the case may be.

Tendering Period refers to the 10 working days period falling within the offer period, during which the eligible shareholders who wish to accept the open offer can tender their shares in the open offer.

LIST OF FURTHER READINGS

1. SEBI (SAST) Regulation 2011 Law and Practice by Abha Jaiswal, Bharat's Publication
2. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011
3. The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulations, 2015
4. The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. What do you mean by the term 'Takeover'? What are the objectives which takeover seeks to achieve?
2. "SEBI has formulated a comprehensive code for takeover of listed companies". Do you agree?
3. Who are the persons considered to be 'persons acting in concert' under the SEBI (SAST) Regulations, 2011?
4. How does an acquirer make a delisting cum open offer?
5. List the procedure to be followed once the public announcement is made.
6. What are the automatic exemptions available under Regulation 3?
7. What are the general obligations of 'Acquirer' and 'Merchant Banker' under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?
8. Briefly explain the provisions with regard to disclosures of shares under the SEBI (SAST) Regulations, 2011.
9. Explain the meaning of different types of takeover bids

Lesson 3
Planning and Strategy

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Planning for mergers and acquisitions
- Process of Funding
- Funding through various types of Financial Instruments
- Funding Through Equity Shares
- Preferential Allotment
- Funding through Preference Shares
- Funding through Options or Securities with Differential rights
- Funding through Swaps or Stock to Stock Mergers
- Funding through External Commercial Borrowings (ECBs)/ Depository Receipts (DRs)
- Funding through Financial Institutions and Banks
- Funding through Rehabilitation Finance
- Funding through Leveraged Buyouts
- Minority and 'Minority Interest' under the Companies Act, 2013
- Rights of Minority Shareholders during Mergers / Amalgamations/ Takeovers
- Legal Provisions of the Companies Act, 2013
- Protection of Minority Interest
- Case Laws/ Judicial pronouncements
- Family holdings and their management

LEARNING OBJECTIVES

The Indian merger and acquisition (M&A) landscape has witnessed several big deals in the past few years. M&As have become an integral part of the Indian economy and daily headlines. Based on macroeconomic indicators, India is on a growth trajectory with the M&A trend likely to continue.

The merger / takeover of an entity involves the amount to be payable to the stakeholders of the amalgamating company. There are various sources of funding, which have been discussed in detail in this chapter.

It is a general rule that the majority of the shareholders prevails. However, there are few exceptions provided under the Companies Act, 2013 to address the rights and protection of the minority interests, which have also been dealt with in this chapter.

This lesson will help understand the planning and strategy and the funding process for mergers and acquisitions.

PLANNING AND STRATEGY FOR MERGER AND ACQUISITIONS

Strategies play an integral role when it comes to merger and acquisition. A sound strategic decision and procedure is very important to ensure success and fulfilling of expected desires. Every company has different cultures and follows different strategies to define their merger. There are various strategic reasons for companies to consider making an acquisition and a successful takeover can help companies achieve their strategic objectives as well as increase cost effectiveness within the business.

The process of merging with another company or acquiring a company is complex. In addition to the legal ramifications, companies must be aware of the potential tax implications as well as ensuring the terms of the deal benefit both parties. Often companies rely on lawyers and professionals to negotiate on their behalf in order to obtain the best possible deal.

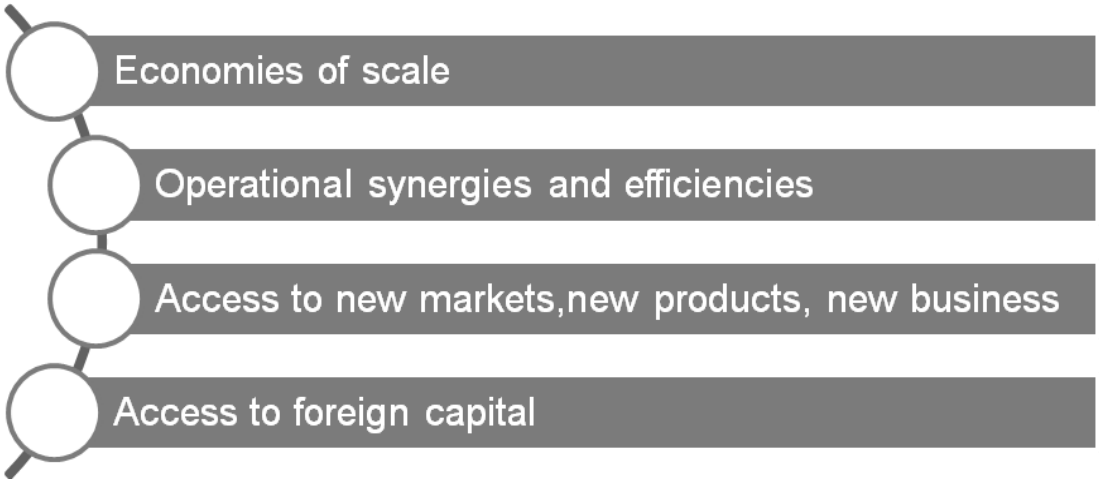
Although many companies consider mergers and acquisitions as opportunities for growth, they can provide a viable business solution for companies attempting to downsize or companies which are looking for an effective exit strategy. By divesting company assets, the company can reduce costs and streamline its operation leading to an increase in profitability. If companies have an underperforming subsidiary, they can rely on mergers and acquisitions to dispose of the asset effectively and in accordance with their overall business strategy.

Strategic assessments of companies, industry expertise, due diligence, merger integration, and operational improvements represent areas where knowledge and skills are required for the success of a merger or acquisition.

The Indian business environment is undergoing massive change with almost all relevant corporate laws/regulations in India have been revamped in the last few years, be it the Takeover Code, delisting guidelines, Companies Act, Accounting, Competition Law, Tax laws,Foreign Exchange Management Act (FEMA) regulations, impacting both inbound and outbound investments.

With the opening up of the economy and the government's thrust on various initiatives, such as Make in India and Digital India, inbound M&A activity is only going to be on the rise. Further global outlook towards India has become positive than ever before with an improved ranking in World Bank's Doing Business 2016 ranking and in the World Economic Forum's Global Competitiveness Index.

Whatever may be the reason for any M&A, the benefits are:



Mergers and Acquisitions – Primary Factors to be considered

Merger or amalgamation is undertaken for acquiring cash resources, eliminating competition, saving on taxes or influencing the economies of large-scale operations. Therefore, there are host of factors, which requires consideration before initiating a merger or amalgamation exercise. A detailed list of the primary factors requiring consideration before initiating a merger or amalgamation from the economic, commercial and legal perspective is explained as follows:

(i) Identification of Parties

Will one or more businesses be transferred to an existing firm or a newly formed entity? Consider drafting heads of terms, do you require a confidentiality agreement? Do you require an exclusivity agreement? Review financial liability of the parties - undertake appropriate searches.

(ii) Due Diligence

Carry out legal, commercial, tax and financial due diligence on the parties entering into the transaction. This will help in identifying risk areas along with any necessary consent you will need to obtain.

(iii) Any third-party consents required?

Ascertain if any third-party consents would be required such as from banks, business contracts, partner / shareholder consents. These should emerge from due diligence. Consider also regulatory consents / licences that may be required.

(iv) Taxation

It will be necessary to ascertain the most suitable tax structure for the transaction and, in particular, the way in which the consideration should be structured, at an early stage, therefore consider consulting tax advisors.

(v) Risk

Sharing of risk – What kind of indemnities / warranties be considered? Should there be a cap on such indemnities and warranties?

(vi) Will the transaction impact on existing loan/finance arrangements?

Check loan documents and constitution documents to see whether any proposed borrowing would be a breach of any existing funding. What will happen in relation to third party funding of the Seller business? Confirm that there are no restrictions on the disposal of the target business or any of its assets. How will the merged business be funded?

(vii) Existing Charges / Modifications over the assets to be acquired

Are there any mortgages, charges or debentures over any of the business assets? If yes, obtain copies and consider how they are to be discharged. If there are floating charges, obtain certificates of non-crystallisation / release. Obtain a Search Report from a Practicing Company Secretary.

(viii) Guarantees and indemnities (bank or other)

Has the Seller given or received any guarantees or indemnities in relation to the business? If yes, then obtain copies (including details of arrangements) and consider in particular, how to ensure the business continues to have the benefit of relevant guarantees.

(ix) Licences

Will the Buyer have all other licences which it needs to operate the business?

(x) Supply contracts

Will supply contracts be transferred or need to be terminated? How will this be done?

(xi) What IP is used in the business?

Obtain a full list of trademarks, service marks, patents, designs, domain names, copyright and other registered and unregistered intellectual property used in the business. Carry out trade mark and patent searches as may be appropriate through an IPR Attorneys.

Process of Funding

The process of funding in the case of mergers and takeovers may be arranged by a company in a number of ways. It may be from its own funds, consisting of further issue of equity and preference share capital, through raising of borrowed funds by way of issuing various financial instruments. A company may borrow funds through the issue of debentures, bonds, external commercial borrowings, issue of securities, loans from Central or State financial institutions, banks, etc. Broadly we can divide them into three categories as described below:

Internal accruals: The retained earnings accumulated over a period of time by well-managed companies may be utilized for the purpose of restructuring.

Borrowings: The required funds could be raised from banks and financial institutions or through external commercial borrowings or by issue of debentures.

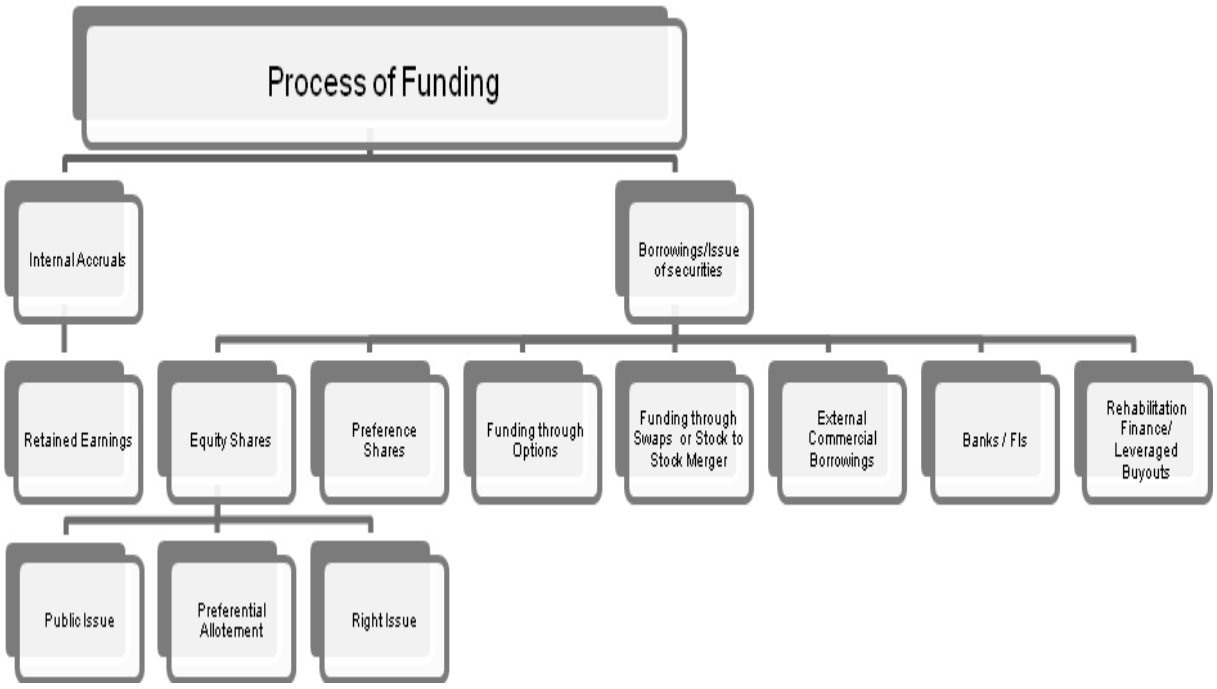
Issue of securities: Funds may also be raised through issue of equity shares, preference shares and other securities, depending upon the quantum and urgency.

Funding through various types of Financial Instruments

Funding may be made through various types of financial instruments. Funding may be done through any of the following modes:

- Funding through Equity Shares
- Preferential Allotment of Shares
- Funding through Preferential Shares
- Funding through Options or Securities with Differential Rights
- Funding though Swaps or Stock to Stock Mergers
- Funding through External Commercial Borrowings (ECBs) and Depository Receipts (DRs)
- Funding through Financial Institutions and Banks
- Funding through Rehabilitation Finance
- Funding through Leveraged Buyouts

The funding through the various types of financial instruments is discussed in detail hereunder:



Funding through Equity Shares

Equity share capital- It can be considered as permanent capital of the company. Equity needs no servicing as the company is not required to pay to its equity shareholders the fixed amount return in form of interest which would be the case if a company were to borrow by issue of bonds or other debt instruments.

Raising money from the public by issue of shares or bonds or debentures is time consuming and involves huge costs. It would require numerous things to be in place and several rounds of discussion would be required to take place between the directors and key promoters having the controlling stake, between the Board of Directors (BOD) and consultants, analysts, experts, Company Secretaries, Chartered Accountants & lawyers. Furthermore, it requires several legal compliances.

Thus planning acquisition by raising funds through public issue may be complicated and long drawn process.

Issue of securities for listed companies

The Securities and Exchange Board of India (the "SEBI") is the nodal authority regulating entities that are listed and to be listed on stock exchanges in India. SEBI through SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 regulates the issue of securities of such companies.

These regulations apply to:

(a) a public issue;

(b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;

(c) a preferential issue;

(d) an issue of bonus shares by a listed issuer;

(e) a qualified institutional placement by a listed issuer;

(f) an issue of Indian Depository Receipts

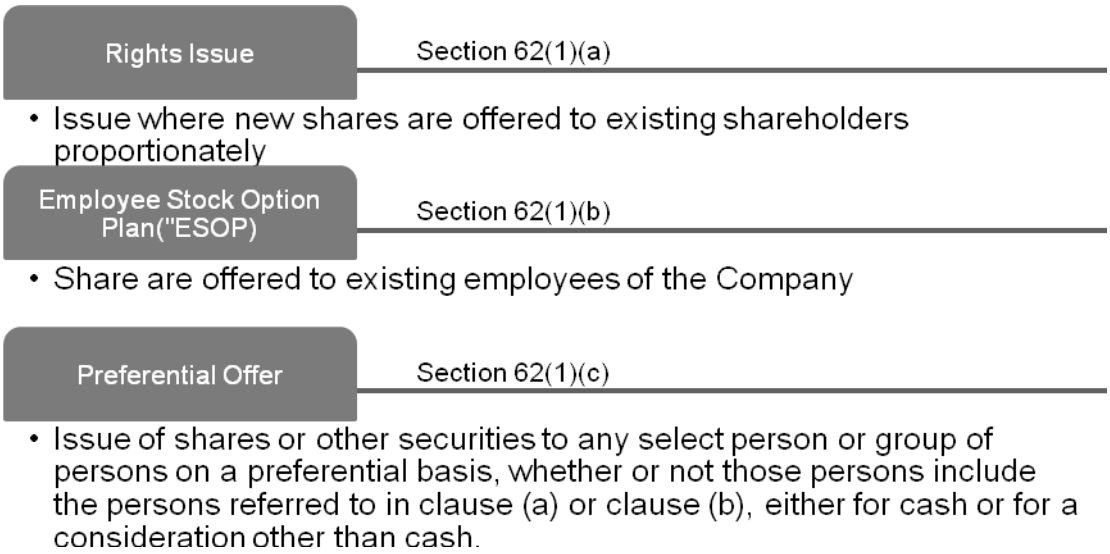
Some of the common requirements of IPO and rights issue have been listed below:

Sl. No.	**Particulars**	**Description**
1.	Filing of draft offer documents	Filing of draft offer document is mandatory with SEBI in case of a public issue and a rights issue(if the aggregate value of the specified securities offered is fifty lakh rupees or more)
2.	General conditions	The issuer shall not make a public issue or rights issue of specified securities if: a) the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board c) unless it has made an application to one or more recognised stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange d) unless it has entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued e) unless all existing partly paid-up equity shares of the issuer have either been fully paid-up or forfeited f) unless firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals, have been made
3.	Appointment of Merchant Banker and other intermediaries	The issuer shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker The issuer shall appoint a registrar which has connectivity with all the depositories
4.	Security Deposit	The issuer shall deposit, before the opening of subscription list, and keep deposited with the stock exchange(s), an amount calculated at the rate of one per cent. of the amount of securities offered for subscription to the public.

Sl. No.	Particulars	Description
5.	Minimum subscription	The minimum subscription to be received in an issue shall not be less than ninety per cent. of the offer through offer document
6.	Allotment	The issuer and merchant bankers shall ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue
7.	Appointment of Compliance Officer	The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances

Preferential Allotment

Before preferential allotment, let us first look at the various options of raising further capital for companies under Companies Act, 2013. Section 62 of the Act has listed some of the possible options, as explained below:



Preferential allotment, in simple words, is an offer for allotment to a select group of identified persons, and does not include public issue, rights issue, ESOP, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities. The provisions of preferential allotment are laid under section 62(1)(c) read with Rule 13 of Chapter IV- The Companies (Share Capital and Debentures) Rules, 2014. This further leads us to follow provisions of Section 42 read with Rule 14 of the Chapter III-Companies (Prospectus and Allotment of Securities) Rules, 2014, which deals with private placement. Hence, for any preferential offer, we need to compulsorily follow the provisions of private placement.

Further, listed companies have to comply with the provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 for the preferential allotment. Listed companies may also raise funds by way of qualified institutional placement. Qualified institutional placement is the special type of the preferential allotment made only to the qualified institutional buyers (QIB).

Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 is also applicable for preferential allotment in case of listed companies. Listed companies in addition to Companies Act, 2013 also need to follow these regulations. Some of its important features have been mentioned below:

Sl.No.	Particulars	Description
1.	Definition of preferential issue	It means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis. It does not include an offer of specified securities made through a public issue, rights issue, bonus issue, employee stock option scheme, employee stock purchase scheme or qualified institutions placement or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities.
2.	Preliminary conditions	A listed company can make preferential issue only if following conditions are satisfied: (a) a special resolution has been passed by its shareholders; (b) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form; (c) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed; (d) the issuer has obtained the Permanent Account Number of the proposed allottees.
3.	Restriction	The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date.
4.	Allotment	Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution.

Funding through Preference Shares

One more source of funding a merger or the takeover may be through the issue of preference shares, but unlike equity capital, issue of the preference share capital as purchase consideration to the shareholder of merging company mostly includes the payment of fixed preference dividend at a fixed rate.

Thus, before deciding to raise funds for this purpose, by an issue of preference shares, the Board of the company has to ensure that the merged company or Target Company would be able to yield sufficient profits for covering additional liability in respect of the payment of preference dividend. A company that is funding its merger or takeover proposal through an issue of preference shares is required to pay a dividend to such shareholders as per agreed terms.

Issue and redemption of preference shares:

Section 55 of the Act read with Rule 9 and Rule 10 of the Companies (Share Capital and Debentures) Rules, 2014 deals with the procedure involved in issue and redemption of preference shares. SEBI regulations shall be followed, in case a company intends to list its preference shares on a recognized stock exchange.

Some of the features pertaining to issue and redemption of preference shares have been listed in the following table:

Sl. No.	Particulars	Description
1.	Issue of irredeemable preference shares	Not permitted, after the commencement of Companies Act, 2013.
2.	Maximum period of redemption	Preference shares shall be redeemed within a period not exceeding twenty years from the date of their issue. However, a company may issue preference shares for a period exceeding twenty years but not exceeding thirty years, for infrastructure projects, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders. The term "infrastructure projects" means the infrastructure projects specified in Schedule VI. [For Schedule VI, refer to Annexure-I, at the end of this chapter]
3.	Authority to issue	Yes, authorization is required in Articles of Association of Company. Further it also requires the approval of shareholders in general meeting through special resolution.
4.	Particulars of resolution	(a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares; (b) the participation in surplus fund; (c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid; (d) the payment of dividend on cumulative or non-cumulative basis. (e) the conversion of preference shares into equity shares. (f) the voting rights; (g) the redemption of preference shares.
5.	Explanatory statement	The explanatory statement shall provide complete material facts concerned with the issue of such shares, including- (a) the size of the issue and number of preference shares to be issued and nominal value of each share; (b) the nature of such shares i.e. cumulative or non - cumulative, participating or non-participating, convertible or non - convertible (c) the objectives of the issue; (d) the manner of issue of shares; (e) the price at which such shares are proposed to be issued;

Sl. No.	Particulars	Description
		(f) the basis on which the price has been arrived at; (g) the terms of issue, including terms and rate of dividend on each share, etc.; (h) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion; (i) the manner and modes of redemption; (j) the current shareholding pattern of the company; (k) the expected dilution in equity share capital upon conversion of preference shares.
6.	Preconditions for issue	Shall not have any subsisting default in the redemption of preference shares issued either before or after the commencement of the Act or in payment of dividend due on any preference shares.
7.	Preconditions for redemption	Such shares shall be fully paid, before redemption.
8.	Manner of redemption	Redemption shall be done out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption. A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. Preference shares may be redeemed: (a) at a fixed time or on the happening of a particular event; (b) any time at the company's option; or (c) any time at the shareholder's option.
9.	Inability to redeem or pay dividend	A company if is not in a position to redeem any preference shares or to pay dividend, if any, it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon.
10.	Transfer to Capital Redemption Reserve Account	A sum equal to the nominal amount of the shares to be redeemed shall be transferred to CRR account from profits, if such shares are proposed to be redeemed out of the profits of the company.
11.	Impact on share capital	Issue of further redeemable preference shares or the redemption

Sl. No.	Particulars	Description
		of preference shares shall not be deemed to be an increase or a reduction, in the share capital of the company.
12.	Register of Members	Register of Members maintained under section 88 shall contain the particulars in respect of such preference shareholder(s).

Funding through Options or Securities with Differential Rights

Companies can also restructure their capital through derivatives and options as the means of raising funds. Indian companies are allowed to issue derivatives or options plus the shares and quasi-equity instruments with differential rights as to dividend and/or voting. Companies may also issue non-voting shares or the shares with differential voting rights to shareholders of Transferor Company. Such issue gives companies an additional source of fund without interest cost and without the obligation to repay, as these are other forms of the equity capital.

The promoters of the companies may be interested in such form of consideration as it does not impose any kind of obligation and there is no loss of control in case of non-voting shares.

Option is a derivative contract: An option gives the holder the right but not the obligation to buy or sell something in the future.

There are two types of Options:

(1) Put option- is one which gives holder the right to sell particular number of shares (or any other commodity) at a given price and typically one buys put options, if the price of the stock is expected to decline.

(2) Call option- gives the holder the right to buy the shares at a predetermined period of time and at a predetermined price. Typically, one buys call options if the price of the underlying stock is expected to rise.

Definition given by the Securities Contracts (Regulation) Act, 1956 (SCRA):

With Securities Laws (Second Amendment) Act, 1999, the term, “derivative” has been included in the definition of securities. The term derivative has been defined under section 2(ac) in Securities Contracts (Regulation) Act, 1956 as follows:

(a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

(b) a contract which derives its value from the prices, or index of prices, of underlying securities.

(c) commodity derivatives; and

(d) such other instruments as may be declared by the Central Government to be derivatives;

Further in terms of section 2(d) of the Securities Contracts (Regulation) Act, 1956 “option in securities” means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a *teji*, a *mandi*, a *teji mandi*, a *galli*, a put, a call or a put and call in securities.

Section 20 of the SCRA which had dealt with prohibition of options in securities had been omitted by the Securities Laws (Amendment) Act, 1995. It means that the options in securities were permitted after the omission of the [1]Section 20 of SCRA.

Securities with differential rights:

Section 48 of the Act deals with the variation of shareholders' rights. This section deals with the procedure involved, when a company intends to vary rights attached with any class of shareholders. The features have been explained below:

(1) Approval of class of shareholders - The rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class —

(a) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.

(2) Impact on rights of other class - The section provides that if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

(3) Cancellation of variation - Variation may be cancelled if, holders of not less than ten per cent of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation. They may apply to the Tribunal to cancel the variation, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal. An application shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be. The application may be made by one or more on behalf of the shareholders entitled to make the application, who may be appointed in writing for this purpose. The decision of the Tribunal on any such application shall be binding on the shareholders. The company shall, within thirty days of the date of the order of the Tribunal, file a copy thereof with the Registrar.

(4) Non-compliance - Where any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

Equity shares with differential rights:

Companies may issue equity shares with differential rights as to dividend, voting or otherwise in compliance with Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014

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1 Prior to omission, section 20 read as under :

"20. Prohibition. of options in securities.—(1) Notwithstanding anything contained in this Act or in any other law for the time being in force, all options in securities entered into after the commencement of this Act shall be illegal.

(2) Any option in securities which has been entered into before such commencement and which remains to be performed, whether wholly or in part, after such commencement shall, to that extent, become void."

Some of its important features are listed below:

Sl.No.	Particulars	Description
1.	Authority to issue	The articles of association of the company authorizes the issue of shares with differential rights;
2.	Approval of shareholders	The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders: Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;
3.	Impact on post-issue capital	The shares with differential rights shall not exceed twenty-six per cent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time
4.	Track record	The company having consistent track record of distributable profits for the last three years
5.	No default in statutory filings	The company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares
6.	No default in payment of statutory dues	The company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend
7.	No default in repayment of borrowings	The company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government
8.	No penalisation	The company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators
9.	No conversion	The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*
10.	Disclosure in Board report	The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential

Sl.No.	Particulars	Description
		rights with which such shares have been issued
11.	Register of Members	Register of Members shall contain all the relevant particulars of such shares along with details of the shareholders

Funding through Swaps or Stock to Stock Mergers

Funding through stock swaps is a very common method. Under this method of funding, the holders of the target company's stock receive shares of the acquiring company's stock in lieu of the merger.

The share exchange ratio is mutually determined by the Board of Directors of both the companies on the basis of the valuation report prepared by the professionals.

Stock swap mergers might involve risk. Along with the normal risks, stock swap mergers consist of the risks associated with the fluctuations in the stock prices of two companies. The terms of deal involve an exchange of shares and are predicted on prices of the two companies' stock at the time of the announcement, drastic changes in shares prices of one or both of companies can cause an entire deal to be re-evaluated.

Funding through External Commercial Borrowings (ECBs)[2] and Depository Receipts

ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis. The framework for raising loans through ECB comprises the following three tracks:

- Track I: Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.
- Track II: Long term foreign currency denominated ECB with minimum average maturity of 10 years.
- Track III: Indian Rupee (INR) denominated ECB with minimum average maturity of 3/5 years.

Various types of ECB: ECBs can be raised as:

1. Loans, eg., bank loans, loans from equity holder, etc.
2. Capital market instruments, e.g.
   (a) Securitized instruments (e.g. floating rate notes / fixed rate bonds / non-convertible, optionally convertible or partially convertible preference shares/debentures
   (b) FCCB[3]
   (c) FCEB[3]
3. Buyers' credit / suppliers' credit.
4. Financial lease.

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[2] For detailed study on ECBs, students may refer RBI's Master Circular No. RBI/FED/2015-16/15 FED Master Direction No.5/2015-16, January 1, 2016, (Updated as on January 16, 2018) available on https://www.rbi.org.in/scriptS/BS_ViewMasDirections.aspx?id=10204#C15.

[3] *A foreign currency convertible bond (FCCB) is a type of corporate bond issued by an Indian company in an overseas market in a currency different from that of the issuer. Investors have the option of redeeming their investment on maturity or converting the bonds into equity any time during the currency of the bond. The repayment of the principal is in the currency in which the money is raised. In case of a foreign currency exchangeable bond (FCEB), investors have the option of converting the bonds into equity of the offered company. The company issuing FCEB shall be part of the promoter group of the offered company and shall hold the equity shares being offered at the time of issuance of FCEB.*

However, ECB framework is not applicable in respect of the investment in non-convertible debentures (NCDs) in India made by Registered Foreign Portfolio Investors (RFPIs).

Available routes for raising ECB: Under the ECB framework, ECBs can be raised either under the automatic route or under the approval route. For the automatic route, the cases are examined by the Authorised Dealer Category-I (AD Category-I) banks. Under the approval route, the prospective borrowers are required to send their requests to the RBI through their ADs for examination. While the regulatory provisions are mostly similar, there are some differences in the form of amount of borrowing, eligibility of borrowers, permissible end-uses, etc. under the two routes. Except FCEBs which can be issued only under the approval route, all other forms of borrowings mentioned above can be raised both under automatic and approval routes.

Eligible Borrowers: The list of entities eligible to raise ECB under the three tracks is set out in the following table:

Track I	Track II	Track III
(i) Companies in manufacturing and software development sectors. (ii) Shipping and airlines companies. (iii) Small Industries Development Bank of India (SIDBI). (iv) Units in Special Economic Zones (SEZs). (v) Export Import Bank of India (Exim Bank) (only under the approval route). (vi) Companies in infrastructure sector, Non-Banking Financial Companies - Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies (CICs). Also, Housing Finance Companies, regulated by the National Housing Bank, Port Trusts constituted under the Major Port Trusts Act, 1963 or Indian Ports Act, 1908.	(i) All entities listed under Track I. (ii) Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (INVITs) coming under the regulatory framework of the Securities and Exchange Board of India (SEBI).	(i) All entities listed under Track II. (ii) All Non-Banking Financial Companies (NBFCs) coming under the regulatory purview of the Reserve Bank. (iii) NBFCs-Micro Finance Institutions (NBFCs-MFIs), Not for Profit companies registered under the Companies Act, 1956/2013, Societies, trusts and cooperatives (registered under the Societies Registration Act, 1860, Indian Trust Act, 1882 and State-level Cooperative Acts/Multi-level Cooperative Act/State-level mutually aided Cooperative Acts respectively), Non-Government Organisations (NGOs) which are engaged in micro finance activities. (iv) Companies engaged in miscellaneous services viz. research and development (R&D), training (other than educational institutes), companies supporting infrastructure, companies

Track I	Track II	Track III
		providing logistics services. (v) Developers of Special Economic Zones (SEZs)/ National Manufacturing and Investment Zones (NMIZs).

Masala Bonds: In 2017, RBI revised the norms for masala bonds. Masala bonds are rupee denominated bonds sold to offshore investors, who take the foreign exchange risk to earn higher interest rates compared with dollar-denominated overseas bond sales. After a review, the RBI declared that from October 3, 2017 masala bonds will no longer form part of the limit for Foreign Portfolio Investment (FPI) investments in corporate bonds and it will form part of ECB. HDFC was the first to issue such bonds, followed by National Highways Authority of India and National Thermal Power Corporation.

The proceeds of these bonds can be used for all purposes except for the following:

(a) Real estate activities other than for development of integrated township / affordable housing projects;

(b) Investing in capital market and using the proceeds for equity investment domestically;

(c) Activities prohibited as per the Foreign Direct Investment (FDI) guidelines;

(d) On-lending to other entities for any of the above objectives; and

(e) Purchase of land.

'Depository receipt' means a foreign currency denominated instrument, whether listed on an international exchange or not, issued by a foreign depository in a permissible jurisdiction on the back of permissible securities issued or transferred to that foreign depository and deposited with a domestic custodian and includes 'Global Depository Receipt' as defined in section 2(44) of the Companies Act, 2013 as any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

The rules relating to the GDR are contained in Depository Receipts Scheme, 2014, which was issued *vide* Notification No. F. No. 9/1/2013-ECB dated 21stOctober, 2014.

Eligibility:

1. The following persons are eligible to issue or transfer permissible securities to a foreign depository for the purpose of issue of depository receipts:

   (a) any Indian company listed or unlisted, private or public;

   (b) any other issuer of permissible securities;

   (c) any person holding permissible securities;

   which has not been specifically prohibited from accessing the capital market or dealing in securities.

2. Unsponsored depository receipts on the back of listed permissible securities can be issued only if such depository receipts:

   (a) give the holder the right to issue voting instructions; and

(b) are listed on an international exchange.

Issue: The following is the procedure for the issue of depository receipts:

- A foreign depository may issue depository receipts by way of a public offering or private placement or in any other manner prevalent in a permissible jurisdiction;
- An issuer may issue permissible securities to a foreign depository for the purpose of issue of depository receipts by any mode permissible for issue of such permissible securities to investors;
- The holders of permissible securities may transfer permissible securities to a foreign depository for the purpose of the issue of depository receipt, with or without the approval of issue of such permissible securities through transactions on a recognized stock exchange, bilateral transactions or by tendering through a public platform.

Limits: The aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such permissible securities under the Foreign Exchange Management Act, 1999.

Pricing: The permissible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under the applicable laws.

Funding through Financial Institutions and Banks

Banks and Financial Institutions may provide end-to-end advisory services to the client in mergers and acquisitions involving target search, analysis of the target and potential synergies for the client, value analysis, pricing strategy, review of the transaction documents, negotiation support, documentation and closure of the transaction.

Funding of a merger or takeover with the help of loans from financial institutions, banks, etc. has its own merits and demerits. Takeover of a company could be achieved in several ways and while deciding the takeover of a going concern, there are matters such as the capital gains tax, stamp duty on immovable properties and the facility for carrying forward of accumulated losses. With parameters playing a critical role, the takeover should be organized in such a way that best suits the facts and circumstances of the specific case and also it should meet the immediate needs and objectives of the management. While discussing modes of acquisition, certainly there would be a planning for organizing the necessary funding for the acquisition. If borrowings from domestic banks and financial institutions have been identified as the inevitable choice, all the financial and managerial information must be placed before the banks and financial institutions for the purpose of getting the necessary resources.

The advantage of funding is that the period of such funds is definite which is fixed at the time of taking such loans. Therefore, the Board of the company is assured about continued availability of such funds for the predetermined period. On the negative side, the interest burden on such loans is quite high which must be kept in mind by the Board while deciding to use borrowed funds from financial institution. Such funding should be thought of and resorted to only when the Board is sure that the merged company or the target company will give adequate returns i.e., timely payment of periodical interest on such loans and re-payment of the loans at the end of the term for which such loans have been taken.

Funding through Rehabilitation Finance

The Insolvency and Bankruptcy Code, 2016 (IBC) seeks to consolidate the existing multiple framework by

creating a single law for insolvency and bankruptcy. This law is a one stop solution for insolvency of corporates, individuals, partnerships and other entities. It received the President's assent on 28 May, 2016.

With the enactment of The Sick Industrial Companies (Special Provisions) Repeal Act, 2003[4], the Sick Industrial Companies (Special Provisions) Act, 1985 came to an end with effect from the 1st December, 2016 and with this BIFR and AIFR also stand dissolved. Further, the administrative provisions under the Insolvency Act were notified on different dates from August to November. Relevant operative provisions were notified on 30 November, 2016. The IBC also amended the Companies Act, 2013 to delete the provisions relating to sick companies.

[5]Section 252 of the Insolvency and Bankruptcy Code, 2016, which has been notified w.e.f. November 1st, 2016 states that the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 shall be amended in the manner specified in the Eighth Schedule. This Eighth Schedule provides that in section 4, for sub-clause (b) of the Repeal Act, the following sub-clause shall be substituted, namely—

"(b) On such date as may be notified by the Central Government in this behalf, any appeal preferred to the Appellate Authority or any reference made or inquiry pending to or before the Board or any proceeding of whatever nature pending before the Appellate Authority or the Board under the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) shall stand abated:

Provided that a company in respect of which such appeal or reference or inquiry stands abated under this clause may make reference to the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 within one hundred and eighty days from the commencement of the Insolvency and Bankruptcy Code, 2016 in accordance with the provisions of the Insolvency and Bankruptcy Code, 2016:

Provided further that no fees shall be payable for making such reference under Insolvency and Bankruptcy Code, 2016 by a company whose appeal or reference or inquiry stands abated under this clause."

Accordingly whatever the matters which were pending before the BIFR/AAIFR under the SICA were too abated and could make reference to the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016. Part II of the Code consisting of Sections 4 to 77 deals with the Insolvency Resolution and Liquidation for Corporate Persons.

Funding through Leveraged Buyouts (LBOs)

Leverage is an investment strategy of using borrowed money, specifically, the use of various financial instruments or borrowed capital to increase the potential return of an investment. When one refers to something (a company, a property or an investment) as "highly leveraged," it means that item has more debt than equity.

A leveraged buyout (LBO) is the acquisition of a company in which the buyer puts up only a small amount of money and borrows the rest. The buyer can achieve this desirable result because the targeted acquisition is profitable and throws off ample cash used to repay the debt. The expectation with leveraged buyouts is that the return generated on the acquisition will more than outweigh the interest paid on the debt, hence making it a very good way to experience high returns whilst only risking a small amount of capital.

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[4] Notification No. SO 3568(E) [F.No.3/2/2011-IF-II] by the Ministry of Finance, dated 25-11-2016.—In exercise of powers conferred by sub-section (2) of section 1 of the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 (1 of 2004), the Central Government hereby notifies the 1st day of December, 2016, as the date on which provisions of the said Act shall come into force.

[5] Section 252 of the IBC, 2016 came into force with effect from 1-11-2016.

In 2000, a landmark deal was witnessed in the Indian corporate history, when Tata Tea acquired the UK brand Tetley for 271 million pounds. This deal was the largest cross border acquisition by any India Company. Apart from the size of the deal, what made it particularly special was the fact that it was the first ever leveraged buy-out by any Indian company.

Structure of the deal:

Tata Tea created a Special Purpose Vehicle (SPV)-christened Tata Tea (Great Britain) to acquire all the properties of Tetley. The SPV was capitalised at 70 mn pounds, of which Tata tea contributed 60 mn pounds; this included 45 mn pounds raised through a GDR issue. The US subsidiary of the company, Tata Tea Inc. had contributed the balance 10 mn pounds.

What Companies Make Good LBO Targets?

Considering that the buyer will put a large amount of debt on the company, it is critical that the company be stable and able to pay off its future debts otherwise it will likely default and go into bankruptcy. With that in mind, below are some types of companies that make good targets:

- Stable, strong cash flow business
- Company with low debt levels
- Non-cyclical businesses
- Companies with large economic moats
- Companies with good existing management teams
- Companies with a large asset base that can be used for collateral
- Distressed companies in good industries

Minority and 'Minority Interest' under Companies Act, 2013

The term "minority" and "minority interest" are not clearly defined in the Companies Act, 2013 or rules made thereunder. However, in various provisions of the Act, members are given various collective statutory rights which can be exercised even if they are not in majority (i.e. holding more than 50% of the numbers/shares/voting rights). In another way, minority can be identified as those members who are not in the control or management of the affairs of the company.

The following are some of the provisions where minority interest is recognised in the Act:

1. At present as per Section 244 of the Companies Act, 2013, in case of a company having share capital, not less than 100 members or not less than 1/10th of total number of members, whichever is less or any member or members holding not less than 1/10th of issued share capital have the right to apply to NCLT in case of oppression and mismanagement. In case of companies not having share capital, not less than 1/5th of total number of members has the right to apply.
2. To reflect the interest of the "Minority", 10% criteria in case of companies having share capital and 20% criteria in the case of other companies is provided for in the Act. To help the Minority shareholders, proviso to Section 244(1) of the Companies Act, 2013 empowers NCLT to allow application by shareholders who are not otherwise eligible (i.e. holding less than 10%-20% as aforesaid). This really opens up possibility of minority actions in deserving cases of oppression and mismanagement.

Oppression and Mismanagement

Although Companies Act, 2013 gives power to the voting decision made by the majority shareholders in general meetings but at the same time it also empowers the minority shareholders by protecting their interests and rights. Section 241 - 246 of the Act has laid down such provisions which will be discussed in detail in the following paras.

Oppression: Remedy against oppression is available in section 241(1)(a) of the Act. Oppression may be defined as conducting the company's affairs in a manner prejudicial to public interest or in a manner oppressive to any member or members or prejudicial to the interests of the company.

Mismanagement: Remedy against mismanagement is available in Section 241(1)(b) of the Act. Mismanagement may be defined as any change which takes place in the management or control of the Company, which will not be in the interests of members.

Few more points relevant in this context are:

(1) If an application is made to the Tribunal, then it may waive all or any of the requirements specified in the aforementioned table for an eligible member.

(2) Any share or shares held by two or more persons jointly, shall be counted only as one member.

(3) Any one or more members may make the application on behalf of other members.

Powers of Tribunal

If an application is made under Section 241 of the Act to the Tribunal and it is of the opinion that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company and that winding-up the company would unfairly prejudice such member or members, then the Tribunal may pass relevant order to resolve the complaint. Orders may provide for the following:

- regulation of conduct of affairs of the company in future
- purchase of shares or interests of any members of the company by other members thereof or by the company
- in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital
- restrictions on the transfer or allotment of the shares of the company
- the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case
- the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Recently Tata-Mistry story captured a lot of eyeballs in the business world. Cyrus Mistry had taken over as Chairman of Tata Sons group in 2012 after Ratan Tata announced his retirement. However, he was removed from Chairmanship in 2016. As a consequence, Mistry moved to NCLT and in his petition alleged that his removal as Chairman and subsequently as a director of the Board of Tata Sons was a result of mismanagement by the Board's trustees and oppression by the promoters.

However, NCLT dismissed Mistry's plea and said that Mistry's removal was not due to the result of mismanagement by the Board and oppression of minority shareholders of the group and that the Board was competent to remove executive Chairman and Mistry was ousted because Tata Sons' Board and its members had lost confidence in him.

CLASS ACTION

On June 1, 2016, the Ministry of Corporate Affairs, notified section 245 of the Companies Act, 2013, enlisting the provisions of class action suits in India. A class action suit is one where the shareholders or depositors of a company collectively institute a suit against the company in Tribunal.

The requirement for this provision was felt in 2009 when the Satyam scam occurred. The shareholders in Satyam Computers Services Limited ("SCSL") were unsuccessful in claiming damages (worth millions) due to the absence of the provision for filing a class action suit under the Companies Act, 1956. While the Indian shareholders suffered a loss, the American investors were able to claim their part of damages in the US courts through a class action suit against SCSL. It was felt class action suits will safeguard the interests of shareholders, whenever the company or its directors participate in any fraudulent, unlawful act, or commit an act which is against the interest of the shareholders. In fact, such suits would be the most effective remedy for raising the voice of the company's shareholders.

The legal framework for class action suits is covered in section 245 of Companies Act, 2013 as well as National Company Law Tribunal Rules, 2016.

After going through section 241 and 245 of the Act, we can question as to why a separate provision was required for class action, although both the provisions look similar.

Section 245 is much wider in scope and a major difference is the option of getting monetary compensation or damages owing to the fraudulent actions of a company.

The provisions of class action come under the head of oppression and mismanagement but there are some differences between the remedies sought under class action under Section 245 and under the general provisions of oppression and mismanagement under Section 242. While under Section 242 the NCLT can order acquisition of the company's shares, restrict transferability or allotment of shares, removal of managing director and other directors of the company, in class action, the orders will mainly be restraining orders. An added advantage of the provisions on class action suit is that they cover depositors also.

Rights of Minority Shareholders during Mergers / Amalgamations/ Takeovers

Power to compromise or make arrangements with creditors and members

1. As per existing provisions of the Act, approval of High Court (prior to 15th December, 2016) /Tribunal (w.e.f. 15th December, 2016) is required in case of corporate restructuring (which, *inter-alia*, includes, mergers/amalgamations, etc.) by a company. The Scheme is also required to be approved by shareholders, before it is filed with the NCLT. The scheme is circulated to all shareholders along with statutory notice (Form No. CAA-2) of the Tribunal convened meetings and the explanatory statement under section 230(3) of the Act read with Rule 6 of Companies (Compromise, Arrangements and Amalgamations) Rules, 2016 for approving the scheme by shareholders.

2. As per proviso to Section 230(4) of the Act, it is provided that any objection to the compromise or arrangement shall be made by persons holding 10% or more of the shareholding or having 5% or more of the total outstanding debt as per latest audited financial statement. Thus, shareholders holding less than 10% or more of the shareholding are not entitled to object to the scheme as matter of statutory right.

There are other built in safeguards in the matter of approval of the scheme of compromise and arrangements. The notice convening the meetings and also the notice of hearing of the petition (in Form CAA-2) is required to be published in the newspaper as per the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The notice is also required to be given to various statutory authorities, sectoral regulators, etc.

Though there may not be any express protection to any dissenting minority shareholders to file their objections as a matter of right on this issue, the Tribunal, while approving the scheme, may follow judicious approach more particularly in view of the publication of the public notices about the proposed scheme in the newspapers. Any interested person (including a minority shareholder) may appear before the NCLT. There have been, however, occasions when shareholders holding miniscule shareholdings, have made frivolous objections against the scheme, just with the objective of stalling or deferring the implementation of the scheme. The courts have, on a number of occasions, overruled their objections. In view of this, proviso to Section 230(4) of the Act has put some limit for the objectors.

3. In case of Takeovers, as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, SEBI has powers to appoint investigating officer to undertake investigation, in case complaints are received from the investors, intermediaries or any other person on any matter having a bearing on the allegations of substantial acquisition of shares and takeovers. SEBI may also carry out such investigation *suo moto* upon its own knowledge or information about any breach of these regulations. Under section 235 of the Act, a transferee company, which has acquired 90% shares of a transferor company through a scheme or contract, is entitled to acquire shares of remaining 10% shareholders. Dissenting shareholders have been provided with an opportunity to approach Tribunal. For this purpose, there is no threshold applicable i.e. even a single dissentient shareholding holding one share may also approach Tribunal. In such case, further acquisition of shares by the transferee company will be subject to the outcome of the decision of the NCLT.

Section 230(12) provides that an aggrieved party may make an application to the Tribunal in the event of any grievances with respect to the takeover offer of companies other than listed companies in such manner as may be prescribed and the Tribunal may, on application, pass such order as it may deem fit. [This sub-section is yet to be notified.]

Legal Provisions of the Companies Act, 2013 and decided case laws

Chapter XV, comprising of sections 230 to 240 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, deals with Compromises, Arrangements and Amalgamations. The relevant sections with brief details and relevant case laws are mentioned below:

Section 230: Power to compromise or make arrangements with creditors and members.

Section 230 corresponds to sections 390, 391, 393 and 394A of the Companies Act, 1956. Except sub-sections (11) and (12), section 230 enforced with effect from 15th December, 2016.

The section provides powers to Tribunal to make order on the application of the company or any creditor or member or in case of company being wound-up, of liquidator for the proposed compromise or arrangement including debt restructuring, etc., between company, its creditors and members.

The word ‘arrangement’ interpreted under the various judicial pronouncements is as under:

'Arrangement', as occurring in section 390(b) of the 1956 Act [corresponding to Explanation to section 230(1) of the 2013 Act] is something by which parties agree to do a certain thing notwithstanding the fact there was no dispute between the parties. *Navjivan Mills Co. Ltd., In re [1972] 42 Comp. Cas. 265 (Guj.)*

The word 'arrangement' as set out in section 390(b) of the 1956 Act is an inclusive definition and contemplates all arrangements and not only reorganisation of the share capital. This is all the more clear, because the word used is 'includes'. *Investment Corpn. of India Ltd., In re [1987] 61 Comp. Cas. 92 (Bom.)*

Any scheme, other than a scheme by way of compromise or reconstruction, which affects the rights of the creditors and the members of the company or any class of them, would fall within the term, 'arrangement'. *Bank of India Ltd. v. Ahmedabad Mfg. & Calico Printing Co. Ltd. [1972] 42 Comp. Cas. 211 (Bom.)*

The word 'arrangement' in section 391 of the 1956 Act is of wide import. By section 390 of the 1956 Act, 'arrangement' includes reorganisation of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or both these methods. *Hindusthan Commercial Bank Ltd. v. Hindusthan General Electrical Corpn. [1960] 30 Comp. Cas. 367 (Cal.)*

The word ‘class’ interpreted by the Gujarat High Court in a case is as under:

Those who are offered substantially different compromises each will form a different class. Even if there are different groups within a class, the interests of which are different from the rest of the class or who are to be treated differently in the scheme, such groups must be treated as separate classes for the purpose of the scheme. The group styled as a class should ordinarily be homogeneous and must have commonality of interest and the compromise offered to them must be identical*. [(See section 391(1) of the 1956 Act) State Bank of India v. Engg. Majdoor Sangh [2000] 27 SCL 103 (Guj.)]*

Section 231: Power of Tribunal to enforce compromise or arrangement

This section corresponds to section 392 of the Companies Act, 1956 and came into force with effect from 15th December, 2016.

The section provides powers to Tribunal to enforce compromise or arrangement with creditors and members as ordered under section 230. Section also provides that, if the Tribunal is satisfied that such compromise or arrangement cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up of the company.

Interpretation of the words 'At time of making such order or at any time thereafter' in Section 231(1)(b) of the 2013 Act:

Clause (b) of sub-section (1) of section 392 of the 1956 Act [corresponding to section 231(1)(b) of the 2013 Act] makes it abundantly clear that the powers conferred by section 392 may be exercised 'at the time of making such order or at any time thereafter'. The provisions, therefore, envisage exercise of power at the very point of time of making the order, meaning thereby, 'before' the order is passed. The expression which follows, namely, 'at any time thereafter' lends further support to this construction, namely, that before the order is signed the power can be exercised under the earlier part of the provision and after order is signed, the power can be exercised under the second part of the provision. The expression 'or at any time thereafter' leaves no room for doubt that the preceding part contemplates exercise of power at a point of time prior to the making of the order. *Bhavnagar Vegetable Products Ltd., In re [1984] 55 Comp. Cas. 107 (Guj.)*

Interpretation of the word 'Modification' used in Section 231(1)(b) of the 2013 Act: In the context of section 392(1)(b) of the 1956 Act [corresponding to section 231(1)(b) of the 2013 Act], 'modification' would mean addition to the scheme of compromise or arrangement or omission therefrom solely for the purpose of making it workable. *S.K. Gupta v. K.P. Jain [1979] 49 Comp. Cas. 342 (SC)*

Section 232: Merger and amalgamation of companies

This section corresponds to section 394 of the Companies Act, 1956 and came into force with effect from 15th December, 2016.

This section provides powers to the Tribunal to order for holding meeting of the creditors or the members and to make orders on the proposed reconstruction, merger or amalgamation of companies. The section provides for manner and procedure in which the meeting so ordered by the Tribunal to be held.

For meaning of the expression "reconstruction/amalgamation", used in the section, the Calcutta High Court opined that there is no particular meaning in the word 'reconstruction' or in the word 'amalgamation'. It has to be found out from the scheme read as a whole whether it is a case of reconstruction or whether it is a case of amalgamation. *[See section 394 of the 1956 Act. Inland Steam Navigation Workers' Union v. Rivers Steam Navigation Co. Ltd. [1968] 38 Comp. Cas. 99 (Cal.)*

In the case of *Sesa Industries Ltd. v. Krishna H. Baja, Civil Appeal Nos. 1430-1431 of 2011, February 7, 2011, [2011] 9 taxmann.com 218 (SC)]*, the Supreme Court opined that the Court before whom scheme of amalgamation is placed for sanction is not expected to put its seal of approval on scheme merely because majority of shareholders have voted in favour of scheme. Since the scheme which gets sanctioned by Court would be binding on dissenting minority shareholders or creditors, Court is obliged to examine scheme in its proper perspective together with its various manifestations and ramifications with a view to find out whether scheme is fair, just and reasonable to concerned members and is not contrary to any law or public policy.

In the case of *Lotus Nikko Hotels Travel (P.) Ltd. v. Ashok Chopra & Co., EFA (OS) NO. 2 OF 2011, February 16, 2017, [2017] 79 taxmann.com 69 (Delhi),* High Court of Delhi opined that, where scheme of arrangement providing for demerger stood confirmed and was made binding, it bound creditor whether or not they might have specifically consented to such scheme.

Section 233: Merger or amalgamation of certain companies

This section came into force from 15th December, 2016. This is a new section and seeks to provide for merger or amalgamation between two small companies or between a holding company and its wholly owned subsidiary or prescribed class or class of companies by giving a notice of the proposed scheme inviting objections or suggestions by both the transferor and the transferee company from Registrar, Official Liquidator or persons affected by the scheme.

The powers of the Central Government are delegated to Regional Directors at Mumbai, Kolkata, Chennai, New Delhi, Ahmedabad, Hyderabad and Shillong.

Section 234: Merger or amalgamation of company with foreign company

This section came in force with effect from 13th April, 2017 and has no corresponding section with the Companies Act, 1956.

This is a new section and provides the mode of merger or amalgamation between companies registered under the Companies Act, 2013 and companies incorporated in the jurisdictions of such companies as may be notified from time to time by the Central Government. The Central Government may, in consultation with Reserve Bank of India make rules for the purpose of merger or amalgamation provided under this section.

Section 235: Power to acquire shares of shareholders dissenting from scheme or contract approved by majority

This section corresponds to section 395 of the Companies Act, 1956 and came into force with effect from 15th December, 2016.

This section provides the manner in which the transferee company shall acquire shares of the shareholders dissenting from the scheme or contract as approved by the majority shareholders holding not less than nine-tenths in value of the shares whose transfer is involved.

The words 'Four months' used in section 235(1) have been interpreted by the Chandigarh High Court. According to it 'Four months' is the maximum period within which the offer is to be accepted; section 395(1) of the 1956 Act [corresponding to section 235(1) of the 2013 Act] does not require that the offer must be kept open for at least four months. *Western Mfg. (Reading) Ltd., In re [1957] 27 Comp. Cas. 144 (Ch.D.)*

In the case of *Radhey Shyam Agarwal v. Bank of Rajasthan Ltd. Company Appeal No. 1 of 2012, September 20, 2013, [2014] 41 taxmann.com 138 (Rajasthan)*, the High Court of Rajasthan observed that the prayers which has been made before the Company Law Board has been incorporated in the appeal and as regards prayer of the petitioner appellant for investigating the affairs of the respondent company i.e. Bank of Rajasthan, after the Bank of Rajasthan stood finally merged under the Scheme of Amalgamation and approved by the RBI under sub-section (4) of sec.44A of the Banking Regulation Act, 1949 and finally confirmed by the Apex Court on writ petition preferred by the petitioner, the question of investigating the affairs of the transferor, Bank of Rajasthan does not survive any further and the Company Law Board in its impugned order dt.30.9.2011 has taken note of the approval being granted by the RBI and the order of the Apex Court dated 13-9-2011 rejecting the writ petition preferred by the petitioner assailing the merger on multifarious grounds. The CLB has further noticed that apart from what is being raised in the company petition, the petitioner has also filed civil suit pending before the District Court Bhilwara and when he failed to succeed in getting interim injunction and also from the High Court on appeal being preferred his company petition on the facts brought on record has rendered infructuous. [Para 6]

After the primary grievance of the appellant being finally crystallized, investigating the affairs of transferor Bank of Rajasthan does not survive any further and the Court is also of the view that the Company Law Board has not committed any error in disposing of the company petition preferred by the appellant vide its order dated 13-9-2011 as having been rendered infructuous and apart from it there is no question of law which emerges from the order of the Company Law Board which may be open for the Court to examine under section 10F of the 1956 Act (Corresponding to section 465 of the 2013 Act). [Para 7]

Section 236: Purchase of minority shareholding

This section came into force with effect from 15th December, 2016. This section corresponds to section 395 of the Companies Act, 1956.

This section provides the procedure and manner in which the registered holder of at least 90 per cent shares of a company shall notify the company of their intention to buy the remaining equity shares of minority shareholders, by virtue of an amalgamation, share exchange, conversion of securities, etc. This section provides the procedure to be followed for acquiring shares held by minority shareholders.

Section 237: Power of Central Government to provide for amalgamation of companies in public interest

This section corresponds to section 396 of the Companies Act, 1956 and came into force from 15th December, 2016.

This section provides power to the Central Government to provide for amalgamation of two or more companies in public interest by passing an order to be notified in the Official Gazette.

In the case of *63, Moons Technologies Ltd. v. Union of India,* the High Court of Bombay opined that final amalgamation order of NSEL with its holding company FTIL passed by Central Government under section 396 was not in violation of principles of natural justice and fair play and was a balanced as well as proportionate decision of Central Government.

Section 238: Registration of offer of schemes involving transfer of shares

This section came into force with effect from 15th December, 2016. The Prescribed fee for Appeal is Rs.2,000 under the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

This section provides mode of registration of offer of schemes or contract involving the transfer of shares. Every circular containing such offer and recommendation and containing a statement shall be accompanied by requisite information and must be registered with the ROC before issue.

Section 239: Preservation of books and papers of amalgamated companies.

Corresponds to section 396A of the Companies Act, 1956 and came into force with effect from 15th December, 2016.

This section provides that 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 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 transferor company or its amalgamation or the acquisition of its shares.

Section 240: Liability of officers in respect of offences committed prior to merger, amalgamation, etc.

This section came into force with effect from 15th December, 2016. No corresponding section to Companies Act, 1956.

This section provide that notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

Protection of Minority Interest

Section 232(3)(e) authorises the Tribunal to make provision for any person who dissent from the scheme. Thus, the Tribunal has to play a very vital role. It is not only a supervisory role but also a pragmatic role which requires the forming of an independent and informed judgment as regards the feasibility or proper working of the scheme and making suitable modifications in the scheme and issuing appropriate directions with that end in view *[Mafatlal Industries Ltd. In re. (1995) 84 Comp. Cas. 230 (Guj.)].*

The Tribunal considers minority interest while approving the scheme of merger

As per existing provisions of the Act, approval of Tribunal is required in case of corporate restructuring

(which, *inter-alia,* includes, mergers/amalgamations, etc.) by a company. The Scheme is also required to be approved by shareholders, before it is filed with the Tribunal. The scheme is circulated to all shareholders along with statutory notice of the court convened meeting and the explanatory statement under section 230(3) read with Rule 6 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 of the Act for approving the scheme by shareholders.

The notice of hearing of petition (in form CAA-2) is also required to be published in the newspaper. As per proviso to Section 230(4) of the Act, members holding 10% or more of the shareholding are entitled to file their objection before NCLT as a matter of right.

Case Studies / Judicial Pronouncements

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 *malafide* intention of promoters in floating separate companies (TPL and TCPL).

In case of Parke-Davis India Limited

In 2003, Parke-Davis India Limited and Pfizer Limited were considering implementation of a Scheme of Merger. The Minority shareholders of Parke-Davis India Ltd objected to the Scheme on the grounds that the approval from the requisite majority as prescribed under the Companies Act, 1956 had not been obtained. They filed an urgent petition before the division bench of the Bombay High Court. The division bench of the Bombay High Court by its order executed a stay order in March 2003 restraining the company from taking further steps in the implementation of the scheme of amalgamation, which was further extended till September 2003. The dissenting shareholders filed a Special Leave Petition with the Supreme Court. The turmoil came to an end when the Supreme Court dismissed the petition filed by the shareholders. Parke-Davis then proceeded to complete the implementation of the scheme of amalgamation with Pfizer.

In case of Tomco with HLL Merger

Similarly, in the case of the merger of Tomco with HLL, the minority shareholders put forward an argument that, as a result of the amalgamation, a large share of the market would be captured by HLL. However, the court turned down the argument and observed that there was nothing unlawful or illegal about it.

Fair and reasonable Scheme made in good faith

Any scheme which is fair and reasonable and made in good faith will be sanctioned if it could reasonably be supported by sensible people to be for the benefit to each class of the members or creditors concerned. In *Sussex Brick Co. Ltd., Re, (1960) 1 All ER 772 : (1960) 30 Com Cases 536 (Ch D)* it was held, *inter alia*, that although it might be possible to find faults in a scheme that would not be sufficient ground to reject it. It was further held that in order to merit rejection, a scheme must be obviously unfair, patently unfair, unfair to the meanest intelligence. It cannot be said that no scheme can be effective to bind a dissenting shareholder unless it complies with the basic requirements to the extent of 100 per cent. It is the consistent view of the Courts that no scheme can be said to be fool-proof and it is possible to find faults in a particular scheme but that by itself is not enough to warrant a dismissal of the petition for sanction of the scheme. If the court is satisfied that the scheme is fair and reasonable and in the interests of the general body of shareholders, the court will not make any provision in favour of the dissentients. For such a provision is not a *sine qua non* to sanctioning a fair and reasonable scheme, unless any special case is made out which warrants the exercise

of court's discretion in favour of the dissentients. *Re, Kami Cement & Industrial Co. Ltd., (1937) 7 Com Cases 348, 364-65 (Bom).*

Minority Protection:

Majority Rule: In order to redress a wrongdoer to a company or to recover monies or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself. *(Foss v. Harbottle [1843] 2 Hare 461 (Ch.))*

Exception to the Rule:

- Ultra vires acts: If the majority of shares are controlled by those against whom the relief is sought, the complaining shareholders may sue in their own names, but must show that the acts complained of are of a fraudulent character or beyond the powers of the company. There is no need to consult the views of the majority before instituting the suit, if from the allegations in the plaint it would appear that the act complained of was *ultra vires*. *(Dhaneswari Cotton Mills Ltd. v. Nilkamal Chakravarthy [1937[7 Comp. Cas. 417 (Cal).*
- Fraud on Minority: Where a minority shareholder files a suit alleging fraud, suit should be tried even if majority has affirmed the transactions *Cook v. Deeks [1916]1AC 554 (PC)*.
- Wrongdoer in Control: Where majority is wrongdoer and pocket property of company, an individual shareholder has right to file a suit. *Menier v. Hooper's Telegraph Works [1874]9 Ch. App. 350 (CA)*
- A minority of shareholder in saddle of power cannot be allowed to pursue a policy of venturing into a litigation to which the majority of the shareholders were opposed. *Life Insurance Corp of India v. Escorts Ltd [1986] 59 Comp Cas.548 (SC).*

Oppression:

- Mere lack of confidence between majority shareholders and minority shareholders would not be enough unless lack of confidence springs from oppression of a minority by a majority in management of company's affairs – *Shanti Prasad Jain v. Kainga Tubes Ltd.* [1965] 35 Comp Cas. 351 (SC)
- A series of illegal acts can lead to conclusion that they are part of same oppressive transaction. *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd*. [1981] 51 Comp Cas. 743 (SC)
- When a complaint is made as regards violations of statutory or contractual right, shareholder may initiate a proceeding in a civil court but a proceeding under section 397 would be maintainable only when an extraordinary situation is bought to notice of court keeping in view wide and far-reaching power of court in relation to affairs of the company and in this situation, it is necessary that alleged illegality in conduct of majority shareholders is pleaded and proved with sufficient clarity and precision- *Sangramsingh P. Gaekwad v. Shantadevi P. Gaekwad [2005] 57 SCL 476 (SC)*

Filing of various form in the process of merger / amalgamation

Various forms filed in the process of merger / amalgamation are appended below:

Form No.	Relevant Section	Rule*	Particulars
CAA 1	Section 230(2)(*c*)(*i*)	Rule 4	Creditor's Responsibility Statement

Form No.	Relevant Section	Rule*	Particulars
CAA 2	Section 230 (3)	Rule 6 and 7	Notice and Advertisement of notice of the meeting of creditors or members
CAA 3	Section 230(5)	Rule 8	Notice to Central Government and other Regulatory Authorities
CAA 4		Rule 13(2) and Rule 14	Report of result of meeting by Chairperson
CAA 5	Section 230	Rule 15(1)	Petition to sanction compromise or arrangement
CAA 6	Section 230(7)	Rule 17(3)	Order on petition
CAA 7	Section 232	Rule 20	Order under section 232
CAA 8	Section 232(7)	Rule 21	Statement to be filed with Registrar of Companies
CAA 9	Section 233(1)	Rule 25(1)	Notice of the scheme inviting objections or suggestions
CAA 10	Section 233(1)(c)	Rule 25(2)	Declaration of solvency
CAA 11	Section 233(2)	Rule 25(4)	Notice of approval of the scheme of merger
CAA 12	Section 233	Rule 25(5)	Confirmation order of scheme of merger or amalgamation
CAA 13	Section 233(5)	Rule 25(6)	Application by the Central Government to the Tribunal
CAA 14	Section 235(1)	Rule 26	Notice to dissenting shareholders
CAA 15	Section 238(1)	Rule 28	Information to be furnished along with circular in relation to any scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company

* The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

Family Holdings and their Management

For any family-owned business, transition is a crucial aspect that every founder or owner should keep in mind while pursuing the strategic business objectives of growth, diversification, expansion or sale. In the present context, passing the baton is clearly a priority for family business owners since the succession can make or break a family business and can have serious implications on the family as well. Thus, a structured approach in determining the transition plan and its communication to stakeholders is essential for managing the succession and survival of the family business and family from generation to generation.

Whether selling the business, keeping the business in the family or transitioning leadership to identified heirs

or a non-family stakeholder, the issues are immense and certainly not simple. As a result 95% of family businesses do not survive the third generation of ownership.

In terms of ownership and governance protocols for family members, typically, a trust or similar entity form becomes pivotal to the succession plan since it can provide a good balance between owners' desires, professional management, responsible business decision matrix and healthy family dynamics. The following are some of the key benefits of succession planning under a trust structure for continuing business legacy and smooth transition of the business from the hands of one generation to another:

Continuity planning: Consolidation of ownership and control under a trust allows the founder/owner and the family to set a clear vision and ensure commitment from the next generation of family members. This results in continued planning from one generation to another, resulting in harmony between goals, objectives, targets, etc., between generations, thereby reducing conflicting objectives/interests between family members.

Generational change: Family-owned firms can struggle to keep pace with global mega trends like demographic shifts and digital technology without the involvement of the new generation. At the same time, the current generation may not always have confidence in the ability of the new generation to take over the business, and may also have limitations relating to their ideas of change and growth. This calls for professionalization of the family firm by introducing external talent, leading to better governance and a more rigorous decision-making process in areas like finance, wealth management and personal expenses.

Conflict management: A trust would lay out specific protocols governing decision making and, in the case of any difference of opinion or deadlock, the process to manage the conflict. This ensures that the business does not suffer even during a phase where family members are not aligned.

Security of family/personal assets: A trust structure can also facilitate ring-fencing of family assets, protecting them from a creditor's claims as well as providing safeguards against claims from family members upon disability, divorce/ partition, etc.

Pooling and simplicity: A trust also serves as a means for pooling of assets and funds under a common control. This can provide heirs the benefit of property without loss of control and helps to avoid the probate or court process in the event of death. It can also simplify asset holding for legal heirs in multiple jurisdictions.

A typical family-owned business, with more than one family constituent, should have a two-tier trust structure where consolidation of the family wealth and control can be achieved under a 'master trust'. The business should be tailored to incorporate an appropriate governance structure that ensures consensus of all family members and stakeholders and deals appropriately with conflict situations. This would also ensure that individual family constituents cannot unilaterally deal with common family assets and provide benefits of consolidation of control. The family and sub-trusts would typically be set up as discretionary trusts and would be customised to meet individual requirements of each family situation.

Annexure I

SCHEDULE VI

(*See* sections 55 and 186)

INFRASTRUCTURE PROJECTS/INFRASTRUCTURAL FACILITIES

The term "infrastructural projects" or "infrastructural facilities" includes the following projects or activities:—

(1) Transportation (including inter modal transportation), includes the following:—

a) roads, national highways, State highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services;

b) rail system, rail transport providers, metro rail, roads and other railway related services;

c) ports (including minor ports and harbours), inland waterways, coastal shipping including shipping lines and other port related services;

d) aviation, including airports, heliports, airlines and other airport related services;

e) logistics services.

(2) *Agriculture,* including the following, namely:—

a) infrastructure related to storage facilities;

b) construction relating to projects involving agro-processing and supply of inputs to agriculture;

c) construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality.

(3) *Water management,* including the following, namely:—

a) water supply or distribution;

b) irrigation;

c) water treatment.

(4) *Telecommunication,* including the following, namely:

a) basic or cellular, including radio paging;

b) domestic satellite service (*i.e.*, satellite owned and operated by an Indian company for providing telecommunication service);

c) network of trunking, broadband network and internet services.

(5) Industrial, commercial and social development and maintenance, including the following, namely:—

a) real estate development, including an industrial park or special economic zone;

b) tourism, including hotels, convention centres and entertainment centres;

c) public markets and buildings, trade fair, convention, exhibition, cultural centres, sports and recreation infrastructure, public gardens and parks;

d) construction of educational institutions and hospitals;

e) other urban development, including solid waste management systems, sanitation and sewerage systems.

(6) *Power,* including the following:—

a) generation of power through thermal, hydro, nuclear, fossil fuel, wind and other renewable sources;

b) transmission, distribution or trading of power by laying a network of new transmission or distribution lines.

(7) *Petroleum and natural gas,* including the following:—

a) exploration and production;

b) import terminals;

c) liquefaction and re-gasification;

d) storage terminals;

e) transmission networks and distribution networks including city gas infrastructure.

(8) *Housing,* including the following:—

a) urban and rural housing including public/mass housing, slum rehabilitation, etc.;

b) other allied activities such as drainage, lighting, laying of roads, sanitation and facilities.

(9) Other miscellaneous facilities/services, including the following:—

a) mining and related activities;

b) technology related infrastructure;

c) manufacturing of components and materials or any other utilities or facilities required by the infrastructure sector like energy saving devices and metering devices;

d) environment related infrastructure;

e) disaster management services;

f) preservation of monuments and icons;

g) emergency services (including medical, police, fire and rescue).

(10) Such other facility service as may be prescribed.

LESSON ROUND UP

- Mode of payment for mergers and acquisition to be selected from an optimum mix of available modes of payment of consideration.
- Selection of financial package depends on many considerations such as: to suit the financial structure of acquirer and acquiree, to provide a desirable gearing level, to be acceptable to vendors. Further it should prove economic to acquirer.
- Preferential offer is also a source of funding wherein shares are offered to a closed group of identified persons.
- Funding through preference share capital, unlike equity share capital, involves the payment of fixed preference dividend like interest on debentures or bonds or a fixed rate of dividend.
- Funding through shares with differential voting rights gives the companies an additional source of fund without interest cost and without an obligation to repay, as these are other form of equity capital.
- Funding can also be done through swaps and employees stock option scheme. The share capital that may be raised through the scheme of employees' stock option can only be a fraction of the entire issue.
- External commercial borrowings are permitted by the Government as a source of finance for Indian corporate for expansion of existing capacity as well as for fresh investment.

- The other modes of funding are through financial institutions and banks, rehabilitation finance and management and leveraged buy outs. All these have got its own merits and demerits.
- At present, in case of a company having share capital, not less than 100 members or not less than 1/10th of total number of members, whichever is less or any member or members holding not less than 1/10th of issued share capital have the right to apply to NCLT in case of oppression and mismanagement.
- Section 232(3)(e) authorises the Tribunal to make provision for those who dissent from the scheme.
- As per proviso to Section 230(4) of the Act, objection to compromise or arrangement shall be made only by person holding 10% or more of the shareholding or having 5% or more of the total outstanding debt as per the latest audited financial statement.

GLOSSARY OF TECHNICAL WORDS

Acquirer: Acquirer means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company.

Designated stock exchange: Recognised stock exchange in which securities of an issuer are listed or proposed to be listed and which is chosen by the issuer as a designated stock exchange for the purpose of a particular issue of specified securities.

Issuer: It means any person making an offer of specified securities.

Relevant Date: It means date of the board meeting in which the proposal for change in objects or variation in terms of a contract, referred to in the prospectus is approved, before seeking shareholders' approval.

Rights Issue: "rights issue" means an offer of specified securities by a listed issuer to the shareholders of the issuer as on the record date fixed for the said purpose.

Target Company: "target company" means a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange.

LIST OF FURTHER READINGS

1. Mergers Acquisitions & Corporate Restructuring, 3rd Edition by Taxmann
2. Creating value from Mergers and Acquisitions by SudiSudarsanam, Prentice Hall
3. Mergers and Acquisitions: Strategy, Value and Integration by G H Ray, PHI
4. Master Guide to Mergers and Acquisitions in India - Tax & regulatory - Ernst &Young

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. "Financing of mergers and acquisitions is a crucial exercise requiring utmost care." Elaborate.
2. Write short note on the various sources of funding in the case of merger / takeovers.
3. Discuss and compare the nature and procedural requirements of preferential offer and private placement and why the terms are used interchangeably.

4. Funding through Leveraged Buyouts is an innovative method of financing. Elucidate.
5. Discuss funding through Rehabilitation Finance as a source of finance for mergers/takeovers.
6. Describe Depository Receipts as a funding options for merger.
7. As a general rule the majority prevail over the minority. Explain the rule and what are the exceptions to this rule?
8. What are the minority shareholder's rights provided under the Companies Act, 2013?
9. How the minority interest is protected under the Companies Act, 2013?
10. Describe remedies available to shareholders and depositors under section 241-244 and 245 of Companies Act,2013 and why there was a need for a separate provision of class action?

Lesson 4
Process of Merger and Acquisition Transactions

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Regulatory Framework for Merger/ Amalgamation
- Provisions of the Companies Act, 2013
- Approvals in a Scheme of Merger & Amalgamation
- Steps involved in Merger
- Due Diligence
- Types of Due Diligence
- Practical Guide to the Due Diligence
- Managing of the Due Diligence Process
- Contents of the Due Diligence Report
- Due Diligence Check-list
- Factors Influencing Valuation
- Valuation Approach
- Other aspects as to the Methods of Valuation
- Regulatory Aspects as to Valuation
- Valuation Strategies for Mergers
- Revised Organization Chart
- Employees Compensation, Benefits and Welfare Activities
- Aligning Company Policies
- Aligning Accounting and Internal Database Management Systems
- Record Keeping
- Integration of Businesses and Operations
- Post-merger Success and Valuation
- Human and Cultural Aspects
- Measuring Post-Merger Efficiency
- Measuring Key Indicators

LEARNING OBJECTIVES

This Chapter outlines the regulatory framework for the merger and amalgamations, provisions contained in the Companies Act, 2013 and process involved in the scheme of merger and amalgamation.

Due diligence process is must before taking over the ownership of the target company. How the due diligence exercise is to be carried out, what are its practical aspects, what should be the contents in the due diligence report, etc. are dealt with in this chapter.

The most important part in the process of merger and amalgamation is the valuation of the various assets/ liabilities of the target company. The various methods prevailing in the valuation exercise have been dealt with.

After merger exercise, the integration is the big issue. Integration involves not only of the financials, accounting and software but also of the human and cultural integration, which have been described in this chapter.

MERGER AND ACQUISITION

Process of Merger & Acquisition involves corporate strategy, corporate finance and management. It involves consolidation of companies i.e. business combination, division and demerger of two or more companies. The merger and amalgamation requires various regulatory approvals and procedures as enunciated in the Companies Act, 2013.

Merger being a strategy, it has to be object oriented and it dwells upon the concept of synergy, which means value of two companies together will be more than of an individual company. Merger & Acquisition could be by way of business purchase/share purchase agreement or by way of sanction of Scheme of Arrangement through the court route.

In a sense, in the case of merger through a court route, once the scheme is sanctioned by the court/tribunal after due process of law and the scheme is filed with the Registrar of Companies, it is irreversible; it carries the stamp of final approval by a judicial authority and is acceptable to the public, shareholders, stakeholders, registering authority.

Merger & Acquisition process is normally proceeded by formulation of strategy, identification of cost benefit analysis, carrying out due diligence, conducting valuation and considering the aspects of stamp duty and other applications. Moreover, the integration issue after the merger exercise is also to be taken care of.

Prerequisites of Merger and Acquisition

1. **Due Diligence**: It refers to the investigating effort made to gather all relevant facts and information that can influence a decision to enter into a transaction or not. Exercising due diligence is not a privilege but an unsaid duty of every party to the transaction. For instance, while purchasing a food item, a buyer must act with due diligence by checking the expiry date, the price, the packaging condition, etc. before paying for the product. It is not the duty of the seller to ask every buyer every time to check the necessary details. M&A due diligence helps individuals avoid legal hassles due to insufficient knowledge of important details.

2. **Business Valuation:** Business valuation or assessment is the first step of merger and acquisition. This step includes examination and evaluation of both the present and future market value of the target company. A thorough research is done on the history of the company with regards to capital gains, organizational structure, market share, distribution channel, corporate culture, specific business strengths, and credibility in the market. There are many other aspects that should be considered to ensure if a proposed company is right or not for a successful merger.

3. **Planning Exit**: When a company decides to sell its operations, it has to undergo the stage of exit planning. The company has to take firm decision as to when and how to make the exit in an organized and profitable manner. In the process the management has to evaluate all financial and other business issues like taking a decision of full sale or partial sale along with evaluating on various options of reinvestments.

4. **Structuring Business Deal**: After finalizing the merger and the exit plans, the new entity or the take-over company has to take initiatives for marketing and creating innovative strategies to enhance business and its credibility. The entire phase emphasize on structuring of the business deal.

5. **Stage of Integration**: This stage includes both the company coming together with their own parameters. It includes the entire process of preparing the document, signing the agreement, and negotiating the deal. It also defines the parameters of the future relationship between the two.

Some of key highlights of Companies Act, 2013 impacting merger and amalgamation are as follows:

- Creation of treasury shares i.e. holding the share in its own name or in the name of the trust, whether on its own behalf or on behalf of any of its subsidiary or associated company is no longer permissible.
- Objections to the scheme can be raised only by shareholders holding at least 10% stake or creditors holding at least 5% of total outstanding debts as per the latest audited financial statements thereby avoiding unnecessary delays.
- Regulators to make representation within 30 days regarding scheme, else deemed 'no objections'.
- No approval of Tribunal is required in case of merger between holding company and its 100% subsidiary or merger between small companies (based on prescribed capital/turnover).
- Merger of Indian company with foreign company located in certain jurisdictions is allowed.
- Shareholders would have an option to vote for the scheme through postal ballot, e-voting in addition to voting physically at a meeting.

DUE DILIGENCE

Diligence: It means prudence; vigilant activity; attentiveness; or care, of which there are infinite shades, from the slightest momentary thought to the most vigilant anxiety. People v. Hewitt, 78 Cal. App. 426, 248 P. 1021, 1024[1].

Due diligence: Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case. *Perry v. Cedar Falls*, 87 Iowa, 315, 54 N.W. 225.

Due diligence is an investigation of a business or person prior to signing a contract, or an act with a certain standard of care. It can be a legal obligation, but the term will more commonly apply to voluntary investigations. A common example of due diligence in various industries is the process through which a potential acquirer evaluates a target company or its assets for an acquisition. The theory behind due diligence holds that performing this type of investigation contributes significantly to informed decision making by enhancing the amount and quality of information available to decision makers and by ensuring that this information is systematically used to deliberate in a reflexive manner on the decision at hand and all its costs, benefits, and risks[2].

Due diligence is integral to business. It is exercised in a simple over-the-counter transaction or a complicated merger and acquisition transaction. For instance, while acquiring a company, the buyer must do thorough research of the credentials of the company, its market valuation, status of accounts receivables, position in the debt market, past performance, etc. It is also essential to study the previous financial reports to analyze the company's performance, to check the company background, its promoters, general reputation, and return to the existing shareholders.

Thus, a due diligence is an investigation or audit of a potential investment. It seeks to confirm all material facts in regard to a sale. It is a way of preventing unnecessary harm/hassles to either party involved in a transaction. It first came into use as a result of the US Securities Act, 1933.

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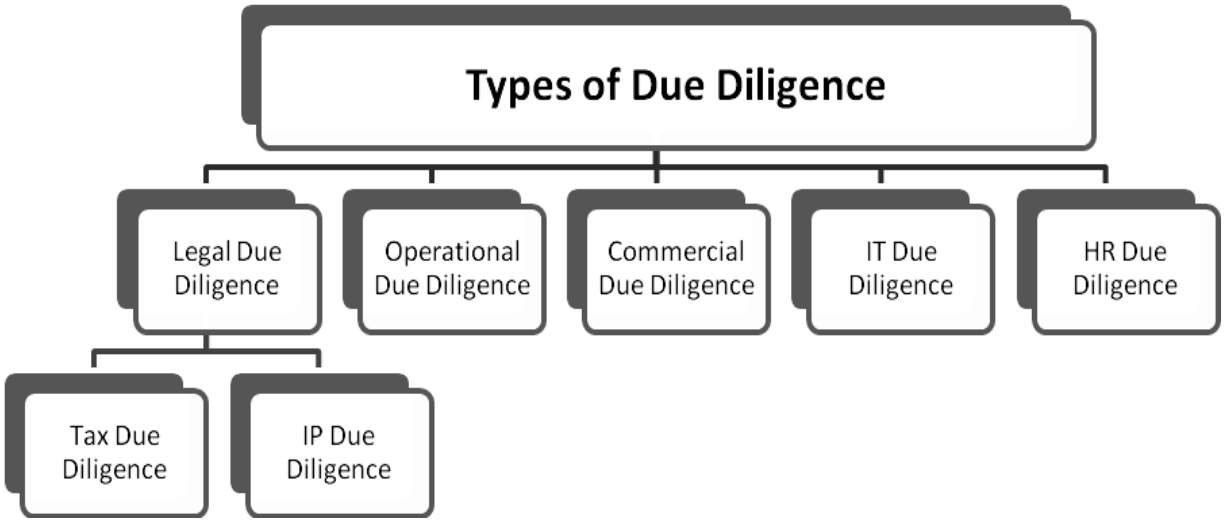
1 Black's Law Dictionary, 4th Revised edition.

2 https://en.wikipedia.org/wiki/Due_diligence

TYPES OF DUE DILIGENCE



The different types of Due Diligence may be as follows:

Legal Due Diligence: Legal Due Diligence is used to ensure that there are no legal issues in buying a business or investing in it. In this, the solicitors will review the important legal documents of the target firm such as employment contracts, board meeting minutes, articles and memorandum of association and patents and copyrights or any other property related documents

Tax Due Diligence: This is aimed at ensuring that there are no past tax liabilities in the seller firm that might have materialized due to mistakes or deception and could hold the acquirer liable for it.

Operational Due Diligence: Operational due diligence (ODD) is the process by which a potential purchaser reviews the operational aspects of a target company during mergers and acquisitions. The ODD review looks at the main operations of the target company and attempts to confirm (or not) that the business plan that has been provided is achievable with the existing operational facilities plus the capital expenditure that is outlined in the business plan.

IP Due Diligence: IP due diligence is focused on establishing what rights the company may have in various intellectual property and where it might rely on the intellectual property of another entity. Typical areas of interest are patent, copyright and trademark filings; descriptions of the company's IP protection processes; licensing agreements.

Commercial Due Diligence: This aims at understanding the market the target business is operating in. This looks at the forecast of the market growth in future and the target's position in the market with relation to its competitors. This also involves interaction with the customers of the business to understand their opinion about the business.

IT Due Diligence: This aims at identifying if there are any IT issues in the target business. This looks into matters such as scalability of systems, robustness of the processes, the level of documentation of processes, compliance with the legislation and ability to integrate various systems.

HR Due Diligence: This aims at understanding the impact of human capital on the proposed deal. This looks

at employment records, compensation schemes, HR processes, ongoing HR litigations, effectiveness of the sales force and cultural factors.

Practical Guide to Due Diligence

Due diligence is a meaningful analysis of the collected information to arrive at some decision about the potential transaction. The due diligence exercise is a crucial task. In this process the financial and non-financial information of the target company is to be collected and analysed in order to decide profitability after acquiring the target company.

A successful due diligence depends to a large extent on the cooperation of the proposed seller. This is possible in the case of 'friendly' takeovers. Generally the buyer conducts a preliminary review of the target and after a 'provisional' offer is made by the buyer to denote interest in the acquisition, an environment is created for the target to allow access to the documents, records and most aspects of the business including the physical inspection of the undertaking.

The collection of the information relating to the target company is not an easy task specifically when the target company does not cooperate in the matter. The information may be gathered from the external as well as internal sources. External sources are available and can be extracted from the public domain; however gathering of the internal information is somewhat difficult.

Normally the due diligence process should incorporate the following areas, in order to assess the nitty-gritty of the transactions of the takeover and to opt for or opt out of the takeover deal:

1. Industry Analysis:

- Competition
- Growth Rate
- Future projections
- Barriers to entry / exit
- Mergers and acquisitions in industry and results

2. Management Analysis:

- Company's HR Policies
- Assessment of Senior Level Management, resumes of key employees their qualifications and work exposures, previous background, etc.
- Summary Plan descriptions of qualified and non-qualified retirement plans
- Business Experience
- Union Contract, copies of collective bargaining agreements, description of all employees problems within last five years including the alleged wrongful termination, harassment discrimination, etc.
- Strike History
- Labour Relations/ Agreements, grievance procedures, labour disputes currently pending or settled within last five years.
- Workman's' compensation claim history / unemployment claim history

- Personnel Schemes, description of benefits of all employees' health and welfare insurance policies
- Profile of permanent employees

3. Financial Analysis:

- Audited Financial Statements along with auditor's reports for at least past five years or since inception.
- Auditor s letters and replies for the past five years or since inception
- The most recent unaudited statements, with comparable statements to the prior year.
- The company's credit report, if available
- Analyst reports, if available
- Budgets and forecasts and strategic plans
- A description of depreciation and amortization methods and changes in accounting methods since inception

  Schedules of:

  - All indebtedness and contingent liabilities
  - Stock
  - Accounts receivable
  - Accounts payable
  - Fixed Assets and its locations (including the land holdings, real estate leases, deeds, mortgages, titled deeds etc)
  - All leases of equipment
  - Sale and purchases of major capital equipments made during the last five years

  Financial ratios:

  - Return on Assets
  - Return on Net worth
  - Gross Profit to Net Profit Ratio
  - Debt Equity Ratio
  - Expense Ratio
  - Debt-Service Coverage Ratio

  Analysis of:

  - Fixed and variable expenses
  - Gross margins
- The company's general ledger
- Replacement cost data
- Valuation of Assets / Liabilities

- A description of the company's internal control procedures
- Insurance coverage of all assets

4. Intellectual property rights

- A list of domestic and foreign patents and patent applications
- A list of trademark and trade names
- A list of copyrights
- A description of important technical know-how
- A description of methods used to protect trade secrets and know-how
- Any work for hire agreements
- A list of and copies of all consulting agreements, agreements regarding inventions, licences, or assignments of intellectual property to or from the company
- Any patent clearance documents
- A list of and summary of any claims or threatened claims by or against the company regarding intellectual property.

5. Taxes

- Income-tax returns for the last five year or since inception
- States sales/VAT returns /GST returns
- Assessment orders
- Tax audit, where applicable
- Any tax settlement documents
- Other tax filing statements (State and Central Excise).

6. Marketing Analysis

- Data on Past Sales
- Customer profile
- Major sales agreements
- Trends
- Distribution channels
- Product Profile
- Development / Disclosure

7. Manufacturing

- Location
- Technology
- Manufacturing process
- Quality
- Research & Development

8. Litigation

- A schedule of all pending litigations
- A description of any threatened litigations
- Copies of insurance policies providing coverage as to pending or threatened litigation
- Documents relating to any injunctions, consent decrees, or settlements to which the company is a party
- A list of unsatisfied judgments.

Managing the Due Diligence Process

Some important steps that may be of immense help, may need to be taken by the acquiring company before they are ready to finalize an offer. During the due diligence process the following points are worth consideration:

- Constitute a due diligence team comprising of technical, legal, financial and taxation experts, etc.
- Assign the task to each of the member and the co-ordination among the members be supervised by a senior level officer.
- Collect the data of the target company with reference to the:
    - corporate records
    - promoter's holding
    - stockholder information
    - IP contracts
    - history of litigation
    - insurance information
    - financials and leases.
- Analyse the above information/ statistics, assess the future prospects and the benefit in acquiring with reference to the market size and cutting of the competition.
- If the proposal, found feasible, follow the regulatory requirements as mentioned in the Companies Act, 2013 and the SEBI Regulations.

Contents of the Due Diligence Report

The contents of a due diligence report should more or less include certain points which would draw the attention of the intending buyer, viz:

- Comments on the management and organisation,
- Details of key managerial/ technical personnel,
- Details of marketing efforts undertaken,
- Details of financial liabilities and commitments that the intending buyer would have to meet after takeover and which are not disclosed in the audited accounts,
- Deviations from the generally accepted accounting policies/ practices,
- Analysis of major expenditure/costs, details of major/critical customers and suppliers,
- Compliance of taxation and other statutory laws as well as status and impact of all litigation in this respect,
- Benefits enjoyed by the intending seller which the intending buyer may lose on takeover and vice versa,
- List of adjustments to the latest financial statements compiled on the basis of all findings, which have an impact on the "price" of the target acquisition to be considered by the intending buyer.

Due Diligence Check-list

The acquiring company is always interested in the financial aspects, human aspects, assets and liabilities of the target company. The following due diligence checks may help in carrying out the process:

Financial Aspects:

- Read the auditor's report and qualifying remarks, if any and director's responsibility statement.
- Whether the company is profit making, dividend paying company
- Calculate financial ratios and compare it with the previous year(s) figures of the company and also compare with the industry trend.
- Whether the Balance sheet have any fictitious assets?
- Whether any assets have been re-valued (particularly of real estates) in current year or in past.
- Calculate Net worth and its components and compare it with the previous year(s) figures.
- Compare the cash flow statements of current year with that of the previous year(s).
- Whether the borrowing from banks/FI is classified as Standard Assets in the books of the bank.
- Whether clear demarcation is made between the capital and revenue income and expenditure.
- Whether any penalty from Revenue Authorities, Stock Exchanges/ SEBI/ CCI/ FEMA levied in the current / past years?
- Whether any litigation against the company, is pending before any court of law?

Debtor's aspects:

- Study the demographic profile of the customer.

- Whether sales are made in concentration / very few buyers are available in the market.
- What is the debt realisation cycle?
- How the sales campaign is made in order to lead the others in the market.

Creditor's aspects:

- Who are the suppliers?
- What are the terms and conditions for sales on credit?
- Whether the supplier is unique or discattered or no single supplier can mis-match the supply?

Material Control Aspect:

- Make a review of all material contracts and commitments of the target company.
- Study various issues pertaining to guaranties, loans, and credit agreements.
- Study the Customer and supplier contracts, Equipment leases, Indemnification agreements, License agreements, Franchise agreements, Equity finance agreements, Distribution, dealer, sales agency, or advertising agreements, Non-competition agreements, Union contracts and collective bargaining agreements, Contracts the termination of which would result in a material adverse effect on the company.

Human Aspect:

- Study the organization chart and biographical information,
- Summary of any labour disputes, information concerning any previous, pending, or threatened labour stoppage,
- Employment and consulting agreements, loan agreements, and documents relating to other transactions with officers, directors, key employees, and related parties,
- Schedule of compensation paid to officers, directors, and key employees for the three most recent fiscal years showing separately salary, bonuses, and non-cash compensation (e.g., use of cars, property, etc.)
- Employee benefits and copies of any pension, profit sharing, deferred compensation, and retirement plans, management incentive or bonus plans not included in above as well as other forms of non-cash compensation, Employment manuals and policies, involvement of key employees and officers in criminal proceedings or significant civil litigation, Actuarial reports for past three years

Regulatory Aspects:

- Study the revenue returns filed by the company and its assessment orders.
- Whether any penalty has been imposed for contraventions of the provisions of the law.
- Whether the company is abiding with the company law compliances. Check the various returns filed with the RoC.

Factors Influencing Valuation

After having done the due diligence process, the next step is to value the business for the purpose of

deciding the swap ratio. A company will change the hand of ownership only when the fair market value is arrived to the satisfaction of the owner's of the seller company. Similarly the buyer company will be ready to pay for the price if it is in the beneficial interest of its owners too. The valuation of the assets and liabilities of the business entity depends upon the various factors. These factors may be as under:

- The past dividend track record of the companies.
- The past earning of the companies.
- The price of shares trading at the bourses of the companies, before the news of the merger deal and after the announcement of the deal.
- Bonus track record of the companies.
- IPO/ FPO of the companies.
- Past history of the prices of the shares of the companies.
- The voting strength in the merged entity of the shareholders.
- The net worth of the companies
- Net assets of the companies.
- Valuation is affected by the liquidity.
- The underlying higher net tangible asset value derives the higher valuations.
- Business valuation is higher in the case of going and profit earning concern in comparison to the closed unit.
- Future earnings
- Order Book
- Future capacity utilisation
- Cash flows
- Net Present Value (NPV)
- Expected Rate of Return (ERR)

General principles of Business Valuation:

In almost all business valuations, there are some principles, which are:

- **Principle of Time Value of Money:** This principle suggests that the value can be measured by calculating the present value of future cash flows discounted at the appropriate discount rate.
- **Principle of Risk and Return:** This principle believes that the investors are basically risk averse and on the other hand expects higher amount of wealth. Higher the risk, higher may be possibility of return and *vice versa*.
- **Principle of Substitution:** This principle believes that understanding the market with competitive forces are very important in order to decide the price consideration. The risk averse investor will not pay more than that of the substitute available in the market.
- **Principle of Alternatives:** This principle suggests that one should explore the various alternatives available in the market and should not rest only on one option. The benefits of vetting of various

alternatives will give a comparative valuation and a prudent investor will choose the most beneficial alternative to his portfolio.

- **Principle of Expectation:** Cash flows are based on the expectations about the performance in future and not the past. In the case of mature companies, we may assume that the growth from today or after some certain period would be constant.
- **Principle of Reasonableness:** In valuation the principle of reasonableness is most important. It takes into consideration various aspects viz: nature of business, historical background, brand image, book value of the stock, earning capacity, dividend tract record, etc.

Valuation Approach

The business valuation approach may consist of several models to provide a reliable value. These are business analysis, accounting and financial analysis, forecasting and valuation itself. The most popular methods of valuation amongst other includes Asset based valuation, Earnings based valuation and Market based valuation.

These methods have been discussed in detail in Chapter 6 of this Study.

Other aspects as to the Methods of Valuation

Relative Method: The Relative Valuation estimates the value of an asset by looking at the pricing of 'comparable assets' relative to a common variable such as earnings, cash flows, book value or sales. In this the profit multiples used are:

- Earnings before interest, tax, depreciation and amortisation (EBITDA)
- Earning before interest and tax (EBIT)
- Profits before tax (PBT)
- Profit after tax (PAT)

Super Profit Method: This approach is based on the concept of the company as a going concern. The value of the net tangible assets is taken into consideration and it is assumed that the business, if sold, will in addition to the net asset value, fetch a premium. The super profits are calculated as the difference between maintainable future profits and the return on net assets. In examining the recent profit and loss accounts of the target, the acquirer must carefully consider the accounting policies underlying those accounts. Particular attention must be paid to areas such as deferred tax provision, treatment of extraordinary items, interest capitalisation, depreciation and amortisation, pension fund contribution and foreign currency translation policies. Where necessary, adjustments for the target's reported profits must be made, so as to bring those policies into line with the acquirer's policies. For example, the acquirer may write off all R&D expenditure, whereas the target might have capitalised the development expenditure, thus overstating the reported profits.

Contingent Claim Method: Contingent Claim valuation uses option pricing models to measure the value of assets that have share option characteristics. Some of these assets are traded financial assets like warrants, and some of these options are not traded and are based on real assets. Projects, patents and oil reserves are examples. The latter are often called real options.

Accounting Professionals Experts: The accounting professionals use the various accounting ratios which are beneficial in deriving the swap ratios. These accounting ratios may be: Dividend Payout Ratio (DP Ratio), Price Earnings Ratio (PE Ratio), Debt Equity Ratio, Net Assets Value (NAV).

Regulatory aspects as to Valuation

Valuation provisions under the Companies Act, 2013

Section 247 of the Companies Act, 2013

Section 247 is a new section and seeks to provide that valuation in respect of any property, stocks, shares, debentures, securities, goodwill or any other assets or net worth of a company or its assets or liabilities shall be valued by a person having such qualification and experience and registered as a valuer, in accordance with such rules as may be prescribed.

Valuation by registered valuers

(1) Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience, registered as a valuer and being a member of an organisation recognised, in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.

(2) The valuer appointed under sub-section (1) shall,—

(a) make an impartial, true and fair valuation of any assets which may be required to be valued;

(b) exercise due diligence while performing the functions as valuer;

(c) make the valuation in accordance with such rules as may be prescribed; and

(d) not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during a period of three years prior to his appointment as valuer or three years after the valuation of assets was conducted by him.

(3) If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees:

Provided that if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(4) Where a valuer has been convicted under sub-section (3), he shall be liable to

(i) refund the remuneration received by him to the company; and

(ii) pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

The Companies (Registered Valuers and Valuation) Rules, 2017

The Central Government vide its Notification No. NO.GSR 1316(E) [F.NO.1/27/2013-CL-V], dated 18-10-2017 notified the Companies (Registered Valuers and Valuation) Rules, 2017.

The notification of these Rules shall, while bringing about a clarity regarding various aspect of valuation will have a major impact on the industry, professionals, stakeholders and the government as well. These rules envisage formation of Registered Valuers Organisations for enrolling and imparting continuous education to Registered Valuers.

Though there is some consensus among professional valuers about generally accepted approaches, methods and procedures; however, a need was felt for education, training, regulation and standardization of prevalent practices in valuation. The notification of these Rules will lead to the setting-up of Valuation Standards that will improve transparency and governance.

Introduction of Valuation Standards will ensure that the valuation reports disclose a true, fair and complete view and result in greater objectivity in valuation procedures. The increased transparency and fairness in the valuation system shall also boost stakeholders' confidence alongside plugging of loopholes in valuation.

Eligibility for registered valuers (Rule 3)

Sub-rule (1) provides that a person shall be eligible to be a registered valuer if he-

(a) is a valuer member of a registered valuers organisation;

Explanation ─ For the purposes of this clause, "a valuer member" is a member of a registered valuers organisation who possesses the requisite educational qualifications and experience for being registered as a valuer;

(b) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;

(c) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;

(d) possesses the qualifications and experience as specified in rule 4;

(e) is not a minor;

(f) has not been declared to be of unsound mind;

(g) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;

(h) is a person resident in India;

Explanation ─ For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 as far as it is applicable to an individual;

(i) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

(j) has not been levied a penalty under section 271J of Income-tax Act, 1961 and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and

(k) is a fit and proper person:

Explanation ─ For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

(i) integrity, reputation and character,

(ii) absence of convictions and restraint orders, and

(iii) competence and financial solvency.

(2) No partnership entity or company shall be eligible to be a registered valuer if-

(a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate of another company or body corporate;

(b) it is undergoing an insolvency resolution or is an undischarged bankrupt

(c) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), (f), (g), (h), (i), (j) and (k) of sub-rule (1);

(d) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or

(e) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer.

Qualifications and experience (Rule 4)

An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:-

(a) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or

(b) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or

(c) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership.

Explanation-I: For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

Explanation-II: Qualifying education and experience for various asset classes is given in an indicative manner in Annexure-IV of these rules.

Explanation-III: for the purposes of this rule and Annexure IV, 'equivalent' shall mean professional and technical qualifications which are recognised by the Ministry of Human Resources and Development as equivalent to professional and technical degree.

Conduct of valuation (Rule 8)

(1) The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18:

Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per- (a) internationally accepted valuation standards; (b) valuation standards adopted by any registered valuer’s organisation.

(2) The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.

(3) The valuer shall, in his report, state the following:-

(a) background information of the asset being valued;

(b) purpose of valuation and appointing authority;

(c) identity of the valuer and any other experts involved in the valuation;

(d) disclosure of valuer interest or conflict, if any;

(e) date of appointment, valuation date and date of report;

(f) inspections and/or investigations undertaken;

(g) nature and sources of the information used or relied upon;

(h) procedures adopted in carrying out the valuation and valuation standards followed;

(i) restrictions on use of the report, if any;

(j) major factors that were taken into account during the valuation;

(k) conclusion; and

(l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

Functions of a Valuer (Rule 10)

A valuer shall conduct valuation required under the Act as per these rules.

Eligibility for registered valuers organisations (Rule 12)

(1) An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if ─

(i) it has been registered under section 25 of the Companies Act, 1956 (1 of 1956) or section 8 of the Companies Act, 2013 (18 of 2013) with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes;

(ii) it is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession;

Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-

(a) an organisation registered as a society under the Societies Registration Act, 1860 (21 of 1860) or any relevant state law, or;

(b) an organisation set up as a trust governed by the Indian Trust Act, 1882 (2 of 1882).

(2) The organisation referred to in sub-rule (1) shall be recognised if it –

(a) conducts educational courses in valuation, in accordance with the syllabus determined by the

authority, under rule 5, for individuals who may be its valuers members, and delivered in class room or through distance education modules and which includes practical training;

(b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation ;

(c) conducts training for the individual members before a certificate of practice is issued to them;

(d) lays down and enforces a code of conduct for valuers who are its members;

(e) provides for continuing education of individuals who are its members;

(f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and

(g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.

(3) A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013 (18 of 2013), within one year from the date of commencement of these rules.

The Securities and Exchange Board of India (Issue of capital and Disclosure Requirements) Regulations, 2018

Face value of equity shares (Regulation 27)

The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing (Regulation 28)

(1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case may be.

(2) The issuer shall undertake the book building process in the manner specified in Schedule XIII.

Price and price band (Regulation 29)

(1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty per cent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in the red herring

prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled “basis of issue price” of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential pricing (Regulation 30)

(1) The issuer may offer its specified securities at different prices, subject to the following:

(a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 33 may be offered specified securities at a price not lower than by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors;

(b) in case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;

(c) In case the issuer opts for the alternate method of book building in terms of Part D of Schedule XIII, the issuer may offer the specified securities to its employees at a price not lower than by more than ten per cent. of the floor price.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

Pricing of frequently traded shares (Regulation 164)

(1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:

a. the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

b. the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than twenty six weeks as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than the higher of the following:

(a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of compromise, arrangement and amalgamation under sections 391 to 394 of the Companies Act, 1956 or sections 230 to 234 the Companies Act, 2013, as applicable, pursuant to which the equity shares of the issuer were listed, as the case may be; or

(b) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period the equity shares have been listed preceding the relevant date; or

(c) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

(4) A preferential issue of specified securities to qualified institutional buyers, not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(5) For the purpose of this Chapter, "frequently traded shares" means the shares of the issuer, in which the traded turnover on any recognised stock exchange during the twelve calendar months preceding the relevant date is at least ten per cent of the total number of shares of such class of shares of the issuer:

Provided that where the share capital of a particular class of shares of the issuer is not identical throughout such period, the weighted average number of total shares of such class of the issuer shall represent the total number of shares.

Explanation: For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchange(s) in which the equity shares of the issuer are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding twenty six weeks prior to the relevant date.

The Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002:

Pricing of Sweat Equity Shares (Regulation 7)

(1) The price of sweat equity shares shall not be less than the higher of the following:—

(a) the average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date; or

(b) the average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

Explanation :—"Relevant date" for this purpose means the date which is thirty days prior to the date on which the meeting of the general body of the shareholders is convened, in terms of clause (a) of sub-section (1) of section 54 of the Companies Act, 2013.

(2) If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on the given date, then the price on that stock exchange shall be considered.

(3) If the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.

(4) If shares are not quoted on the given date, then the share price on the next trading day shall be considered.

The Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

Pricing (Regulation 17)

The company granting option to its employees pursuant to ESOS will have the freedom to determine the exercise price subject to conforming to the accounting policies specified in regulation 15.

Accounting policies (Regulation 15)

(1) Any company implementing any of the share based schemes shall follow the requirements of the 'Guidance Note on Accounting for employee share-based Payments' (Guidance Note) or Accounting Standards as may be prescribed by the Institute of Chartered Accountants of India (ICAI) from time to time, including the disclosure requirements prescribed therein.

(2) Where the existing Guidance Note or Accounting Standard do not prescribe accounting treatment or disclosure requirements for any of the schemes covered under these regulations then the company shall comply with the relevant Accounting Standard as may be prescribed by the ICAI from time to time.

The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009

Offer price (Regulation 15)

(1) The offer price shall be determined through book building in the manner specified in Schedule II, after fixation of floor price under sub-regulation (2) and disclosure of the same in the public announcement and the letter of offer.

(2) The floor price shall be determined in terms of regulation 8 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as may be applicable.

The Companies (Share Capital and Debentures) Rules, 2014.

Issue of sweat equity shares (Rule 8)

Under the Companies (Share Capital and Debentures) Rules, 2014, the sub rules of rule 8 states that the:

- The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.
- A copy of gist along with critical elements of the valuation report obtained under clause (6) and clause (7) shall be sent to the shareholders with the notice of the general meeting.
- Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect there of obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-
    (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

(b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

SEBI (SAST) Regulations, 2011

Offer Price

Offer price is the price at which the acquirer announces to acquire shares from the public share holders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SEBI (SAST) Regulations, 2011 for frequently or infrequently traded shares.

Consolidated FDI Policy (Effective from August 28, 2017)

Issue price of shares: Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than –

(a) the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company are listed on any recognised stock exchange in India;

(b) the fair valuation of shares done by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis, where the shares of the company are not listed on any recognised stock exchange in India; and

(c) the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

However, where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, as applicable, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

Issue of Foreign Currency Convertible Bonds (FCCBs) and Depository Receipts (DRs): The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under the Foreign Exchange Management Act, 1999.

Issue of Rights/Bonus Shares:

FEMA provisions allow Indian companies to freely issue Rights/Bonus shares to existing non-resident shareholders, subject to adherence to sectoral cap, if any. However, such issue of bonus/rights shares has to be in accordance with other laws/statutes like the Companies Act, as applicable, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (in case of listed companies), etc. The offer on right basis to the persons resident outside India shall be:

(a) in the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company;

(b) in the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

Valuation Strategies for Mergers

A fair market valuation is an estimate or opinion of the theoretical worth of a company's equity based upon its underlying assets, income generating ability, and comparable transactions. There are accepted procedures,

methods and formulae for preparing valuations. These accepted approaches and methods have been tested in tax, legal and other contentious matters. Different valuation approaches will frequently yield strikingly different results for a given company. It's the duty of the analyst or valuer to select the approach that is most appropriate given the facts and circumstances of the company. The asset approach might be most appropriate when valuing a capital intensive company with steady sales. The asset based approach may not be appropriate for a service industry. Further a combined approach may also be used in some strategies.

Regulatory Framework for Merger/ Amalgamation

Companies Act, 2013 has brought many enabling provisions with regard to mergers, compromise or arrangements, especially with respect to cross border mergers, time bound and single window clearances, enhanced disclosures, disclosures to various regulators, simplified procedure for smaller companies, etc.

The Regulatory framework of Mergers and Amalgamations covers:

1. The Companies Act, 2013
2. National Company Law Tribunal Rules, 2016
3. Companies (Compromise, Arrangements and Amalgamations) Rules, 2016
4. Income Tax Act, 1961
5. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
6. Competition Act, 2002
7. Approval from industry specific regulators, wherever required.

1. Companies Act, 2013

Chapter XV of Companies Act, 2013 comprising Sections 230 to 240 contains provisions on Compromises, Arrangements and Amalgamations. The scheme of Chapter XV is as follows:

1. Section 230-231 deals with compromise or arrangements with creditors and members and power of the Tribunal to enforce such a compromise or arrangement.
2. Section 232 deals with mergers and amalgamation including demergers.
3. Section 233 is relating to the merger or amalgamation of small companies or between the holding company and its wholly owned subsidiary (also called fast track mergers)
4. Section 234 deals with amalgamation with foreign company (also called cross border mergers).
5. Section 235 deals with acquisition of shares of dissenting shareholders.
6. Section 236 deals with purchase of minority shareholding.
7. Section 237 contains provisions as to the power of the Central Government to provide for amalgamation of companies in public interest.
8. Section 238 deals with registration of offer of schemes involving transfer of shares.
9. Section 239 deals with preservation of books and papers of amalgamated companies.
10. Section 240 deals with liability of officers in respect of offences committed prior to merger, amalgamation, etc.

2. Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (read with National Company Law Tribunal Rules, 2016)

Rules 3 to Rule 29 contain provisions dealing with the procedure for carrying out a scheme of compromise or

arrangement including amalgamation or reconstruction.

3. Income Tax Act, 1961

The Income Tax Act, 1961 covers aspects such as tax relief to amalgamating/amalgamated companies, carry forward of losses, exemptions from capital gains tax, etc. For example, when a scheme of merger or demerger involves the merger of a loss making company or a hiving-off of a loss making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, *inter alia* , the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferor Company.

4. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) on September 2, 2015. Companies are required to comply with the following:

- Scheme of Arrangement (Regulation11)
- Draft scheme of arrangement & scheme of arrangement (Regulation 37)
- Minimum Public Shareholding (Regulation 38)

For details please refer to Chapter 10 of this Study.

5. Indian Stamp Act, 1899

It is necessary to refer to the Indian Stamp Act, 1899 to check the stamp duty payable on transfer of undertaking through a merger or demerger.

6. Competition Act, 2002

The provisions of Competition Act, 2002 and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 are to be complied with.

Provisions of the Companies Act, 2013

Chapter XV, comprising of sections 230 to 240 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, deals with Compromises, Arrangements and Amalgamations. The relevant details are explained below:

Section 230 - Power to compromise or make arrangements with creditors and members.

Section 230 lays down in detail the power of a company to make compromise or arrangements with its creditors and members. Under this section, a company can enter in to a compromise or arrangement with its creditors or its members, or any class thereof.

Scope of Section 230

Section 230 deals with the rights of a company to enter into a compromise or arrangement (i) between itself and its creditors or any class of them; and (ii) between itself and its members or any class of them. The arrangement contemplated by the section includes a re-organisation of the share capital of a company by consolidation of its shares of different classes or by sub-division of its shares into shares of different classes or by both these methods.

The section also applies to compromise or arrangement entered into by companies under winding-up.

Therefore, an arrangement under this section can take a company out of winding-up.

Sub-section (1)–Application to the Tribunal for convening meetings of members/creditors.

Where a company or a creditor or a member of the company proposes a compromise or arrangement between it and its creditors or between it and its members or with any class of the creditors or any class of members, the company or the creditor or member, or where the company is being wound-up, the liquidator may make an application to the Tribunal. On such application, the Tribunal may order a meeting of the creditors or members or any class of them as the case may be and such meetings shall be called, held and conducted in such manner as the Tribunal may direct.

The key words and expressions under sub-section are 'creditors', 'Tribunal', 'class of creditors or members', 'a company which is being wound-up', 'liquidator'. When a company is ordered to be wound-up, the liquidator is appointed and once winding-up commences liquidator takes charge of the company in all respects and therefore it is he who could file any application of any compromise or arrangement in the case of a company which is being wound-up. A company which is being wound-up would mean a company in respect of which the court has passed the winding-up order.

Sub-section (2)– Disclosures to the Tribunal by applicant under sub-section 1:

Sub-section (2) provides that the company or any other person, who makes an application as provided under sub-section (1) shall disclose by affidavit to the Tribunal:

(a) all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

(b) reduction of share capital of the company, if any, included in the compromise or arrangement;

(c) any scheme of corporate debt restructuring consented to by not less than seventy-five percent of the secured creditors in value, including—

(i) a creditor's responsibility statement in the prescribed form;

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

Sub-section (3) – Notice of the meeting.

Notice of the meeting called in pursuance of the order of the tribunal shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by

1. a statement disclosing the details of the compromise or arrangement,

2. a copy of the valuation report, if any, and
3. explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture holders and
4. the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
5. such other matters as may be prescribed:

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed: When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

Sub-section (4) – Notice to provide for voting by themselves or through proxy or through postal ballot.

Sub-section (4) states that a notice under sub-section(3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice.

Provided that any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent. of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

Sub-section (5) – Notice to be sent to the regulators seeking their representations.

Section 230 (5) states that a notice under sub-section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

Sub-section (6): Approval and sanction of the scheme

Section 230 (6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound-up, on the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be and the contributories of the company.

Sub-section (7): Order of the tribunal sanctioning the scheme to provide for the certain matters

An order made by the Tribunal shall provide for all or any of the following matters, namely:

a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

b) the protection of any class of creditors;

c) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;

d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act,1985 shall abate;

e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement.

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Sub-Section (8): The order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

Sub-section (9): The Tribunal may dispense with calling of meeting of creditors

Section 230 (9) states that the Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety percent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

Sub-Section (10):

Compromise in respect of buy back is to be in compliance with section 68. As per Section 230 (10), no compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

Sub-Section (11):

Section 230(11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board

Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

Rule 3 provides that an application under sub-section (1) of section 230 of the Act may be submitted in Form no. NCLT-1 (appended in the National Company Law Tribunal Rules, 2016) along with:—

(i) a notice of admission in Form No. NCLT-2 (appended in the National Company Law Tribunal Rules, 2016);

(ii) an affidavit in Form No. NCLT-6 (appended in the National Company Law Tribunal Rules, 2016);

(iii) a copy of scheme of compromise or arrangement, which should include disclosures as per sub-section (2) of section 230 of the Act; and

(iv) fee as prescribed in the Schedule of Fees.

(2) Where more than one company is involved in a scheme in relation to which an application under sub-rule (1) is being filed, such application may, at the discretion of such companies, be filed as a joint-application.

(3) Where the company is not the applicant, a copy of the notice of admission and of the affidavit shall be served on the company, or, where the company is being wound up, on its liquidator, not less than fourteen days before the date fixed for the hearing of the notice of admission.

(4) The applicant shall also disclose to the Tribunal in the application under sub-rule (1), the basis on which each class of members or creditors has been identified for the purposes of approval of the scheme.

Rule 4 provides that for the purposes of sub-clause (i) of clause (c) of sub-section (2) of section 230 of the Act, the creditor's responsibility statement in Form No. CAA. 1 shall be included in the scheme of corporate debt restructuring.

Explanation:— For the purpose of this rule, it is clarified that a scheme of corporate debt restructuring as referred to in clause (c) of sub-section (2) of section 230 of the Act shall mean a scheme that restructures or varies the debt obligations of a company towards its creditors.

Rule 6 provides that (1) Where a meeting of any class or classes of creditors or members has been directed to be convened, the notice of the meeting pursuant to the order of the Tribunal to be given in the manner provided in sub-section (3) of section 230 of the Act shall be in Form No. CAA.2 and shall be sent individually to each of the creditors or members.

(2) The notice shall be sent by the Chairperson appointed for the meeting, or, if the Tribunal so directs, by the company (or its liquidator), or any other person as the Tribunal may direct, by registered post or speed post or by courier or by e-mail or by hand delivery or any other mode as directed by the Tribunal to their last known address at least one month before the date fixed for the meeting.

Explanation: - It is hereby clarified that the service of notice of meeting shall be deemed to have been effected in case of delivery by post, at the expiration of forty eight hours after the letter containing the same is posted.

(3) The notice of the meeting to the creditors and members shall be accompanied by a copy of the scheme of compromise or arrangement and a statement disclosing the following details of the compromise or arrangement, if such details are not already included in the said scheme:—

(i) details of the order of the Tribunal directing the calling, convening and conducting of the meeting:—

(a) date of the Order;

(b) date, time and venue of the meeting.

(ii) details of the company including:

a) Corporate Identification Number (CIN) or Global Location Number (GLN) of the company;

b) Permanent Account Number (PAN);

c) name of the company;

d) date of incorporation;

e) type of the company (whether public or private or one-person company);

f) registered office address and e-mail address;

g) summary of main object as per the memorandum of association; and main business carried on by the company;

h) details of change of name, registered office and objects of the company during the last five years;

i) name of the stock exchange (s) where securities of the company are listed, if applicable;

j) details of the capital structure of the company including authorised, issued, subscribed and paid up share capital; and

k) names of the promoters and directors along with their addresses.

(iii) if the scheme of compromise or arrangement relates to more than one company, the fact and details of any relationship subsisting between such companies who are parties to such scheme of compromise or arrangement, including holding, subsidiary or of associate companies;

(iv) the date of the board meeting at which the scheme was approved by the board of directors including the name of the directors who voted in favour of the resolution, who voted against the resolution and who did not vote or participate on such resolution;

(v) explanatory statement disclosing details of the scheme of compromise or arrangement including:—

a) parties involved in such compromise or arrangement;

b) in case of amalgamation or merger, appointed date, effective date, share exchange ratio (if applicable) and other considerations, if any;

c) summary of valuation report (if applicable) including basis of valuation and fairness opinion of the registered valuer, if any, and the declaration that the valuation report is available for inspection at the registered office of the company;

d) details of capital or debt restructuring, if any;

e) rationale for the compromise or arrangement;

f) benefits of the compromise or arrangement as perceived by the Board of directors to the company, members, creditors and others (as applicable);

g) amount due to unsecured creditors.

(vi) disclosure about the effect of the compromise or arrangement on:

a) key managerial personnel;

b) directors;

c) promoters;

d) non-promoter members;

e) depositors;

f) creditors;

g) debenture holders;

h) deposit trustee and debenture trustee;

i) employees of the company;

(vii) Disclosure about effect of compromise or arrangement on material interests of directors, Key Managerial Personnel (KMP) and debenture trustee.

Explanation- For the purposes of these rules it is clarified that-

a) the term 'interest' extends beyond an interest in the shares of the company, and is with reference to the proposed scheme of compromise or arrangement.

b) the valuation report shall be made by a registered valuer, and till the registration of persons as valuers is prescribed under section 247 of the Act, the valuation report shall be made by an independent merchant banker who is registered with the Securities and Exchange Board or an independent chartered accountant in practice having a minimum experience of ten years.

(viii) investigation or proceedings, if any, pending against the company under the Act.

(ix) details of the availability of the following documents for obtaining extract from or for making or obtaining copies of or for inspection by the members and creditors, namely:

a) latest audited financial statements of the company including consolidated financial statements;

b) copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with;

c) copy of scheme of compromise or arrangement;

d) contracts or agreements material to the compromise or arrangement;

e) the certificate issued by Auditor of the company to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the Accounting Standards prescribed under section 133 of the Companies Act, 2013; and

f) such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;

(x) details of approvals, sanctions or no-objection(s), if any, from regulatory or any other governmental authorities required, received or pending for the proposed scheme of compromise or arrangement.

(xi) a statement to the effect that the persons to whom the notice is sent may vote in the meeting either in person or by proxies, or where applicable, by voting through electronic means.

Explanation- For the purposes of this rule, disclosure required to be made by a company shall be made in respect of all the companies, which are part of the compromise or arrangement.

Rule 7 provides that the notice of the meeting under sub-section (3) of section 230 of the Act shall be advertised in Form No. CAA.2 in at least one English newspaper and in at least one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated, or such newspapers as may be directed by the Tribunal and shall also be placed, not less than thirty days before

the date fixed for the meeting, on the website of the company (if any) and in case of listed companies also on the website of the SEBI and the recognized stock exchange where the securities of the company are listed:

Provided that where separate meetings of classes of creditors or members are to be held, a joint advertisement for such meetings may be given.

Rule 8 provides that for the purposes of sub-section (5) of section 230 of the Act, the notice shall be in Form No. CAA.3, and shall be accompanied with a copy of the scheme of compromise or arrangement, the explanatory statement and the disclosures mentioned under rule 6, and shall be sent to.-

i. the Central Government, the Registrar of Companies, the Income-tax authorities, in all cases;

ii. the Reserve Bank of India, the Securities and Exchange Board of India, the Competition Commission of India, and the stock exchanges, as may be applicable ;

iii. other sectoral regulators or authorities, as required by Tribunal.

(2) The notice to the authorities mentioned in sub-rule (1) shall be sent forthwith, after the notice is sent to the members or creditors of the company, by registered post or by speed post or by courier or by hand delivery at the office of the authority.

(3) If the authorities referred to under sub-rule (1) desire to make any representation under sub-section (5) of section 230, the same shall be sent to the Tribunal within a period of thirty days from the date of receipt of such notice and copy of such representation shall simultaneously be sent to the concerned companies and in case no representation is received within the stated period of thirty days by the Tribunal, it shall be presumed that the authorities have no representation to make on the proposed scheme of compromise or arrangement.

Section 231 – Power of the Tribunal to enforce compromise or arrangement

As per section 231(1) when the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

(a) shall have power to supervise the implementation of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

Sub-section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up the company and such an order shall be deemed to be an order made under section 273.

Section 232 – Merger and amalgamation of companies

Sub-section (1): Tribunal’s power to call meeting of creditors or members, with respect to merger or amalgamation of companies

Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal —

a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and

b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies, the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply *mutatis mutandis.*

Sub-section (2): Circulation of documents for members/creditors meeting.

Section 232(2) states that when an order has been made by the Tribunal under sub-section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:

a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;

b) confirmation that a copy of the draft scheme has been filed with the Registrar;

c) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

d) the report of the expert with regard to valuation, if any;

e) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

Sub-section (3): Sanctioning of scheme by Tribunal

Section 232(3) states that the Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;

b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

No transferee company can hold shares in its own name or under any trust.

A transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished;

c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer;

d) dissolution, without winding-up, of any transferor company;

e) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;

f) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;

g) the transfer of the employees of the transferor company to the transferee company;

h) when the transferor company is a listed company and the transferee company is an unlisted company,—

A) the transferee company shall remain an unlisted company until it becomes a listed company;

B) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal: The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

i) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

j) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out:

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

Sub-section (4): Transfer of property or liabilities

Sub-section (4) states that an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect

Sub-section (5): Certified copy of the order to be filed with the registrar.

Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

Sub Section (6): Effective date of the scheme.

Section 232(6) states that the scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

Sub-section (7): Annual statement certified by CA/CS/CWA to be filed with Registrar every year until the completion of the scheme.

Section 232(7) states that every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

Sub-section (8): Punishment

Section 232(8) states that if a transferor company or a transferee company contravenes the provisions of this section, the transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Section 233 –Merger or amalgamation of certain companies

Section 233 prescribes simplified procedure for Merger or amalgamation of

• two or more small companies, or

• between a holding company and its wholly-owned subsidiary company, or

• such other class or classes of companies as maybe prescribed;

Sub-section (1)

Accordingly sub-section(1) of Section 233 states that notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:—

a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;

b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety percent of the total number of shares;

c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

Sub-section (2): The sub-section states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

Sub-section (3): Central Government to issue confirmation order, where there are no objections or suggestions from registrar or official liquidator.

Section 233(3) states that on the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

Sub-section (4): Objections if any by the registrar or official liquidator to be communicated to the central government.

Section 233(4) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

Sub-section (5): Application by Central Government to the Tribunal.

Section 233(5) states that if the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

Sub-section (6): Tribunal's action to Central Government's application

Section 233(6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit: If the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

Sub-section (7): Registrar having jurisdiction over transferee company has to be communicated

Section 233(7) states that a copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

Sub-section (8): Effect of Registration of the scheme.

Sub-Section (8) states that the registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding up.

Sub-section (9)

This sub-section states that the registration of the scheme shall have the following effects, namely:—

a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;

b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

Sub-section (10): Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished

Section 233(10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

Sub-section (11): Transferee Company to file an application with Registrar along with the scheme registered

The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

Section 234: Merger or amalgamation of a company with a foreign company

Section 234(1) states that the provisions of this Chapter XV of the Companies Act, 2013 unless otherwise provided under any other law for the time being in force, shall apply *mutatis mutandis* to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the share holders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose. For the purposes of sub-section(2), the expression “foreign company” means any company or body corporate incorporated outside India whether having a place of business in India or not.

Section 235: Power to acquire shares of shareholders dissenting from scheme or contract approved by majority

Section 235 of the Companies Act, 2013 prescribes the manner of acquisition of shares of shareholders dissenting from the scheme or contract approved by the majority shareholders holding not less than nine tenth in value of the shares, whose transfer is involved. It includes notice to dissenting shareholders, application to dissenting shareholders to tribunal, deposit of consideration received by the transferor company in a separate bank account etc.

Section 236: Purchase of minority shareholding

Section 236 prescribes the manner of notification by the acquirer (majority) to the company, offer to minority for buying their shares, deposit an amount equal to the value of shares to be acquired, valuation of shares by registered valuer, etc.

Section 237: Power of Central Government to provide for amalgamation of companies in public interest

Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those 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.

Continuation of legal proceedings

Section 237(2) states that the order under sub-section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transfer or company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

Interest or rights of members, creditors, debenture holders not to be affected.

As per Section 237(3), every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

Sub-section 4: Appeal to Tribunal

As per Section 237(4) any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

Sub-section 5: Conditions for order

As per Section 237 (5) No order shall be made under this section unless —

(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 (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and

(c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of 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 share holders therein, or from any creditors or any class of creditors thereof.

Sub-section 6

As per Section 237(6) the copies of every order made under this section shall, as soon as may be after it has been made, be laid before each House of Parliament.

Section 238: Registration of offer of schemes involving transfer of shares

Section 238(1) states that in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235, — (a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed; (b) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available; and (c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered:

Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

Section 238(2) states that an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under sub-section (1).

Section 238(3) states that the director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section(1), shall be liable to a penalty of one lakh rupees.

Section 239: Preservation of books and papers of amalgamated companies

As per section 239, the books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter 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 transferor company or its amalgamation or the acquisition of its shares.

Section 240: Liability of officers in respect of offences committed prior to merger, amalgamation, etc.

As per Section 240, notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

Approvals in Scheme of Amalgamation

Merger or amalgamation of companies involves various issues including the regulatory approvals. These regulatory approvals are to be obtained not only from the sector in which the company is operating (for example in case of merger of two banks, RBI's approval is needed) but from other departments like Income Tax, SEBI, ROC, etc.

The companies are required to obtain following approvals in respect of the scheme of amalgamation:

(i) Authorisation

— Pre-approval authorisation about appointment of intermediaries, advisors, etc.

— Approval of Valuation Report by Audit Committee

(ii) Approval of Board of Directors

— approval of scheme of amalgamation by the Board of both the companies.

Board resolution should, besides approving the scheme, authorise a Director/Company Secretary/ other officer to make application to Tribunal, to sign the application and other documents and to do every thing necessary or expedient in connection therewith, including changes in the scheme.

(iii) Approval of Shareholders/Creditors, etc

Members' and creditors' approval to the scheme of amalgamation is *sine qua non* for Tribunal's sanction. This approval is to be obtained at specially convened meetings held as per Tribunal's directions [Section 230(1)]. However, the Tribunal may dispense with meetings of members/creditors [Section 230(9)].

The scheme of compromise or arrangement has to be approved as directed by the Tribunal, by–

— the members of the company; or

— the members of each class, if the company has different classes of shares; and

— the creditors; or

— each class of creditors, if the company has different classes of creditors.

The approval of the members and creditors (or each class of them) has to be obtained at specially convened meetings as per the Tribunal directions. An application seeking directions to call, hold and conduct meetings is made to the Tribunal, which has jurisdiction having regard to the location of the registered office of the company. The steps include:

— First motion petition before the Tribunal

— Scrutinizers report about the approval by the shareholders/creditors, etc.

— Second motion petition before the Tribunal

— Notices should be sent to various stakeholders, public inviting any objections to the scheme.

(iv) Approval of the Stock Exchanges

A listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before Tribunal with the stock exchange(s).

(v) Approval of Financial Institutions

The approval of the Financial Institutions, trustees to the debenture holders and banks, investment corporations would be required if the Company has borrowed funds either as term loans, working capital requirements and/or have issued debentures to the public and have appointed any one of them as trustees to the debenture holders.

(vi) 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.

(vii) Approval of the Tribunal

- Both companies (amalgamating as well as amalgamated) involved in a scheme of compromise or arrangement or reconstruction or amalgamation is required to seek approval of the respective Tribunal for sanctioning the scheme.

- Every amalgamation, except those, which involve sick industrial companies, requires sanction of Tribunal which has jurisdiction over the State/area where the registered office of a company is situated.
- If transferor and transferee companies are under the jurisdiction of different Tribunals, separate approvals are necessary.
- The notice of every application filed with the Tribunal has to be given to the Central Government (Regional Director, having jurisdiction of the State concerned).
- After the hearing is over, the Tribunal will pass an order sanctioning the Scheme of amalgamation, with such directions in regard to any matter and with such modifications in the Scheme as the Judge may think fit to make for the proper working of the Scheme. [Section 230; Rule 5, Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

The Tribunal under Section 230-234 of the Act is also empowered to order the transfer of undertaking, property or liabilities either wholly or in part, allotment of shares or debentures and on other supplemental and incidental matters.

(viii) Approval of Reserve Bank of India

Where the scheme of amalgamation envisages issue of shares/cash option to Non-Resident Indians, the amalgamated company is required to obtain the permission of Reserve Bank of India subject to conditions prescribed under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

(ix) Approvals from Competition Commission of India (CCI)

The provisions relating to regulation of combination as provided under Sections 5 and 6 of the Competition Act, 2002 would also be required to be complied with by companies, if applicable. These provisions are effective from June 01, 2011.

For details of regulatory approval requirements, please refer to Lesson-10 titled 'Regulatory approvals of scheme' of this Study Material.

Filing requirements in the process of Merger/Amalgamation

The following forms, reports, returns, etc. are required to be filed with the Registrar of Companies, SEBI and Stock Exchanges at various stages of the process of merger/amalgamation:

1. (a) when the objects clause of the memorandum of association of the transferee company is altered to provide for amalgamation/merger, for which special resolution is passed;

   (b) the company's authorised share capital is increased to enable the company to issue shares to the shareholders of the transferor company in exchange for the shares held by them in that company for which a special resolution for alteration of its articles is passed;

   (c) a special resolution is passed to authorise the Company's Board of Directors to issue shares to the shareholders of the transferor company in exchange for the shares held by them in that company; and

   (d) a special resolution authorizing the transferee company to commence the business of the transferor company or companies as soon as the amalgamation/merger becomes effective; the company should file with ROC within thirty days of passing of the aforementioned special

resolutions. The following documents should be annexed to the said e-form: (i) certified true copies of all the special resolutions; (ii) certified true copy of the explanatory statement annexed to the notice for the general meeting at which the resolutions are passed, for registration of the resolution. This e-form should be digitally signed by Managing Director/Director/Manager or Secretary of the Company duly authorized by Board of Directors. This e-form should also be certified by Company Secretary or Chartered Accountant or Cost Accountant (in whole time practice) by digitally signing the e-form.

2. In compliance with the listing regulations, the transferee company is required to give notice to the stock exchanges where the securities of the company are listed, of the Board meeting called for the purpose of discussing and approving amalgamation.

3. In compliance with the listing regulations, the transferee company is required to give intimation to the stock exchanges where the securities of the company are listed, of the decision of the Board approving amalgamation and also the swap ratio, before such information is given to the shareholders and the media.

4. The transferee company is required to file with the Registrar of Companies, INC-28 along with a certified copy of the Tribunal's order on summons directing the convening and holding of meetings of equity shareholders/creditors including debentures holders etc. as required under Section 230 of the Companies Act. This e-form should be digitally signed by the Managing Director or Director or Manager or Secretary of the Company duly authorized by the Board of Directors. However, in case of foreign company, the e-form should be digitally signed by an authorized representative of the company duly authorized by the Board of Directors.

The original certified copy of the Tribunal order is also required to be submitted at the concerned ROC office simultaneously while filing INC-28, failing which the filing will not be considered and legal action will be taken.

5. In compliance with the listing regulations, the transferee company is required to simultaneously furnish to the stock exchanges where the securities of the company are listed, copy of every notice, statement, etc. sent to members of the company in respect of a general meeting in which the scheme of arrangement of merger/amalgamation is to be approved.

6. In compliance with the listing regulations, the transferee company is required to furnish to the stock exchanges where the securities of the company are listed, minutes of proceedings of the general meeting in which the scheme of arrangement of merger/amalgamation is approved.

7. To file e-form with ROC within thirty days of passing of the special resolution, the following documents should be annexed to the said e-form: (i) certified true copy of the special resolution approving the scheme of arrangement of merger/amalgamation; (ii) certified true copy of the explanatory statement annexed to the notice for the general meeting at which the resolution is passed, for registration of the resolution. This e-form should be digitally signed by Managing Director/ Director/Manager or Secretary of the Company duly authorized by Board of Directors. The e-form should also be certified by Company Secretary or Chartered Accountant or Cost Accountant (in whole time practice) by digitally signing the e-form.

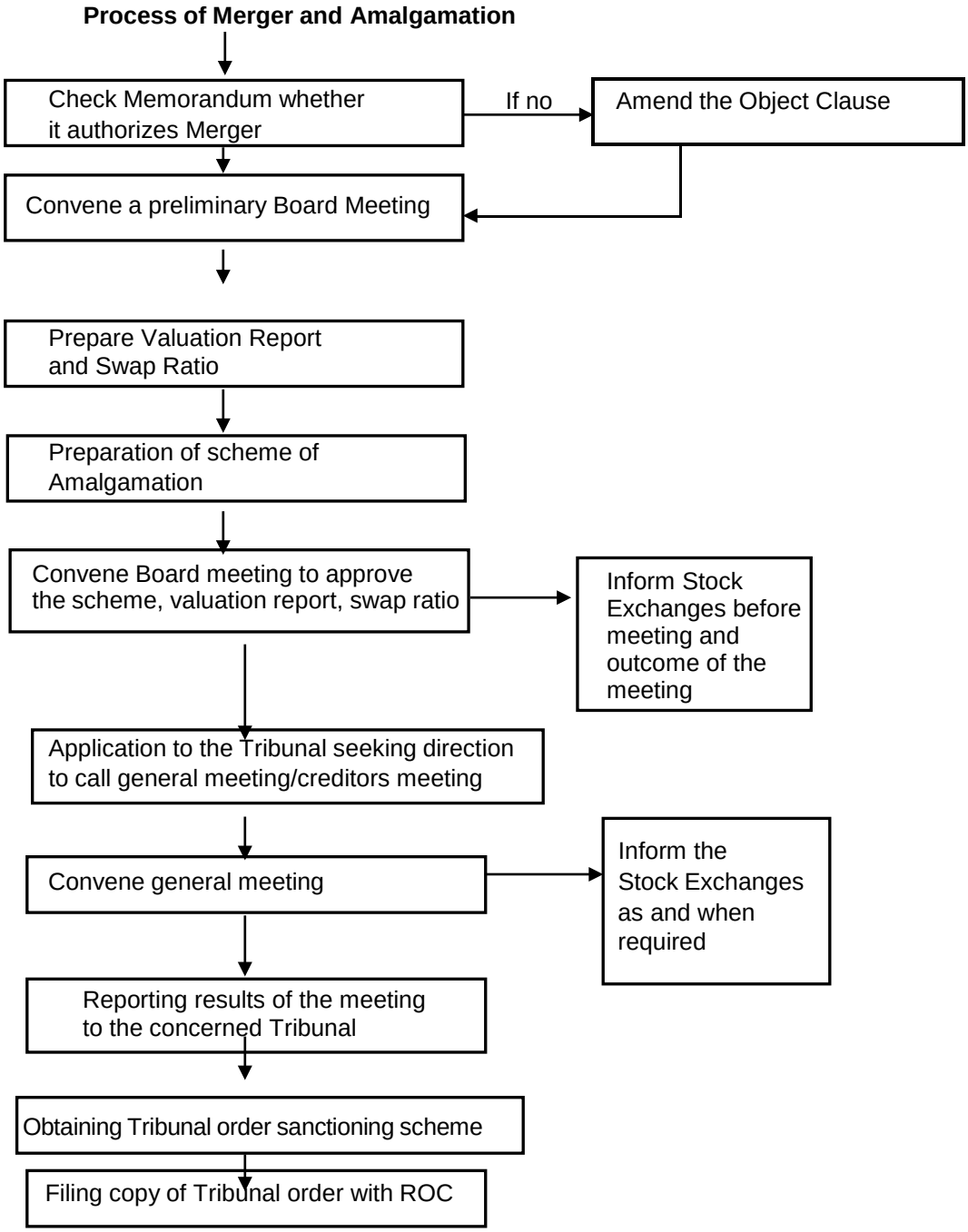
8. The transferee company is required to file with the Central Government notice of every application made to the Tribunal under Section 230 to 240 of the Companies Act, 2013. No notice need be given to the Central Government once again when the Tribunal proceeds to pass final order to dissolve the transferor company.

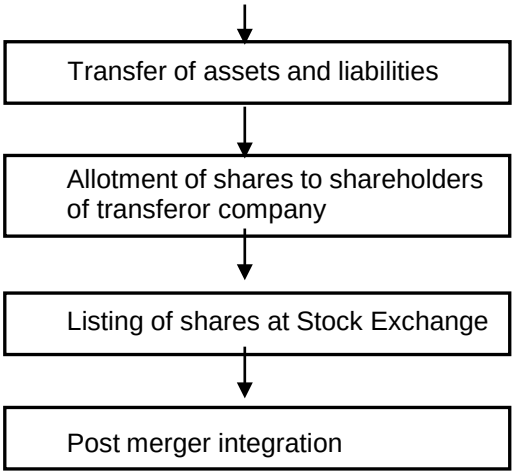
9. To file with the Registrar of Companies within thirty days of allotment of shares to the shareholders of the

transferor company in lieu of the shares held by them in that company in accordance with the shares exchange ratio incorporated in the scheme of arrangement for merger/amalgamation, the return of allotment along with the prescribed filing fee as per requirements of the Act. This e-form should be digitally signed by Managing Director or Director or Manager or Secretary of the Company duly authorised by the Board of Directors. The e-form should also be certified by Company Secretary or Chartered Accountant or Company Secretary (in whole time practice) by digitally signing the e-form.

Steps involved in Merger

STEPS INVOLVED IN MERGER - A FLOW CHART





Following steps are usually involved in the merger:

1. To ensure the Memorandum of Association contain an enabling clause relating to authorisation of the companies to undertake the amalgamation/merger/demerger of the companies.
2. Place memorandum before the Board of Directors for in-principal approval of such merger.
3. Authorisation by the Board to appoint:
   - Valuers'
   - Merchant Bankers for fairness opinion
   - Advocates, counsels, advisors, etc. to draft Scheme, file petitions, plead before NCLT & other authorities.
4. Valuation Report by Independent Valuers.
5. Working on the swap ratio by Valuers/Chartered Accountants/in-house Advisors/in-house Counsels.
6. Drafting of the scheme of amalgamation.
7. Convening of the Audit Committee/Board meeting and placement of valuation report, swap ratio, etc. for approval of the Board along with the information to the concerned stock exchanges (before and after conclusion of the meeting) where the shares of the companies are listed.
8. In principle approval by stock exchanges
9. No complaint report.
10 Approval of Scheme of Arrangement/Valuation Report/Swap ratio/Fairness opinion by Audit Committee and Board.
11. May please refer to check list on the NSE/BSE website.
12. Application to the National Company Law Tribunal seeking direction to call General Meeting of shareholders/for each type of shareholders as well as creditors/secured/unsecured/other classes of the company.
13. Order of NCLT to contain - time, venue, date, quorum approval – how obtained/majority type, e-voting/postal ballot/physical meeting.

14. Filing of Scrutinizers' Report – time line
15. Convening of General Meeting of the shareholders (inform the concerned Stock Exchanges – before and after the conclusion of the meeting).
16. Scrutinizers' Report.
17. Filing of Second Motion Petition.
18. Public Notices.
19. Notices to Central Govt., ROC, OL, RBI, etc.
20. Outcome of the General Meeting to be apprised to the Tribunal.
21. Obtaining of the sanction of the Tribunal.
22. Filing the copy of order of the Tribunal to the Registrar of Companies.
23. Preparation of financial statements, approval by the Board indicating transfer of assets and liabilities
24. Listing of shares at stock exchanges.
25. Post-merger integration.

Some of steps involved in merger are mentioned in detail below:

The procedure commences with an application to stock exchange for NOC and then an application for seeking directions of the Tribunal for convening, holding and conducting meetings of creditors or class of creditors, members or class of members, as the case may be, to the stage of the Tribunal's order sanctioning the scheme of compromise or arrangement is contained in Sections 230 to 240 of the Companies Act, 2013 and rules 3-29 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The Rules also prescribe Forms for various purposes relating to compromise or arrangement. Brief detail of steps involved is given below :

(i) Memorandum to authorise amalgamation

The memorandum of association of most of the companies contains provisions in their objects clause, authorizing amalgamation, merger, absorption, take-over and other similar strategies of corporate restructuring. If the memorandum of a company does not have such a provision in its objects clause, the company should alter the objects clause, for which the company is required to hold a general meeting of its shareholders, pass a special resolution and file along with a certified copy of the special resolution along with copy of explanatory statement and Memorandum of Association & Articles of Association and a copy of agreement with the concerned Registrar of Companies and the prescribed filing fee. The e-form should be digitally signed by Managing Director or Director or Manager or Secretary of the company duly authorized by the Board of Directors. The e-form should also be certified by chartered accountant or cost accountant or company secretary (in whole time practice) by digitally signing the e-form.

Alteration should be registered by the Registrar of Companies and only on such registration the alteration will become effective.

Observing Memorandum of Association of Transferee Company

It has to be ensured that the objects of the Memorandum of Association of the transferee company cover the objects of the transferor company or companies. If not then it will be necessary to follow the procedure for amendment of objects clause by passing a special resolution at an Extraordinary General Meeting convened for this purpose. It has been held by various decisions of the courts that there is no necessity to have special

power in the object clause of the Memorandum of Association of a company for its amalgamation with another company. It has been laid down that to amalgamate with another company is power of the company and not an object of the company.

Since the amalgamation will involve issue of shares by the transferee company to the shareholders of the transferor companies, a general meeting convened for the purpose of the amendment of the Object Clause of Memorandum of Association of the transferee company to incorporate the object of the transferor company, should also cover resolutions relating to the increase of authorised capital, consequential changes in the Articles of Association and resolution authorizing the Directors to issue shares of the shareholders of the transferor companies without offering them to the existing shareholders of the company.

Convening a Board Meeting

A Board Meeting is to be convened and held to consider and approve in principle, amalgamation and appoint an expert for valuation of shares to determine the share exchange ratio.

Consequent upon finalization of scheme of amalgamation, another Board Meeting is to be held to approve the scheme.

Preparation of Valuation Report

Simultaneously, Chartered Accountants are requested to prepare a Valuation Report and the swap ratio for consideration by the Boards of both the transferor and transferee companies and if necessary it may be prudent to obtain confirmation from merchant bankers on the valuation to be made by the Chartered Accountants.

Preparation of scheme of amalgamation or merger

All the companies, which are desirous of effecting amalgamation or merger, must interact through their company's auditors, legal advisors and practicing company secretary who should report the result of their interaction to the respective Board of directors. The Boards of the involved companies should discuss and determine details of the proposed scheme of amalgamation or merger and prepare a draft of the scheme of amalgamation or merger. If need be, they can obtain opinion of experts in the matter. The drafts of the scheme finally prepared by the Boards of both the companies should be exchanged and discussed in their respective Board meetings. After such meetings a final draft scheme will emerge. The scheme must define the "effective date" from which it shall take effect subject to the approval of the Tribunal.

Application to Tribunal seeking direction to hold meetings

Rule 3 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 lays down that an application under Section 230 of the Companies Act, 2013 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.

Jurisdiction of Tribunal

Following are the provisions under the Companies Act, 1956. Since the1956 Act has been replaced by the 2013 Act, sections referred to herein shall differ. The NCLT/Tribunal is now the relevant authority (replacing the relevant High Court) constituted under Section 408 of the 2013 Act.

As explained earlier if the registered offices of both the companies are situated in the same State, a joint application or separate applications should be moved to the High Court having jurisdiction over the State in which registered offices of the companies are situated. However, if the registered offices of the companies involved are situated in different States, they should make separate applications to their respective High Courts.

Accordingly, an application should be made to the NCLT under Section 230 of the Companies Act, 2013 in accordance with the provisions of rule 3 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 for an order directing convening of meeting(s) of creditors and/or members or any class of them, by a Judge's summons supported by an affidavit.

Normally, an application under Section 230 of the Act is made by the company, but a creditor or a member may also make the application. Although a creditor or a member or a class of creditors or a class of members may move an application under Section 230(1) of the Act, yet, such an application may not be accepted by the Tribunal because the scheme of compromise or arrangement submitted to the Tribunal along with the application may not have the approval of the Board of directors of the company or of the company in general meeting. However, the Tribunal has the discretion to give such directions as it may deem proper.

Where the company is not the applicant

Rule 3(3) of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 lays down that where the company is not the applicant, a copy of the notice of admission and of the affidavit shall be served on the company, or, where the company is being wound up on the liquidator not less than 14 days before the date fixed for the hearing of the notice of admission.

Where an arrangement is proposed for the merger or for the amalgamation of two or more companies, the petition must pray for appropriate orders and directions under Section 232 of the Act for facilitating the reconstruction or amalgamation of the company or companies.

Obtaining order of the Tribunal for holding class meeting(s)

On receiving a petition, the Tribunal may order meeting(s) of the members/creditors to be called, held and conducted in such manner as the court directs. Once the ordered meetings are duly convened, held and conducted and the scheme is approved by the prescribed majority in value of the members/creditors, the Tribunal is bound to sanction the scheme.

The Tribunal looks into the fairness of the scheme before ordering a meeting because it would be no use putting before the meeting, a scheme containing illegal proposals which are not capable of being implemented. At that stage, the Tribunal may refuse to pass order for the convening of the meeting.

According to Rule 5 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, upon hearing the application under sub-section (1) of section 230 of the Act, the Tribunal shall, give directions as it may think necessary in respect of the following matters:

(i) determining the members/creditors whose meeting or meetings have to be held for considering the proposed scheme of merger or amalgamation;

(ii) fixing time and place for such meetings;

(iii) appointing a chairman or chairmen for the meetings;

(iv) fixing quorum and procedure to be followed at the meetings including voting by proxy;

(v) determining the values of the members/creditors, whose meetings have to be held;

(vi) notice to be given of the meetings and the advertisement of such notice; and

(vii) the time within which the chairman of the meeting or chairmen of the meetings are to report to the Tribunal the result of the meeting or meetings, as the case may be.

Draft Notice: Explanatory statement under Section 230 of the Companies Act, 2013 and form of proxy are required to be filed and settled by the concerned Tribunal before they can be printed and dispatched to the shareholders.

After obtaining the Tribunal's order containing directions to hold meeting(s) of members/creditors, the company should make arrangement for the issue of notice(s) of the meeting(s). The notice should be in Form No. CAA-2 of the said Rules and must be sent by the person authorised by the Tribunal in this behalf. The person authorised may be the person appointed by the Tribunal as chairman of the meeting, or if the Tribunal so directs by the company or its liquidator if the company is in liquidation, or by any other person as the Tribunal may direct. The Tribunal usually appoints an advocate to be the chairman of such a meeting.

Notice of the meeting should be sent under certificate of post 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 230 setting forth the terms of the proposed compromise or arrangement explaining its effects and an explanatory statement in terms of the provision of section 230(3) of the Act.

Notice by advertisement

Generally, the Tribunal directs that the notice of meeting of the creditors and members or any class of them be given through newspaper advertisements also. Where the Tribunal has directed that the notice of the meetings should also be given by newspaper advertisements, such notices are required to be given in the prescribed Form and published once in an English newspaper and once in the regional language of the State in which the registered office of the company is situated.

The notice must particularly disclose any material interest of the directors, managing director or manager whether as shareholders or creditors or otherwise and the effect on their 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. Such information must also be included in the form of a statement in the notice convening the meeting, where such notice is given by a newspaper advertisement, or, if this is not practicable, such advertised notice must give notification of the place at and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement. If debenture holders are affected, the statement must give like information as far as it affects the trustees for the debenture holders. Statements which have to be supplied to creditors and members as a result of press notification must be supplied by the company to those entitled, free of charge. The Chairman appointed by the Tribunal has to file an affidavit at least 7 days before the meeting confirming that the direction relating to issue of notices and the advertisement has been duly complied with, as required under Rule 12 of the said Rules.

Information as to merger or amalgamation

Section 230(3) of the Companies Act, 2013 lays down that where a meeting of creditors or members or any class of them is called under Section 230(1):

A notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture holders of the company, individually at the address registered with the company which shall be accompanied by a statement disclosing the details of the compromise or arrangement, a copy of the valuation report, if any, and explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and such other matters as may be prescribed:

Provided that such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as maybe prescribed:

Provided further that where the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

Holding meeting(s) as per Tribunal's direction

The meetings are to be held as per directions of the Tribunal under the chairmanship of the person appointed by the Tribunal for the purpose. Normally, the Tribunal appoints a Chairman and alternate Chairman of each meeting. Tribunal also appoints Scrutinizer for holding voting through postal ballot and e-voting.

Convening of General Meeting

— At the General Meeting convened by the Tribunal, resolution will be passed approving the scheme of amalgamation with such modification as may be proposed and agreed to at the meeting. The Extraordinary General Meeting of the Company for the purpose of amendment of Object Clause, consequent change in Articles and issue of shares can be convened on the same day either before or after conclusion of the meeting convened by the Tribunal for the purpose of approving the amalgamation.

— Following points of difference relating to the holding and conducting of the meeting convened by the Tribunal may be noted:

(a) Proxies are counted for the purpose of quorum;

(b) Proxies are allowed to speak;

(c) The vote must be put on poll or by voting through electronic means [Rule 13 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

In terms of Section 230(1), the resolution relating to the approval of amalgamation 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. The resolution will be passed only if both the criteria namely, majority in number and three fourth in value vote for the resolution is met.

— The minutes of the meeting should be finalized in consultation with the Chairman of the meeting and should be signed by him once it is finalised and approved. Copies of such minutes are required to be furnished to the Stock Exchange in terms of the listing requirements.

Reporting of the Results

The chairman of the meeting will submit a report of the meeting indicating the results to the concerned Tribunal in Form No.CAA-4 of the said Rules within the time fixed by the Tribunal, or where no time has been fixed, within three days after the conclusion of the meeting. The Report must state accurately:

(a) the number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present at the meeting;

(b) the number of creditors or class of creditors or the number of members or class of members, as the case may be, who voted at the meeting either in person or by proxy;

(c) their individual values; and

(d) the way they voted.

Petition to Tribunal for confirmation of scheme

When the proposed scheme of compromise or arrangement is agreed to, with or without modifications, as provided in Section 230 of the Act, a petition must be made to the Tribunal for confirmation of the scheme of compromise or arrangement. The petition must be made by the company and if the company is in liquidation, by the liquidator, within seven days of the filing of the report by the chairman. The petition is required to be made in Form No. CAA-5 of the said rules. On hearing the petition the Tribunal shall fix the date of hearing and shall direct that a notice of the hearing shall be published in the same newspapers in which the notice of the meeting was advertised or in such other papers as the Tribunal may direct, not less than 10 days before the date fixed for hearing (Rule 16).The Tribunal also directs that notices of petition be sent to the objectors or to their representatives under sub-section (4) of section 230 of the Act and to the Central Government and other authorities who have made representation under rule 8 and have desired to be heard in their representation.

Obtaining order of the Tribunal sanctioning the scheme

An order of the Tribunal on summons for directions should be obtained which will be in Form No. CAA. 6 (Refer Rule 17).

Filing of copy of Court's order with ROC

According to the provisions of Section 230(8) of the Companies Act, 2013 a certified copy of the order passed by the Tribunal is required to be filed with the concerned Registrar of Companies. This is required to be filed with INC-28 as prescribed in the Companies Act, 2013 within a period of 30 days of the receipt of the order.

Conditions precedent and subsequent to Tribunal's order sanctioning scheme of arrangement

The Tribunal shall not sanction a scheme of arrangement for amalgamation, merger, etc. of a company which is being wound-up with any other company or companies unless it has received a report from the Registrar of Companies to the effect that the affairs of the company have not been conducted in a manner prejudicial to public interest. When an order has been passed by the Tribunal for dissolution of the transferor company, the transferor company is required to deliver to the Registrar a certified copy of the order for registration within thirty days and the order takes effect from the date on which it is so delivered.

Copies of the order of Tribunal are required to be affixed to all copies of Memorandum and Articles of Association of the transferee company issued after certified copy has been filed as aforesaid. The transferor company or companies will continue to be in existence till such time the Tribunal passes an order for dissolution without winding-up, prior to which it must receive 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 the members or to public interest. The practice in India is that in certain High Courts the Order on amalgamation is passed only after the Report of the Official Liquidator is received, whereas in certain cases the order of dissolution is passed after which amalgamation is approved by the concerned High Court. [High Court has been replaced by the Tribunal under the 2013 Act.]

The above sets out briefly the procedure relating to merger and amalgamation in India. It will be obvious from the foregoing that considerable amount of paper work and documentation are required to be prepared during the course of the process of merger. Since the law requires approval of the shareholders both in majority in number and three-fourth in value, it has to be ensured that adequate number of shareholders, whether in

person or by proxy attend the meeting so that the resolution can be passed by the requisite majority as mentioned above. Normally the time frame for such merger will depend on the opposition, if any, to the proposed merger from shareholders or creditors but in normal case it may take any thing between six months to one year to complete the merger from the time the Board approves the scheme of amalgamation till the merger becomes effective on filing of the certified copies of the Tribunal's Order.

Revised Organization Chart

One modification that has great potential to affect the new business is a change in the organizational structure. Regardless of whether the changes are large or small, planning and an intense analysis are vital to creating a decision-making and communication framework that will support post-merger objectives and help the new business grow.

Structural Change Considerations

An organizational structure refers to the levels of hierarchy, chain of command, management systems and job structures and roles. In response to a merger, duplicate departments need to be merged or eliminated, and at least some employees from both companies will either transfer to new positions or leave the company. Communication patterns will typically change as managers acquire new employees and everyone adapts to changes in policies and procedures designed to fit the new company.

Premerger Due Diligence

Review the organizational structures of both businesses to see how well each compares to the mission and long-term objectives for the new company. Analyze hierarchies and reporting relationships to see where the existing structures clash and where they're synchronized. Once an initial review is completed, appoint an integration team to speak with core employees and get their perspective on what works and what doesn't work in their respective structures. Make preliminary decisions about which features best support the new business.

Structural Change Options

Organizational structure change options include starting from scratch, eliminating one in favor of the other and combining the best features of both structures into one. Which is the best option depends on the size, complexity and objectives of the new business. For example, two small businesses with flat organizational structures may need to convert to a more hierarchical and organized structure that allows for greater internal controls and division of responsibilities. It is also useful when the owners or chief executive officer delegates some decision-making responsibilities.

The Three Phases of Change

Changing an organizational structure due to a merger involves much more than creating a new organizational chart. Although the chart will reflect decisions made about how the new business's employees will communicate with one another and make decisions, this typically occurs in multiple phases. The first phase is awareness, during which employees from both businesses come to understand the new company's direction and what it will mean to them. The goal of the second phase is acceptance, as the integration team works to build new relationships and employees at every level transition into new roles and new ways of getting work done. In the final phase, the merger is complete and the new organizational structure becomes fully adopted.

For example in merger of the associate banks of SBI with that of the State Bank of India, some of the branches of the erstwhile associate banks were allowed to shift to other places or closed down. Further the

Administrative offices/ Regional offices were also reorganized since these offices of the merged bank lost their identity and the authority of the existing Regional/ Zonal Offices of the acquiring bank were expanded to have control over more branches or realigned. Similarly apart from the relocation of the branches and regional/zonal offices, the authority and responsibility of the middle level and higher level officers were also realigned and tuned with the requirement after the merger.

Employee Compensation, Benefits and Welfare activities

Employee's compensation in the two companies varies. For example in the case of merger between the Bank of Rajasthan Ltd. (BoR) and the ICICI Bank Ltd which was held in 2010, the BoR employees were aligned with the Indian Bank Association (IBA), while the ICICI Bank was having its own compensation and not linked with the IBA compensation policy. In order to have consistency in compensation policy the merged bank employees were forced to adopt the compensation policy of the acquiring bank.

Whatever the strategy is adopted, companies need to be sensitive with regard to terms and conditions of employment. Usually, courts would uphold terms of employment to be no less favorable than existing terms and conditions. Post acquisition, the parent company may want the acquired company to adopt compensation structure of the parent entity. It would result in re-aligning the structure as well as pay scales of existing employees.

Aligning Company Policies

After merger the merged entity is usually forced to adopt the policies of the merging company. The accounting software and policies of the amalgamating companies are to be aligned with that of the amalgamated company in a phased manner. For example in the case of the merger of the two banking companies, the acquiring bank imposes its accounting software (like Finacle) on the merged bank and also various policies like Deposit Policy, Loan Policy, Recovery & Compromise Policy, etc. in order to have uniformity in serving the customers. However if the products of the erstwhile (merged) entity is good enough, the same are allowed to be continued till the conclusion of the scheme. At the time of the merger of the Bank of Rajasthan Ltd (BoR) with ICICI Bank Ltd, the customers of the BoR were charged for the same service charges for some time and allowed to continue with some of the product schemes as per the sanction terms and conditions, in order to win the customer's confidence in the acquiring bank too.

Aligning Accounting and Internal Database Management Systems

Besides passing appropriate accounting entries to capture the merger/ acquisition/ financial structure, the company may need to adopt accounting policies, practices based on those followed by its new parent organization post acquisition. The company needs to understand any reporting and database requirements of acquiring company or merged entity to provide relevant data to the new management and to align existing systems with those of the parent/ merged entity. This may involve providing suitable training to concerned personnel and understanding issues, if any, to avoid incorrect reporting.

Record Keeping

Preservation of books and papers of amalgamated companies: Section 239[3] provides that 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 and before granting such permission, that Government may appoint a person to examine the books and papers or any

3 Enforced with effect from 15-12-2016.*See* also Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

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 transferor company or its amalgamation or the acquisition of its shares.

Maintenance of records of merging entity and making suitable entries in the records (e.g. registers under Companies Act reflecting changes in shareholding, directors etc. as applicable) of merged entity is a must. One will need to dive deep to ensure maintenance of all past records including statutory and non-statutory registers, original copies of various forms, returns, certificates, approvals, litigation and property records. Company may need to relocate the records to centralized storage maintained by the merged/new entity.

Integration of Businesses and Operations

The integration of business and operations after merger is the crucial part and many points require attention on the issue. These may be list out as under:

- Assessment of the future cash flow generation in order to have organic growth after having gone through the process of inorganic growth.
- Integration of the accounting software, accounting policy.
- Integration of various other software.
- The customer retention of the merged entity and acquisition of more customers.
- Satisfaction of the human resources and retaining of the talent.

Post-Merger Success and Valuation

Every merger is not successful. The factors which are required to measure the success of any merger are briefly discussed below:

- The earning performance of the merged company can be measured by return on total assets and return on net worth. It has been found that the probability of success or failure in economic benefits was very high among concentric mergers. Simple vertical and horizontal mergers were found successful whereas the performance of concentric mergers was in between these two extremes i.e. failure and success.
- Whether the merged company yields larger net profit than before, or a higher return on total funds employed or the merged company is able to sustain the increase in earnings.
- The capitalisation of the merged company determines its success or failure. Similarly, dividend rate and payouts also determines its success or failure.
- Whether merged company is creating a larger business organisation which survives and provides a basis for growth.
- Comparison of the performance of the merged company with the performance of similar sized company in the same business in respect of (i) Sales, (ii) assets, (iii) net profit, (iv) earning per share and (v) market price of share. In general, growth in profit, dividend payouts, company's history, and increase in size provides base for future growth and are also the factors which help in determining the success or failure of a merged company.
- Fair market value is one of the valuation criteria for measuring the success of post merger company. Fair market value is understood as the value in the hands between a willing buyer and willing seller, each having reasonable knowledge of all pertinent facts and neither being under pressure or

compulsion to buy or sell. Such valuation is generally made in pre-merger cases.

- In valuing the whole enterprise, one must seek financial data of comparable companies in order to determine ratios that can be used to give an indication of the company position. The data is analyzed to estimate reasonable future earnings for the subject company. The following information must be made available and analyzed for post-merger valuation:
    - All year-end balance sheets and income statements, preferably audited, for a period of five years and the remaining period up to the valuation date.
    - All accounting control information relating to the inventory, sales, cost, and profit contribution by product line or other segment; property cost and depreciation records; executives and managerial compensation; and corporate structure.
    - All records of patents, trademarks, contracts, or other agreements.
    - A history of the company, including all subsidiaries.

  Analysis of these items provides data upon which forecasts of earnings, cash flow, etc. can be made.

- Gains to shareholders have so far been measured in terms of increase or decrease in share prices of the merged company. However, share prices are influenced by many factors other than the performance results of a company. Hence, this cannot be taken in isolation as a single factor to measure the success or failure of a merged company.

- In some mergers there is not only increase in the size of the merged or amalgamated company in regard to capital base and market segments but also in its sources and resources which enable it to optimize its end earnings.

- In addition to the above factors, a more specific consideration is required to be given to factors like improved debtors realisation, reduction in non-performing assets, improvement due to economies of large scale production and application of superior management in sources and resources available relating to finance, labour and materials.

Human and Cultural Aspects

Human Aspects: The merger and acquisition in the corporate world is a common phenomenon. It may be the horizontal merger or vertical merger. A horizontal merger decreases competition in the market, while vertical merger is a merger between companies in the same industry, but at different stages of production process. However the most neglected part in the merger story is the human aspect. The employees of the amalgamated entity face secondary treatment in the amalgamating company. They are harassed, transferred recklessly and demoted one or two scale lower, which leads to frustration and are forced to take voluntary retirement. In this way the company losses the good employees too. The recent merger of the Bank of Rajasthan Ltd with ICICI Bank Ltd and the Associate Banks of State Bank of India with the State Bank of India are good examples, in which many of the employees of the merged entities have opted the voluntary retirement.

Cultural Aspects: Apart from the human aspects the cultural issue in the case of merger is also a crucial issue. Integration of the employees accustomed of different cultural background is a typical aspect. Implementation of structural nature may be financially and legally successful. But if cultural issues are ignored, the success may only be transient. Culture of an organisation means the sum total of things the people do and the things the people do not do. Behavioural patterns get set because of the culture. These patterns create mental blocks for the people in the organization. Pre-merger survey and summarization of varying cultures of different companies merging, needs to be carried out. People belonging to the each

defined culture need to be acquainted with other cultures of other merging companies. They need to be mentally prepared to adopt the good points of other cultures and shed the blockades of their own cultures. Such an open approach will make the fusion of cultures and ethos easy and effective.

Measuring Post-merger Efficiency

The criterion to judge a successful merger differs in different conditions. Different factors may be considered for making value judgements such as growth in profit, dividend, company's history, increase in size, base for growth, etc. Several studies suggest different parameters to assess the success of mergers:

- Successful merger creates a larger industrial organization than before, and provides a basis for growth [Edith Perirose].
- In Arthur Dewing's study, three criteria were considered viz. (a) merger should give a larger net profit than before (b) merger should provide a higher return on total funds (c) there should be a sustained increase in earnings.
- Earnings on capitalization and dividend records determine the success of merger [Shaw L.].

During the studies in late 1960s, two types of efficiency improvements were expected to result from mergers: (1) improvements due to economies of large scale production (2) application of superior management skills to a larger organisation. Some other researches in the seventies and eighties, measure efficiency based on stock market measures, labour productivity or total factor productivity, etc. These improvements pointed towards market dominance, but for gauging efficiency, resultant profitability was accepted as a benchmark. In order to ensure progress, a conscious and concerted effort to keep track of several key elements is required, along with answers to the following questions:

1. What impact is the integration (merger/acquisition) having on key indicators of business performance? Whether synergies which were hypothesized during the valuation are being realized?
2. Are the activities and milestones developed with the integration process on target?
3. What are the major issues emerging during the integration, requiring considerable attention?
4. What important facts have emerged during the merger or acquisition that can be used to improve subsequent mergers or acquisition?

Measuring Key Indicators

The main purpose of a merger or acquisition is to deliver the expected financial results namely earnings and cash flow. However, there are certain other measures that serve as key indicators and they also need to be measured. The indicators may be grouped as:

i. Financial outcomes.

ii. Component measures of these outcomes namely revenues, costs, net working capital and capital investments.

iii. Organisational indicators such as customers, employees and operations.

All the areas being integrated and both the acquirer and target, or in a merger, both partners, should be brought within the ambit of continuous appraisal. Also, the appraisal should be based on benchmarks to ensure that merger or acquisition are yielding the financial and strategic objective so intended and are not resulting in value leakage.

There are broadly four possible reasons for business growth and expansion which is to be achieved by the merged company. These are (1) Operating economies, (2) Financial economies, (3) Growth and diversification, and (4) Managerial effectiveness.

LESSON ROUND-UP

- Chapter XV, comprising of sections 230 to 240 of the Companies Act, 2013 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, deals with Compromises, Arrangements and Amalgamations.
- Section 230 is relating to the power of the company to compromise or to make arrangement with its creditors and members.
- Section 230(2) deals with regard to information as to compromises and arrangements with creditors and members.
- Section 232 deals with facilitation of merger and amalgamation of companies.
- Sections 235-236 deal with provisions regarding the power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority shareholders.
- Section 237 contains provisions as to the power of the central government to provide for amalgamation of companies in national interest.
- Section 247 of the Companies Act, 2013 deals with the valuation by registered valuers.
- Merger or amalgamation of companies involves various issues including the regulatory approvals. These regulatory approvals are to be obtained not only from the sector in which the company is operating (for example in case of merger of two banks, RBI's approval is needed) but from other departments like Income Tax, SEBI, ROC, etc.
- Due diligence is an investigation of a business or person prior to signing a contract, or an act with a certain standard of care. It can be a legal obligation, but the term will more commonly apply to voluntary investigations.
- General principles of Business Valuation are: Principle of Time Value of Money, Principle of Risk and Return, Principle of Substitution, Principle of Alternatives, Principle of Reasonableness.
- The most popular methods of valuation amongst other include Asset based valuation, Earnings based valuation and Market based valuation. Other aspects as to the Methods of Valuation are Relative Method, Super Profit Method, Contingent Claim Method, and Accounting Professionals Experts.
- 'Post-merger reorganization' is a wide term which encompasses the reorganization of each and every aspect of the company's functional areas to achieve the objectives planned and aimed at.
- There are broadly four possible reasons for business growth and expansion which is to be achieved by the merged company. These are (1) Operating economies, (2) Financial economies, (3) Growth and diversification, and (4) Managerial effectiveness.
- Human and cultural integration is central to the success of any merger.
- The earning performance of the merged company can be measured by return on total assets and return on net worth.
- In general, growth in profit, dividend payouts, company's history and increase in size provides the base for future growth and are also the factors which help in determining the success or failure of a merged company.

GLOSSARY OF TECHNICAL WORDS

Merger: An amicable involvement of two or more companies to form one unit, and to increase overall efficiency. The shareholders of merged companies are offered equivalent holdings in the new company.

Amalgamation: The joining of one or more companies into a new entity. None of the combining companies remains; a completely new legal entity is formed.

Offer Price: The price offered per share by the acquirer.

Share Exchange Ratio: The offer price divided by the acquirer's share price.

Synergy: Cost savings and revenue enhancements that are expected to be achieved in connection with a merger/acquisition.

LIST OF FURTHER READINGS

1. Guide to Companies Act by A Ramaiya, Lexis Nexis Butterworths
2. Master Guide to Companies Act 2013 & Company Rules by Taxmann
3. Mergers Acquisitions & Corporate Restructuring, 3rd Edition by Taxmann
4. The Companies Act, 2013 with Rules and Ready Referencer by S K Kataria, Bloomsbury Publication
5. Guide to Takeovers and Mergers by Sridharan and Pradhan, Wadhwa & Co.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Write a detailed note on the merger and acquisition provisions contained in the Companies Act, 2013 and its relevant rules.
2. Describe the regulatory authorities from whom the approvals are to be taken in case of merger/ amalgamation and its process.
3. What are the procedural steps involved in a merger?
4. Discuss the role of Tribunal in approving a scheme of reconstruction or restructuring under Sections 230-240 of the Companies Act, based on decided cases from the standpoint of shareholders and employees.
5. ABC & Co (P) Ltd. and XYZ Ltd. have finalized a scheme of arrangement. The registered offices of both the companies are located in Delhi. A joint-petition is proposed to be filed before the Tribunal for sanction of the scheme.

   Give your brief opinion in the light of the provisions of the Companies Act, 2013 and the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 whether such a joint-petition can be filed.
6. What do you understand by Due Diligence? Mention the types of due diligence and what should be the contents of the due diligence report?
7. Discuss the relevant provisions on valuation as contained in the Companies Act, 2013 and its relevant rules.
8. List out the points which are to be taken care of in the case of pre and post merger/takeover exercise.

Lesson 5
Documentation – Merger and Amalgamation

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Documentation in M&A
- List of documents filed in case of a scheme of amalgamation
- Merger and Amalgamation process at National Company Law Tribunal
- Drafting of Scheme
- Drafting of Notice
- Drafting of Explanatory Statement
- Drafting of Application and Petition
- Filing of Rejoinder

LEARNING OBJECTIVES

Under Companies Act, 2013, a Scheme of merger or amalgamation firstly requires approval of members or creditors. Post their approval, if the Tribunal sanctions the Scheme, then the same is binding on the company, all the creditors, or class of creditors or members or class of members.

Drafting of scheme, plaints, applications, reply/written statement require the skills and knowledge of a draftsman. These should be drafted after looking into the provisions of law so that no relevant detail is omitted.

A Company Secretary must know the nuances involved in mergers and amalgamations and also the important aspects of the legal documentation thereto.

The objective of the study lesson is to make the students understand the mechanics of mergers and amalgamations including the documentation involved, points to be factored while drafting such documents and general provisions under the Companies Act, 2013 and NCLT Rules with respect to mergers and amalgamations.

INTRODUCTION

Documentation is an important aspect in fulfillment of legal requirements and obligations in merger and amalgamation for an effective and successful venture. The quantum of such obligations will depend upon the size of company, debt structure and profile of its creditors, compliances under the corporate laws, controlling regulations, etc. In all or in some of these cases legal documentation would be involved. If foreign collaborators are involved, their existing agreements would need a mandatory documentation to protect their interests if their terms and conditions so require. Secured debenture holders and unsecured creditors would also seek legal protection to their rights with new or changed management of the amalgamating company. Regulatory bodies like the RBI, Stock Exchanges, the SEBI, etc. would also ensure adherence to their respective guidelines, regulations or directives. In this way, while drafting the scheme of merger and amalgamation the transferor and transferee would have to ensure that they meet legal obligations in all related and requisite areas.

Where a compromise or arrangement is proposed for the purposes of or in connection with scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition shall pray for appropriate orders and directions under section 230 read with section 232 of the Act.

Stages involved in Mergers and Amalgamation under the Companies Act, 2013

In brief, it can be said that there are broadly eight stages involved in merger and amalgamation, which are listed below:

Stage 1 – Drafting of the Scheme

Stage 2 – Obtaining the approval of the Board of Directors of the companies involved

Stage 3 – Obtaining approval of the stock exchanges in case of listed companies

Stage 4 – Application / Petition for convening the meeting of members/creditors shall be filed with National Company Law Tribunal

Stage 5 – Convening meetings of the Shareholders and Creditors and obtaining their consent on Scheme

Stage 6 – Approvals or No objection from Regional Director / Official Liquidator

Stage 7 – Filing of final petition with NCLT for approving the Scheme

Stage 8 – Obtaining order for approval for scheme of merger/amalgamation from the National Company Law Tribunal

A sample scheme of merger has been annexed to this Chapter as **Annexure A** for better understanding.

List of Documents filed in case of a scheme of amalgamation

In this case there are two companies to the amalgamation, i.e., the Transferor (1st Applicant) and the Transferee (2nd Applicant)

S. No.	Document
1.	Memorandum and Articles of Association of the First Applicant Company
2	Audited Balance Sheet of the First Applicant Company – latest
3.	Board Resolution for approval and authorization of the scheme by the First Applicant Company

4.	List of Equity Shareholders of the First Applicant Company
5.	Consent Affidavits filed by the Equity Shareholders of the First Applicant Company
6.	Auditors Certificate stating out the no. of Secured Creditors in the First Applicant Company
7.	Auditor's Certificate listing out the no. of Unsecured Creditor in the First Applicant Company
8.	Consent Affidavit filed by no. of Unsecured Creditor of the First Applicant Company
9.	Auditors Certificate of the 1st Applicant Company in relation to the accounting treatment proposed in the Scheme of Amalgamation
10.	Memorandum and Articles of Association of the Second Applicant Company
11.	Audited Balance Sheet of the Second Applicant Company
12.	Board Resolution for approval and authorization of the Scheme by the Second Applicant Company
13.	List of Equity Shareholders of the Second Applicant Company
14.	Auditors Certificate listing out the no. of Secured Creditors in the Second Applicant Company
15.	Consent Affidavit filed by the no. of Secured Creditor of the Second Applicant Company
16.	Auditors Certificate listing out the no. of Unsecured Creditors in the Second Applicant Company
17.	Consent Affidavit filed by the no. of Unsecured Creditor of the Second Applicant Company
18.	Auditors Certificate of the 2nd Applicant Company in relation to the accounting treatment proposed in the Scheme of Amalgamation
19.	Certificate of the Chartered Accountant for Non-Applicability of obtaining a Valuation Report
20.	Fairness Opinion issued by the Merchant Banker on the Scheme of Amalgamation
21.	Undertaking regarding the Non-Applicability of paragraph I(A) 9(a) of Annexure I of SEBI Circular No. CIR/CFD/CMD/16/2015 dated 30 November 2015
22.	Observation Letter issued by the Stock Exchanges approving the Scheme of Amalgamation
23.	Scheme of Amalgamation

Merger and Amalgamation process at National Company Law Tribunal (NCLT)

It must be ensured that the companies under amalgamation have a clause in the object clause of their Memorandum of Association to undergo amalgamation though the absence may not be an impediment, but this will make matters smooth. A draft scheme of amalgamation shall be prepared for getting it approved in Board meeting of each company.

Persons eligible for filing the petition before NCLT

1. An application for merger & amalgamation shall be filed with Tribunal (NCLT) by both the transferor(s) and the transferee company in the form of petition under section 230-232 of the Companies Act, 2013 for the purpose of sanctioning the scheme of amalgamation.

2. Where more than one company is involved in a scheme, such application may, at the discretion of such companies, be filed as a joint-application.

In case, the registered office of the companies involved is in different states, there will be two Tribunals having the jurisdiction over those. Both the companies shall have to file separate petition with the respective Tribunals.

(1) Drafting of Scheme

The Scheme of amalgamation would comprise of various parts containing details about Transferor Company, Transferee Company. The Scheme in particular would comprise of the following in detail:

Introductory Part

1. Basic Details of the Transferor & Transferee company like date of incorporation, CIN and registered office and address for service of notice
2. Main objects in Memorandum of Association of Transferor and Transferee Company
3. Jurisdiction of the Bench
4. Limitation
5. Facts of the case - reason in brief for going into merger or amalgamation
6. Nature of business
7. Share Capital of the companies involved and shareholding relationship between the companies involved
8. Definition Clause

Operating Part – The scheme

9. Appointed Date - The scheme shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.
10. Transfer of the undertaking of the Transferor Company or transfer of the Transferor Company *per se*
11. Transfer of assets
12. Transfer of debts and liabilities
13. Transfer of licenses, approvals / permissions
14. Transferor of Company's staff, workmen and employees
15. The transfer of undertaking or the Transferor Company not to affect the transaction / contracts of transferor Company
16. Enforcement of contracts, deeds, bonds and other instruments
17. Enforcement of Legal Proceedings
18. Issue and Allotment of Shares under the Scheme
19. Increase in Authorized Share Capital
20. Accounting Treatment

21. Conduct of business by the transferor Company till effective date
22. Dissolution of Transferor Company
23. Effect of Scheme
24. Expenses relating to the Scheme
25. Scheme conditional upon approval / sanctions
26. Effect of non-receipt of approvals
27. General terms and conditions applicable for the scheme

Prayer / Relief Part

28. Approval of scheme
29, Particulars of Bank draft evidencing payment of fee for the Application

In addition to the above, a clean and clear drafting of the Petition is required to be submitted to the NCLT, which would make process easier. Following are the standard guidelines for presenting an application or petition before NCLT, prescribed in National Company Law Tribunal Rules, 2016.

1. The petition / application being filed shall fall under the proper territorial jurisdiction of NCLT Bench.
2. The petition / application and all enclosures shall be legibly typewritten in English language.
3. The petition / application / appeal / reply shall be printed in double line spacing on one side of the standard petition paper with an inner margin of about 4 cms width on top and with a right margin of 2.5 cm left margin of 5 cm and duly paginated, indexed and stitched together in paper book form.
4. The petition/ application shall be filed in triplicate by duly authorised representative of the companies or by an advocate duly appointed in this behalf.
5. The petition shall also be accompanied by an index.
6. The cause title of the petition/application shall be "Before the National Company Law Tribunal" and it shall also specify the Bench to which it is presented.
7. All the relevant provisions of the Companies Act, 2013 / NCLT Rules, 2016 shall be clearly mentioned in the petition / application.
8. The petition/application shall be divided into paragraphs and shall be numbered consecutively and each paragraph shall contain a separate fact or point.
9. The foot of petition / application shall have name and signature of the authorized representative.
10. The name of the petitioner / applicant along with complete address, viz, the name of the road street lane and municipal division or ward, municipal door and other number of the house, the name of the town or village; the post office; postal district and pin code shall be mentioned in the petition / application.
11. The fax number, mobile number, valid email addresses of the petitioner / applicant shall also be mentioned.
12. Every interlineations, eraser or correction or deletion in petition / application shall be initialed by the party or his authorized representative.
13. The affidavit verifying the petition in Form NCLT-6 shall be drawn on non-judicial /stamp paper of requisite value duly attested by Notary public / Oath Commissioner.

14. Full name, parentage, age, description of each party, date, address and in case a party sues or being sued in a representative character, has been set out in accordance to Rule 20(5) of the NCLT Rules, 2016.

15. Petition / application / appeal reply has been drawn in the prescribed form as per Annexure A of NCLT Rules, 2016 with stipulated fee given in the Schedule of these rules. The fee is to be paid by way of demand draft / PO drawn in favour of the "The Pay & Accounts Officer, Ministry of Corporate Affairs, New Delhi".

16. The documents attached with petition / application shall be duly certified by the authorized representative or advocate filing the petition or application.

17. The annexure to the petition / application shall be serially numbered.

18. The *Vakalatnama* shall bear court fee stamp.

19. The documents with regard to shareholding/paid-up capital/latest balance sheet of the petitioner/ applicant shall be attached.

(2) Submission of Application / Petition

Petition to the Tribunal for merger & amalgamation shall be submitted in Form No. NCLT-1 along with following documents:

1. A notice of admission in Form No. NCLT-2
2. An affidavit in Form No. NCLT-6
3. A copy of Scheme of compromise and arrangement (Merger & Amalgamation)
4. The applicant shall also disclose to the Tribunal in the application, the basis on which each class of members or creditors has been identified for the purposes of approval of the scheme.

(3) Calling of Meeting by Tribunal

The Tribunal upon hearing the application may either give relevant directions / order for conducting the meeting of the creditors or class of creditors, or of the members or class of members or may dismiss the application for any appropriate reason.

Drafting of Notice of Meeting

The Notice of the meeting pursuant to the order of Tribunal shall be given in Form No. CAA-2. The table below provides basic information about Notice of Meeting:

Person entitled to receive the notice	The notice shall be sent individually to each of the Creditors or Members and the debenture-holders at the address registered with the company
Person authorized to send the notice	Chairman of the Meeting or if Tribunal so directs- by the Company or its liquidator or by any other person
Modes of sending of notice	By Registered post, or by Speed post, or by courier, or By e-mail, or by hand delivery, or by any other mode as directed by the Tribunal

The notice shall be accompanied with a copy of the scheme. Additionally, if the scheme does not include the following details, then the same shall also be sent along with the notice.

(a) Details of the order of the Tribunal directing the calling, convening and conducting of the Meeting

- Date of the Order;
- Date, time and venue of the meeting

(b) Details of the company including –

- Corporate Identification Number (CIN) or Global Location Number (GLN) of the company;
- Permanent Account Number (PAN);
- Name of the company;
- Date of incorporation;
- Type of the company (whether public or private or one-person company);
- Registered office address and e-mail address;
- Summary of main object as per the memorandum of association; and main business carried on by the company;
- Details of change of name, registered office and objects of the company during the last five years;
- Name of the stock exchange (s) where securities of the company are listed, if applicable;
- Details of the capital structure of the company including authorized, issued, subscribed and paid-up share capital;
- Names of the promoters and directors along with their addresses

(c) Relationship between companies: if the scheme of compromise or arrangement relates to more than one company, then the fact and details of any relationship subsisting between such companies who are parties to such scheme of compromise or arrangement, including holding, subsidiary or of associate companies.

(d) Disclosure about the effect of the compromise or arrangement on:

- Key managerial personnel;
- directors;
- promoters;
- non-promoter members;
- depositors;
- creditors;
- debenture holders;
- deposit trustees and debenture trustees;
- employees of the company

(e) Disclosure about effect of M&A on material interests of directors, Key Managerial Personnel (KMP) and debenture trustee. The term ‘interest’ extends beyond an interest in the shares of the company, and is with reference to the proposed scheme of compromise or arrangement.

(f) Details of Board Meeting: The date of the board meeting at which the scheme was approved by the board of directors, the name of the directors who voted in favor of the resolution, the names of the directors who voted against the resolution and the names of the directors who did not vote or participate on such resolution.

(g) Investigation or proceedings, if any, pending against the company under the Act.

(h) Details of the availability of the following documents for obtaining extract from or for making/obtaining copies of or for inspection by the members and creditors, namely:

- latest audited financial statements of the company including consolidated financial statements;
- copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with;
- copy of scheme of compromise or arrangement;
- contracts or agreements material to the compromise or arrangement;
- the certificate issued by auditor of the company to the effect that the accounting treatment if any proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133 of the Companies Act, 2013 and
- such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;

(i) Details of approvals, sanctions or no-objection(s), if any, from regulatory or any other government authorities required, received or pending for the purpose of scheme of compromise or arrangement.

(j) A statement to the effect that the persons to whom the notice is sent may vote in the meeting either in person or by proxies, or where applicable, by voting through electronic means.

Drafting of the Explanatory Statement

Explanatory Statement disclosing details of the scheme of compromise or arrangement include the following:

(a) Parties involved in compromise or arrangement;

(b) Appointed date, effective date, share exchange ratio (if applicable) and other considerations, if any;

(c) Summary of valuation report (if applicable) including basis of valuation and fairness opinion of the registered valuer, if any, and the declaration that the valuation report is available for inspection at the registered office of the company;

(d) Details of capital or debt restructuring, if any;

(e) Rationale for the compromise or arrangement;

(f) Benefits of the compromise or arrangement as perceived by the Board of directors to the company, members, creditors and others (as applicable);

(g) Amount due to unsecured creditors.

Further details to be provided in the Notice

1. A copy of the valuation report, if any
2. Copy of the order of Tribunal in pursuance of which the meeting is to be convened or has been dispensed with copy of scheme of Merger & Amalgamation

3. Contracts or agreements material to the Merger & Amalgamation
4. Such other information or documents as the Board or Management believes necessary and relevant for making decision for or against the scheme;
5. The draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;
6. a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties
7. Confirmation that a copy of the draft scheme has been filed with the Registrar;
8. The report of the expert with regard to valuation, if any;

The notice along with the aforementioned documents and information shall also be placed on the website of the company, if any. In case of a listed company, these documents shall be sent to Securities and Exchange Board (SEBI) and stock exchanges where the securities of the companies are listed, for placing on their website.

Basic principles of drafting of application and petition

Before any professional commences drafting of Petition, Written Statement, Replication/Rejoinder or Miscellaneous application (cumulatively called pleadings), it is absolutely necessary to keep in mind the provisions of Code of Civil Procedure (in short CPC), Limitation Act, Indian Evidence Act, procedural laws and certain basic and fundamental principles of drafting and pleadings must be kept in mind. Therefore, for anyone wishing to appear before NCLT or NCLAT, the professional must acquaint himself with CPC, Cr. PC, Limitation Act, Indian Evidence Act, Law of Contracts, Sale of Goods Act, etc.

ORDER 6 RULE - 2 CPC

1. Every pleading shall contain only a statement in a concise form of material facts on which the party is relying upon. However, text of documents or evidence in the form of (a) Agreement/MOU (d) Letters (c) e-mails (d) Negotiable instruments (e) Deeds (f) written documents or well settled position of law need not be elaborated in the pleadings but only reference is required to be made. Every pleading should not contain arguments. Further, (a) every pleading shall be divided into paragraphs, numbered consecutively, each allegation should be in a separate paragraph (b) dates, sums and numbers shall be expressed in a pleading in figures as well as in words. The Supreme Court has observed that "every pleading must state all material facts and not law. (i) *Mayar (H. K.) Ltd. and Ors. Vs. Owners and Parties , Vessel M. V . Fortune Express and Ors* [AIR 2006 SC1828] (ii) *Ramesh Kumar Agarwal Vs. Rajmala Exports Pvt. Ltd. and Ors.* [AIR 2012SC 1887]
2. However, as per Order 6 Rule 4 CPC, in all cases, where the party alleges (a) mis-representation (b) fraud (c) breach of trust (d) willful default (e) undue influence, the party alleging any of these, must state clearly and specifically time, date month or year when any of the aforesaid happened - however, merely vague allegations are not sufficient and adequate and the court will not take cognizance.
3. Before any one proceed to commence drafting, it is absolutely necessary to gather information/ documents/papers by having extensive discussions with the clients. The information could be gathered by asking the questions on the following points:

- Whether all Factual Details have been taken out
- All Evidence Necessary for Drafting
- Appointment of Additional Directors
- Cessation of Office of Existing Directors
- Removal of Promoter Directors
- Illegal Transfer of Shares / Removal of Directors
- Information can be obtained under Right to Information Act, 2005.

ORDER 6 RULE-14 CPC

PLEADING TO BE SIGNED

4. Every pleading shall be signed by the party and his pleader, if any, provided that where a party pleading is, by reason of absence or for other good cause; unable to sign the pleading, it may be signed by any person duly authorized by him to sign the same or to sue or defend on his behalf. The authorization to sign the pleadings could be either by way of (a) Board resolutions in case of body corporate or (b) Power of Attorney duly executed.

Forms of Pleadings

5. Generally, the rules prescribe the format of petition or application but does not prescribe the format for filing of Written Statement/Reply or Rejoinder or Replication. Therefore, the contents of petition must always be set out under various headings or sub-headings in accordance with the format prescribed – otherwise, the Registry of the NCLT or NCLAT may raise objection and your petition will not be listed for admission hearing and consequently, grant of interim relief may be delayed. The petition must adhere to the following:-
   (a) Form prescribed
   (b) Set brief description of each of the petitioner and respondents;
   (c) Narrate the Facts.

Other General Points to be kept in mind while filing Application / Petition with NCLT Rule 34 of the NCLT Rules, 2016

1. Where a particular situation is not provided in the NCLT Rules, the NCLT may for reasons to be recorded in writing, determine the procedure in a particular case in accordance with the principles of natural justice.
2. The general heading in all proceedings before the Tribunal , in all advertisement and notices shall be in Form No. NCLT-4.
3. Every petition or application or reference shall be filled in form as provided in Form No. NCLT-1 with attachments thereto accompanied by Form No. NCLT-2 and in case of an interlocutory application, the same shall be filed in Form No. NCLT-1 accompanied by such attachments thereto along with the Form No. NCLT-3.
4. Every petition or application including interlocutory application shall be verified by an affidavit in Form No. NCLT-6.
5. Notice to be issued by the NCLT to the opposite party shall be in Form No. NCLT-5.

FINAL ORDER OF TRIBUNAL

On the date of final hearing, if the Tribunal is satisfied that meeting of creditors or members has been held as per the prescribed procedure and required disclosures were made to them, then the Tribunal may, by order, sanction the compromise or arrangement. The order shall be in Form No. CAA. 6. However, no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the prescribed accounting standards.

The order may include directions in regard to any matter or such modifications in the compromise or arrangement for the proper working of the compromise or arrangement. The Tribunal also has the power to supervise the implementation of the compromise or arrangement. Moreover, if the Tribunal is satisfied that the compromise or arrangement sanctioned cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up the company.

Statement of compliance in mergers and amalgamations

Every company in relation to which an order has been made by the Tribunal sanctioning the scheme shall file with the Registrar of Companies a statement in Form No. CAA.8, until the scheme is fully implemented within two hundred and ten days from the end of each financial year. The statement shall be duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

Filing of Rejoinder

Rule 42 of the NCLT Rules, 2016

Where the respondent states such additional facts as may be necessary for the just decision of the case, the Bench may allow the petitioner to file a rejoinder to the reply filed by the respondent, with an advance copy to be served upon the respondent.

Annexure - A

Sample Scheme of merger

BEFORE THE NATIONAL COMPANY LAW TRIBUNAL, BENCH, AT BANGALORE

IN THE MATTER OF SECTIONS 230 and 232 OF THE COMPANIES ACT, 2013

AND

IN THE MATTER OF ABC PRIVATE LIMITED

AND

IN THE MATTER OF SCHEME OF AMALGAMATION OF ABC PRIVATE LIMITED WITH XYZ PRIVATE LIMITED AND THEIR RESPECTIVE SHAREHOLDERS AND CREDITORS

PREAMBLE

(i) The Scheme of Amalgamation provides for the amalgamation of ABC Pvt. Ltd. (hereinafter referred to as 'Transferor Company') with XYZ Pvt. Ltd. (hereinafter referred to as 'Transferee Company')

pursuant to Sections 230 and 232 of the Companies Act, 2013.

(ii) Transferor Company was incorporated on May 23,1999 bearing CIN as U17110KA1999PTC019786 as a Private Limited Company limited by shares under the provisions of the Companies Act, 1956 with the Registrar of Companies, Karnataka at Bangalore. The main object of the Transferor Company, as per the Memorandum of Association is to carry on the business of information technology. The Transferor Company is a wholly owned subsidiary of the Transferee Company.

(iii) Transferee Company is a company incorporated on August 23, 2000 bearing CIN: U72300 KA 2000 PTC 044988 as a Private Limited Company limited by shares with Registrar of Companies, Karnataka at Bangalore under the Companies Act, 1956. The Registered Office of the Company, at present, is situated at Pritech Park, Block 10, Unit 1, Sarjapur Ring Road, Bangalore – 560103, Karnataka. The main objects of the Transferee Company, as per the Memorandum of Association is as follows:

(a) To provide information technology enabled services, web enabled services, business process outsourcing services and other services relating to back office operations and all kinds of business support services, including but not limited to operation support services, corporate function services, corporate support service, database services, information management services, telecom services, contact center services, consultancy services, document services, data processing services, data management services, activities for collating, accounting, managing, processing, analyzing, distributing, developing and storing documents, information and data, information technology support services, financial control support services, administration support services, professional/legal support, human resources support services, payroll support services, correspondence management services, online support services, financial and revenue accounting.

(b) To establish, maintain and run data processing/ computer centres, support and call centers, customer care and other customer service centers, providing database services including software and hardware support services, networking services, remote maintenance, testing services, network / web complex management services, digital certification services, information technology consultancy services, and other information technology and operations services.

(c) To organize, review and catalogue electronic documents, populate electronic databases and prepare reports, and conduct research including multi-jurisdictional surveys, to provide service management and business process management services in corporate, financial and general information research, financial analytics and for the purpose to act as representative, advisor, consultant, know how provider, sponsor, franchiser, licenser, job worker. To provide software development services and to produce software in connection with the above mentioned areas of expertise or otherwise."

The shares of the Transferee Company are held by XYZ Pte. Limited (99.10%) and XYZ International LLC, USA (0.10%).

(iv) WHEREAS to rationalize and streamline the various functions of the entities in India, to eliminate multiple entities, to achieve administrative convenience, to achieve cost savings from more focused operational efforts and to rationalize, standardize and simplify the business processes, productivity improvements and administrative expenses, it has been decided by the Board of Directors of the Transferor Company and the Transferee Company to amalgamate the Transferor Company into the Transferee Company.

(v) The Scheme of Amalgamation is divided into the following parts:

Part A - Definitions and Share capital

Part B - Amalgamation of ABC Pvt. Ltd. with XYZ Pvt. Ltd.

Part C - General Terms and Conditions

PART A – DEFINITIONS AND SHARE CAPITAL

1. DEFINITIONS

In this Scheme, unless repugnant to the context, the following expressions shall have the following meaning:

1.1 "Act" or "the Act" means the Companies Act, 2013 and shall include any statutory modifications, re-enactment or amendments thereof for the time being in force.

1.2 "Appointed Date" means April 01, 2018 or such other date as may be fixed or approved by the Hon'ble NCLT or any other appropriate authority.

1.3 "Board of Directors" or "Board" shall mean the Board of Directors of the Transferor Company and the Transferee Company as the case may be or any committee thereof duly constituted or any other person duly authorized by the Board for the purpose of this Scheme;

1.4 "Effective Date" means the latest date on which the certified copies of the order of the National Company Law Tribunal Bangalore Bench sanctioning the Scheme, as defined hereunder, are filed with the Registrar of Companies, Karnataka at Bangalore by the Transferor and the Transferee Companies.

1.5 "NCLT" means the National Company Law Tribunal, Bangalore Bench having jurisdiction in relation to the Transferor Company and the Transferee Company.

1.6 "Scheme" or "the Scheme" or "this Scheme" means this Scheme of Amalgamation of ABC Pvt. Ltd. with XYZ Pvt. Ltd. and their respective shareholders and creditors, in its present form as submitted to/ approved or directed by the NCLT or this Scheme with such modification(s), if any made, as per Clause 19 of the Scheme.

1.7 "Transferee Company" means XYZ Pvt. Ltd., a company incorporated under the Act and having its registered office at Pritech Park, Block 10, Unit 1, Sarjapur Ring Road, Bangalore – 560103, Karnataka.

1.8 "Transferor Company" means ABC Pvt. Ltd., a company incorporated under the Act and having its registered office at 40/2, Avenue Road, Ulsoor, Bangalore-560042, Karnataka.

1.9 "Undertaking" shall mean and include the whole of assets, properties, liabilities and the undertaking of the Transferor Company existing as on Appointed Date and specifically include the following (without limitation):

(i) The whole of the undertaking of the Transferor Company, including all secured and unsecured debts, if any, liabilities, duties and obligations and all the assets, properties, rights, titles and benefits, whether movable or immovable, real or personal, in possession or reversion, corporeal or incorporeal, tangible or intangible, present or contingent and including but without being limited to land and building (whether owned, leased, licensed), all fixed and movable plant and machinery, vehicles, fixed assets, work in progress, current assets, investments, reserves, provisions, funds, licenses, registrations, copyrights, patents, trade names, trademarks and other rights and licenses in respect thereof, applications for copyrights, patents, trade names,

trademarks, leases, licenses, tenancy rights, premises, ownership flats, hire purchase and lease arrangements, lending arrangements, benefits of security arrangements, computers, office equipment, telephones, telexes, facsimile connections, internet connections, communication facilities, equipment and installations and utilities, electricity, water and other service connections, benefits of agreements, contracts and arrangements, powers, authorities, permits, allotments, approvals, consents, privileges, liberties, advantages, easements and all the right, title, interest, goodwill, benefit and advantage, deposits, reserves, provisions, advances, receivables, deposits, funds, cash, bank balances, accounts and all other rights, benefits of all agreements, subsidies, grants, Minimum Alternate Tax, tax credits (including but not limited to credits in respect of income tax, sales tax, value added tax, turnover tax, service tax, Goods and Service tax etc), Software License, Domain / Websites etc., in connection / relating to the Transferor Company and other claims and powers of whatsoever nature and wheresoever situated belonging to or in the possession of or granted in favour of or enjoyed by the Transferor Company, existing as on the Appointed Date.

(ii) All staff, workmen, and employees, if any, of the Transferor Company in service on the Effective Date.

(iii) All records, files, papers, information, computer programs, manuals, data, catalogues, quotations, sales advertising materials, lists of present and former customers and suppliers, customer credit information, customer pricing information and other records, whether in physical form or electronic form of the Transferor Company existing as on the Appointed Date.

1.10 Any references in the Scheme to “upon the Scheme becoming effective” or “effectiveness of the Scheme” shall mean the Effective Date.

1.11 All terms and words not defined in this Scheme shall, unless repugnant or contrary to the context or meaning thereof, have the same meaning ascribed to them under the Act, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and other applicable laws, rules, regulations, bye laws, as the case may be, including any statutory modification or re-enactment thereof from time to time.

2. SHARE CAPITAL

2.1 The authorized and issued and paid up share capital of the Transferee Company as at March 31, 2018 is as under:

Authorized capital	Amount (`)
50,000,000 equity shares of `10 each	500,000,000
Issued, subscribed and paid-up capital	Amount (`)
15,000,000 equity shares of `10 each fully paid-up	150,000,000

Subsequent to March 31, 2018, there has been no change in the capital structure of Transferee Company.

2.2 The authorized and issued share capital of the Transferor Company as at March 31, 2018 is as under:

Authorized capital	Amount (`)
10,000,000 equity shares of `10 each	100,000,000
Issued, subscribed and paid-up capital	Amount (`)
5,000,000 equity shares of `10 each fully paid-up	5,000,000

Subsequent to March 31, 2018, there has been no change in the capital structure of Transferor Company.

PART B

AMALGAMATION OF TRANSFEROR COMPANY WITH TRANSFEREE COMPANY

3. DATE OF TAKING EFFECT AND OPERATIVE DATE

The Scheme set out herein in its present form or with any modification(s) approved or imposed or directed by the Hon'ble NCLT or made as per Clause 19 of the Scheme, shall be effective from the Appointed Date but shall be operative from the Effective Date.

4. AMALGAMATION OF THE TRANSFEROR COMPANY WITH THE TRANSFEREE COMPANY

4.1 Subject to the provisions of this Scheme as specified hereinafter and with effect from the Appointed Date, the Undertaking of the Transferor Company, as defined in clause 1.9, including all the debts, liabilities, duties and obligations of the Transferor Company of every description and also including, without limitation, all the movable and immovable properties and assets (whether tangible or intangible) of the Transferor Company comprising, amongst others, all furniture and fixtures, computers/data processing, office equipment, electrical installations, telephones, telex, facsimile and other communication facilities, deposits, reserves, provisions, advances, receivables, deposits, funds, cash, bank balances and business licenses, permits, authorizations, approvals, lease, tenancy rights, permissions, incentives, if any, and all other rights, patents, know-how, trademark, service mark, trade secret or other intellectual property rights, proprietary right, title, interest, contracts, consent, approvals and rights and powers of every kind, nature and description whatsoever, privileges, liberties, easements, advantages, benefits and approvals, if any, existing as on Appointed Date, shall, under the provisions of Sections 230 to 232 of the Act, and pursuant to the order of the Hon'ble NCLT sanctioning this Scheme and without further act, instrument or deed, but subject to the charges affecting the same as on the Effective Date, be transferred and/or deemed to be transferred to and vested in the Transferee Company so as to become the properties, assets, rights, and undertaking(s) of the Transferee Company.

4.2 With effect from the Appointed Date, all statutory licenses, permissions, approvals or consents to carry on the operations of the Transferor Company, if any, existing as on Appointed Date shall stand vested in or transferred to the Transferee Company without any further act or deed and shall be appropriately mutated by the statutory authorities concerned in favour of the Transferee Company upon the vesting and transfer of the undertaking of the Transferor Company pursuant to this Scheme. The benefit of all statutory and regulatory permissions,

licenses, approvals and consents, registrations shall vest in and become available to the Transferee Company pursuant to this Scheme.

4.3 With effect from the Appointed Date all debts, liabilities, duties and obligations of the Transferor Company existing as on the Appointed Date whether provided for or not in the books of account of the Transferor Company and all other liabilities which may accrue or arise after the Appointed Date but which relate to the period on or up to the day of the Appointed Date shall be the debts, liabilities, duties and obligations of the Transferee Company including any encumbrance on the assets of the Transferor Company or on any income earned from those assets and further that it shall not be necessary to obtain the consent of any third party or other person who is a party to any contract or arrangement by virtue of which such liabilities have arisen, in order to give effect to the provisions of this Clause.

4.4 The transfer and vesting as aforesaid shall be subject to the existing charges/ hypothecation / mortgages, if any, as may be subsisting and agreed to be created over or in respect of the said assets or any part thereof, provided however, any reference in any security documents or arrangements to which the Transferor Company is a party wherein the assets of the Transferor Company have been or are offered or agreed to be offered as security for any financial assistance or obligations shall be construed as reference only to the assets pertaining to the Transferor Company and vested in the Transferee Company by virtue of this Scheme to the end and intent that the charges shall not extend or deemed to extend to any assets of the Transferee Company.

4.5 All staff, workmen and employees, if any, engaged in the Transferor Company as on the Effective Date shall stand transferred to the Transferee Company, without any further act or deed to be done by the Transferor Company or the Transferee Company and, subject to the provisions hereof, on terms and conditions not less favorable than those on which they are engaged by the Transferor Company, without any interruption of service as a result of the amalgamation of the Transferor Company into the Transferee Company.

4.6 All items as detailed under Para 1.9 in relation to the Transferor Company shall stand transferred to or vested in the Transferee Company, without any further act or deed done by the Transferor Company or the Transferee Company.

4.7 Without prejudice to the above provisions, with effect from the Appointed Date, all inter-party transactions between the Transferor Company and the Transferee Company, if any, shall be considered as intra-party transactions for all purposes from the Appointed Date.

5. CONSIDERATION

5.1 The entire issued, subscribed and paid-up Equity Share Capital of the Transferor Company is held by the Transferee Company. Upon the Scheme becoming effective, no shares of Transferee Company shall be allotted in lieu or exchange of the holding in Transferor Company and, the whole of the investment of the Transferor Company in the share capital of the Transferee Company shall stand cancelled in the books of Transferee Company. Upon the coming into effect of this Scheme, the share certificates, if any, and/ or the shares in electronic form representing the shares held by the Transferee Company in Transferor Company shall be deemed to be cancelled without any further act or deed for cancellation thereof by Transferee Company, and shall cease to be in existence accordingly.

PART C
GENERAL TERMS AND CONDITIONS

6. ACCOUNTING TREATMENT IN THE BOOKS OF THE TRANSFEREE COMPANY

6.1 On the Scheme becoming effective, the Transferee Company shall account for the amalgamation under the Scheme in its accounts in accordance with "Pooling of Interest" method prescribed under Accounting Standard 14 "Accounting for Amalgamations" or if applicable under Appendix C of Indian Accounting Standard 103 (Business Combinations of Entities under common control) as prescribed under Companies (Accounting Standards) Rules, 2006 including any amendments thereto as may be prescribed under the Companies Act, 2013, read with rules made thereunder."

6.2 All the assets and liabilities recorded in the books of Transferor Company shall be transferred to and vested in the books of Transferee Company pursuant to the scheme and shall be recorded by Transferee Company at their respective book values as appearing in the books of Transferor Company.

6.3 The identity of the reserves of Transferor Company shall be preserved and they shall appear in the financial statements of Transferee Company in the same form and manner, in which they appeared in the financial statements of Transferor Company prior to this scheme being effective.

6.4 The investments in the equity capital of Transferor Company as appearing in the financial statements of Transferee Company shall stand cancelled.

6.5 Inter-company balances, loans and advances if any, will stand cancelled.

6.6 In case of any differences in accounting policy between Transferor Company and Transferee Company, the accounting policies followed by Transferee Company will prevail and the difference till the appointed date shall be adjusted in capital reserves of Transferee Company, to ensure that the financial statements of Transferee Company reflect the financial position on the basis of consistent accounting policy.

6.7 Subject to any corrections and adjustments as may, in the opinion of the Board of Directors of the Transferee Company, be required and except to the extent otherwise by law required, the reserves of the Transferor Company, if any, will be merged with the corresponding reserves of the Transferee Company.

7. CONSEQUENTIAL MATTERS RELATING TO TAX AND COMPLIANCE WITH LAW

7.1 Upon the Scheme coming into effect, all taxes / cess / duties payable by or on behalf of the Transferor Company up to the Appointed Date and onwards including all or any refunds and claims, including refunds or claims pending with the revenue authorities, including the right of carry forward of accumulated losses and Minimum Alternate Tax credit under Section 115JAA of the Income-tax Act, 1961, Goods and Services tax, expenses incurred by the Transferor Company but deduction to be claimed on payment basis / on compliance with withholding tax provisions (as the case may be) under Sections 43B, 40(a)(i) and 40(a)(ia) of the Income-tax Act, 1961, if any, shall, for all purposes, be treated as the tax / cess / duty, liabilities or refunds, claims, accumulated losses and Minimum Alternate Tax credit of the Transferee Company.

7.2 Upon the Scheme becoming effective, the Transferee Company is expressly permitted to revise its income-tax returns, sales tax returns, excise & CENVAT returns, service tax returns, Goods and Service tax return, other tax returns and to restore as input credit of service tax adjusted earlier or claim refunds / credits as required.

7.3 The Transferee Company is also expressly permitted to claim refunds, credits, including restoration of input CENVAT credit, Goods and Service tax, tax deduction in respect of nullifying of any transactions between the Transferor Company and Transferee Company.

7.4 In accordance with the Cenvat Credit Rules framed under Central Excise Act, 1944, as are prevalent on the Effective Date, the unutilized credits relating to excise duties / service tax/ Goods and Services tax paid on inputs / capital goods / input services lying in the accounts of the undertaking of the Transferor Company shall be permitted to be transferred to the credit of the Transferee Company, as if all such unutilized credits were lying to the account of the Transferee Company. The Transferee Company shall accordingly be entitled to set off all such unutilized credits against the excise duty / service tax payable by it.

7.5 Upon the Scheme becoming effective, unabsorbed tax losses and unabsorbed tax depreciation of the Transferor Company, if any, till the Appointed Date, would accrue to the Transferee Company in accordance with the provisions of the Income Tax Act, 1961.

7.6 This Scheme has been drawn up to comply with the conditions relating to "Amalgamation" as specified under the tax laws, including Section 2(1B) and other relevant sections of the Income tax Act, 1961. If any terms or provisions of the Scheme are found to be or interpreted to be inconsistent with any of the said provisions at a later date, whether as a result of any amendment of law or any judicial or executive interpretation or for any other reason whatsoever, the aforesaid provisions of the tax laws shall prevail. The Scheme shall then stand modified to the extent determined necessary to comply with the said provisions. Such modification will however not affect other parts of the Scheme. The power to make such amendments as may become necessary shall vest with the Board of Directors of the Transferor Company and the Transferee Company, which power shall be exercised reasonably in the best interests of the companies concerned.

8. AUTHORISED SHARE CAPITAL

8.1 Upon the Scheme becoming effective, the authorized share capital of the Transferor Company shall stand combined with the authorized share capital of the Transferee Company. Filing fees and stamp duty, if any, paid by the Transferor Company on its authorized share capital, shall be deemed to have been so paid by the Transferee Company on the combined authorized Share capital and accordingly, the Transferee Company shall not be required to pay any fee/ stamp duty for its increased authorized share capital.

8.2 Clause V of the Memorandum of Association and the Articles of Association of the Transferee Company shall, without any further act, instrument or deed, be and stand altered, modified and amended pursuant to Sections 61 and 64 and other applicable provisions of the Act by deleting the existing Clause and replacing it by the following:

"The Authorized Share Capital of the Company is `900,000,000/- (Rupees Ninety crore only) divided into 90,000,000 (Nine crore only) equity Shares of the face value of Rs 10/- (Rupees ten only) each with powers to increase or reduce in accordance with the law".

8.3 The approval of this Scheme by the shareholders of the Transferee Company under sections 230 and 232 of the Act, whether at a meeting or otherwise, shall be deemed to have the approval under Sections 13, 14, 61, 64 and other applicable provisions of the Act and any other consents and approvals required in this regard.

9. TRANSACTIONS BETWEEN APPOINTED DATE AND EFFECTIVE DATE

With effect from the Appointed Date and up to the Effective Date:

9.1 The Transferor Company shall deemed to have held and stood possessed of and shall hold and stand possessed of all their properties and assets pertaining to the Undertaking of the Transferor Company for and on account of and in trust for the Transferee Company. The Transferor Company hereby undertakes to hold its said assets with utmost prudence until the scheme comes into effect.

9.2 The Transferor Company shall carry on its activities with reasonable diligence, business prudence and shall not, except in the ordinary course of business or without prior written consent of the Transferee Company alienate charge, mortgage, encumber or otherwise deal with or dispose of the Transferor Company or part thereof.

9.3 It is clarified that any advance tax paid / Tax Deduction at Source ("TDS") credits / TDS certificates received by the Transferor Company shall be deemed to be the advance tax paid by / TDS credit / TDS certificate of the Transferee Company.

9.4 All the profits or income, if any, accruing or arising to the Transferor Company or expenditure or losses, if any, arising or incurred or suffered by the Transferor Company pertaining to the undertaking of the Transferor Company shall for all purposes be treated and be deemed to be and accrue as the income or profits or losses or expenditure as the case may be of the Transferee Company.

9.5 The Transferor Company shall not vary the terms and conditions of employment of any of the employees, existing as on the Effective Date, except in the ordinary course of business or without the prior consent of the Transferee Company or pursuant to any pre-existing obligation undertaken by the Transferor Company as the case may be, prior to the Effective Date.

9.6 The Transferor Company shall not make any change in its capital structure either by any increase (by issue of equity or shares on a rights basis, bonus shares, convertible debentures or otherwise), decrease, reduction, reclassification, subdivision or consolidation, re-organization, or in any other manner which may, in any way, affect the share exchange ratio, except by mutual consent of the respective Boards of Directors of the Transferor Company and the Transferee Company or except as may be expressly permitted.

10. EMPLOYEES OF THE TRANSFEROR COMPANY

10.1 On the Scheme becoming effective, all staff, workmen and the employees, if any, of the Transferor Company in service on the Effective Date shall be deemed to have become staff, workmen and the employees of the Transferee Company, without any break or interruption in their services, and on the basis of continuity of service, and the terms and conditions of their employment with the Transferee Company shall not be less favourable than those applicable to them with reference to their employment with the Transferor Company on the Effective Date.

10.2 It is expressly provided that, on the Scheme becoming effective, any provident fund, gratuity fund, superannuation fund or any other special fund or trusts, if any, created or existing for the benefit of the staff, workmen and the employees of the Transferor Company in service as on the Effective Date shall become trusts/funds of the Transferee Company for all purposes whatsoever in relation to the administration or operation of such fund or funds or in relation to the obligation to make contributions to the said fund or funds in accordance with the provisions thereof as per the terms provided in the respective trust deeds, if any, to the end and intent that all rights, duties, powers and obligations of the Transferor Company in relation to such fund or funds shall become those of the Transferee Company. It is clarified that, for the purpose of the said fund or funds, the service of the staff, workmen and employees, if any, of the Transferor Company will be treated as having been continuous with the Transferee Company from the date of employment as reflected in the records of the Transferor Company.

11. VALIDITY OF EXISTING RESOLUTIONS

Upon the coming into effect of the Scheme, the resolutions of the Transferor Company as are considered necessary by the Board of Directors of the Transferee Company which are validly subsisting be considered as resolutions of the Transferee Company. If any such resolutions have any monetary limits approved under the provisions of the Act or of any other applicable statutory provisions, then the said limits, as are considered necessary by the Board of Directors of the Transferee Company, shall be added to the limits, if any, under the like resolutions passed by the Transferee Company.

12. LEGAL PROCEEDINGS

12.1 If any suit, appeal or other proceeding of whatever nature by or against the Transferor Company is pending, the same shall not abate or be discontinued or in any way be prejudicially affected by reason of or by anything contained in this Scheme, but the said suit, appeal or other legal proceedings may be continued, prosecuted and enforced by or against the Transferee Company, as the case may be, in the same manner and to the same extent as it would or might have been continued, prosecuted and enforced by or against the Transferor Company as if this Scheme had not been made.

12.2 In case of any litigation, suits, recovery proceedings which are to be initiated or may be initiated against the Transferor Company, the Transferee Company shall be made party thereto and any payment and expenses made thereto shall be the liability of the Transferee Company.

13. CONTRACTS, DEEDS, ETC.

13.1 Subject to the other provisions of this Scheme, all contracts, deeds, bonds, insurance, letters of intent, undertakings, arrangements, policies, agreements and other instruments, if any, of whatsoever nature pertaining to the Transferor Company to which the Transferor Company is party and subsisting or having effect on the Effective Date, shall be in full force and effect against or in favour of the Transferee Company, as the case may be, and may be enforced by or against the Transferee Company as fully and effectually as if, instead of the Transferor Company, the Transferee Company had been a party thereto.

13.2 The Transferee Company shall enter into and/or issue and/or execute deeds, writings or confirmations or enter into any tripartite arrangements, confirmations or novations, to which the Transferor Company will, if necessary, also be party in order to give formal effect to the provisions of this Scheme, if so required or becomes necessary. The Transferee Company shall be deemed to be authorized to execute any such deeds, writings or confirmations on behalf of the Transferor Company and to implement or carry out all formalities required on the part of the Transferor Company to give effect to the provisions of this Scheme.

14. STATUTORY LICENSES, PERMISSIONS, APPROVALS

With effect from the Appointed Date and upon the Scheme becoming effective, all statutory licenses, permissions, approvals, copyrights, trademarks or consents, if any, relating to the Undertaking of the Transferor Company shall stand vested in or transferred to the Transferee Company without any further act or deed and shall be appropriately mutated by the statutory authorities concerned in favour of the Transferee Company. The benefit of all statutory and regulatory permissions, environmental approvals and consents, registrations or other licenses and consents shall vest in and become available to the Transferee Company pursuant to this Scheme. In so far as the various incentives, subsidies, rehabilitation schemes, special status and other benefits or privileges enjoyed, granted by any government body, local authority or by any other

person, or availed of by the Transferor Company are concerned, the same shall vest with and be available to the Transferee Company on the same terms and conditions.

15. SAVING OF CONCLUDED TRANSACTIONS

The transfer of Undertaking as described hereinabove and the continuance of proceedings by or against the Transferor Company, the same shall not affect any transaction or proceedings already concluded by the Transferor Company on and after the Appointed Date till the Effective Date, to the end and intent that the Transferee Company accepts and adopts all acts, deeds and things done and executed by the Transferor Company in respect thereto as done and executed on behalf of the Transferee Company.

16. DISSOLUTION OF THE TRANSFEROR COMPANY

On the Scheme becoming effective, the Transferor Company shall stand dissolved without being wound-up.

17. CONDITIONALITY OF THE SCHEME

This Scheme is and shall be conditional upon and subject to:

17.1 The requisite, consent, approval or permission of the Central Government or any other statutory or regulatory authority, which by law may be necessary for the implementation of this Scheme.

17.2 The Scheme being approved by the requisite majorities in number and value of such classes of persons including the respective members and/or creditors of the Transferor Companies and the Transferee Company as required under the Act and as may be directed by the NCLT.

17.3 The sanction of the NCLT under Section 230 and 232 of the Act in favor of the Transferor Companies and the Transferee Company under the said provisions and the necessary orders under sections 232 of the Act being obtained.

17.4 The certified copy of the order of the Hon'ble NCLT under sections 230 and 232 of the Act sanctioning the Scheme is filed with the Registrar of Companies Karnataka at Bangalore.

17.5 Each part in Section of the Scheme shall be given effect to as per the chronology in which it has been provided for in the Scheme. The Scheme shall be effective from the Effective Date. However, failure of any one part of one Section for lack of necessary approval from the shareholders / creditors / statutory regulatory authorities shall not result in the whole Scheme failing. It shall be open to the concerned Board of Directors to consent to severing such part(s) of the Scheme and implement the rest of the Scheme as approved by the Hon'ble NCLT with such modification.

17.6 Compliance with such other conditions as may be imposed by the Hon'ble NCLT.

18. APPLICATION TO HON'BLE NCLT

The Transferor Company and the Transferee Company shall, with all reasonable dispatch, make applications pursuant to Sections 230 and 232 of the Act, to the NCLT for sanction and carrying out the Scheme and for consequent dissolution of the Transferor Company without winding-up. The said companies shall also apply for and obtain such other approvals, as may be necessary in law, if any, for bringing the Scheme into effect and be entitled to take such other steps and proceedings as may be necessary or expedient to give full and formal effect to the provisions of this Scheme.

19. MODIFICATION OR AMENDMENTS TO THE SCHEME

Subject to approval of the Hon'ble NCLT, the Transferor Company and the Transferee Company by

their respective Boards of Directors, may assent to/make and/or consent to any modifications/amendments to the Scheme or to any conditions or limitations that the Hon'ble NCLT and/or any other Authority under law may deem fit to direct or impose, or which may otherwise be considered necessary, desirable or appropriate as a result of subsequent events or otherwise by them (i.e. the Board). The Transferor Company and the Transferee Company by their respective Board are authorised to take all such steps as may be necessary, desirable or proper to resolve any doubts, difficulties or questions whatsoever for carrying the Scheme into effect, whether by reason of any directive or Order of any other authorities or otherwise howsoever, arising out of or under or by virtue of the Scheme and/or any matter concerned or connected therewith.

20. EFFECT OF NON-RECEIPT OF APPROVALS

In the event of any approvals or conditions enumerated in the Scheme not being obtained or complied with, or for any other reason, the Scheme cannot be implemented, the Board of Directors of the Transferee Company and the Transferor Company shall mutually waive such conditions as they consider appropriate to give effect, as far as possible, to this Scheme and failing such mutual agreement, or in case the Scheme not being sanctioned by the Hon'ble NCLT, the Scheme shall become null and void and each party shall bear and pay their respective costs, charges and expenses in connection with the Scheme.

21. COSTS, CHARGES & EXPENSES

In the event of the Scheme being sanctioned by the Hon'ble NCLT, the Transferee Company shall bear and pay all costs, charges, expenses, taxes including duties, levies in connection with the Scheme.

Authorised Representative

ABC Pvt. Ltd.

Place: Bengaluru
Date:

LESSON ROUND-UP

- There are various stages in the process of merger and amalgamations under the Companies Act, 2013.
- It is necessary to understand the key terms used in the process of mergers and amalgamations for better documentation.
- Documentation is a very important aspect for filing the scheme along with proper enclosures before the NCLT for seeking approval of the scheme.
- The Scheme of amalgamation would comprise of various parts containing details about Transferor Company, Transferee Company and further details about these two companies.
- Legal provisions of the mergers and amalgamations are contained in Section 230 to 240 of the Companies Act, 2013.
- Detailed care should be taken while drafting the Scheme of amalgamation, notice and explanatory statement.
- There are various forms prescribed under the National Company Law Tribunal Rules, 2016 and the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 for various applications / petitions to be submitted before NCLT.
- Various documents are to be attached with Petition / Application to be submitted for merger and amalgamation and due care has to be taken to ensure that all such documents are duly enclosed.

GLOSSARY OF TECHNICAL WORDS

Documentation: The process of classifying and annotating texts that provides official information or that serves as a record.

Drafting: In legal sense, means an act of preparing the legal documents like agreements, contracts, deeds, etc.

Petition: Petition and application are interchangeable terms normally used to indicate formal applications for seeking a remedy provided by law.

Rejoinder: A written statement/reply of the plaintiff/petitioner by way of defense to pleas' raised in the counter affidavit/written statement from the defendant/respondent.

LIST OF FURTHER READINGS

1. Drafting of Contracts by Ravi Singhania, Bloomsbury Publications
2. Legal writing and Contract Drafting by Madhavan & Ryder, Bloomsbury Publications
3. Law Practice & Procedure of National Company Law Tribunal by Taxmann's
4. National Company Law Tribunal and National Company Law Appellate Tribunal: Law Practice and Procedure by Prachi Manekar Wazalwar

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. What are the steps involved in the merger and amalgamation?
2. Who are the persons eligible for filing petition before the National Company Law Tribunal?
3. What are the various forms prescribed under the NCLT Rules?
4. What are the various documents to be enclosed along with various types of petitions / applications to be made before the NCLT?
5. Discuss briefly the points to be considered while drafting a scheme of merger and amalgamation.
6. Discuss briefly the contents of the explanatory statement to be attached to the notice to the shareholders relating to merger and amalgamation.

Lesson 6
Valuation of Business and Assets for Corporate Restructuring

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Need and purpose of valuation
- Factors influencing valuation
- Preliminary steps in valuation
- Types of valuation
- Valuation principles and techniques
- Sensitivity Analysis
- Valuation under SEBI (SAST) Regulations, 2011
- Valuation of stock options under ESOP Guidelines
- Valuation of shares under SEBI (Delisting of Securities) Guidelines
- Valuation of Slump Sale
- Valuation of demergers
- Principles and techniques of reporting
- Relative valuation
- Swap ratio

LEARNING OBJECTIVES

There are a number of situations in which a business or a share or any other assets or property may be required to be valued. Valuation is essential for (i) strategic partnerships, (ii) mergers or acquisitions of shares of a company and/or acquisition of a business.

Valuation is also necessary for introducing employee stock option plans (ESOPs) and joint ventures. From the perspective of a valuer, a business owner, or an interested party, valuation provides a useful base to establish a price for the property or the business or to help determine ways and means of enhancing the value of his firm or enterprise.

The main objective in carrying out a valuation is to conclude a transaction in a reasonable manner without any room for any doubt or controversy about the value obtained by any party to the transaction.

After reading this lesson you will be able to understand the meaning, purpose and methods of valuation.

Business Valuation

Valuation is the process of determining the economic worth of a company/business based on its business model and external environment and supported with reasons and empirical evidence. During valuation, a valuer looks at the company's management, composition of its capital structure, the prospect of future earnings and market value of assets, etc. Proper valuation helps an entity or business make an intelligent decision. In a merger or amalgamation or demerger or acquisition, valuation is essential to fix the value of the shares to be exchanged in a merger or the consideration payable for an acquisition.

The use of different valuation techniques and principles has made valuation a subjective process. Conflict in valuation could result from the choices with respect to any of these namely valuation base or approach or method or technique. In the case of merger, for instance, the asset value can be determined both at the market price and the cost price. A great deal more depends upon the rationale of the parties to a transaction and therefore, it is important that the merging parties should first discuss and agree upon the valuation bases, approaches, methods and techniques.

When it comes to merger / amalgamation, calculating the swap ratio is at the core of the valuation process. It is the ratio at which the shares of the acquiring company will be exchanged with the shares of the acquired company. For instance, a swap ratio of 1:2 means that the acquiring company will provide its one share for every two shares of the other company.

Valuation models are used to determine the true value of a business mostly by financial market participants. Business valuation can be for the entire company or a part of the operations of a company. There are tools and methods used for valuation. Usually the valuation is done by analysing the financial statements, the cash flows and other market factors.

Valuation involves financial modeling. This financial model can be different for different entities. Because one financial model for an industry may not be suitable for another industry. Which model to use for which industry is subjective. For example recently Infosys, decided to buy-back its share for `13,000 crore. Under the buy-back arrangement, value per share was `1,150 per share. This buy-back was undertaken to improve the earnings per share and return surplus cash to shareholders while supporting share price during period of sluggish market condition.

Valuation Motives

An important aspect in the merger/amalgamation/takeover activity is the valuation aspect. The method of valuation of business, however, depends to a great extent on the acquisition motives. The acquisition activity is usually guided by strategic behavioural motives. The reasons could be (a) either purely financial (taxation, asset-stripping, financial restructuring involving an attempt to augment the resources base and portfolio-investment) or (b) business related (expansion or diversification) or (c) behavioural reasons have more to do with the personal ambitions or objectives (desire to grow big) of the top management. The expansion and diversification objectives are achievable either by building capacities on one's own or by buying the existing capacities or a combination of both.

The decision criteria in such a situation would be the present value of the differential cash flows. These differential cash flows would, therefore, be the limit on the premium which the acquirer would be willing to pay. On the other hand, if the acquisition is motivated by financial considerations (specifically taxation and asset-stripping), the expected financial gains would form the limit on the premium, over and above the price of physical assets in the company. The cash flow from operations may not be the main consideration in such situations. Similarly, a merger with financial restructuring as its objective will have to be valued mainly in terms of financial gains. It would, however, not be easy to determine the level of financial gains because the

financial gains would be a function of the use to which these resources are put.

Situations requiring Valuation

The following are some of the usual circumstances when valuation of shares or enterprise becomes essential:

1. When issuing shares to public either through an initial public offer or by offer for sale of shares of promoters or for further issue of shares to public.
2. When promoters want to invite strategic investors or for pricing a first issue or a further issue, whether a preferential allotment or rights issue.
3. In making investment in a joint venture by subscription or acquisition of shares or other securities convertible into shares.
4. For making an 'open offer' for acquisition of shares.
5. When company intends to introduce a 'buy back' or 'delisting of shares'.
6. In schemes involving mergers/demergers, share valuation is resorted to in order to determine the consideration for the purpose of issue of shares or any other consideration to shareholders of transferor or demerged companies.
7. On directions of Tribunal or Authority or Arbitration Tribunals.
8. For determining fair price for effecting sale or transfer of shares as per Articles of Association of the company.
9. As required by the agreements between two parties.
10. To determine purchase price of a 'block of shares', which may or may not give the holder thereof a controlling interest in the company.
11. To value the interest of dissenting shareholders under a scheme of amalgamation, merger or reconstruction.
12. Conversion of debt instruments into shares.
13. Advancing a loan against the security of shares of the company by the Bank/Financial Institution.
14. As required by provisions of law such as the Companies Act, 2013 or Foreign Exchange Management Act, 1999 or Income Tax Act, 1961 or the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 [the Takeover Code] or SEBI (Share Based Employee Benefits) Regulations, 2014 or SEBI (Buy Back of Securities) Regulations, 2018 or Delisting Guidelines.

Factors influencing valuation

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 to those future earnings. The process of arriving at this value includes a detailed 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.

(8) 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.

Preliminary steps in valuation

A business valuation involves analytical and logical application/analysis of historical/future tangible and intangible attributes of business. The preliminary study to valuation involves the following aspects:

1. Purpose of valuation.
2. Goodwill/Brand name in the market.
3. Business environment of the entity to be valued.
4. Estimation/forecast of future cash flows as accurately as possible.
5. Is company listed on any stock exchange?
6. If listed, whether shares of the company are traded frequently?
7. The industry in which the entity is part of
8. The industry P/E ratio, past and future growth rate.
9. Who are the competitors locally, internationally?
10. Whether any similar valuation has been done recently
11. The technology concerning the enterprise and its probability of obsolescence.
12. The accepted discounting rate.
13. Study of market capitalization aspects.
14. Identification of hidden liabilities through analysis of material contracts.

Methods of Valuation (Valuation Techniques)

The commonly used methods of valuation are:

1. Assets-based method
2. Income-based method
3. Market capitalisation method
4. Discounted cash flow method

5. Liquidation value method

Assets-Based Approach

In the Asset based approach, a simple way to calculate is to consider net book value. However this may not give the correct value of the entity since historical cost does not reflects the true value of the assets. Another way is to calculate the replacement cost. The third method is to find out the fair value of the assets and arrive at the net realizable value which is also called the liquidation value. Of these three methods net realizable value is the most reasonable one and likely to give the correct valuation.

Example 1

ABC Ltd. has the following values in its books:

Particulars	**(` in thousand)**
Land and building	300
Plant and machinery	200
Inventory	200
Investment	100
Receivables	300
Cash	100
Current liabilities	300
Term loans	200

Land and buildings will fetch 500 more. Plant and machinery will fetch 100 less. Inventory will fetch 50 less. Receivables will fetch 50 less. Current liabilities of 50 will not be payable.

Calculate the net realizable value of this business.

	Book Value	**Impairment/Appreciation**	**Realizable Value**
Assets			
Land & Buildings	300	+500	800
Plant & Machinery	200	-100	100
Investments	100		100
Inventory	200	-50	150
Receivables	300	-50	250
Cash	100		100
TOTAL	1200	300	1500
Liabilities			
Bank Borrowings	200		200
Current Liabilities	300	-50	250
		Net Realisable Value	**1050**

This method also known as Net Asset Value method by which basically we arrive at a realisable value

starting from the book value, which is believed to be closer to market value of the assets. This method may look simple on the face of it as long as the assets can be valued based on similar assets available in the market. However, if the entity has some intangible assets such as brand, technical know-how, designs, trademark, etc., it gets more complicated because there may not be readily available market value for such intangible assets. The valuation methods for intangible assets are totally different. We will deal with them later in this chapter.

The Asset based approach is likely to be used when the business is non-operating such as under corporate insolvency resolution or under liquidation. Under the Insolvency and Bankruptcy Code, 2016, liquidation value is defined as realizable value. This is determined by appointing two independent valuers. The average value given by the valuers based on International Valuation Standards is taken as the liquidation value.

The asset based approach is useful in combination with the other methods such as cash flow methods. For example company-A has net assets of `15,00,000 whereas company-B has net assets of `5,00,000. The cash flows of the two companies are same. It is very easy to say that company-B is more valuable than company-A based on the comparison. However in the worst case scenario of insolvency or liquidation the risk in company-A is less, as it has more assets that can be liquidated.

Income-Based Approach

In the income based approach, as the name suggests, value of the business is calculated based on future income flows of the entity. In this approach the most important factor is determination of future cash flows of the business. The more accurate the forecast of cash flows, more correct will be the valuation. The future cash flows of the business are discounted at a predetermined rate to arrive at the present value of the business.

Another way of income approach is based on market capitalisation. In this approach the net earnings are capitalised. For this the earnings before interest and tax depreciation and amortization is considered. Another method used is to look at the price earnings of similar businesses. By comparing similar businesses, model is built and the share price of the company under consideration is estimated.

For example, company-A is in FMCG business and we want to find out the value of the business. The earnings per share of company-A is `5.5. Now let us look at businesses in the FMCG industry which are listed on the stock exchange. Company-B has price earnings ratio of 39. Company-C has a price earnings ratio of 45. Another FMCG company-D has a price earnings ratio of 33. The average price earnings ratio of companies B, C and D is 39. Now let us apply this average ratio to company-A's earnings per share. 5.5 × 39 = 214.5. So the value of the company A per share is `214.5.

Suppose the earnings of the company is `2 crore then the value of the company is 2 × 39 equal to `68 crores. This method of calculation can be tricky because in a volatile market the prices of stocks may fluctuate widely. Moreover listed companies always have a better valuation because of the liquidity. Normally unlisted companies evaluation is reduced by 30 to 50%. That is if a listed company's value is `100 crore then a similar but unlisted company will have a value of only Rs.50 crore with other things remaining same. The price earnings approach is useful in takeovers and mergers.

Cash Flow-Based Approach

One of the cash flow based approach is to consider the growth in the annual dividend paid by the company. Known as the Gordon Growth model, this model is useful for the valuation of an unlisted company. The present value of future dividends is calculated using the following formula. The rate of return required by equity shareholders is calculated based on similar listed companies.

$P_0 = D_0(1 + g) /(r_e – g)$

Where: P_0 = share price

g = rate of growth of dividend

d_0 = current dividend

r_e = rate of return required by the equity shareholders

The rate of return required by the equity shareholders can be estimated by the analysis of a listed company. Also we have to take into account the level of borrowings of the listed company. Because higher the borrowings, higher will be the risk for the investor. There are two ways of calculating the required rate of return by equity shareholders.

(1) By using the following formula rearranged as:

$$r_e = \frac{D_0(1+g)}{P_0} + g$$

We can also use the capital asset pricing model to estimate r_e as shown below:

Required rate of return, $r_e = R_f + \beta(R_m – R_f)$

where: R_f = risk free rate; R_m = return from the market; β = the beta value for a listed company in the same type of business, appropriately adjusted for gearing; g - future dividend growth rate from Time 1 onwards.

Example

Valuation based on shareholders' rate of return earned from a listed company

Let us calculate the value for Company A based on the following data:

Current Dividend = `10

Annual dividend growth rate = 5% per annum.

We are assuming that this will continue in the future also.

The values for similar parameters for a listed company are given below:

Share price = `150

Current Dividend= `20

Annual dividend growth rate = 10% per annum

Now from the details given above we have to find out rate of return of the listed company and apply the same to the unlisted company to find out value of a share of the unlisted company.

Step 1 (listed company)

$$r_e = \frac{D_0(1+g)}{P_0} + g$$

$$r_e = \frac{20(1+0.1)}{150} + 0.1 = 0.24.6\% \text{ or say } 25\%$$

Step 2 (unlisted company, Company A)

$$P_0 = \frac{D_0(1+g)}{r_e - g} + g$$

$$P_0 = \frac{10(1+0.05)}{0.25 - 0.05} + 0.1 = 52.5$$

From the above calculation we have arrived at the value of the share of the unlisted company as Rs.52.5. This multiplied by the number of equity shares will give the value of the company.

Estimating the value of target Company

Let us consider Company B, and do the valuation using β. If β is equal to 1, there is no difference and the share price moves exactly with the market. If β is greater than 1 means the company has higher risk, hence the fluctuation with market is higher. That is, if the market moves up 10% the share price will move up more than 10%. If the market falls by 10% the share price will fall by more than 10%.

The current dividend = `15

Average dividend growth rate = 5% per annum

Company B is entirely equity financed.

Now let us compare with a listed company in the same business with the following parameters.

β = 1.5

R_f = risk free rate = 8%

R_m = return from the market = 20%

The debt/equity ratio of the company is 1.5, Tax rate = 30%. The shareholders' required rate of return in the listed company is given by the capital asset pricing model equation:

$r_e = R_f + \beta(R_m - R_f) = 8\% + 1.5(20\% - 8\%) = 26\%$

This is the return required by the shareholders of a company geared in the ratio 1.5. However, Company B is fully equity financed, so 26% is inappropriate for the shareholders of that company.

We can use the asset beta formula for adjusting β values which will take care of the debt-equity ratio differences. Given below is the asset beta formula:

$$\beta a = \left[\frac{Ve}{Ve + Vd(1-T)} \times \beta e + \frac{Vd(1-T)}{Ve + Vd(1-T)} \times \beta d\right]$$

the second set of brackets can be safely assumed to be zero because βd, the beta of debt, is normally zero.

Therefore,

$$\beta a = \left[\frac{Ve}{Ve + Vd(1-T)} \times \beta e\right]$$

Where:

βa = known as the 'asset beta', which is a factor relevant to the business risk in a company which is fully equity financed in the same industry.

βe = known as the 'equity beta', which is a factor relevant to the risk experienced by a holder of equity in a company with debt, in the same industry.

So, to convert the beta value of the geared listed company to the beta value if that company were ungeared use:

$$\beta a = \left[\frac{8 \times 1.5}{8 + 2(1 - 0.3)}\right] = 1.27$$

Therefore, the cost of equity of an ungeared company in the same business as the geared company is:

re = Rf + β(Rm – Rf) = 8% + 1.27(20% – 8%) = 23.24%, say 23%

Therefore, the value of a share in Company B, an unlisted, fully equity financed company, is:

$$P_0 = \frac{D_0(1+g)}{r_e - g} + g$$

$$P_0 = \frac{15(1+0.5)}{(0.23-0.05)} = 87.5$$

Thus we get a value of Rs.87.5 per share for Company B.

Discounted Cash Flow Method (DCF)

Discounted Cash Flow Method involves discounting future cash flow projections, from the newly formed company, to its present value. If the present value is higher than the actual cost of merger, then the merger is viable. The present value is calculated using the weighted average cost of capital.

In this method as the name suggests, it involves discounting the cash flows of the entity to be valued. The value of the entity is arrived at by adding the discounted free cash flows. Requirements of this method are:

- Forecast of the free cash flows.
- Estimate the discount rate which will be the weighted average cost of capital.

Cost of capital is calculated based on the cost of debt and cost of equity and taking a weighted average. The present value of future cash flows is calculated using the standard formula:

$$PV = CF_1 / (1+r) + CF_2 / (1+r)^2 + \ldots [TCF / (r - g)] / (1+r)^{n-1}$$

Where,

PV = present value

CF1= cash flow in year 1

r = discount rate

TCF = the terminal year cash flow

g = growth rate assumption in perpetuity beyond terminal year

n = the number of periods in the valuation model including the terminal year

The formula for calculating free cash flows is:

Free cash flows = operating profit + depreciation + amortization of goodwill - capital expenditures – cash taxes - change in working capital.

Example:

The free cash flows of Company A are forecasted as shown below:

The calculation of present value is given below:

The cost of debt is = 12%

The cost of equity = 16%

Debt/Equity ratio = 1:1

Weighted average cost of capital = (12% +16%)/2 = 14%

PV of Year 1 cash flows = 100 / (1+14%) = 87.7

PV of Year 2 Cash flows = 100/ (1+14%)^2 = 76.95

PV of Year 3 Cash flows = 100/ (1+14%)^3 = 101.2

PV of Year 4 Cash flows = 100/ (1+14%)^4 = 106.5

PV of Year 5 Cash flows = 100/ (1+14%)^5 = 103.8

PV of terminal value = 300/ (1+14%)^5 = 155.8

The terminal value is the residual value of cash flows beyond the 5th year.

`'000

	Year1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Terminal value**
Free Cash flows	100	100	150	180	200	300
PV	87.7	76.95	101.2	106.5	103.8	155.8

Total of all PVs = 87.7 + 76.95 +101.2 + 106.5 +103.8 +155.8 = 631.95

The value of the business = `6,31,950

Profit Multiplier Method or EBIDTA Multiple method

In this method, the average profit of the entity is taken and multiplied by a factor to arrive at the value. The multiplying factor is normally the Price/Earnings ratio. The profit considered is earnings before interest, depreciation, taxes and amortization (EBIDTA). Let us take an example of a company A.

Average EBIDTA = `50,000

P/E ratio of the industry of Company A = 12

Value of the company = 12 x 50000 = `6,00,000

Market based approach

Under the market based approach, we look for a similar business which has changed hands in the recent past and value the target entity on the same basis. If exactly similar business transaction is not available, a closely similar transaction can be taken and adjustments can be made for any variations in any parameter to arrive at the correct valuation. The adjustments can be for difference in size, quantity or quality. It is easy to value a company which is publicly traded. However, when a similar company is not available then it becomes necessary to make adjustments as mentioned above.

There are two popular types of market approach methods, one is based on guideline transaction method and the other based on guideline public method, i.e., publicly traded entity. Market approach method is useful in case of Real Estate Company because we can easily estimate by looking at similar sale transactions. Also we can look at recent merger and acquisition transactions in the same industry and make adjustments for any size, product or other relevant factor to arrive at the target company valuation. There is also another method called back solve method. This involves analysis of equity transactions of the target entity in the past 12 months with unrelated investors.

Valuation of Goodwill

In mergers & acquisitions it may be necessary to value goodwill. Goodwill is the excess of purchase consideration over the fair value of the net assets acquired. The value of goodwill can be calculated in two ways:

1. Capitalisation of Future Maintainable profit (CFMP) method
2. Capitalisation of Super Profit method

To understand this better let us take the following example:

Company A has maintained a normal profit of Rs.300 lakhs. Due to addition of capacity, the future maintainable profits are likely to be higher by 10%. Normal rate of return is 15%. The average capital employed is `1,500 lakhs.

Value of Goodwill = CFMP — ACE

Where

CFMP - Capitalised value of Future Maintainable Profit

ACE - Average capital employed

$$CFMP = \frac{FMP}{NR}$$

FMP – Future maintainable profit

NR – Normal rate of return

In the above example,

$$CFMP = \frac{300}{15\%} = 2,000$$

ACE = 1,500

Value of goodwill = CFMP – ACE = 2,000 – 1,500 = ` 500 lakhs

In the second method, capitalised value of super profit (CVSP) is taken as value of goodwill. In the above example,

FMP = 300

Normal profit = ACE × NR = 1500 × 15% = 225

Value of goodwill = $\frac{\text{FMP - Normal Profit}}{\text{NR}} = \frac{300 - 225}{15\%}$ = ` 500 lakh

Though in this example the value of goodwill is same in both the methods, it may not be same in every case.

How is average capital employed calculated? Company A has fixed assets whose replacement cost is 1000. Investments are worth 200. Inventory 200 and receivables will fetch 400. The Company has a loan of 300 and current liabilities of 200.

		` in lakh
Add:		
Replacement cost of fixed assets	+	1,000
Fair value of investments	+	200
Fair value of Inventory	+	200
Fair value of Receivables	+	400
Cash balance	+	100
Less:		
Loans	-	300
Current liabilities	-	200
Capital Employed		**1,400**

Valuation of Intangible Assets

Intangible assets are knowledge based assets. They are intellectual properties and hence are different from tangible assets. Intangible assets do not have physical substance. Examples of intangible assets are:

- Brands
- Patents
- Trademarks
- Designs
- Copyrights
- Technical know-how
- Software

- Formulations
- Franchises
- Goodwill

A brand is a distinguishing symbol, mark, logo, name, word, sentence or a combination of these items that companies use to distinguish their product from others in the market. A trademark is a recognizable sign, design, or expression which identifies products or services of a particular source from those of others, although trademarks used to identify services are usually called service marks.

Some of the intangible assets such as Trademark, Copyright, Patent and Brand are legally enforceable. These are called legal intangible assets. Business intangible assets are Goodwill, customer list, customer loyalty, etc.

The need for intangible assets is:

- Business Value addition
- Distinguish product from similar products
- Improve value for stakeholders
- Create a business image

The legal provisions governing intangible assets at national level are given below:

- Companies Act, 2013, Schedule II
- Patents (Amendment) Act, 2005 & Patents (Amendment) Rules, 2006
- Trade Marks Act, 1999 & Trade Marks Rules, 2002
- Copyright Amendment Act, 2012
- Indian Accounting Standards
- AS 26 – Intangible Assets- Recognition, Measurement, Amortisation & Disclosures
- AS 14 –Valuation of Intangible Assets acquired by way of Amalgamation
- AS 12 – Valuation of Intangible Assets acquired by way of Government Grant
- AS 22 – Deferred Tax Assets
- AS 19 – Accounting for Leases
- AS 21 – Goodwill arising on consolidation

At the international level the legal provisions are governed by the following:

- International Financial Reporting Standards (IFRS)
- IAS 38 – Intangible Assets
- IAS 13 – Fair value Measurement
- IAS 36 – Impairment of Assets
- IFRS 3 – Business Combinations
- WIPO – World Intellectual Property Rights Organization

- The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
- The Patent Cooperation Treaty

Valuation methods for intangible assets

Valuation of intangible assets is done in a fashion similar to business valuation. The methods can be classified into three approaches:

Income Approach – Discount Cash Flow Models

Cost Approach – What it cost to generate the brand value

Market Approach – Comparable transactions value

Economic Value Added (EVA)

Investors invest money as capital in an enterprise in the form of equity and/or debt. This capital comes at a cost. The weighted average cost of debt and equity is known as the cost of capital. An enterprise invests this capital for business purpose and earns returns for the investors. How do we determine the success of this business enterprise?

Obviously by its financial performance. The financial performance can be determined by excess earnings of the enterprise over and above the cost of capital. This is known as the “economic value added” (EVA). The formula can be put in a simple way:

EVA = NOPAT – (INVESTED CAPITAL × WACC)

Where NOPAT - Net operating profit after tax

WACC - Weighted Average Cost of Capital

NOPAT = EBIT (1- Tax rate)

Where EBIT – Earnings before interest and tax

Invested Capital = (Total assets – non-interest bearing liabilities)

Basically, EVA reflects the profitability of the enterprise. If positive, means that the enterprise generates true economic profit. The purpose of a business enterprise is creation of wealth to investors. Unless the EVA is positive, the investors do not get any return on their investment.

Let us see how to calculate the WACC. The formula is given below:

$WACC = (K_e \times E) + (K_d \times D)\ (1- T_X)$

Where K_e– Cost of equity

E – % of equity in total financing

K_d – Cost of debt

D – % of debt in total financing

T_X – Corporate tax rate

In the above formula the most difficult parameter to determine is the cost of equity. This is the expected rate of return by equity shareholders. So if the enterprise wishes to maintain its share price at a particular level, it

needs to maintain the rate of return sufficient to keep the equity shareholders happy. Cost of equity is calculated from the following formula:

$K_e = r_f + \beta (r_m - r_f)$

Where, K_e= Cost of equity

r_f = Risk-free rate, the amount obtained from investing in securities and considered risk free, such as government bonds

r_m = Rate of market return,

β = Systematic risk available from the market

Cost of debt is fairly easy to determine. This is the average of rate of interest the enterprise pays on its debt. Since the interest on debt is tax deductible, the cost of debt is required to be adjusted for the tax benefit.

If the EVA is positive, then the enterprise is creating wealth. If EVA is negative then the enterprise is destroying wealth. The following example shows how EVA is calculated.

Example:

ABC Company Limited				
Tax Rate	30%		Market Value of Debt	2,000,000
Cost of Equity	12.00%		Market Value of Equity	4,000,000
Before-Tax Cost of Debt	9.00%		Market Value of Capital	6,000,000
EBIT/Capital	20.00%			
After-Tax Cost of Debt	6.30%			
WACC	10.10%			
Calculation of Net Income				
Operating Profit Before Taxes (EBIT)	1,200,000			
- Interest	180,000			
Taxable Income	1,020,000			
- Taxes	306,000		Return on Capital	11.90%
Net Income	714,000		Return on Equity	17.85%
EVA Calculation				
Market Value of Capital	6,000,000			
x Cost of Capital	10.10%			
Cost of Capital at Market Value	606,000			
Operating Profit Before Taxes	1,200,000			

- Cash Operating Taxes	360,000			
Net Operating Profit Less Taxes	840,000			
- Cost of Capital	606,000			
Economic Value Added	**234,000**			

From the above example it is clear that the enterprise should generate enough profits to exceed the WACC on the capital to add Economic Value.

Sensitivity Analysis

The financial performance of an enterprise depends on many factors. The needs of the customer with respect to the product or service are a major factor. Market competition is another factor. Government policies may change affecting the cost and hence the price. The product may face obsolescence due to new technologies. Cheaper alternatives may affect the customer preference. Thus the profitability of an enterprise may be sensitive to any of the factors. If we take these factors as independent variables, then given a change in one or more of the variables, how the profitability will change? This technique is known as "Sensitivity Analysis". This technique can also be used to test the validity of any model. For example, in business valuation, there are variables such as discount rate, future growth rate, market share, beta value, required rate of return, etc. Each of these factors can be varied to test the business valuation model.

Let us look at an example to understand this concept better. In the example below, the variables analysed are Sales and the EBT%. How sensitive is the EBT% to decrease or increase in sales.

		Current	**10% decline in sales**	**10% increase in sales**	**20% decline in sales**	**32% Increase in sales**
Sales		100000	90000	110000	88000	132000
Cost of Sales	70%	70000	63000	77000	61600	92400
Gross Profit		30000	27000	33000	26400	39600
Fixed Cost		15000	15000	15000	15000	15000
Interest	10%	5000	5000	5000	5000	5000
Earnings before tax		10000	7000	13000	6400	19600
EBT %		10%	8%	12%	7%	15%

As can be seen the sensitivity analysis is:

Variable = Sales	Variable = EBT%
0% change from current	10%
10% increase	Decrease by 2% to 8%
10% increase	2% increase to 12%

20% decrease	3% decrease to 7%
32% increase	5% increase to 15%

Let us take another example of business valuation of an enterprise which has 2 crore shares issued and paid-up, has current earnings of `10 per share.

	Current	**Earnings decrease by 10%**	**Earnings increase by 10%**	**P/E ratio increases by 20%**	**P/E ratio decreases by 20%**
P/E ratio of industry	25	25	25	30	20
Earnings per share (Rs.)	10	9	11	10	10
Market price of share (Rs.)	250	225	275	300	200
Value of the enterprise (Rs. in cr.)	500	450	550	600	400

Valuation under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

As per Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the open offer for acquiring shares under regulation 3, regulation 4, regulation 5 or regulation 6 shall be made at a price not lower than the price determined in accordance with sub-regulation (2) or sub-regulation (3), as the case may be.

As per regulation 3, a person acquiring shares of a company has to make a public announcement of an open offer for acquiring shares of the company if,

- As per the SAST regulations, any person acquiring 25% or more of voting rights of a target company
- If any person already holding 25%, acquiring further voting rights of 5% or more

As per regulation 4, making a public announcement of an open offer for acquiring shares of the company will be required if a person acquires directly or indirectly, control over such target company.

Regulation 5(1) covers indirect acquisition by any person and persons acting in concert which may enable him to exercise or direct the exercise of such percentage of voting rights in, or control over, a target company.

Regulation 5(2) specifies when indirect acquisition will be treated as direct acquisition

(a) the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired;

(b) the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or

(c) the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired;

is in excess of eighty per cent, on the basis of the most recent audited annual financial statements, such

indirect acquisition shall be regarded as a direct acquisition of the target company for all purposes of these regulations including without limitation, the obligations relating to timing, pricing and other compliance requirements for the open offer.

For the purposes of computing the percentage referred to in clause (c) of this sub-regulation, the market capitalisation of the target company shall be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

The disclosure requirements are:

- Up to 5% - no disclosures
- 5% up to 25% - disclosure to Stock Exchange
- To cross 25% - open offer of minimum 26%
- Above 25% - up to 5% p.a up to 75%
- Shareholding in Acquirer + PAC in aggregate
- Increase in threshold & offer size

Regulation 6 specifies requirements of a voluntary offer:

- Minimum eligibility – 25%
- Offer size – minimum of 10%
- Last 52 week voluntary acquisition by self & PAC – cannot make a voluntary offer
- Cannot acquire shares from open market during offer period
- Cannot acquire shares for 6 months post offer period except through another voluntary offer
- Regulation 7 specifies the requirements of offer size
- At least 26% of total shares as of 10th day of PA (including shares to be acquired through PA)
- If shareholding would exceed the maximum limit, undertaking to bring it down within time given under the Securities Contracts (Regulations) Act, 1956.
- Such person who has exceeded the maximum limit, cannot make a voluntary delisting offer for a period of 12 months post offer period.

Valuation and issue of Sweat Equity Shares

Sweat equity shares are issued for consideration other than cash such as technical know-how, brand equity, design, patent or any other intangible asset. The intangible asset could come from promoters or director or even employee of the company.

Section 54 of the Companies Act, 2013, specifies the conditions under which sweat equity shares may be issued.

A company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:

(a) the issue is authorised by a special resolution passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

(2) The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

Valuation of sweat equity shares involves two steps:

(i) Valuation of the share price

(ii) Valuation of the intangible asset

The valuation of the share price shall be done by a registered valuer and the intangible asset also will be valued by a registered valuer.

Example:

Sadhana Nitro Chem Limited made issue of sweat equity shares in 2017 to its Director. The disclosures made in accordance with Regulation 6(3) of SEBI (Issue of Sweat Equity Shares) Regulations, 2002 is given below:

Sr. No.	Particulars	Relevant Disclosures
1	Total no. of shares to be issued as sweat equity	114319
2	The current market price of the shares of the company	`52.40
3	The value of the intellectual property rights or technical know-how or other value addition to be received from the employee or director along with the valuation report / basis of valuation.	`50,23,200
4	The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company	Mr. Abhishek Javeri, Chief Financial Officer and Executive Director. He is associated with company since 24th January, 2007 as Director and since 10th February, 2016 as CFO
5	The consideration to be paid for the sweat equity	The shares are allotted in lieu of part of the remuneration payable to Mr. Abhishek Javeri
6	The price at which the sweat equity shares shall be issued	`43.94 (As per valuation report by merchant banker, the price shall not be less than `43.94)

7	Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity	The remuneration paid is within the limit set under Section 197 read with Schedule V of the Companies Act, 2013.
8	Diluted Earnings Per Share pursuant to the issue of securities to be calculated in accordance with International Accounting Standards / standards specified by the Institute of Chartered Accountants of India.	N.A Since the Company has incurred loss during the F.Y. 2015-16

From the above example it can be seen that the sweat equity shares were issued at a value of `43.94, less than the market price. The value of the intellectual property right, i.e., the human resource value has been arrived at as `50,23,200. This has been estimated by a registered valuer.

There are various methods for valuation of intangible assets such as human resources, technical know-how, patents, copyright, brands, etc. The commonly used methods are:

- Historical cost method
- Replacement cost method
- Present value of future cashflows method
- The Lev and Schwartz method

Under the historical cost method, cost incurred in recruitment, training and development, cost of retaining, cost of attrition, etc. of human resources is considered in calculation. For other intangible assets, the cost incurred in bringing the intangible asset to its present state is taken.

Under the replacement cost method, the value of intangible asset is calculated based on the current cost which will be incurred to create the intangible asset. This method is more reasonable in the sense that it takes into consideration all the changes in the cost components.

Under the Present Value method, the future cash flows from the economic benefits of the intangible asset is estimated and discounted at the rate of cost of capital to arrive at the present value which is taken as the value of intangible asset.

The Lev and Schwartz method is used for human resources accounting. As per this model, the value of human capital of a person who is 'y' years old, is the present value of his future earnings from employment. The following formula is used to calculate the present value:

$$E(V_y) = \sum P_y(t+1) \sum I(t)/(1+r)^{t-y}$$

Where:

$E(V_y)$ = expected value of a 'y' year old person's human capital

t = the person's retirement age

$P_y(t)$ = probability of the person leaving the organisation

I(t) = expected earnings of the person in period

r = discount rate

Valuation of Stock Options under the SEBI (ESOP) Guidelines

Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 provides for regulation of all schemes by companies for the benefit of their employees. The regulations apply to the following schemes:

- employee stock option schemes;
- employee stock purchase schemes;
- stock appreciation rights schemes;
- general employee benefits schemes; and
- retirement benefit schemes.

ESOP or employee stock option scheme means a scheme under which a company grants employee stock option directly or through a trust. A company may provide a scheme under which an employee has an option to buy the shares of the company at a predetermined date at a predetermined price. The value of the share price for ESOP can be determined in two ways:

- Intrinsic value method
- Fair value method

Under the Intrinsic value method, the value of ESOP is the difference between the market price and the price at which option can be exercised. For example, the market price of a company's share is Rs.250 and the option at which the share can be exercised is `150, the intrinsic value is:

Intrinsic value of the share = Market price – ESOP exercise price

= 250 – 150 = `100

For the estimation of Fair Value of an option, the Black-Scholes formula can be used. The Black-Scholes formula is a partial differential equation which is useful for European type of call option, i.e, an option which can be exercised only at the end. The formula takes the following variables into consideration:

- current underlying price
- options strike price
- time until expiration, expressed as a percent of a year
- implied volatility
- risk-free interest rates

The formula is given below. In the first half of the formula, the price is multiplied by change in the call premium in relation to a change in the underlying price. The second half gives the current value of paying the exercise price upon expiration, i,e, at the end of the option period.

$$C = SN(d_1) - N(d_2)K_e^{-rt}$$

$$d_1 = \frac{\ln(S/K) + (r + s^2/2)t}{s.\sqrt{t}}$$

$d_2 = d_1 - s.\sqrt{t}$

Where:

C - call premium

S - current market price

t – time until option exercise

K – option striking price

r - risk free interest

N – Cumulative normal distribution

e - exponential term

s – standard deviation

In – natural log

The value of the option is calculated by taking the difference between the two halves.

Valuation of Shares under the SEBI (Delisting of Securities) Guidelines

SEBI (Delisting of Equity Shares) Regulations, 2009 specifies provisions for delisting of equity shares of a company from stock exchanges where the company's shares are listed.

A company can voluntarily de-list its shares due to various reasons such as it may find it expensive to maintain the listing requirements or its share is not frequently traded or it may by closing down its business etc.

Compulsory Delisting of the companies happens when the whereabouts of the directors or promoters is not known or when there is a reduction of public shareholding below the required limit. The shareholders are required to pass a special resolution approving the delisting which shall be valid for a period of one year within which a final application should be made to the stock exchange for the listing. There are two options for delisting. In the first option no Exit opportunity is given when the shares of the company continues to be listed in one of the stock exchanges. In the second option exit opportunity is given through reverse book building when equity share do not remain listed in any Stock Exchange.

Acquirer or promoters shall within 1 working day from the date of receipt of inprinciple approval from the stock exchange make a public announcement giving all the material information as specified in schedule 1 of the regulations. A letter of offer to the public shareholders of equity shares shall be sent not later than 2 working days from the date of public announcement. The office will remain open for 5 days. The offer price shall be determined through book building in the manner specified in schedule II after fixation of floor price and disclosure of the same in the public announcement in the letter of offer. Reverse book building is a process where sell order from the shareholders are collected online for a buyback. Reverse book building helps to discover a price for the buyback which will be equal to or above the floor price. Floor price is the minimum price at which the bids can be placed and is determined on the basis of regulation 15. The floor price shall be determined in terms of regulation 8 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations.

In terms of Regulation 8 of the Takeover Regulations, the floor price shall be higher of the following:

1. the highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;

2. the volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;
3. the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty six weeks immediately preceding the date of the public announcement;
4. the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;
5. where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies;
6. the per share value computed under Regulation 8(5) of the Takeover Regulations.

The "Discovered Price" is the minimum price per Offer Share payable by the Acquirer for the Offer Shares it acquires pursuant to the Delisting Offer, as determined in accordance with the Delisting Regulations, which will be the price at which the shareholding of the Acquirer Group reaches 90% pursuant to a reverse book-building process conducted in the manner specified in Schedule II of the Delisting Regulations and shall not be lower than the Floor Price.

Example

Delisting of shares of Essar Oil Limited in December 2015. The Promoter issued the PA seeking to acquire, in accordance with the Delisting Regulations, and on the terms and conditions set out therein and in the Offer Letter, up to 142,489,858 Equity Shares representing 28.54% of the fully paid up equity share capital of the Company from the Public Shareholders. The Public Shareholders holding Equity Shares of the Company were invited to submit bids pursuant to the reverse book-building process as prescribed in the Delisting Regulations through the Stock Exchange Mechanism of the Stock Exchanges during the Bid Period (December 15, 2015 to December 21, 2015) in accordance with the Delisting Regulations. In terms of regulation 15(1) of the Delisting Regulations, the Discovered Price (being the price at which the shareholding of the Promoter Group reaches 90% pursuant to the Equity Shares tendered in the RBP) is `262.80 per Equity Share. The Promoter has accepted the Discovered Price of `262.80 per Equity Share ("Exit Price") as the final price for the Delisting Offer.

Valuation for Slump Sale under Income-tax Act, 1961

As per section 2(42C) of Income-tax Act 1961, 'slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Section 50B of the Income-tax Act, 1961 provides the mechanism for computation of capital gains arising on slump sale. On a plain reading of the Section, some basic points which arise are: Section 50B reads as 'Special provision for computation of capital gains in case of slump sale'.

As per section 50B(1), any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place. The salient features of these provisions are:

- The capital asset was held for more than 36 months preceding the date of transfer
- The cost of acquisition will be the net worth of the undertaking or division
- A certificate of Chartered Accountant certifying the net worth will be required to be obtained

For the purpose of this 'slump sale' the net worth is calculated as shown below:

Net worth = WDV of assets – liabilities as per books

Where the entire value of the asset has been depreciated, its value will be taken as Nil.

Valuation of demergers/Relative valuation

In a demerger, a company splits into two different entities. So the valuation of each entity is estimated on a standalone basis and the relative value as a ratio is arrived at. How the value of the shares of each entity post demerger is found out? As seen before, the value of a share can be found by any of the following methods:

(i) Asset based approach
  (a) Net asset value

(ii) Income based approach
  (a) Discounted cash flow method
  (b) Earnings capitalisation
  (c) Excess earnings method
  (d) Incremental cash flows method

(iii) Market based approach
  (a) Market price
  (b) Comparable transaction multiple

Example

The Sintex stock was demerged into two: the Plastics Company (Sintex Plastics Technologies Limited or SPTL) and the Textiles arm (listed as Sintex).

The Sintex stock was at `105 before the demerger date. And then it came down to `20 post demerger. Because the listed company – Sintex – was the smaller part. The bigger part was in SPTL, which listed much later. SPTL has later listed and stabilised at `107. So, If you owned one share of Sintex earlier at `105, it's now worth `31.8 (one share of Sintex) plus `107 (one share of SPTL) for a total value of `137.8. When the stock demerged, a certain amount of book assets and debt etc went to each company. Based on the split of such book value, the purchase value may be determined. However, the market may decide the share price of each entity very differently.

How the book value was split for the two entities, the company has given the calculation as follows:

Post demerger Entity name	**% cost of acquisition of equity shares of Sintex Industries**
Sintex Industries Limited	36.38%
Sintex Plastics Technology Limited	63.62%

Net book value of assets which relate to the custom moulding undertaking and prefab undertaking as on the appointed date 1st April 2016 was INR 369.2 crore and 1535.80 cr. respectively whereas the net worth of Sintex Industries immediately before the demerger was INR 2994.54 crore, Thus the proportion of net book value of Assets of Sintex Industries transferred vis-à-vis the net worth of Sintex Industries immediately before such demerger will be 63.62%, that is 12.33% custom moulding undertaking 51.29% for prefab undertaking. Accordingly the cost of acquisition of the equity shares in Sintex plastic will be 63.62% of the total cost of acquisition of the original equity shares in Sintex Industries prior to the demerger.

Valuation in Acquisition – Case Study

In 2008, Tata Motors acquired Jaguar and Land Rover from Ford. On June 2, 2008, the Company completed the acquisition of Jaguar Land Rover from Ford Motor Company of U.S. (Ford) for a consideration of US$ 2.5 billion (on a cash free, debt free basis) (Rs.10765.19 crore) in an all cash transaction out of the purchase consideration. Ford also contributed about US$ 600 million to the Jaguar Land Rover pension plans. Jaguar and Land Rover are global premium automotive businesses encompassing engineering, design, manufacture and marketing of Jaguar luxury performance cars and Land Rover premium all-terrain vehicles.

The purchase consideration included the ownership by Jaguar and Land Rover of necessary Intellectual Property Rights, 3 major manufacturing facilities, 2 advanced design and engineering centres in U.K., a worldwide network of 20 national sales companies and a minimum assured capital allowance of approximately US$ 1.1 billion for future tax set-offs. Jaguar Land Rover also tied up with Ford for supply of engines, stampings and other components on a long term basis for its business as also for transition support in areas of auto financing, IT, accounting and access to Ford's test facilities.

The Jaguar Land Rover acquisition was routed through the Company's 100% subsidiary, Jaguar Land Rover Limited, U.K., which had availed a short term bridge loan facility of US$ 3 billion from a syndication of banks and guaranteed by the Company. The Company prepaid part of the said facility out of proceeds of a Rights Issue and certain divestments and the balance outstanding as on March 31, 2009 was US$ 2.02 billion. For repayment of the said amount, the Company in May 2009 raised resources through further divestments and issued Secured Non-Convertible Credit Enhanced Rupee Debentures in four tranches, having tenors up to 7 years, aggregating `4,200 crores on a private placement basis. The balance facility of US$ 1 billion was rolled over and guaranteed by the Company, by extending the final maturity up to December 2010.

How the valuation of JLR was arrived at? JLR's valuation book position was as shown below:

JLR	**$ million**
Net tangible assets	2,246
Net intangible assets	2,010
Net current assets	(107)
Pension assets	696
Other assets	297
Total assets	5142
Warranty liabilities and other provisions	2,667
Pension liabilities	19
Net Asset Value	**2,456**

Thus the net asset value was $2.5 billion. Also, JLR was projected to generate EBIDTA of $1 million annually. So the valuation was 2.5 times the EBIDTA of JLR.

Valuation under the Insolvency and Bankruptcy Code, 2016 & its Regulations

Insolvency and Bankruptcy Code, 2016 provides for the Corporate Insolvency Resolution and also for liquidation process. As per Section 18 (f) of the Code, the Resolution Professional is required to take control and custody of all tangible and intangible assets over which the corporate debtor has ownership rights. As per Section 36 of the Code, the Liquidator will form a Liquidation Estate from the assets of the corporate debtor.

Under the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, as per Regulation 35(1), Fair Value and Liquidation value shall be determined in the following manner:

(a) the two registered valuers appointed under Regulation 27 shall submit to the resolution professional, an estimate of the fair value and of the liquidation value computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor;

(b) if in the opinion of the resolution professional, the two estimates of a value are significantly different, he may appoint another registered valuer who shall submit an estimate of the value computed in the same manner; and

(c) the average of the two closest estimates of a value shall be considered the fair value or the liquidation value, as the case may be.

Under the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regulation 35 states that:

Where valuation is conducted under Regulation 35 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 or Regulation 34 of the IBBI (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017, as the case may be, the liquidator shall consider the average of the estimates of the values arrived under those provisions for the purpose of valuations under these Regulations.

If not covered above, the liquidator shall appoint at least two registered valuers to value the assets. The registered valuers appointed shall independently submit to the liquidator the estimates of the realizable value of the asset(s) computed in accordance with the Companies (Registered Valuers and Valuation) Rules, 2017, after physical verification of the assets of the corporate debtor. The average of the estimates received shall be considered the value of the assets.

Schedule I of the Regulations states that the liquidator shall make auction and the reserve price shall be the value of the asset arrived at in accordance with Regulation 35. Such valuation shall not be more than six months old. However, in the event that an auction fails at such price, the liquidator may reduce the reserve price up to seventy-five per cent of such value to conduct subsequent auctions.

Principles and techniques of reporting

Valuation Report exercise is based on the observation, inspection, analysis, and calculation. During this process, the valuer goes through various documents, records his observation, makes relevant calculation and records these calculation and analyses results. In this process, many documents are generated which forms the basis of his conclusion on the valuation of the subject matter. It is very necessary

for him to preserve all such records so that these documents may help him to substantiate his conclusion on valuation. Moreover, all these documents also become the matter of reference in near future.

Contents of Summarized Valuation Report

An expert group of Ministry of Corporate Affairs suggested the following coverage in case of the Valuation Report for Corporate Strategies. Considering the share holder's interest and the need for transparency and upholding corporate governance principles and after taking into consideration aspects of minority interest, transparency and corporate governance the Expert Group recommended that the following matters should compulsorily be covered in the Valuation Report, in a clear, unambiguous and non-misleading manner, consistent with the need to maintain confidentiality:

1. Background Information
2. Purpose of Valuation and Appointing Authority
3. Identity of the valuer and any other experts involved in the valuation
4. Disclosure of valuer Interest/Conflict, if any
5. Date of Appointment, Valuation Date and Date of Report
6. Sources of Information
7. Procedures adopted in carrying out the Valuation
8. Valuation Methodology
9. Major Factors influencing the Valuation
10. Conclusion
11. Caveats, Limitations and Disclaimers.

1. Background Information

The valuation report should briefly cover the following:

- Brief particulars of company or business which is the valuation subject
- Proposed Transaction
- Key historical financials
- Capital structure of the company, if relevant, and any changes as a result of the proposed transaction
- Shareholding pattern, any significant changes (Promoters/FIs), and any changes as a result of the transaction (Note – a table of before and after shareholding patterns ought to be disclosed)
- High/low/average market volumes/price for last six months, where applicable
- Related party issues with respect to the transaction.

2. Purpose of Valuation & Appointing Authority

The context and purpose of the valuation and the appointing authority commissioning the exercise must be clearly stated e.g. the Management's decision to seek an advisory opinion should be disclosed, or, the Audit Committee Chairman's decision to appoint or the appointment of an independent valuer itself should be disclosed with the date of the decision.

3. Identity of the valuer and any other experts involved in the valuation

Identity of the Registered Valuer (with his registration number) as well as organization doing the valuation and any other experts consulted in the process of valuation. The separation of the advisory team and details of the Chinese walls maintained between the independent valuer team and the advisory team, if appointed with particulars of the degree of strict separation and compliance of Chinese walls should be mentioned.

4. Disclosure of Valuer Interest/Conflict, if any

The Expert Group also recommends that a valuer shall disclose in his Report, possible sources of conflict and material interests, including association or proposed association/with the company, its associates, the counter-party to the transaction or its associates, in the form of auditor, lead advisor or in any other capacity, together with the nature of the fee arrangements for the same. If the valuer has a separate advisory engagement, the conflict disclosure should clearly record that neither the valuer or the members of the team working on the independent valuation have directly or indirectly, through the client or otherwise shared any advisory perspective or have been influenced or undertaken advocating a management position in determining the value.

5. Date of Appointment, Valuation Date and Date of Report

The Report should clearly state the date of the appointment of the valuer, Valuation Date (i.e. the date as of which the valuation assessment is done if this be other than the date of the report) and the date of the report.

6. Sources of Information

The valuer should clearly indicate in the report the principal sources of information, both internal and external, which have been relied upon for the purpose of valuation.

7. Procedures adopted in carrying out the valuation

Procedures adopted in carrying out a valuation may vary with circumstances, nature and purpose of valuation as well as information and time available. The principal procedures actually adopted by the valuer in carrying out the valuation should be set out briefly in the report. Such procedures may typically include:

- Review of Past Financials
- Review and Analysis of Financial Projections
- Industry Analysis
- SWOT Analysis
- Comparison with similar transactions
- Comparison with other similar listed companies
- Discussions with Management
- Review of principal agreements/documents

etc.The valuer should also include in his report:

• an affirmative statement that information provided and assumptions used by Management/Others in developing projections have been appropriately reviewed, enquiries made regarding basis of key assumptions in context of analysis of business being valued and the industry/economy; and

• an affirmative statement on adequacy of information and time for carrying out the valuations; with such

modifications as may be appropriate and warranted. The affirmative statement shall not negate the professional liability for expertise applied in determining value and if the degree of inadequacy of information is severe, fundamental questions and information as assessed by the valuer as key for the appropriate stage of valuation needs to be disclosed.

8. Valuation Methodology

Where as one method may be more or less applicable to a particular case, they are often used in conjunction to arrive at the fair value of a company/asset/business. The following are some of the methods which are often used for valuations. The methods enumerated below are merely illustrative and not exhaustive.

- Asset Approach

  Book Value, Adjusted Book Value, and Liquidation Value

- Income Approach

  Capitalization of Earnings, Capitalization of Excess Earnings, and Discounted Future Earnings/Cash Flows.

- Market Approach

  Current Market Prices, Historical Market Prices, Price to Earnings, Price to Revenue, Price to Book Value, Price to Enterprise Value, etc.

- Comparable transactions/Valuations

  Comparable International and Domestic Transactions.

The valuation methodology adopted by the valuer has to be disclosed. The valuer should mention in the report the rationale and appropriateness for the adoption of a particular method or a combination of methods and emphasis/reliance placed on the chosen method/combination of methods in reaching the final conclusion.

9. Major Factors influencing the Valuation

The valuer should also mention any key factors which have a material impact on the valuation, including inter alia the size or number of the corporate assets or shares, its/their materiality or significance, minority or majority holding and changes on account of the transaction, any impacts on controlling interest, diminution or augmentation therein and marketability or lack thereof.

10. Conclusion

In conclusion, the report must contain clear statement of the value ascribed to the business/assets in question.

11. Caveats, Limitations and Disclaimers

Any caveats, limiting condition or other disclaimers to the report must be clearly stated with appropriate specificity i.e. the valuer shall not disclaim liabilities for his expertise or deny his duty of care.

Swap Ratio

In a merger or acquisition between two companies, the ratio at which the acquiring company offers its own shares in exchange for the target company's shares, is known as the swap ratio.

Example:

In October 2017, Indusind Bank acquired a micro finance company Bharat Financial Inclusion Ltd. The swap ratio had been decided at 639 shares of IndusInd Bank for every 1,000 shares of Bharat Financial. This means that the value of one share of Bharat Financial is equal to 0.639 share of Indusind Bank, swap ratio of 1:0.639.

Recently in 2018, IDFC Bank and Capital First announced merger between the two to form a combined entity with assets under management of `88,000 crore, branch network of 194 and customer base of over 5 million. As per the agreement, IDFC Bank will issue 139 shares for every 10 shares of Capital First. So the swap ratio here is 1:13.9.

LESSON ROUND-UP

- Business valuation is necessitated in many circumstances such as mergers, acquisitions, demerger, takeovers, sale of a division, sale of intangible assets such as brands, patents, technical know-how, Goodwill, etc.
- Broadly there are three approaches to Valuation namely – Asset-based approach, Income-based approach and Market-based approach.
- Asset based valuation method is based on the simple assumption that adding the value of all the assets of the company and subtracting the liabilities, leaving a net asset valuation, can best determine the value of a business.
- Under Income based approach the methods are, Discounted cash flow method, Earnings capitalisation method, Excess earnings method, Incremental cash flows method
- Under the Market based approach the methods are market price and comparable transaction multiple methods.
- Economic value added is another parameter to measure the financial performance of an enterprise.
- Valuation in takeovers, delisting, ESOPs are subject to SEBI regulations.
- Valuation in a slump sale is governed by Income-tax Act, 1961
- Swap ratio is the exchange ratio in a merger or acquisition between two entities.

GLOSSARY OF TECHNICAL WORDS

Book value: Total assets, without the inclusion of intangibles such as goodwill, minus total liabilities. The book value of a company is its base liquidation value.

Current assets: Cash, accounts receivable, securities, inventory, and any other assets that can be converted into cash within one year or during the normal course of business.

Current liabilities: Liabilities payable within one year. They include accounts payable, notes payable, accrued expenses such as wages and salaries, taxes payable, and the portion of long-term debts due within one year.

Fair market value: A price at which a willing buyer and a willing seller, both knowing the relevant facts about the business, would transfer a company.

Intangible assets: Business assets that are not material in nature, which have been created through time and effort. Some examples of intangible assets are patents and goodwill.

Net Present Value: The value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net worth: The business owner's equity in a company, calculated by subtracting the company's total liabilities from its total assets.

Valuation: A value estimate or opinion, or the process of estimating value. A valuation report is usually a written document setting forth an opinion of a business's value as of a specified date, supported by the presentation and analysis of relevant data.

Working capital: The capital available to the business on a short term, calculated by subtracting current liabilities from current assets.

LIST OF FURTHER READINGS

1. Business Valuation in India, Wolters Kluwer Publications
2. Business Valuation (Text and Cases) by Pitabas Mohanty, Taxmann's
3. Valuation by Registered Valuers by Kamal Garg, Bharat's Publication
4. Mergers and Acquisitions by Sheeba Kapil, Wiley Publications
5. Mergers & Acquisitions and Corporate Valuation by Dr. Manu Sharma, Dreamtech press.

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation.)

1. What is meant by business valuation?
2. What are the different approaches in business valuation?
3. What are the methods under Asset approach?
4. What are the methods under Income approach?
5. How business valuation is done under market approach?
6. What is economic value added (EVA)?
7. How goodwill is valued?
8. What are the disclosure requirements under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011?
9. How the floor price is determined under Regulation 8 of SEBI (Delisting of Securities) Guidelines?
10. What is slump sale? How the value is determined under the provisions of Income Tax Act, 1961?
11. What is meant by swap ratio? Where is it used?

Lesson 7
Accounting in Corporate Restructuring - Concept and Accounting Treatment

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Introduction
- Applicability
- Accounting Standard-14: Accounting for Amalgamations
  - Types of amalgamation
  - Methods of accounting for amalgamations
  - Consideration for amalgamation
  - Treatment of Reserves on Amalgamation
  - Goodwill on amalgamation
  - Balance of profit & loss account
  - Disclosure requirements
  - Amalgamation after Balance sheet date
- Ind AS-103 Business Combination
  - Business and Business Combination
  - Accounting for Business Combination
  - Identifying the acquirer
  - Determine the acquisition date
  - Recognising and measuring the identifiable assets and liabilities acquired
  - Recognising goodwill or bargain purchase
  - Other aspects of business combination
- Recent developments in M&A Accounting
- IFRS-3 Business combination
- Demerger
- Internal Reconstruction

LEARNING OBJECTIVES

With the notification of Ind-AS accounting standards for specified companies, the accounting for corporate restructuring has undergone a sea change. Ind-AS 103 on Business combination deals with accounting of corporate restructuring. Companies for which Ind-AS-103 is not applicable, Accounting Standard-4 continues to apply.

Accounting Standard-14 (AS-14) deals with Accounting for amalgamations. According to AS-14 amalgamation may be either in the nature of merger or in the nature of purchase. It prescribes certain conditions to be fulfilled for consideration of amalgamation in the nature of merger. It includes aspects relating to transfer of assets and liabilities, shareholders of transferor companies becoming shareholders of transferee company, consideration for amalgamation and continuity of business of transferor Company(ies), etc.

Ind-AS 103 deals with meaning of business, business combination. According to Ind-AS 103, business combination is accounted applying acquisition method. It also deals with method of identifying acquirer, determining the acquisition date, value at which the assets and liabilities are accounted by the acquirer, accounting for non-controlling interest, Goodwill and Gain on bargain purchase. It also deals with accounting for business combination of entities under common control.

After reading this lesson you will be able to understand various developments happening in M&A accounting, concepts of demerger and internal reconstruction and also major difference between Ind-AS 103 and IFRS 3.

Introduction

Corporate restructuring implies a process by which the legal, ownership or operational or other structures of the company is reorganised to make it more profitable or to make corporate more agile to meet the competition and operational requirements. Restructuring may also happen as a response to major events like buyout, bankruptcy, demerger or due to financial restructuring.

The most common forms of corporate restructuring are mergers/amalgamations, acquisitions/takeovers, financial restructuring, divestitures/demergers and buy-outs. It is essentially the process of re-designing one or more aspects of the Company.

Accounting for corporate restructuring is dealt with following accounting standards:

(a) Accounting for Amalgamation (AS-14) - Applicable to those who have to comply with Companies (Accounting Standards) Rules, 2016

(b) Business Combinations (IND AS-103) - Applicable to those who have to comply with Companies (Indian Accounting Standards) Rules, 2015

Accounting Standard-14 (AS-14) deals with accounting for amalgamations. According to AS-14 amalgamation may be either in the nature of merger or in the nature of purchase. It prescribes certain conditions to be fulfilled for consideration of amalgamation in the nature of merger. It includes aspects relating to transfer of assets, and liabilities, shareholders of transferor companies becoming shareholders of transferee company, consideration for amalgamation, continuity of business of transferor company(ies).

AS-14 further prescribes that amalgamation in the nature of merger should be accounted for under pooling of Interest method and amalgamation in the nature of purchase should be accounted for under the purchase method. It also covers aspects such as treatment of reserves/goodwill in a scheme of amalgamation, amalgamation after the balance sheet date, etc.

Indian Accounting Standard - 103 (IND AS-103) lays down the accounting principles for business combination and not for asset combination. IND AS-103 is substantially different from Accounting for Amalgamation (AS-14). To apply the IND AS-103, there should be transaction which meets the definition of business combination.

APPLICABILITY

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.

Business Combinations (IND AS-103) applies to a transaction or other event that meets the definition of a business combination.

Exception

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (acquired company) in consideration by payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Business Combinations (IND AS-103) does not apply to the following:

(a) The formation of a joint venture

(b) The acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in Ind AS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

(c) Accounting for combination of entities or business under common control.

ACCOUNTING STANDARD-14 ACCOUNTING FOR AMALGAMATIONS

Types of Amalgamation

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

(a) Amalgamation in the nature of merger.

(b) Amalgamation in the nature of purchase.

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified above is not satisfied. These amalgamations are in effect a mode by which one company acquires another company and hence, the equity shareholders of the combining entities do not continue to have a proportionate share in the equity of the combined entity or the business of the acquired company is not intended to be continued after amalgamation.

Example:

X Ltd. takes over Y Ltd. under the scheme of merger sanctioned by the Tribunal. Y Ltd. ceases to exist. Consideration is discharged by way of issue of equity shares of X Ltd. to the shareholders of Y Ltd. in the

ratio 1:1. X Ltd. already held 5% in Y Ltd. as an investment prior to the effective date of merger *i.e.* 1st October 2017. 86% of the shareholders (by face value) of Y Ltd. excluding X Ltd. agreed to become shareholders of X Ltd. Whether the above case will qualify to be classified as merger as per AS-14.

Solution:

Even if we exclude the shares of Y Ltd. already held by X Ltd., consequent to the allotment of shares pursuant to merger, 90% criteria for amalgamation to be classified as merger is being met. Since 90% of the remaining shares *i.e.* 95% comes out to 85.5% shareholders. Thus the threshold is being met. Hence the above case will qualify as merger.

METHODS OF ACCOUNTING FOR AMALGAMATION

There are two main methods of accounting for amalgamations:

(a) the pooling of interests method; and

(b) the purchase method.

The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

The Pooling of Interests Method

Since merger is a combination of two or more separate business, there is no reason to restate carrying amounts of assets and liabilities. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

If, at the time of the amalgamation, the transferor and the transferee company have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported in accordance with Accounting Standard (AS-5), Net Profit or Loss for the Period 'Prior Period Items and Changes in Accounting Policies'.

The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves. It has been clarified that the difference between the issued share capital of the transferee company and share capital of the transferor company should be treated as capital reserve. The reason given is that this difference is a kin to share premium. Furthermore, reserve created on amalgamation is not available for the purpose of distribution to shareholders as dividend and/or bonus shares. It means that if consideration exceeds the share capital of the transferor company (or companies),the unadjusted amount is a capital loss and adjustment must be made, first of all in the capital reserves and incase capital reserves are insufficient, in the revenue reserves. However, if capital reserves and revenue reserves, are insufficient the unadjusted difference may be adjusted against revenue reserves by making addition thereto by appropriation from profit and loss account. There should not be direct debit to the profit and loss account. If there is insufficient balance in the profit and loss account also, the difference should be reflected on the assets side of the balance sheet in a separate heading.

The Purchase Method

In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as in case of statutory reserve.

Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognized in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve.

The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortization period should not exceed five years unless a somewhat longer period can be justified.

The reserves of the transferor company, other than statutory reserve should not be included in the financial statements of the transferee company. The statutory reserves refer to those reserves which are required to be maintained for legal compliance. The statute under which a statutory reserve is created may require the identity of such reserve to be maintained for a specific period.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, such statutory reserves of the transferor company should be recorded in the financial statements of the transferee company by crediting the relevant statutory reserve account. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of "miscellaneous expenditure" or other similar category in the balance sheet. W hen the identity of the statutory reserves is no longer required to be maintained,boththereservesandtheaforesaidaccountshouldbereversed.

Let us recapitulate

There are two types of amalgamation and two methods of accounting for amalgamations under AS 14. The types of amalgamation are amalgamation in the nature of merger and amalgamation in the nature of purchase. There are two main methods of accounting for amalgamations viz. the pooling of interests method; and the purchase method. The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

CONSIDERATION FOR AMALGAMATION

The consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. In determining the value of the consideration, assessment is made of the fair value of its various elements.

The consideration for the amalgamation should include any non-cash element at fair value. The fair value may be determined by a number of methods. For example, in case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up, and where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

While the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and areas on able estimate of the amount can be made. In all other cases, the adjustment should be recognized as soon as the amount is determinable.

Example:

A Ltd. takes over B Ltd., on 1st April, 2017 and discharges consideration for the business as follows:

(a) Issued 42,000 fully paid equity shares of Rs.10 each at par to the equity shareholders of B Ltd.

(b) Issued fully paid up 15% preference shares of Rs.100 each to discharge the preference shareholders (Rs.1,70,000) of B Ltd. at a premium of 10%

(c) It is agreed that the debentures of B Ltd. (Rs.50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Calculate the amount of purchase consideration.

Solution:

Calculation of purchase consideration:

(a) 42,000 equity shares @ `10	=	4,20,000
(b) 15% preference shares of `170000*110%	=	1,87,000
Total	=	6,07,000

(c) Not to be included in purchase considered as it is payment to debenture holders.

Treatment of Reserves on Amalgamation

If the amalgamation is an 'amalgamation in the nature of merger'

If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

If the amalgamation is an 'amalgamation in the nature of purchase'

If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved, dealt within the certain circumstances mentioned below.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the

transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the afore said nature (referred to here in after as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. W hen the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt within the manner stated below 'under' treatment of goodwill on amalgamation,. If the result of the computation is positive, the difference is credited to Capital Reserve.

Goodwill on Amalgamation

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to nature of goodwill, it is difficult to estimate its useful life, but estimation is done on a prudent basis. Accordingly, it should be appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

The following factors are to be taken into account in estimating the useful life of goodwill:

(i) the forcible life of the business or industry;

(ii) the effects of product obsolescence, changes in demand and other economic factors;

(iii) the service life expectancies of key individuals or groups of employees;

(iv) expected actions by competitors or potential competitors; and

(v) legal, regulatory or contractual provisions affecting the useful life.

Example:

What is goodwill and capital reserve as per AS-14?

Goodwill is the excess of the price paid in a purchase over the fair value of the net identifiable assets acquired.

Capital reserve is the excess of the fair value of the net identifiable assets acquired over the purchase price.

Balance of Profit and Loss Account

In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

Disclosure Requirements

(a) For ***amalgamations of every type following disclosures*** should be made in the first financial statements following the amalgamations:

  (i) names and general nature of business of the amalgamating companies;

  (ii) effective date of amalgamation for accounting purposes;

  (iii) the method of accounting used to reflect the amalgamation; and

  (iv) particulars of the scheme sanctioned under a statute.

(b) In case of ***amalgamations accounted for under the pooling of interests method, the following additional disclosures*** are required to be made in the first financial statements following the amalgamation:

  (i) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

  (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

(c) In case of ***amalgamations accounted for under the purchase method the following additional disclosures*** are required to be made in the first financial statements following the amalgamations:

  (i) consideration for the amalgamation and a description of the consideration paid or contingently payable, and

  (ii) the amount of any difference between the consideration and the value of net identifiable assets required, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Amalgamation after the Balance Sheet Date

While an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made as per the provisions of AS-4, 'Contingencies and Events Occurring after the Balance Sheet Date', but the amalgamation should not be incorporated in that financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Indian Accounting Standard 103- Business Combinations

Ind AS 103 defines business combination which has a wider scope when compared to AS-14 which deals only with amalgamation. Business combination is the process under which two or more business organisations or their net assets are brought under common control in a single business entity.

Business and Business Combination

Business: A business consists of inputs and process applied to those inputs that have the ability to create outputs. Thus, a business has three elements:

(a) Input: An economic resource that creates or has the ability to create outputs when one or more

processes are applied to it. Example Non-current assets.

(b) Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Example: Strategic management processes.

(c) Output: The results of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividend, lower costs or other economic benefits directly to investors or other owners, members or participants.

Business Combination

A transaction or other event in which an acquirer obtains control of one or more business. Transactions sometimes referred to as true mergers or mergers of equals are also business combinations as that term is used in this IND AS.

A business combination is an act of bringing together of separate entities or business into one reporting unit. The result of business combination is one entity obtains control of one or more businesses. If an entity obtains control over other entities which are not business, the act is not a business combination. In such a case the reporting entity will account it as asset acquisition.

From the definition of Business Combination, it is clear that for business combination, control by one entity of another is sufficient and both the entities can continue to exist.

For example, if X Ltd., acquires 70% shares of Y Ltd., then it is a case of business combination even if X Ltd. and Y Ltd. will continue to exist. X Ltd. becomes a holding company of Y Ltd. and therefore, they become one reporting entity by reporting consolidated financial statements.

Difference between Ind AS-103 and Ind AS-110 Consolidated Financial statements.

It may seem that Ind AS-110 Consolidated Financial statements and Ind AS-103 Business Combination deal with the same thing that is not accurate.

Both standards deal with business combinations and their financial statements.

While Ind AS-110 defines a control and prescribes specific consolidation procedures, Ind AS-103 is more about the measurement of the items in the consolidated financial statements, such as goodwill, non-controlling interest, etc.

While preparing consolidated financial statements, first you have to apply Ind AS-103 for measurement of assets and liabilities acquired, non-controlling interest and goodwill/bargain purchase then the consolidation procedure as per Ind AS-110.

An entity shall account for each business combination by applying the acquisition method. Applying the acquisition method requires the following:

(a) Identifying the acquirer

(b) Determining the acquisition date

(c) Recognising and measuring the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquire; and

(d) Recognising and measuring goodwill or a gain from a bargain purchase

(e) Disclosures

Business Combination of Entities under Common Control

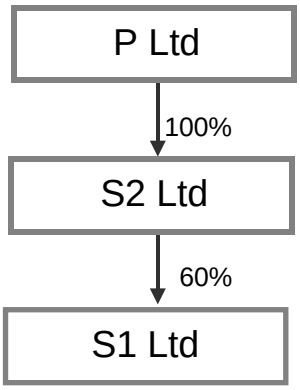
Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

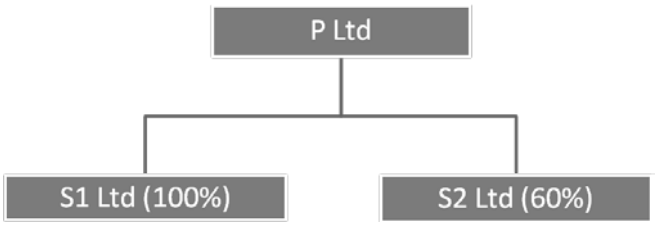
The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination is not relevant to determining whether the combination involves entities under common control. This is because of partially-owned subsidiary in nevertheless under the control of the parent entity.

Example:

Consider the following two groups:



P Ltd. acquires from S1 Ltd., its 60% stake in S2 Ltd. for Rs.10 Crores. After that the position of the group will be as below:



Method of accounting for common control business combinations

Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

The pooling of interest method is considered to involve the following:

(a) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(b) No adjustments are made to reflect fair values or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.

(c) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, prior period information shall be restated only from that date.

The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

The excess, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor is recognised as goodwill in the financial statements of the transferee entity; in case of any deficiency, the same shall be treated as capital reserve.

Disclosures

The following disclosures shall be made in the first financial statements following the business combination:

(a) Names and general nature of business of the combining entities

(b) The date on which the transferor obtains control of the transferee

(c) Description and number of shares issued, together with the percentage of each entity's equity shares exchanged to effect the business combination; and

(d) The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

Business Combination after the balance sheet date

When a business combination is effected after the balance sheet but before the approval of the financial statements for issue by either party to the business combination, disclosure is made in accordance with Ind AS 10 Events after the reporting period, but the business combination is not incorporated in the financial statements. In certain circumstances, the business combination may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Recent Development's in M&A Accounting

AS-14 Accounting for amalgamations did not provide guidance in many situations such as demerger, reverse acquisition. In the absence of specific accounting guideline companies were using various alternative accounting alternatives for achieving tax efficiencies.

In the cases court approved mergers and acquisition, the accounting treatment was prescribed by the courts which sometimes used to be contrary to the accounting standard.

With the introduction of IND-AS 103 – Business combination and Companies Act, 2013 accounting treatment of Mergers and Acquisitions have undergone a drastic change.

Section 232 of the Companies Act 2013 provides that accounting treatment prescribed in the court approved scheme for merger, demerger, amalgamation or group restructuring should be in accordance with the notified accounting standards prescribed in the Companies Act, 2013.

Certain other developments in M&A accounting are as below:

(a) Method of Accounting for business combination

Under AS-14 many companies were able to account for business combination between commonly controlled enterprises using purchase method. As a result of this, tax benefits for goodwill amortisation was available while computing book profit for MAT purpose.

Under IND AS-103 it is mandatory to use pooling of interest method for business combination between commonly controlled enterprises.

As a result of this accounting alternatives gets restricted and the consequent tax benefits will also be not available.

(b) Appointed date v. Effective date

In court approved merger, demerger and other restructuring accounting was done from the appointed date once the court order became effective.

With the implementation of IND-AS 103 Business combination this is going to change. As per IND-AS 103 accounting for business combination should be done on the date on which the acquirer obtains control.

(c) Accounting for goodwill

AS-14 provided an accounting choice to compute the goodwill at the fair value of the assets takenover or at the net asset value of the assets taken over. However, this choice is not available in IND AS 103 Business combination, as the goodwill has to be computed using the fair value of the net assets taken over.

AS-14 provides for amortisation of goodwill over a period of five years. IND-AS 103 Business combination prohibits amortisation of goodwill and is required to test goodwill for impairment annually. This will result in a volatile profit and loss account.

Goodwill amortisation was available as tax deductible item while computing MAT liability. This will not be available in the IND-AS regime.

(d) Common control business combinations

IND AS prescribes specific accounting principles for common control business combinations. It mandates the use of the pooling of interest method with restatement of the comparative period presented for the period the entities were in common control. The requirement to restate comparative may not be fully in sync with the tax treatment of considering the merger or amalgamation only from the appointed date.

IFRS 3- Business Combination

The principles of IND- AS 103 Business combination and IFRS 3 are same to a very great extent.

There are only few carve out in IND-AS 103 when compared to IFRS 3. They are as follows:

IFRS-3 excludes from its scope business combinations of entities under common control. Ind AS 103 (Appendix C) gives the guidance in this regard.

IFRS-3 requires bargain purchase gain arising on business combination to be recognised in profit or loss account. IND-AS 103 requires that the bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve.

The main reason for this carve out is, the recognition of such gains in profit or loss would result into recognition of unrealised gains as the value of net assets is determined on the basis of fair value of net assets acquired.

Demerger

Demerger is a method of corporate restructuring by which a business unit or subsidiary of a company becomes an independent entity from its parent's entity. The parent firm distributes shares of subsidiary to its shareholders through a stock dividend. In most cases demerger unlocks hidden shareholder value. For the parent company, it sharpens the management focus. For the new entity, it gets independence to make decisions, explore new opportunities based on its strength.

The word demerger has got statutory recognition in the Income Tax Act, 1961. As per Income Tax Act, 1961 demerger in relation to companies, means the transfer, pursuant to a scheme of arrangement under Companies Act, 2013 by a demerged company of its one or more undertakings to any resulting company subject to conditions specified.

As per various court decisions AS-14 -Accounting for Amalgamations is not applicable to demergers.

Case 1 – Scheme of arrangement between Sony India Private Limited (Sony India) and Sony Software Centre Private Limited (Sony Software) with reference to transfer of software undertaking of Sony India to Sony Software

The Delhi High Court (the High Court), while approving scheme of arrangement between Sony India and Sony Software in 2012 has clarified that AS-14 (i.e., accounting standards issued by the Institute of Chartered Accountants of India) is applicable only to amalgamations and not to demerger. As per the scheme of arrangement, 'Software Undertaking' of Sony India is proposed to be transferred to Sony Software under Sections 391 to 394 of the Companies Act, 1956. One of the conditions of the scheme was that any excess in the value of net assets of software undertaking transferred to the resulting company shall be applicable for distribution to the shareholders of the resulting company.

Regional Director of Northern Region, Ministry of Corporate has raised objection in his affidavit filed with the High Court stating that excess, if any, in the value of the net assets of the software undertaking should be adjusted to the capital reserve as prescribed in AS-14 and not to the general reserve as proposed in the scheme of arrangement.

The petitioners contended that AS-14 is applicable only to amalgamations and not to demerger. It was clarified that AS-14 is applicable only to amalgamations and not to demerger. On a plain reading of the accounting standard under reference, it is clear that the same is applicable only in case of an amalgamation and not in case of demergers. This has also been held by the Gujarat High Court in the case of 2010 1CLJ 351 tiled Gallops Realty (P) Ltd. v. State of Gujarat.

Case2- Gallops Realty (P) Ltd. *v.* State of Gujarat

In Case of High Court of Gujarat, *Gallops Realty (P) Ltd., In re* v. *K.A. PUJ, J.*(2010), under Section 391, read with sections 394 and 100, of the Companies Act, 1956 Petitioner-companies, i.e., demerged

company and resulting company, sought for sanction of composite scheme of arrangement in nature of purchase of shares and demerger of hotel business of demerged company to resulting company and consequent reconstruction of share capital of demerged company under section 391, read with sections 394, 78 and 100 consisting of reduction of paid-up share capital as well as utilization of share premium account. Regional Director stated that as per scheme, capital profit on demerger would be transferred to general reserve in books of resulting company which was not in consonance with generally accepted accounting principles as also Accounting Standard-14 which provide that any profit arising out of a capital transaction ought to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve. It was held that the observation of Regional Director was not in consonance with accounting principles in general and Accounting Standard-14 in particular, as ***Accounting Standard-14 is applicable only in case of amalgamation and not in case of demerger, as envisaged in instant scheme.***

Applicability of IND-AS 103 for Demerger Transactions

As discussed above the concept of demerger is recognised in the Income Tax Act, 1961. However, tax benefits are available only if the conditions of demerger provided in section 2(19AA) are met. One such condition is that assets and liabilities are to be recorded by the transferee company at the book value of the transferor company.

The requirement to record assets and liabilities at fair value in case of non-common control business combination under IND-AS 103 may create problem in achieving a most tax efficient demerger.

Internal Reconstruction

When a company incurs loss for number of years, the balance sheet does not reflect the true position of the business, as a higher net worth is depicted, than that of the real one. In such a company the assets are overvalued and it has many intangible assets and fictitious assets. Such a situation does not depict a true picture of financial statements. Such a situation requires reconstruction. Such a reconstruction may be carried out internally.

In an internal reconstruction, the assets are revalued, liabilities are negotiated, and losses suffered are written-off by reducing the paid-up value of shares and/or varying the rights attached to different classes of shares. Existing company is not liquidated.

Internal reconstruction may be done in the following ways:

(a) Cost reduction through closure of units.

(b) Redundancy programmes.

(c) Management or organisational restructuring involving decentralization.

LESSON ROUND-UP

- 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.
- AS14 is not applicable to demergers.
- AS 14 provides for two types of amalgamations viz. amalgamation in the nature of merger and amalgamation in the nature of purchase.
- There are two main methods of accounting for amalgamations viz. the pooling of interests method; and the purchase method.

- The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.
- The consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.
- If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.
- If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved, dealt within the certain circumstances specified.
- Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life.
- AS14 also prescribes certain disclosure requirements.
- While an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made as per the provisions of AS-4, contingencies and events occurring after the Balance Sheet Date, but the amalgamation should not be incorporated in the financial statements.
- While filing for approval of any draft Scheme of amalgamation/merger/reconstruction, etc. with the stock exchange under the listing agreement, the company is also required to file an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards
- A business combination is an act of bringing together of separate entities or business into one reporting unit. The result of business combination is one entity obtains control of one or more businesses. If an entity obtains control over other entities which are not business, the act is not a business combination. In such a case the reporting entity will account it as asset acquisition.
- An entity shall account for each business combination by applying the acquisition method.
- For each business combination, one of the combining entities shall be identified as the acquirer. Most of the time, it is straightforward - the acquirer is usually the investor who acquires an investment or a subsidiary. The acquiree is the business that the acquirer obtains control of in business combination
- The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquire.
- The acquirer shall measure the identifiable assets acquired and liabilities assumed at their acquisition date fair values.
- On the acquisition date, the acquirer shall recognise separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.
- The acquirer shall recognize goodwill as of the acquisition date measured based on the principles discussed above.
- Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.
- In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition date fair value and recognise the resulting gain or loss, if any, in profit or loss.
- The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

- During the current reporting period; or
- After the end of the reporting period but before the financial statements are approved for issue

- Section 232 of the Companies Act 2013 provides that accounting treatment prescribed in the court approved scheme for merger, demerger, amalgamation or group restructuring should be in accordance with the notified accounting standards prescribed in the Companies Act, 2013.
- The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement.

GLOSSARY OF TECHNICAL WORDS

Acquiree: An acquiree is a target company that is subject to an acquisition attempt by an acquirer.

Acquirer: An acquirer is a person or company that purchases all or a portion of an asset or company.

Acquisition Date: The acquisition date is the date on which the acquirer obtains control of the acquire

Appointed date: Appointed date is the date which is chosen by the management for effecting the Scheme and its accounting entries.

Business combination: A business combination is a transaction in which the acquirer obtains control of another business (the acquiree).

Common control business combination: Common control business combination means a business combination involving entities or business in which all the combining entities or business are ultimately controlled by the same party or parties both before and after the business combination

Effective date: Effective date is the date from which the Scheme becomes effective in terms of law and the date on which all the necessary approvals have been obtained.

Goodwill: Goodwill is an intangible asset which represents non-physical items that add to a company's value but cannot be easily identified or valued.

Measurement period: The measurement period is the period after the acquisition date during which the parent may adjust the provisional amounts recognised in respect of the acquisition of the subsidiary

Transferee Company: A company into which a transferor company is amalgamated. The company buying other company is known as "Transferee Company".

Transferor Company: A company which is amalgamated into another company. The company selling its business is known as "Transferor Company".

LIST OF FURTHER READINGS

1. Financial Management, 2nd Edition by P C Tulsian, S. Chand Publications
2. Master Guide to Merger and Acquisition in India – Tax and Regulatory, 4th Edition, CCH India
3. Mergers & Acquisitions and Corporate Valuation, Dr. Manu Sharma, Wiley Publication
4. Accounting for Amalgamation -AS-14 (Revised) issued by the Ministry of Corporate Affairs.
5. Business Combination (Ind AS -103) issued by the Ministry of Corporate Affairs
6. Students Guide to Ind AS Converged IFRS by Dr D.S. Rawat

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Does AS-14 apply to demerger? Explain.
2. What are the types of amalgamation provided under AS-14?
3. What are the methods of accounting provided under AS-14?
4. How the balance in profit and loss account of transferor is treated in case of amalgamation in the nature of merger?
5. What is business as per IND-AS 103?
6. What is the meaning of Business Combination as per IND-AS 103?
7. How are assets and liabilities measured at acquisition date in IND-AS 103?
8. How is the acquisition date identified in IND-AS 103?
9. How is goodwill measured as per IND-AS 103?
10. How is gain from bargain purchase accounted?

Lesson 8
Taxation and Stamp Duty Aspects of Corporate Restructuring

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Taxation aspects of mergers and amalgamations
- Taxation aspects of slump sale
- Taxation aspects of demerger
- Deemed Dividend
- Constitutional background on levy of stamp duty
- Stamp duty payable on High Court order sanctioning amalgamation
- Amalgamation of holding and subsidiary companies – exemption from payment of stamp duty

LEARNING OBJECTIVES

Stamp duty and taxation aspects are closely linked to the financial aspects. Taxation aspects of merger and demerger includes aspects such as capital gain and carry forward of losses after merger. Deemed dividend and its tax implications are also important considerations.

The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty.

After reading this lesson you will be able to understand the regulatory aspects and court decisions as to the stamp duty aspects of mergers demergers, tax advantage on mergers, demergers etc.

INTRODUCTION

In any merger or amalgamation, financial aspects of the transaction are of prime importance as the same are expected to accrue financial benefits. While framing a scheme of merger or amalgamation, a company has to fulfill the conditions prescribed under the Company Law as already discussed in previous lessons, but it has also to look after two very important aspects, i.e., taxation and stamp duty.

Tax considerations predominate and inevitably direct the manner in which the entire scheme has to be designed. Tax planning in cases of amalgamations of companies is perhaps the most vital aspect of decision-making involved in framing of the scheme of amalgamation. A company planning a merger or a takeover, need to do intensive tax planning before finalising the deal to get the maximum tax concession and benefits in the deal. In India, law provides for ample benefits in the form of various provisions to companies going in for amalgamation.

Since a merger or demerger inevitably entails some transfer of property, movable or immovable, it attracts the imposition of stamp duty which is essentially a form of revenue for the government arising out of taxation of various transactions governed under the Indian Stamp Act, 1899. The exposition of stamp duty is a vital aspect because it could substantially increase the costs of a merger deal.

In corporate restructuring through amalgamation and merger, stamp duty planning assumes a significant role and all out efforts are made to pay as less a duty on such amalgamations as possible and yet proceed with the acquisitions through mergers and amalgamations. The incidence of stamp duty is an important consideration in the planning of any merger.

Since the stamp duty levied on amalgamations or mergers differs from one State to another, there is disadvantage of effecting amalgamations in one State compared to another and therefore professional time and attention is devoted to work out the best method which can affect stamp duty savings on such amalgamations or mergers.

TAXATION ASPECTS OF MERGERS AND AMALGAMATIONS

The word ‘amalgamation’ or ‘merger’ is not defined anywhere in the Companies Act, 1956. However, the Companies Act, 2013 without strictly defining the term explains the concept. A ‘merger’ is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business. Section 2(1B) of the Income Tax Act, 1961 defines the term ‘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 the amalgamating company or companies and the company with which they merge or which is formed as a 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-fourths 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.

Example:

Company "A" merges with another Company "B" in a scheme of amalgamation, and immediately before the amalgamation, company "B" held 20% of the shares in Company "A", the abovementioned condition will be satisfied if shareholders holding not less than 3/4th in value of the remaining 80% of share in company "A" i.e. 60% thereof (3/4th of 80), become shareholders of company "B" by virtue of the amalgamation.

Thus, for a merger to be qualified as an 'amalgamation' for the purpose of the Income Tax Act, 1961, the above three conditions have to be satisfied.

Carry forward and set off of accumulated loss and unabsorbed depreciation allowance

Under Section 72A of Income Tax Act,1961, a special provision is made which relaxes the provision relating to carrying forward and set-off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation. Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company, or an amalgamation of a banking company referred to in clause (c) of Section 5 of the Banking Regulations Act,1949 with a specified bank, or one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business, then, not withstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or; as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

It is to be noted that as unabsorbed losses of the amalgamating company are deemed to be the losses for the previous year in which the amalgamation was effected, the amalgamated company will have the right to carry forward the loss for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year in which the amalgamation was effected.

However, the above relaxations shall not be allowed in the assessment of the amalgamated company unless,

(a) the amalgamated company–

(i) has been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;

(ii) has held continuously as on date of the amalgamation at least three fourth of the book value of fixed assets held by it two years prior to the date of amalgamation;

Example:

X Ltd. holds the following assets on 5th November, 2015. What is the value of asset to be held on 5th November, 2017 for carry forwarding and set-off of unabsorbed depreciation and loss?

Assets	**Book Value on 05/11/2015 (Rs. in lakhs)**
A	30
B	50
C	60
D	40
E	12
F	8
Total	**200**

In this case, assets carrying book value of at least Rs.150 lakh (75% of Rs.200 lakh) as on 05/11/2015 should be held on 05/11/2017 as well. Thus, if the company has assets A, B, C and D on 05/11/2017 it shall satisfy the above condition as total value on 05/11/2015 was Rs.180 lakh. Alternatively, it should have at least assets B, C and D (Rs.150 lakh) or assets A, C, D, E, F (Rs.150 Lakh) or A, B, C, E (Rs.150 lakh) on 05/11/2017. It may be noted that the value of these assets as on date of amalgamation i.e. 05/11/2017 is not relevant.

(b) the amalgamated company —

(i) holds continuously for a minimum of five years from the date of amalgamation at least three fourth of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;

(ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;

(iii) fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

It further provides that in case where any of the above conditions are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of amalgamated company chargeable to tax for the year in which such conditions are not complied with.

In a case where any of the conditions laid down are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

In case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall,

(a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

(b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which assets of the undertaking have been retained by the demerged company and transferred to the resulting company, and shall be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

Where there has been reorganization of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions, then the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation, of the successor limited liability partnership for the purpose of the previous year in which business reorganization was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

If any conditions laid down are not complied with, the set off or loss allowance or depreciation made in any previous year in the hands of the successor limited liability partnership, shall deemed to be the income of the limited liability chargeable to tax in the year in which such conditions are not complied with.

For the purpose of this section, "accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or demerged company, as the case may be, under the head "Profit and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of Section 72 of the Income Tax Act, 1961 if the reorganization of business or amalgamation or demerger had not taken place. Similarly "unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganization of business or amalgamation or demerger had not taken place.

For the purpose of this section "unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions, of this Act, if the reorganization, of business or conversion or amalgamation or demerger had not taken place.

Capital Gains Tax

Capital gains tax is leviable if there arises capital gain due to transfer of capital assets. The word 'transfer' under section 2(47) of the Income Tax Act, 1961 includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law or in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment or any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act,1882 (4 of 1882) or any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring or enabling the enjoyment of any immovable property.

Capital gain arises only when a capital asset is transferred. If the asset transferred is not a capital asset, it will not be taxed as capital gain. Section 2(14) of the Income Tax Act, 1961 defines capital assets as below:

Capital asset means,

(a) Property of any kind held by an assessee, whether or not connected with his business or profession

(b) Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under Securities and Exchange Board of India Act, 1992.

But does not include the following:

(1) Any stock in trade (Other than the securities referred to in sub-clause (b)), consumables stores or raw materials held for the purpose of his business or profession

(2) Personal effect

(3) Agricultural land in India, which is not an urban agricultural land. In other words, it must be rural agricultural land.

Explanation: For the removal of doubts, it is hereby clarified that "property" includes and shall be deemed to have always included any rights in or in relation to an Indian Company, including rights of management or control or any other rights whatsoever.

In an amalgamation capital gain arises if there is a transfer of capital asset. However, section 47 of the Income Tax Act, 1961 treats certain transactions from amalgamation as not transfer and hence capital gains tax will not be applicable.

(vi) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company

(via) any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if—

(a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

(b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;

(viab) any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if—

(A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

(vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company

(vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if—

(a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated :

Provided that the provisions of sections 230 to 232 of the Companies Act, 2013 shall not apply in

case of demergers referred to in this clause.

(vicc) any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if—

(a) the shareholders, holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated:

Provided that the provisions of sections 230 to 232 of the Companies Act, 2013 shall not apply in case of demergers referred to in this clause

(vid) any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking

(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if—

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder itself is the amalgamated company, and

(b) the amalgamated company is an Indian company

Even in the absence of Section 47(vii) of the Act, a shareholder is not liable to pay any capital gains tax since an amalgamation does not include exchange or relinquishment of the assets. Amalgamation does not involve an exchange or relinquishment of shares by amalgamating company as held in *CIT v. Rasik Lal Manek Lal (1975) 95I TR 656).* However, no benefit will be available under Section 47(vii) if the shareholders of amalgamating company are allotted something more than share in the amalgamated company viz. bonds or debentures *[CIT v. Gautam Sarabhai Trust (1988)173 ITR 216(Guj.)].*

When a proprietary concern is sold as a going concern for a consideration to a Company and the proprietor receives consideration as shares in the company and proprietor has held more than 51% shares for five years the capital gains will be exempt under section 47 (xiv) and is not liable to be taxed under section 50B of the Income Tax Act, 1961. *ACIT v Madan Mohan Chandak (2011) 14 taxmann.com 27 (Chennai)*

Amortisation of Preliminary Expenses

The benefit of amortization of preliminary expenses under section 35D of the Income-tax Act, 1961 are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled to the amortization is transferred to another Indian company in a scheme of amalgamation within the 5 years period of amortisation. In that event the deduction in respect of previous year in which the amalgamation takes place and the following previous year within the 5 years period will be allowed to the amalgamated company and not to the amalgamating company.

Capital Expenditure on Scientific Research

In the case of an amalgamation if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provision of section

35 of the Income-tax Act, 1961 would apply to the amalgamated company as they would have applied to amalgamating company if the latter had not transferred the asset.

Expenditure on Acquisition of Patent Right or Copyright

Where the assessee has purchased patent right or copyrights, he is entitled to a deduction under Section 35A of the Income-tax Act, 1961 for a period of 14 years in equal installments. The amalgamated company gets the right to claim the unexpired installments as a deduction from its total income.

The deduction under this section is however available for expenditure incurred before 1st April, 1998 only.

Expenditure on Amalgamation

Section 35DD of the Income-tax Act, 1961 provides that where an assessee being an Indian company incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

Expenditure on know-how

Section 35AB(3) of the Income-tax Act, 1961 provides that where there is a transfer of an undertaking under a scheme of amalgamation or demerger and the amalgamating or the demerged company is entitled to a deduction under this section, then the amalgamated or the resulting company, as the case may be, shall be entitled to claim deduction under this section in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the amalgamating company or the demerged company, as the case may be, had such amalgamation or demerger not taken place.

The deduction under this section is however available for any lump sum consideration paid in any previous year relevant to the assessment year commencing on or before 1st April, 1998.

Expenditure for obtaining Licence to Operate Telecommunication Services (Section 35 ABB)

The provisions of the section 35ABB of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining licence to operate communication services shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

Deduction for expenditure on prospecting, etc., for certain minerals (Section 35E)

The provisions of section 35E of the Income Tax Act, 1961 relating to expenditure on prospecting, etc., for certain minerals shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company as if the amalgamation has not happened.

TAX ASPECTS ON SLUMP SALE

Section 180(1) of the Companies Act, 2013 empowers the Board of Directors of a company, after obtaining the consent of the company by a special resolution to sell, lease or otherwise dispose off the whole or substantially the whole of the undertaking(s) of a company.

Explanation-

(i) “undertaking” shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an

undertaking which generates twenty per cent of the total income of the company during the previous financial year;

(ii) the expression "substantially the whole of the undertaking" in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year

The transaction in this case, is normally of either of the following type:

(a) Sale of a running concern.

(b) Sale of a concern which is being wound-up.

(a) Sale of a Running Concern

This type of sale as a going concern provides for the continuation of the running of the undertaking without any interruption. But there is always a problem of fixing a value in the case of a running concern for all tangible and intangible assets including fixing a value for the infrastructure and other environmental facilities available. In view of all this, the seller normally fixes a lump sum price called 'slump price'.

The noun 'slump' means 'a gross amount, a lump'. Similarly, 'slump sum' means a 'lump sum' [Chambers Twentieth Century Dictionary, 1983 Edn., p1220). A slump sale or a slump transaction would, therefore, mean a sale or a transaction which has a lump sum price for consideration.

(b) Sale of a concern which is being wound-up

On the other hand a sale in the course of winding up, is nothing but a realization sale aimed at collecting the maximum price for distributing to the creditors and the balance to the contributories (the shareholders). By the very nature of the transaction, this is a piecemeal sale and not a slump sale. In this case, there will be liability to tax as per the various provisions of the Income Tax Act and the criteria which is applicable to a slump sale is not applicable here.

Normally, any sale of a capital asset will give rise to a capital receipt and any profit derived may give rise to capital gains in certain cases. This is true in the case of sale of an undertaking also.

Section 2(42C) of the Income Tax Act, 1961 defines slump sale as a means of transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the Individual assets and liabilities in such sales.

Determination of the value of an asset or liability (for sole purpose of payment of stamp duty, registration fees or other similar taxes or fee) shall not be regarded as assignment of values to individual assets or liabilities.

As per section 50B of the Income Tax Act, 1961 any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains from the transfer of long-term capital asset and shall be deemed to be the income of the previous year in which the transfer took place.

Any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assesee for not more than thirty six months immediately preceding the date of transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

In Doughty v. Commissioner of Taxes, the Privy Council laid down the following principles: The sale of a whole concern engaged in production process, e.g. dairy farming or sheep rearing, does not give rise to a revenue profit. The same might be said of a manufacturing business which is sold with the lease holds and

plant, even if there are added to the sale piece goods in stock and even if these piece goods form a very substantial part of the aggregate sold. Where, however, business consists entirely in buying and selling, it is difficult to distinguish for income tax purposes between an ordinary and realisation sale, the object in either case being to dispose of the goods at a profit. The fact that the stock is sold out in one sale does not render the profit obtained any different in kind from the profit obtained by a series of gradual and smaller sales. In the case of such a realization sale, if there is an item which can be traced as representing the stock-in-trade sold, the profit obtained by the sale of the stock-in-trade, though it is in conjunction with the sale of the whole concern, may be treated as taxable income. But where there is a sale of the whole concern and a transfer of all the assets for a single unapportioned consideration, there cannot be said to be any revenue profit realised on the sale of the stock-in-trade which is sold with all the other assets, although the business of the concern may consist entirely in buying and selling.

The Supreme Court, based on the above decision held in the following two cases that the price received on the sale of industrial undertaking is a capital receipt.

CIT v. West Coast Chemicals and Industries Ltd.– 46 ITR 135 — Where a slump price is paid and no portion is attributable to the stock-in-trade, it may not be possible to say that there is a profit other than what results from the appreciation of capital. The essence of the matter, however, is not that an extra amount has been gained by the selling out or the exchange but whether it can fairly be said that there was a trading, from which alone profit can arise in business.

CIT v. Mugneeram Bangur and Co. – 57I TR 299 — In the case of a concern carrying on the business of buying land, developing it and then selling it, it is easy to distinguish a realization sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realization sale. The mere fact that in the schedule, the price of land was stated does not lead to the conclusion that part of the slump price is necessarily attributable to the land sold.

The same view was also reiterated by the Gujarat High Court in the following cases:

1. Sarabhai M. Chemicals Pvt. Ltd. v. P.M. Mittal, Competent Authority–126 ITR1.
2. Artex Manufacturing Co. v. CIT–131 ITR 559.

At the same time, the Gujarat High Court also recognized that when an undertaking as a whole is sold as a going concern there will be liability under the head Capital Gains. In 126 ITR 1 the Gujarat High Court stated as follows:

It is well settled that business is property and the undertaking of a business is a capital asset of the owner of the undertaking. When an undertaking as a whole is transferred as a going concern together with its goodwill and all other assets, what is sold is not the individual itemised property but what is sold is the capital asset consisting of the business of the undertaking and any tax that can be attracted to such a transaction for a slump price at book value would be merely capital gains tax and nothing else but capital gains tax. Plant or machinery or any fixture or furniture is not being sold as such. What is sold is the business of undertaking for a slump price. If the capital asset, namely, the business of the undertaking, has a greater value than its original cost of acquisition, then, capital gains may be attracted in the ordinary case of a sale of an undertaking.

The Bombay High Court also recognized that there will be a capital gains tax when a sale of business as a whole occurs (Refer *Killic Nixon and Co .v. CIT* 49 ITR 244).

Where assessee company had sold its entire running business with all assets and liabilities in one go, the Supreme Court held it was a slump sale of a long term capital asset and be taxed under section 50B and not

under section 50(2). Section 50(2) applies to a case where any block of assets are transferred by assesse *CIT Vs Equinox solution (P) Ltd. 2017 80 taxmann.com 277 (SC).*

TAX ASPECTS OF DEMERGER

Tax concession/incentives in case of demerger

Section 2(19AA) of the Income Tax Act, 1961 defines the term demerger as follows:

"demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 231 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertakings to any resulting company in such a manner that—

(i) 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;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1.—For the purposes of this clause, "undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2.—For the purposes of this clause, the liabilities referred to in sub-clause (ii), shall include—

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3.—For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4.—For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette, by the Central Government.

Explanation 5.—For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette.

If any demerger takes place within the meaning of section 2(19AA) of the Income-tax Act, 1961 the tax concessions shall be available to:

1. Demerged company.
2. Shareholders of demerged company.
3. Resulting company

These concessions are on similar lines as are available in case of amalgamation. However some concessions available in case of amalgamation are not available in case of demerger.

1. Tax concession to demerged company

(i) Capital gains tax not attracted [Section 47(vib)]

According to section 47(vib), where there is a transfer of any capital asset in case of a demerger by the demerged company to the resulting company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the resulting company is an Indian company.

(ii) Tax concession to a foreign demerged company [Section 47(vic)]

Where a foreign company holds any shares in an Indian company and transfers the same, in case of a demerger, to another resulting foreign company, such transaction will not be regarded as transfer for the purpose of capital gain under section 45 if the following conditions are satisfied:

(a) the shareholders holding not less than three-fourths in value of the shares] of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated:

Provided that the provisions of sections391 to 394 of the Companies Act, 1956 (1 of 1956) (Now sections 230 to 232 of Companies Act, 2013) shall not apply in case of demergers referred to in this clause;

(iii) any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of subs-section (1) of section 9, which derives directly or indirectly its values

substantially from the share or shares of an Indian Company, held by the demerged foreign company to the resulting foreign company will not be regarded as transfer for the purpose of capital gains if the following conditions are satisfied: [Section 47(vicc)]

(a) Shareholders holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company and

(b) Such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.

(iv) Reserves for shipping business: Where a ship acquired out of the reserve is transferred in a scheme of demerger, even within the period of eight years of acquisition there will be no deemed profits to the demerged company.

2. Tax concessions to the shareholders of the demerged company [Section 47(vid)]

Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company shall not be regarded as a transfer if the transfer or issue is made in consideration of demerger of the undertaking.

In the case of demerger the existing shareholder of the demerged company will hold after demerger:

(a) shares in resulting company; and

(b) shares in demerged company.

And in case the shareholder transfers any of the above shares subsequent to the demerger, the cost of such shares shall be calculated as under:—

Cost of acquisition of shares in the resulting company *[Section 49(2C)]:*

The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

Cost of acquisition of shares in the demerged company *[Section 49(2D)]:*

The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under sub-section (2C).

For the above purpose net worth shall mean the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Period of holding of shares of the resulting company *[Section 2(42A)(g)]:*

In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

3. Tax concessions to the resulting company

The resulting company shall be eligible for tax concessions only if the following two conditions are satisfied:

(i) The demerger satisfies all the conditions laid down in section 2 (19AA); and

(ii) The resulting company is an Indian company.

The following concessions are available to the resulting company pursuant to a scheme of demerger:

(a) Expenditure on acquisition of patent rights or copyrights [Section 35A]

In the case of a demerger patent right or copyrights which comes as a part of demerger to the resulting company, the resulting company will be entitled to a deduction under Section 35A of the Income-tax Act, 1961 for a period of 14 years in equal installments. The resulting company gets the right to claim the unexpired installments as a deduction from its total income. The demerged company will not be able to claim the deductions.

The deduction under this section is however available for expenditure incurred before 1st April,1998 only.

(b) Expenditure on know-how [Section 35AB]

Section 35AB (3) of the Income-tax Act, 1961 provides that where there is a transfer of an undertaking under a scheme of demerger and the demerged company is entitled to a deduction under this section, then the resulting company, shall be entitled to claim deduction under this section in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the demerged company, had such demerger not taken place.

The deduction under this section is however available for any lump sum consideration paid in any previous year relevant to the assessment year commencing on or before 1st April, 1998.

(c) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]

The provisions of the section 35ABB of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining licence to operate communication services shall, as far as may be, apply to the resulting company as they would have applied to the demerged company if the latter had not transferred the licence.

(d) Amortisation of certain preliminary expenses [Section 35D]

The benefit of amortization of preliminary expenses under section 35D of the Income-tax Act, 1961 are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled to the amortization is transferred to another Indian company in a scheme of demerger within the 5 years period of amortisation. In that event the deduction in respect of previous year in which the demerger takes place and the following previous year within the 5 years period will be allowed to the resulting company and not to the demerged company.

(e) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E(7A)]

The provisions of section 35E of the Income Tax Act, 1961 relating to expenditure on prospecting, etc., for certain minerals shall, as far as may be, apply to the resulting company as they would have applied to the demerged company as if the demerger has not happened.

(f) Treatment of bad debts [Section 36(1)(vii)]

Where due to demerger the debts of the demerged company have been taken over by the resulting company and subsequently by such debt or part of debt becomes bad such bad debt will be allowed as a deduction to the resulting company. This is based upon the decision of the Supreme Court in the case of *CIT v. Veerabhadra Rao (T.), K. Koteswara Rao & Co.*(1985) 155 ITR 152 (SC) which was decided in the case of amalgamation of companies.

Section 36(1)(vii) provides that the deductions provided for in the following clauses shall be allowed in

respect of the matters dealt with therein, in computing the income referred to in section 28—

Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:

Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:

Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.

Explanation 1.—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee;

Explanation 2.—For the removal of doubts, it is hereby clarified that for the purposes of the proviso to clause (vii) of this sub-section and clause (v) of sub-section(2), the account referred to there in shall be only one account in respect of provision for bad and doubtful debts under clause (viia) and such account shall relate to all types of advances, including advances made by rural branches;

(g) Amortisation of expenditure in case of amalgamation or demerger [Section 35DD]

Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the demerger takes place.

(h) Carry forward and set off of business losses and unabsorbed depreciation of the demerged company [Section 72A(4)&(5)]

Section 72A(4): Notwithstanding anything contained in any other provisions of this Act, in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall—

(a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

(b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

Section 72A(5): The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

(i) Deduction available under section 80-1A(12) or 80-1B(12)

Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.:

Section 80-IA(12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings:

Section 80-IB(12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Deemed Dividend

Section 2(22)(e) of the Income Tax Act, 1961 defines the term deemed dividend as any payment by a company, not being a company in which public are substantially interested, of any sum by way of advance or loan to the following:

(a) To a shareholder, being a person who is the beneficial owner of the shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits), holding not less than 10% of the voting rights, or

(b) To any concern in which such shareholder is a member or a partner and in which he has a substantial interest, or

(c) On behalf, of for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

Exceptions to deemed dividend:

(a) any advance or loan made, to a shareholder or to such concern in which the shareholder is interested, by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company

(b) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off

(c) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (now Section 68 of the Companies Act, 2013)

(d) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.

The expression "accumulated profits" in sub-clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place.

In the case of an amalgamated company, the accumulated profits, whether capitalised or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalised or not, of the amalgamating company on the date of amalgamation.

For the purposes of this clause,—

(a) "concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern.

Taxability

According to the provisions of the Section 8 of the Income Tax Act, 1961, dividend income becomes taxable in the year in which it is declared or distributed or paid. As per the provisions of Section 10(34), dividend income is exempt in the hands of the shareholders as it is charged to Dividend Distribution Tax under section 115-O of the Income Tax Act, 1961. However, deemed dividend as defined above does not come under the ambit of Section 115-O and hence, it is taxable in the hands of the shareholders at the marginal rate of tax.

Finance Act, 2018 has bought the deemed dividend within the ambit of dividend distribution tax under section 115-O, at the rate of 30% in the hands of the closely held companies. Since deemed dividend under section 2(22)(e) is also proposed to be brought under the purview of the dividend distribution tax under section 115-O, therefore, exemption under section 10(34) shall also be applicable to shareholders and income from such deemed dividend shall be tax free.

STAMP DUTY ASPECTS OF MERGER AND AMALGAMATIONS

The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.

Constitutional background on levy of stamp duty on Amalgamation and Mergers

Article 265

Article 265 of the Constitution prohibits levy or collection of tax except by authority of law.

Article 246, read with the Seventh Schedule of the Constitution provides legislative powers to be exercised by the Parliament and the State Legislatures.

The Seventh Schedule consists of three lists viz., List I-Union List, List II-State List and List III-Concurrent List. List I is the exclusive domain of the Parliament to make laws in relation to that matter and it becomes a prohibited field for the State Legislature. List II is within the exclusive competence of the State Legislature and then the Parliament is prohibited to make any law with regard to the same except in certain circumstances. In List III, both Parliament and State Legislature can make laws subject to certain conditions. Matters not mentioned in any of the three lists fall within the exclusive domain of the Parliament.

Article 372

All the laws in force immediately before the commencement of the Constitution continue to be in force until altered or repealed or amended by a competent Legislature or other competent authority. Accordingly, the Indian Stamp Act, 1899 is continuing to this extent.

The relevant entries in the Seventh Schedule regarding stamp duty are as follows:

List I Entry 91

“91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.”

List II Entry 63

“63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to stamp duty.”

List III Entry 44

“44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duties.”

In exercise of power conferred by Entry 63, List II the State Legislature can make amendment in the Indian Stamp Act, 1899 under article 372, in regard to the rates of stamp duty in respect of documents other than those specified in provisions of List I.

Stamp duty is levied in India on almost all, except a few documents, by the States and hence the rate and incidence of stamp in different states varies. The State Legislature has jurisdiction to levy stamp duty under entry 44, List III of the Seventh Schedule of the Constitution of India and prescribe rates of stamp duty under entry 63, List II.

Under the provisions of the Companies Act, 1956 it has been decided that by sanctioning of amalgamation scheme, the property including the liabilities are transferred as provided in sub-section (2) of section 394 of the Companies Act and on that transfer instrument, stamp duty is levied.

Therefore, it cannot be said that the State Legislature has no jurisdiction to levy such duty on an order of the High Court sanctioning a scheme of compromise or arrangement under section 394 of the Companies Act, 1956. [*Li Taka Pharmaceuticals Ltd. and another v. State of Maharashtra and others ibid*].

Stamp Duty Payable on a Tribunal Order Sanctioning Amalgamation

Section 232 of the Companies Act, 2013 is the corresponding section to the Section 394 of the Companies Act, 1956 and for understanding the payment of Stamp duty on Tribunal Order sanctioning Amalgamation, it is necessary to take reference of the judicial pronouncement under the Companies Act, 1956, which is as under:

1. In amalgamation the undertaking comprising property, assets and liabilities, of one (or more) company (amalgamating or Transferor Company) are absorbed by and transferred company merges into or integrates with Transferee Company. The former loses its entity and is dissolved (without winding-up).
2. The transfer and vesting of Transferor Company's property, assets, etc. into Transferee Company takes place "by virtue of" the High Court's order [Section 394(2)]. Thus, the vesting of the property occurs on the strength of the order of the High Court sanctioning the scheme of amalgamation, without any further document or deed. Property includes every kind of property, rights and powers of every description [Section 394(4)(d)].
3. For the purpose of conveying to the transferee company the title to the immovable property of the transferor company, necessary registration in the lands records in the concerned office of the State in which the property is situated, will be done on the basis of the High Court order sanctioning the amalgamation. If any stamp duty is payable under the Stamp Act of the State in which the property is situated, it will be paid on the copy of the High Court order.
4. An order of the High Court under section 394 is founded and based on the compromise or arrangement between the two companies for transferring assets and liabilities of the transferor company to the transferee company and that order is an instrument as defined in Section 2(1) of the Bombay Stamp Act, 1958 which included every document by which any right or liability is transferred [*Li Taka Pharmaceuticals Ltd. v. State of Maharashtra (1996)22 CLA154: AIR 1997 Bom 7].*
5. Thus, an order of the High Court sanctioning a scheme of amalgamation under Section 394 of the companies Act, 1956 is liable to stamp duty only in those States where the states stamp law provides.

   In *Hindustan Lever Ltd. v. State of Maharashtra (2003) 117 Comp Cas SC 758* the Supreme Court considered this issue. Tata Oil Mills Company Ltd. (TOMCO) was merged with the *Hindustan Lever Ltd (HLL).* The State imposed stamp duty on the order sanctioning the scheme of merger. The demand was challenged by the company on two grounds that State Legislature is not competent to impose stamp duty on the order of amalgamation passed by a court and such order of the court is neither instrument nor document (transferring properties from transferor company to transferee company) liable to stamp duty.

   The Supreme Court dismissed the appeal of the company on following reasons:

   Transfer of property has been defined to mean an act by which a living person conveys property, in present or in future, to one or more living persons. Companies or associations or bodies of individuals, whether incorporated or not, have been included amongst living persons. It clearly brings out that a company can affect transfer of property. The word *inter vivos* in the context of section 394 of the Companies Act, 1956 would include, within its meaning, also a transfer between two juristic persons or a transfer to which a juristic person is one of the parties. The company would be a juristic person created artificially in the eyes of law capable of owning and transferring the property. The method of

transfer is provided in law. One of the methods prescribed is dissolution of the transferee company along with all its assets and liabilities. Where any property passes by conveyance, the transaction is said to *be inter vivos* as distinguished from a case of succession or devise.

The State Legislature would have the jurisdiction to levy stamp duty under Entry 44 List III of the Seventh Schedule of the constitution and prescribes rate of stamp duty under Entry 63, List II. It does not in any way impinge upon any Entry in List I. Entry 44 of List III empowers the State Legislature to prescribe rates of stamp duty in respect of documents other than those specified in List I. By sanctioning a scheme of amalgamation, the property including the liabilities are transferred as provided in Section 394 of the Companies Act, 1956 and on that transfer instrument, stamp duty is levied. Therefore, it cannot be said that the State Legislature has no jurisdiction to levy such duty. Under the scheme of amalgamation, the whole or any part of the undertaking, properties or liability of any company concerned in the scheme are to be transferred to the other company. The intended transfer is a voluntary act of the contracting parties. The transfer has all trappings of a sale. While exercising its power in sanctioning a scheme of arrangement, the court has to examine as to whether the provisions of the statute have been complied with. Once the court finds that the parameters set out in section 394 of the Companies Act, 1956 have been met then the court would have no further jurisdiction to sit in appeal over the commercial wisdom of the class of persons who with their eyes open give their approval, even if, in the view of the court a better scheme could have been framed. Two broad principles underlying a scheme of amalgamation are that the order passed by the court amalgamating the company is based on a compromise or arrangement arrived at between the parties; and that the jurisdiction of the company court while sanctioning the scheme is supervisory only. Both these principles indicate that there is no adjudication by the court on merits as such.

The order of the court under sub-section (2) of section 391 has to be presented before the Registrar of Companies within 30 days for registration and shall not have effect till a certified copy of the order has been filed with the Registrar and the Registrar of Companies certifies that the transferor company stands amalgamated with the transferee company along with all its assets and liabilities. Thus, the amalgamation scheme sanctioned by the court would be an instrument within the meaning of section 2(i) of the Bombay Stamp Act, 1958. By the said instrument the properties are transferred from the transferor company to the transferee company, the basis of which is the compromise or arrangement arrived at between the two companies. A document creating or transferring a right is an instrument. An order effectuating the transfer is also a document.

6. The company will provide to the Collector of Stamps—

   — application for adjudication of the High Court order for determination of stamp duty payable;

   — proof of the market value of equity shares of the transferor company (Stock Exchange quotation or a certificate from Stock Exchange) as of the appointed day;

   — certificate from an approved valuer or valuation of the immovable property being transferred to the transferee company.

7. The Collector thereafter will adjudicate the order and determine stamp duty.

8. The stamp duty will be paid in the manner prescribed under the Stamp Rules. The duty-paid Order will be registered with the Sub-Registrar of Assurances where the lands and buildings are located.

Incidence of Levy of Stamp Duty

Stamp duty is levied on "Instruments". Section 3 of the Bombay Stamp Act, 1958 specifies the following essentials for the levy of stamp duty:

(1) There must be an instrument

(2) Such instrument is one of the instruments specified in Schedule I

(3) Such instrument must be executed.

(4) Such instrument must have either—

  (a) not having been previously executed by any person in the 'State' or

  (b) having been executed outside the State, relates to any property situated in the State or any matter or thing done or to be done in the State and is received in the State.

Instrument

The term 'instrument' is defined in Section 2(i) of the Bombay Stamp Act, 1958 as follows:

"Instrument" includes every document by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded but does not include a bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, debentures, proxy and receipt."

An award is an instrument within the meaning of the Stamp Act and the same is required to be stamped as was decided in the case *Hindustan Steel Ltd. v. Dilip Construction Co., AIR 1969 SC 1238.*

The scheme of amalgamation sanctioned by the court would be an instrument within the meaning of Section 2(1) where by the properties are transferred from the transferor company to the transferee company based on compromise arrived at between the two companies. The State legislature would have the jurisdiction to levy stamp duty under Entry 44, List II of the Seventh Schedule of the Constitution on the order of the court sanctioning scheme of amalgamation vide the case *Hindustan Lever v. State of Maharashtra, AIR 2004*.

This definition is an inclusive definition and includes any document which purports to transfer assets or liabilities considered as an instrument.

Order of Court under Section 394 of Companies Act, 1956 - A Transfer

It was earlier held that when transfer takes place by virtue of a court order to a scheme of amalgamation, stamp duty is leviable. By virtue of Section 2(g), the order of the Court ordering the transfer of assets and liabilities of the transferor company to the transferee company is deemed to be a conveyance. The definition of conveyance is given below:

As per Section 2(g) of the Bombay Stamp Act, 1958, "Conveyance" includes—

(i) a conveyance on sale,

(ii) every instrument,

(iii) every decree or final order of any Civil Court,

(iv) every order made by the High Court under Section 394 of the Companies Act, 1956 in respect of amalgamation of companies;

By which property, whether moveable or immovable, or any estate or interest in any property is transferred to, or vested in, any other person, *inter vivos*, and which is not otherwise specifically provided for by Schedule I;

The amended definition of term 'conveyance' under section 2(g) of the Bombay Stamp Act, 1958 (amended in 1985) *inter-alia* includes every order made by the High Court under section 394 of the Companies Act, 1956 in respect of amalgamation of companies by which property, whether moveable or immovable, or any estate or interest in any property of transferor is transferred to, or vested in the transferee company.

Transfer of the property of a partnership firm to a limited company on its conversion was held to be treated as a conveyance and, hence, chargeable to stamp duty, irrespective of the fact that the partners of the firm were the shareholders of the Company [In re The *Kandoli Tea Company 13 Cal 43; Foster v. Commissioners,*(1894)1QB516].

The landmark decision of Bombay High Court in *Li Taka Pharmaceuticals v. State of Maharashtra* (1996) 8 SC 102 (Bom.) has serious implications for mergers covered not just by the Bombay Stamp Act, 1958 but also mergers covered by Acts of other States. The following are the major conclusions of the Court:

(1) An amalgamation under an order of Court under Section 394 of the Companies Act,1956 is an instrument under the Bombay Stamp Act, 1958.

(2) States are well within their jurisdiction when they levy stamp duty on instrument of amalgamation.

(3) 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.

The Calcutta High Court in the case of *Emami Biotech Ltd*. (2012) held that a Court order sanctioning a scheme of amalgamation or demerger under section 391 to 394 of the Companies Act, 1956 is an instrument and conveyance within the meaning of the Stamp Act applicable to the State of West Bengal and is accordingly, subject to stamp duty.

This case is related to a scheme sanctioned by the Calcutta High Court in West Bengal.

Stamp Duty on Other Documents

Usually, in a merger, several other documents, agreements, indemnity bonds, etc. are executed, depending on the facts of each case and requirements of the parties. Stamp duty would also be leviable as per the nature of the instrument and its contents.

Amalgamation between Holding and Subsidiary Companies—Exemption from payment of Stamp Duty

The Central Government has exempted the payment of stamp duty on instrument evidencing transfer of property between companies limited by shares as defined in the Indian Companies Act, 1913, in a case:

(i) where at least 90 percent 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 percent of the issued share capital of the other, or

(iii) where the transfer takes place between two subsidiary companies each of which having not less than 90 percent 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).

A circular was issued in the year 1937 vide which exemption was granted on payment of Stamp Duty when there is an amalgamation/merger between holding and subsidiary company. Delhi High Court in the case of *Delhi Towers Ltd. Vs. GNCT of Delhi* made reference to this circular.

However, stamp duty 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.

LESSON ROUND-UP

- Financial aspects of mergers denote financial benefits in terms of stamp duty and taxation related aspects.
- Under Section 72A, a special provision is made which relaxes the provision relating to carrying forward and set-off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation.
- Capital gains tax is leviable if there arises capital gain due to transfer of capital assets.
- The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.
- Usually, in a merger, several other documents, agreements, indemnity bonds, etc. are executed, depending on the facts of each case and requirements of the parties. Stamp duty would also be leviable as per the nature of the instrument and its contents.

GLOSSARY OF TECHNICAL WORDS

Deemed Dividend: Deemed dividend is the amount paid in such a manner and to such persons as specified in section 2(22)(e) of the Income Tax Act, 1961.

Slump Sale: Slump sale means of transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the Individual assets and liabilities in such sales.

Stamp duty: Stamp duty is levied in India on almost all, except a few documents, by the States. The State Legislature has jurisdiction to levy stamp duty under Entry 44, List III of the Seventh Schedule of the Constitution of India. Hence, the rate of duty varies from one state to another state. Under the provisions of the Companies Act, by sanctioning of amalgamation scheme, the property including the liabilities is transferred and on that transfer instrument, stamp duty is levied.

Conveyance: Conveyance means a conveyance on sale, every instrument, every decree or final order of any civil court, every order made by the High Court in respect of amalgamation of companies by which property, whether moveable or immovable or any estate or interest in any property is transferred to or vested in, any other person.

Instrument: Instrument includes every document by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded but does not include a bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, debentures, proxy and receipt.

LIST OF FURTHER READINGS

1. Master Guide to Mergers and Acquisition in India – Tax and Regulatory, 4th Edition, CCH
2. Mergers Acquisitions & Corporate Restructuring, 3rd Edition, Taxmann
3. Income Tax Act, 1961
4. Indian Stamp Act, 1899
5. State Stamp Acts

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Describe the financial benefits that would arise out of merger.
2. What are the tax advantages of mergers? Discuss provisions related to capital gains.
3. Discuss the taxation aspects of slump sale.
4. What are provisions related to taxation aspects of demerger?
5. What is deemed dividend? Discuss its taxability.
6. Explain the constitutional background of Indian Stamp Act, 1899 with respect to merger.
7. Is the order of Tribunal an instrument? Is stamp duty compulsory on the Tribunal order?

Lesson 9
Competition Act

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Competition aspects of combinations
- Kind of combinations
- Combination thresholds
- Regulation of combinations
- Exemptions
- Relevant market
- Appreciable effect on competition within the relevant market in India
- Filing Process
- Role of CCI
- Inquiry into combination by the Commission
- Orders of Commission

LEARNING OBJECTIVES

Competition law being an economic legislation regulates merger (called combinations), deals with threshold limits (domestic/cross border), notice to Competition Commission of India, etc.

In mergers and acquisitions, Companies Act tries to protect the interest of secured creditors and SEBI Act tries to protect the interest of investors. The objective of Competition Act is protecting the appreciable adverse effect on competition in the relevant market in India. The impact of combinations directly affects the market and players in the market including the customers.

The paradigm requires the corporates to possess multiple expertise, through business restructuring. Mergers, acquisitions and takeovers are widely accepted business strategies in the global platform. The economic reasons behind such strategies may be increased market share, cost reduction, managing competition, financial/tax benefits, increased economies of scale, etc.

After reading this lesson, you will be able to understand, the competition aspects of merger and the important regulatory aspects of combinations as specified in the Competition Act, 2002.

INTRODUCTION

The Sherman Anti-Trust Act of 1890 (Sherman Anti-Trust Act) can be said to be the origin of anti-trust/competition law. This legislation was the result of intense public opposition to the concentration of economic power in large corporations and in combinations of business concerns that had been taking place in the U.S. in the decades following the Civil War.

The Sherman Antitrust Act was the first measure enacted by the U.S. Congress. The Sherman Antitrust Act was based on the constitutional power of Congress to regulate interstate commerce. In 1914, US Congress passed two measures that provided additional support for the Sherman Antitrust Act. One was the Clayton Antitrust Act, which elaborated on the general provisions of the Sherman Act and specified a number of illegal practices that either contributed to or resulted from monopolization. It explicitly outlawed commercial practices such as price discrimination (i.e., charging different prices to different customers), the buying out of competitors and interlocking boards of directors. The other was the establishment of the Federal Trade Commission, an agency with the power to investigate possible violations of antitrust laws and to issue orders forbidding unfair competitive practices. Gradually, competition law came to be recognized as one of the key pillars of a market economy. This recognition led to enactment of competition law in many countries including developing countries.

Limiting Competition

It would be wrong to conclude that mergers limit or restrict competition from the consumers' point of view. In mergers business enterprises achieve what could be termed as a buy out of the competitor's market shares or stake. The purpose of such acquisition could be to consolidate or to eliminate the competition posed by the acquired enterprise. It does not mean new competitive forces cannot emerge or survive. It is only natural for business enterprises and the people who drive such enterprises to look at opportunities for acquiring more and more market stake. Mergers therefore are tools in the hands of the entrepreneurial community to keep a watch on the competition and take appropriate action.

Following statutory provisions apply to mergers, amalgamations and acquisitions from competition law perspective:

- Competition Act, 2002
- The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011
- The Competition Commission of India (General) Regulations, 2009
- Notification No. S.O. 93(E) dated January 8, 2013
- Notification No. S.O. 673(E) dated March 4, 2016
- Notification No. S.O. 674(E) dated March 4, 2016
- Notification No. S.O. 675(E) dated March 4, 2016
- Notification No. S.O. 988(E) dated March 29, 2017
- Notification No. S.O. 2039(E) dated June 29, 2017

COMPETITION ACT, 2002

At the behest of the Directive Principles of State Policy, the first Indian competition law was enacted in 1969 and was named the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act).

In the wake of economic reforms since 1991, it was felt that the MRTP Act has become obsolete in the light of international economic developments which relate more particularly to competition laws and thus there was a need to shift the focus from curbing monopolies to promoting competition. Therefore, a 'High Level Committee on Competition Policy and Law' was constituted by the Central Government which submitted its Report on May 23, 2002. In accordance with the recommendations of this Committee, the Competition Act, 2002 was passed by both Houses of Parliament in 2002 and received the assent of President in January 2003. It provided for setting-up of a quasi-judicial body, *i.e.,* the CCI, comprising of a Chairperson and two to ten other Members, to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto.

In exercise of these powers, the sections 3 and 4 were brought into force from 20th May 2009 and section 5 and 6 were brought into force with effect from 1st June 2011.

Preamble

An Act to provide for, keeping in view of the economic development of the country, the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in market, in India, and for matters connected therewith or incidental thereto. The Supreme Court in *Competition Commission of India vs. Steel Authority of India Ltd. and Another* [2010] 98 CLA 278 (SC) explained the objective of the Act.

Key Provisions

Key provisions of the Act are contained in section 3, 4, 5 and 6. Through these sections, the Act declares anti-competitive agreements as *void;* prohibits abuse of dominant position, and regulates large combinations.

Section 5 and 6 provides for regulation of the combinations beyond the prescribed threshold. A combination includes the acquisition of control, shares, voting rights, assets as well as the cases of merger or amalgamation. Section 6 provides that no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be *void*.

Competition Commission of India (CCI / Commission)

Section 7 of the Act provides for the establishment of the Competition Commission of India (Commission). The Commission is a statutory body, established under the Act with the legislative mandate inter alia to prevent practices having adverse effect on competition, to promote and sustain competition in the markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in the markets, in India. To perform the above mentioned functions, under the scheme of the Act, the Commission is vested with inquisitorial, investigative, regulatory, adjudicatory and advisory jurisdiction. As such, the purpose of filing information before the Commission is only to set the ball rolling as per the provisions of the Act.

National Company Law Appellate Tribunal (NCLAT)

The Act also provided for the establishment of Competition Appellate Tribunal (COMPAT) which was in operation till 25th May 2017. With effect from 26th May 2017, COMPAT has been merged with the National Company Law Appellate Tribunal (NCLAT) constituted under the Companies Act, 2013 and the NCLAT has been designated as the Appellate Authority under the Act.

Combinations and the Competition Act, 2002 (Act)

Section 5 defines the combination as (i) acquisition of control, shares, voting rights or assets; or (ii) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service; or (iii) merger or amalgamation. A combination beyond the prescribed thresholds is regulated under the Act. Section 6 declares a combination as *void* if it causes or is likely to cause an adverse effect on competition within the relevant market in India.

Kinds of combinations

Based on the economic activities being carried out by the parties, combinations may be classified into three categories:

Horizontal combinations

Horizontal combinations involve the joining together of two or more enterprises engaged in producing the same goods, or rendering the same services. They may be termed as competitors to each other. They result in reduction in the number of competing firms in an industry and may create a dominant enterprise.

Vertical combinations

Vertical combinations involve the joining together of two or more enterprises where one of them is an actual or potential supplier of goods or services to the other. They involve enterprises operating at different levels of the production chain. The object of these combinations may be to ensure a source of supply or an outlet for products or to enhance the efficiency.

Conglomerate combinations

Conglomerate combinations involve the combination of enterprises not having horizontal or vertical connection. These enterprises are engaged in unrelated activities and may be affected with an objective to diversify into new areas by the acquiring enterprise.

Based on the geographical location of the enterprises, the combination may be classified into two categories:

Domestic combinations

Domestic combinations involve the joining together of two or more enterprises located in India only.

Cross-border combinations

Cross-border combinations involve the joining together of two or more enterprises where one or more of them are operating from other countries. In such combinations, the combination needs to be approved by the Commission only if the overseas enterprises satisfy the local nexus test, as stated in section 5 of the Act.

In essence, only if the enterprises exceed the *de minimis* exemption thresholds and the thresholds under Section 5 of the Competition Act, will they be considered to have local nexus. This aligns the position in India more with the international standards.

Combination Regulations (Regulations)

Competition Act requires mandatory notification of combination. Assets and turnover thresholds for such mandate are prescribed by the Act, and are modifiable by the Government as prescribed under section 20(3) of the Act. The basic concern is with the existence or likelihood of the proposed combination causing

appreciable adverse effect on competition in the relevant market in India. The process of combination analysis undertaken by the Commission is therefore broken down into: (a) delineation of the relevant market (product and geographic); (b) identification of overlap in the relevant market; and finally, (c) subjecting the combination to competition analysis under section 20(4) of the Act to ensure that there is no appreciable adverse effect on competition in the relevant market. The test under section 20(4) of the Act involves balancing of the benefits and the adverse effects on competition, due to the proposed combination.

To aid and assist the parties to the combination in relation to certain procedural and substantive provisions, the CCI has provided for informal non-binding pre-merger consultative process and has also provided for couple of guidance notes i.e., Introductory Note[1] and Notes to Form I in order to assist the notifying parties in drafting the merger notification form(s) to be submitted to the Commission.

The Section 5 and 6 of the Competition Act are the operative and substantive provisions dealing with the combinations and Section 29 to 31 along with the CCI (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2011 (**Combination Regulations**)[2] set-up the procedural provisions in relation to the combinations. In addition to Combination Regulations, the applicable provisions in relation to confidentiality under Section 57 of the Competition Act and CCI (General) Regulation 2009 are applicable. Further, a transaction will be construed as a combination for the purposes of Competition Act, if the transaction crosses certain minimum thresholds in terms of the assets and/ or turnover of the enterprises affected by the transaction.

What is a Combination?

Section 5 provides the financial thresholds and all combinations exceeding these financial thresholds are required to be mandatorily approved by the Commission. The said section reads as under:

5. Combination

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if—

(a) any acquisition where—

(i) the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets have been acquired or are being acquired jointly have,—

(A) either, in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or

(ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have,—

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US

1 Introductory Notes to Forms available at http://cci.gov.in/sites/default/files/regulation_pdf/intnotes.pdf

2 Combination Regulation came into force on June 1, 2011 and the CCI has amended the Combination Regulations five times i.e., in February 23, 2012; April 4, 2013; March 28, 2014; July 1, 2015; and January 8, 2016 respectively.

dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or

(b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if—

(i) the enterprise over which control has been acquired along with the enterprise over which the acquirer already has direct or indirect control jointly have,—

(A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or

(ii) the group, to which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition, jointly have or would jointly have,—

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or

(c) any merger or amalgamation in which—

(i) the enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have,—

(A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or

(ii) the group, to which the enterprise remaining after the merger or the enter- prise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have,—

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees Fifteen Hundred Crores in India.

Explanation.— For the purposes of this section,—

(a) “control” includes controlling the affairs or management by—

(i) one or more enterprises, either jointly or singly, over another enterprise or group;

(ii) one or more groups, either jointly or singly, over another group or enterprise;

(b) "group" means two or more enterprises which, directly or indirectly, are in a position to

(i) exercise twenty-six per cent or more of the voting rights in the other enterprise; or

(ii) appoint more than fifty per cent of the members of the board of directors in the other enterprise; or

(iii) control the management or affairs of the other enterprise;

(c) the value of assets shall be determined by taking the book value of the assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout- design or similar other commercial rights, if any, referred to in sub-section (5) of section 3.

Note: In view of the notifications issued by the Central Government, from time to time, the financial thresholds and the definition of the group as stated above section should be read with the narratives given in the subsequent paragraphs.

Combinations as envisaged under section 5(a), 5(b) and 5(c) were explained by the Supreme Court in *Competition Commission of India v. Thomas Cook (India) Ltd. & Anr. (Civil Appeal No.13578 of 2015)* in the following manner:

Under section 5(a), a combination is formed if the acquisition by one person or enterprise of control, shares, voting rights or assets of another person or enterprise subject to certain threshold requirement that is minimum asset valuation or turn over within or outside India.

Under Section 5(b) of the Act the combination is formed if the acquisition of control by a person over enterprise when such person has already acquired direct or indirect control over another enterprise engaged in the production, distribution or payment of a similar or identical or substitutable good provided that the exigencies provided in section 5(b) in terms of asset or turnover are met.

Under section 5(c) merger and amalgamation are also within the ambit of combination. The enterprise remaining after merger or amalgamation subject to a minimum threshold requirement in terms of assets or turnover is covered within the purview of section 5(c).

Thresholds

In exercise of its powers under section 20(3), the Central Government has *vide* Notification No.S.O.675(E) dated March 4, 2016, the value of assets and the value of turnover has been enhanced by 100% for the purposes of Section 5 of the Act.

Section 5 is applicable when the combined assets of the parties or the group to which the target entity would belong after the acquisition.

Following table gives an overview of the present thresholds, which would remain in force till March 3, 2021:

THRESHOLDS FOR FILING NOTICE				
		Assets		**Turnover**
Enterprise Level	**India**	> `2000 crore	**OR**	> `6000 crore
	Worldwide with India leg	> US$ 1 bn With at least Rs.1000 crore in India		> US$ 3 bn With at least Rs.3000 crore in India
OR				
Group Level	**India**	> Rs.8000 crore	**OR**	> Rs.24000 crore
	Worldwide with India leg	> US$ 4 bn With at least Rs.1000 crore in India		> US$ 12 bn With at least Rs.3000 crore in India

***De Minimis* Exemption**: The Central Government has granted exemption to acquisition of small targets which is known as *de minimis* exemption. Combinations where the assets or the turnover is below the specified thresholds need not be notified to the Commission for its approval. According to Notification No.S.O.988(E) dated March 27, 2017, all forms of combinations involving assets of not more than Rs.350 crore in India or turnover of not more than Rs.1,000 crore in India, are exempt from Section 5 of the Act for a period of 5 years. Following table gives an overview of the thresholds for availing of the *De Minimis* exemption:

THRESHOLDS FOR AVAILING OF *DE MINIMIS* EXEMPTION				
		Assets		**Turnover**
Target Enterprise	**In India**	≤ `350 crore	**OR**	≤ `1000 crore

When a portion of the business is being acquired

Notification No. S.O.988 (E) dated March 27, 2017 has given a relaxation to the combinations where a portion of an enterprise or division or business is being acquired, taken control of, merged or amalgamated with another enterprise.

The Notification prescribes the manner of determination of the value of assets and turnover when a portion of an enterprise or division or business is being acquired. According to the said Notification, in such cases, the value of assets of the said portion or division or business and or attributable to it, shall be the relevant assets and turnover to be taken into account for the purpose of calculating the thresholds under section 5 of the Act. The value of the said portion or division or business shall be determined by taking the book value of the assets as shown, in the audited books of accounts of the enterprise or as per statutory auditor's report where the financial statement have not yet become due to be filed, in the financial year immediately preceding the financial year in which the date of the proposed combination falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights, if any,

referred to in sub-section (5) of section 3. The turnover of the said portion or division or business shall be as certified by the statutory auditor on the basis of the last available audited accounts of the company.

Group

As per Notification No.S.O.673(E) dated March 4, 2016, the exemption to the "group" exercising less than fifty per cent of voting rights in other enterprise from the provisions of Section 5 of the Act under Notification No.S.O.481(E) dated March 4, 2011, has been continued for a further period of 5 years. As a result, the definition of the group, as amended by the notification, would read as under:

"Group" means two or more enterprises which, directly or indirectly, are in a position to —

(i) exercise fifty per cent or more of the voting rights in the other enterprise; or

(ii) appoint more than fifty per cent of the members of the board of directors in the other enterprise; or

(iii) control the management or affairs of the other enterprise.

Regulation of combinations

Section 6 of the Competition Act, 2002 prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be *void*. Section 6 read as under:

6. Regulation of combinations

6. (1) No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

(2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, shall give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within thirty days of—

(a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

(2A) No combination shall come into effect until two hundred and ten days have passed from the day on which the notice has been given to the Commission under sub-section (2) or the Commission has passed orders under section 31, whichever is earlier.

(3) The Commission shall, after receipt of notice under sub-section (2), deal with such notice in accordance with the provisions contained in sections 29, 30 and 31.

(4) The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.

(5) The public financial institution, foreign institutional investor, bank or venture capital fund, referred to in sub-section (4), shall, within seven days from the date of the acquisition, file, in the form as may be specified

by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

Explanation.—For the purposes of this section, the expression—

(a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to section 115AD of the Income-tax Act, 1961(43 of 1961);

(b) "venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23 FB) of section 10 of the Income-tax Act, 1961(43 of 1961).

Note: In view of the notification issued by the Central Government, the impact of sub section (2) stated above section should be read with the narratives given in the subsequent paragraphs.

Section 6 makes it very clear that the parties are required to take prior approval from the Commission. The Supreme Court in *SCM Solifert Limited & Anr. v Competition Commission Of India (Civil Appeal No. 10678 of 2016)* observed as under:

> It is apparent from section 6(2) of the Act that the proposal to enter into combination is required to be notified to the Commission. The legislative mandate is apparent that the notification has to be made before entering into the combination. The Preamble of the Act contains that the Commission has been established to prevent practices having an adverse effect on the competition. The combination cannot be entered into and shall come into effect before order is passed by Commission or lapse of certain time from date of notice is also apparent from the terminology used in section 6(2A) which provides that no combination shall come into effect until 210 days have passed from the date of notice or passing of orders under section 31 by the Commission, whichever is earlier. The provisions made in Regulation 5(8) also buttress the aforesaid conclusion. Notice of Section 6(2) is to be given prior to consummation of the acquisition. Ex post facto notice is not contemplated under the provisions of section 6(2). Same would be in violation of the provisions of the Act.
>
> The expression "proposes to enter into a combination" in section 6(2) and further details to be disclosed in the notice to the Commission are of the 'proposed combination' and the specific provisions contained in section 6(2A) of the Act provides that no combination shall come into effect until 210 days have passed from the date on which notice has been given or passing of orders under section 31 by the Commission, whichever is earlier. The intent of the Act is that the Commission has to permit combination to be formed, and has an opportunity to assess whether the proposed combination would cause an appreciable adverse effect on competition. In case combination is to be notified ex post facto for approval, it would defeat the very intendment of the provisions of the Act.

Section 6 covers many facets of the combination regulation like the time lines for filing of the notice, the manner of dealing with the notice, exemption to certain institutions etc. The same are discussed in details in the following paragraphs.

Exemption from filing notice within 30 days

Section 6(2) provides that the notice relating to a proposed combination needs to be filed within 30 days. Section 6(2A) further provides that a combination shall come into effect until 210 days have passed from the day on which the notice has been given to the Commission or the Commission has passed orders under section 31, whichever is earlier. However, vide Notification no. S.O. 2039(E) dated 29th June, 2017, the Commission has relaxed the 30-day norm. The said notification does away with the deadline of filing the notice within 30 days and provides parties the flexibility to file combinations when they are ready to file a

notice with Commission. Of course, the parties need to ensure that the combination is not acted upon unless the same is approved by the Commission.

Exemption to specified institutions

The provisions of section 6 do not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement. In other words, this exemption is available only to a (i) public financial institution; (ii) foreign institutional investor; (iii) bank; or (iv) venture capital fund. Moreover, the exemption is available only for share subscription or financing facility or any acquisition, and that too, only if the acquisition is pursuant to any covenant of (i) a loan agreement; or (ii) an investment agreement.

However a duty is cast upon these institutions if they claiming the said exemption. They are required to file Form III as specified in schedule II to the Combination Regulations, 2011 giving details of the control, the circumstances for exercise of such control and the consequences of default arising out of loan agreement or investment agreement, within seven days from the date of such acquisition or entering into such agreement, as the case may be. There is no need to pay any filing fee for filing the Form III.

According to the explanation to section 6(5):

(a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to section 115AD of the Income-tax Act, 1961;

(b) "venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23FB) of section 10 of the Income-tax Act, 1961.

Exemptions to Banking Sector and Oil and Gas Sector

Section 54(a) of the Act empowers the Central Government to grant exemption to any class of enterprises from all or any provisions of the Act if such exemption is necessary in the interest of security of the State or public interest. To exercise the said power, the Central Government has to issue a notification giving details about the extent of exemption and the duration of such exemption. With regard to the combinations relating to banking sector and oil and gas sectors, the Central Government has issued the following three notifications.

(i) *Regional Rural Banks:* Regional Rural Banks in respect of which the Central Government has issued a notification under sub-section (1) of section 23A of the Regional Rural Banks Act, 1976 are exempted from complying with the provisions of the application sections 5 and 6 of the Competition Act, 2002 for a period of five years. - S.O. 2561(E). 10th August 2017 issued by the Ministry of Corporate Affairs.

(ii) *Nationalized banks:* All cases of reconstitution, transfer of the whole or any part thereof and amalgamation of nationalized banks, under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, are exempted from complying with the provisions of the application of sections 5 and 6 of the Competition Act, 2002 for a period of five years. - S.O. 2828(E). 30th August 2017 issued by the Ministry of Corporate Affairs.

(iii) *Oil and Gas Sectors:* All cases of combinations under section 5 of the Act involving the Central Public Sector Enterprises (CPSEs) operating in the Oil and Gas Sectors under the Petroleum Act, 1934 and the rules made thereunder or under the Oilfields (Regulation and Development) Act, 1948 and the rules made thereunder, along with their wholly or partly owned subsidiaries operating in the Oil and Gas Sectors, are exempted from complying with the provisions of the application of sections

5 and 6 of the Competition Act, 2002 for a period of five years. - S.O. 3714(E). 22nd November 2017 issued by the Ministry of Corporate Affairs.

Ordinarily exempt transactions under Combination Regulations

The Combinations Regulations, 2011 provide for the procedural framework on regulation of the combinations. Schedule I to the Regulations provides a list of transactions which are ordinarily not likely to raise competition concerns and hence normally exempt from approval requirements. They are known as 'ordinarily exempt' transactions. However, such ordinarily exempt transactions also need prior approval of the Commission if the same is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination. In other words, the parties will have to approach the Commission, before giving effect to the proposed combination. The Commission has highlighted this fact in in the matter of *SCM Soilfert Limited / Deepak Fertilizers* (order under section 43A relating to Combination Registration No. C-2014/05/175), in the following words:

> "It is observed that the categories of combinations listed in Schedule I to the Combination Regulations must be interpreted in light of the Commission's objectives (listed in Section 18 of the Act) and the intent of Schedule I (expressed in Regulation 4 of the Combination Regulations). This means that the categories of combinations listed in Schedule I as normally not notifiable ought not to include combinations which envisage or are likely to cause a change in control or are of the nature of strategic combinations including those between competing enterprises or enterprises active in vertical markets."

Control

One of the most important facets of the Indian merger control regime is the element of 'control'. Control over an enterprise has the ability to change the competitive dynamics of any market, and the CCI, like all other competition regulators, gives due importance to changes in control.

Under the provisions of the Competition Act, 2002, 'control' includes 'controlling the affairs and management by (i) of or more enterprises whether jointly or singly, over another enterprise or group, or (ii) one or more groups, over another group of enterprise. Further, the definition of 'group' under the Competition Act, 2002 yields further clues as to what control may be seen as. 'Group is defined under the Competition Act, 2002 and two or more enterprises which, directly or indirectly, are in a position to exercise 26% cent or more of the voting rights in the other enterprise; or appoint more than 50% of the members of the board of directors in the other enterprise; or control the affairs and management of the other enterprise. By way of a notification, the MCA exempted enterprises in which less than 50% of the shareholding was held, from the definition of group. However, for the purpose of control, the 26% limit still applies.[3]

Apart from the 'positive control' over an enterprise which comes from owning more than 50%of the voting rights of a company or control over more than 50% of the board of directors of a company, the CCI also considered 'negative control', i.e. control exercised contractually by way of affirmative voting rights (AVRs) / veto rights over the strategic business decisions of the company. This is concurrent with the practice in other advanced jurisdictions such as the EU, which also follow the test of decisive control.[4]The CCI judges each case on its merits and circumstances, and seeks to distinguish between rights that are purely investment protection rights, and those that enable the holder to control the key strategic business decisions of the company.

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3 As affirmed by the CCI in *In Re Turbo Aviation Pvt. Ltd.* [Case No. 59 of 2015].

4 In *Independent Media Trust*, [Case No. C – 20102/03/47], the CCI took the position that the ability to exercise decisive control over the management and affairs of the target company amounts to control for the purposes of the Competition Act, 2002.

Explanation (a) to section 5 gives the meaning of 'control' for the purpose of regulation of combinations. It reads as follows:

"Control" includes controlling the affairs or management by—

(i) one or more enterprises, either jointly or singly, over another enterprise or group;

(ii) one or more groups, either jointly or singly, over another group or enterprise.

From the control perspective, a combination may involve acquisition of control; acquisition of joint control; transfer from joint control to sole control; or continuation of joint control even after acquisition has taken place. Based on the Regulations and the interpretation by the CCI in numerous cases, the term control can have different dimensions such as joint control, indirect control, common control, negative control, strategic control etc.

Notice to the Commission disclosing details of the proposed combination

As stated earlier, section 6(2) envisages that any person or enterprise, who or which proposes to enter into any combination, shall give a notice to the Commission disclosing details of the proposed combination, in the form prescribed and submit the form together with the fee prescribed by regulations. The said section 6(2) provides that the intimation of proposed combination should be submitted within 30 days, however vide S.O. 2039(E) dated 29th June 2017, the Central Government has relaxed this compliance and linked it with the provisions of section 6(2A) of the Act. Hence the parties are free to file notice of combinations to the Commission at any time convenient to them but they have to ensure that the combination is not acted upon unless the same is approved by the Commission. Contravention of this provision would attract the result into the imposition of penalty under section 43A of the Act.

Inquiry into combination by the Commission

The Commission under section 20 of the Competition Act may inquire into the appreciable adverse effect caused or likely to be caused on competition in India as a result of combination in the following circumstances:

(i) upon its own knowledge or information (*suo moto*); or

(ii) upon receipt of notice under section 6(2) relating to acquisition referred to in section 5(a); or acquiring of control referred to in section 5(b); or merger or amalgamation referred to in section 5(c) of the Act.

It has also been provided that a *suo moto* enquiry shall be initiated by the Commission within one year from the date on which such combination has taken effect. Thus, the Act has provided a time limit within which *suo moto* inquiry into combinations can be initiated. This provision dispels the fear of enquiry into combination between merging entities after the expiry of stipulated period.

On receipt of the notice under section 6(2) from the person or an enterprise which proposes to enter into a combination, it is mandatory for the Commission to inquire whether the combination referred to in that notice, has caused or is likely to cause an appreciable adverse effect on competition (AAEC) within the relevant market in India.

Competition Test (AAEC)

The Commission shall have due regard to all or any of the following factors listed under section 20(4) for the purposes of determining whether the combination causes or is likely to cause an 'appreciable adverse effect on competition' (AAEC) in the relevant market:

(a) actual and potential level of competition through imports in the market;

(b) extent of barriers to entry into the market;

(c) level of combination in the market;

(d) degree of countervailing power in the market;

(e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

(f) extent of effective competition likely to sustain in a market;

(g) extent to which substitutes are available or likely to be available in the market;

(h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

(i) likelihood that the combination would result in the removal of a vigorous and effective competition or competitors in the market;

(j) nature and extent of vertical integration in the market;

(k) possibility of a failing business;

(l) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

The above yardsticks are to be taken into account irrespective of the fact whether an inquiry is instituted, on receipt of notice under section 6(2) or upon its own knowledge. The scope of assessment of adverse effect on competition will be confined to the “relevant market”. Most of the facts enumerated in section 20(4) are external to an enterprise. It is noteworthy that sub clause (n) of Section 20(4) requires to invoke principles of a “balancing”. It requires the Commission to evaluate whether the benefits of the combination outweigh the adverse impact of the combination, if any. In other words if the benefits of the combination outweigh the adverse effect of the combination, the Commission will approve the combination. Conversely, the Commission may declare such a combination as *void*.

Relevant market

Relevant market is the mix of relevant geographic market and relevant product market. Sub-section (r) of section 2 defines relevant market to mean the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets.

Relevant geographic market

Sub-section (s) of section 2 defines the relevant geographic market to mean a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighboring areas.

Relevant product market

Sub-section (t) of section 2 defines the relevant product market to mean a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

Filing of notice (Form)

For seeking approval to the proposed combination, parties to the combination are required to give notice to the Commission by filing Form I or Form II. Format of these forms are given in Schedule II to the Combination Regulations.

Notice by filing of Form I: Regulation 5(2)

According to Regulation 5(2), the notice should ordinarily be filed in Form I wherein:

(a) the parties to the combination are engaged in production, supply, distribution, storage, sale or trade of similar or identical or substitutable goods or provision of similar or identical or substitutable services and the combined market share of the parties to the combination after such combination is NOT more than 15% in the relevant market ;

(b) the parties to the combination are engaged at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or trade in goods or provision of services, and their individual or combined market share is NOT more than 25% in the relevant market.

Notice by filing of Form II: Regulation 5(3)

According to Regulation 5(3), parties to the combination may, at their option, give notice in Form II, preferably in the instances where -

(a) the parties to the combination are engaged in production, supply, distribution, storage, sale or trade of similar or identical or substitutable goods or provision of similar or identical or substitutable services and the combined market share of the parties to the combination after such combination is more than 15% in the relevant market;

(b) the parties to the combination are engaged at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or trade in goods or provision of services, and their individual or combined market share is more than 25% in the relevant market.

Time for forming *prima facie* opinion

As prescribed by regulation 19(1) of the Combination Regulations, the Commission shall form its prima facie opinion as to whether a combination is likely to cause or has caused an appreciable adverse effect on competition within the relevant market in India within thirty working days of the receipt of such notice.

Time for final order

In terms of section 31(11) of the Act, the Commission is required to pass an order or issue direction in accordance with provisions of Section 31 of the Act within two hundred and ten days from the date of the notice given to the Commission.

Form to be complete in all respect

Regulation 14 provides that the notice shall not be valid unless it is in conformity with the Combination Regulations. Therefore, it is necessary, *inter alia*, that information provided in the notice is complete and correct. The parties to the combination should ensure that the information contained in the notice has been carefully prepared. Lack of complete information and/or submission of incorrect information may lead to invalidation of the notice or may significantly delay the process of inquiry and examination of the notice.

Filing fee

The filing fee payable along with Form I or Form II is as follows:

(a) where the notice is filed in Form I : `15,00,000;

(b) where the notice is filed in Form II: `50,00,000.

The fee may be paid either by tendering demand draft or pay order or banker's cheque, payable in favour of the Competition Commission of India (Competition Fund), New Delhi or through Electronic Clearance Service (ECS) by direct remittance to the Competition Commission of India (Competition Fund).

Filing process

In case of an acquisition or acquiring of control of the enterprise, the acquirer shall file the notice in applicable form. In case of a merger or amalgamation, parties to the combination shall jointly file the notice. The duly filled in notice is required to be delivered along with a copy and an electronic version thereof to the Commission's office.

In case the notifying party has requested confidentiality with respect to information or document(s) submitted during the inquiry, the non-confidential version thereof is required to be additionally filed along with an electronic copy. A request for confidentiality may be made only if making the document or documents or part or parts thereof public will result in disclosure of trade secrets or destruction or appreciable diminution of the commercial value of the information or can be reasonably expected to cause serious injury. The notifying party(ies) should clearly state the reasons and justification for requesting confidentiality and the implications for the business of the parties to the combination from the disclosure of such information/documents. Further, in case request for confidentiality is made by the parties to the combination, it shall be substantiated with cogent reasons and detailed explanation for grant of such confidential treatment. In this regard, it may be noted that mere statement(s) that the document(s) or information or part(s) thereof contain trade secret(s) or are of such commercial value that disclosure of same will cause serious injury, shall not be sufficient ground for accepting the request for confidentiality. Further, in accordance with sub-regulation (3) of regulation 30 of the Combination Regulations, an affidavit regarding grant of confidentiality should also be filed along with the letter making request for grant of confidentiality.

If the notifying party is an Indian company, a certified copy of the board resolution authorizing the said person(s) to sign the notice should be provided. For body corporates organised/incorporated under foreign laws, the following documents may be submitted:

(a) for body corporates which are required to pass board resolutions for such authorisation, a certified copy of the board resolution authorizing the said person(s) to sign the notice;

(b) for body corporates which under the laws applicable to such enterprises are not required to pass a board resolution for such authorisation, an authorization letter issued by any of any of the key managerial personnel (i.e., Chief Executive Officer or the Managing Director, Company Secretary, Director, Chief Financial Officer or their equivalent as per the applicable law) in favour of the person signing the notice. The said authorisation should be printed on the company letter head and should,

wherever applicable, bear the company seal or its equivalent as per the applicable law; and

(c) In the event any document submitted by the notifying party(ies) are in a language other than English, translation in English of the said document is required to be provided.

Summary of combination

A summary of the combination, not containing any confidential information, in not less than 2000 words, comprising *inter alia* the details regarding: (a) the products, services and business(es) of the parties to the combination; (b) the values of assets/turnover for the purpose of section 5 of the Act; (c) the respective markets in which the parties to the combination operate; (d) the details of agreement(s)/other documents and the board resolution(s) executed/passed in relation to the combination; (e) the nature and purpose of the combination; and (f) the likely impact of the combination on the state of the competition in the relevant market(s) in which the parties to the combination operate, along with nine copies and an electronic version thereof shall be separately given while delivering the notice.

Summary for website

A summary of the combination, not containing any confidential information, in not more than 500 words, comprising details regarding: (a) name of the parties to the combination; (b) the type of the combination; (c) the area of activity of the parties to the combination; and (d) the relevant market(s) to which the combination relates, along with an electronic version thereof shall be separately given while delivering the notice. The summary so submitted shall be published on the website of the Commission.

Consultation with the Commission

Consultation prior to filing of notice of the proposed combination

In accordance with international best practices, the Commission allows for an informal and verbal consultation with the staff of the Commission prior to filing of the notice to a proposed combination in terms of regulation 5 of Combinations Regulations, under section 6(2).

Such pre-filing consultations help the parties intending to file a notice with the Commission in identifying the information required for filing a complete and correct Form I/II/III as well in identifying additional information that the Commission may require to assess the likely impact of the proposed combination on competition in the relevant markets.

The parties intending to file a notice with the Commission are encouraged to approach the Commission for pre-filing consultations. A request for pre-filing consultation should be made by the parties intending to file a notice at the earliest and at least 10 days before the intended date of filing, to allow time for allocating a case team for the pre-filing consultation. A copy of draft application comprising of Form I/II/, as the case may be and supporting documents should be forwarded along with the request for scheduling a pre-filing consultation.

A summary of the proposed combination along with the following details should also be submitted:

a. Basic details of the proposed combination including various steps involved in the same;

b. A brief description of the relevant market(s) and sector(s) involved;

c. The likely impact of the proposed combination on competition in those markets and sectors in general terms;

d. Key issues regarding which the parties wish to seek consultation from the Commission;

e. Any other details which according to the parties may be pertinent for a meaningful consultation.

Publication of the details of combination

Where the Commission forms a prima facie opinion that the combination has caused or is likely to cause appreciable adverse effect on competition within the relevant market in India, the Secretary shall, within 7 working days of such decision convey the direction of the Commission to the parties to the combination, to publish the details of the combination within 10 working days of the date of such direction. The details of combination shall be published by the parties in Form IV, as specified in Schedule II to the Regulations. The parties shall publish the details of the combination in all India editions of four leading daily newspapers including at least two business newspapers. Any person(s) adversely affected or likely to be affected by the combination may send comments / objections/ suggestions in writing with supporting documents within 15 working days from the date of this publication.

Procedure for investigation of combination

The Competition Commission of India (CCI) has been empowered to deal with Form I or Form II in accordance with provisions of sections 29, 30 and 31 of the Act. Section 29 prescribes procedure for investigation of combinations. Section 30 empowers the Commission to determine whether the disclosure made to it under section 6(2) is correct and whether the combination has, or is likely to have, an appreciable adverse effect on the competition. Section 31 provides that the Commission may allow the combination if it will not have any appreciable adverse effect on competition or pass an order that the combination shall not take effect, if in its opinion, such a combination has or is likely to have an appreciable adverse effect on competition.

The procedure for investigation by the Commission has been stipulated under section 29 of the Act. It involves the following stages:

(i) The Commission first has to form a *prima facie* opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India. Further, when the Commission has come to such a conclusion then it shall proceed to issue a notice to the parties to the combination, calling upon them to show cause why an investigation in respect of such combination should not be conducted.

(ii) After receipt of the response of the parties to the combination, the Commission may call for the report of the Director General.

(iii) When pursuant to response of parties or on receipt of report of the Director General whichever is later, the Commission is, prima facie, of the opinion that the Combination is likely to cause an appreciable adverse effect on competition in relevant market, it shall, within seven working days from the date of receipt of the response of the parties to the combinations or the receipt of the report from Director General under section 29 (1A) whichever is later, direct the parties to the combination to publish within ten working days, the details of the combination, in such manner as it thinks appropriate so as to bring to the information of public and persons likely to be affected by such combination.

(iv) The Commission may invite any person affected or likely to be affected by the said combination, to file his written objections within fifteen working days of the publishing of the public notice, with the Commission for its consideration.

(v) The Commission may, within fifteen working days of the filing of written objections, call for such additional or other information as it deem fit from the parties to the said combination and the

information shall be furnished by the parties above referred within fifteen days from the expiry of the period notified by the Commission.

(vi) After receipt of all the information and within 45 days from expiry of period for filing further information, the Commission shall proceed to deal with the case, in accordance with provisions contained in section 31 of the Act.

Thus, the provisions of section 29 provides for a specified timetable within which the parties to the combination or parties likely to be affected by the combination are required to submit the information or further information to the Commission to ensure prompt and timely conduct of the investigation. It further imposes on Commission a time limit of 45 working days from the receipt of additional or other information called for by it under sub-section (4) of section 29 for dealing with the case of investigation into a combination, which may have an adverse effect of the competition.

Orders of Commission on combinations

The Commission, after consideration of the relevant facts and circumstances of the case under investigation by it under section 28 or 30 and assessing the effect of any combination on the relevant market in India, may pass any of the written orders indicated herein below:

a. Approve: Where the Commission comes to a conclusion that any combination does not, or is not likely to, have an appreciable adverse effect on the Competition in relevant market in India, it may, approve that Combination.

b. Reject: Where the Commission is of the opinion that the combination has, or is likely to have an adverse effect on competition, it shall direct that the combination shall not take effect.

c. Modify: Where the Commission is of the opinion that adverse effect which has been caused or is likely to be caused on competition can be eliminated by modifying such combination then it shall direct the parties to such combination to carry out necessary modifications to the combination.

Deemed approval

A deeming provision has been introduced by section 31(11). It provides that, if the Commission does not, on expiry of a period of 210 days from the date of filing of notice under section 6(2) pass an order or issue any direction in accordance with the provisions of section 29(1) or section 29(2) or section 29(7), the combination shall be deemed to have been approved by the Commission. In reckoning the period of 210 days, the period of thirty days specified in section 29(6) and further period of thirty working days specified in section 29(8) granted by Commission shall be excluded. Furthermore where extension of time is granted on the request of parties the period of two hundred ten days shall be reckoned after deducting the extended time granted at the request of the parties.

Extra Territorial Jurisdiction of Commission

Section 32 extends the jurisdiction of Competition Commission of India to inquire and pass orders in accordance with the provisions of the Act into an agreement or dominant position or combination, which is likely to have, an appreciable adverse effect on competition in relevant market in India, notwithstanding that,

(a) an agreement referred to in section 3 has been entered into outside India; or

(b) any party to such agreement is outside India; or

(c) any enterprise abusing the dominant position is outside India; or

(d) a combination has taken place outside India; or

(e) any party to combination is outside India; or

(f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

The above clearly demonstrate that acts taking place outside India but having an effect on competition in India will be subject to the jurisdiction of Commission. The Commission will have jurisdiction even if both the parties to an agreement are outside India but only if the agreement, dominant position or combination entered into by them has an appreciable adverse effect on competition in the relevant market of India.

Power to impose penalty for non-furnishing of information on combination

Section 43A provides that if any person or enterprise who fails to give notice to the Commission under sub-section (2) of section 6, the Commission shall impose on such person or enterprise a penalty which may extend to one per cent of the total turnover or the assets, whichever is higher, of such a combination. Thus, failure to file notice of combination falling under section 5 attracts deterrent penalty. The Commission's approach on imposing the penalty under section 43A is reflected in its following orders.

It is a settled law that every discretion has to be exercised judicially. Section 43(A) of the Act gives discretion to the Commission to impose penalty in case a person or enterprise fails to give notice to the Commission under section 6(2) of the Act. This penalty can extend up to 1% of the total turnover or the assets of such a combination, whichever is higher. Thus the discretion available to the Commission is quite wide. The Commission may impose penalty of only a token amount or up to 1% of the turnover or assets of the combination. While exercising this discretion, the Commission has to keep into mind the conduct of the parties and the circumstance under which the parties failed to give notice to the Commission. - *PJSC/ Jet Airways (India) Limited* (Order under section 43A on the Combination Registration No. C-2013/05/122)

In deciding about the penalty under Section 43A of the Act, the Commission has to consider the implications of a violation of sub-section (2) of Section 6 of the Act, read with other relevant provisions of the Act, as also what could be the mitigating and/or aggravating factors. This decision has to be taken in the backdrop of the Commission's approach to regulation of combinations. The Commission's approach in dealing with combination notices is quite clear. We consider inorganic growth through combinations as a positive business strategy for the economy that deserves due support, and the analysis at the *prima facie* stage focuses on quickly sifting out only those few cases where competition concerns may require a more in-depth inquiry in phase II. - *Zulia Investments Pte. Ltd and Kinder Investments Pte. Ltd/ DBS Group Holdings Ltd.* (Order under section 43A on the Combination Registration No. C-2013/06/124)

No requirement to establish *mens rea* under section 43A

The COMPAT in its order in Appeal No.59/2015 *(SCM Soilfert Limited V. Competition Commission of India)* held that Section 43A has no requirement of establishment of *mens rea* as the legislature has not used the phrase "wilful failure" and failure simpliciter has penal consequences. The imposition of penalty under Section 43A is on account of breach of a civil obligation and once it is established that there was a failure to notify the proposed combination as required under Section 6(2) of the Act, penalty has to follow.

Penalty on Individuals (Key Managerial Person)

The Commission has the power to hold guilty if an individual while working as Director or Manager or Secretary or any other officer of the Company (or enterprise) is found to be responsible for the actions that lead to the contravention of the Act. Such person is liable to be proceeded against and punished with severe

personal penalty as per the provisions of Section 48 read with Section 27 of the Act.

LESSON ROUND-UP

- The preamble of the Competition Act, 2002 states that this is an Act to establish a Commission to prevent anti-competitive practices, promote and sustain competition, protect the interests of the consumers and ensure freedom of trade in markets in India.
- Section 4 prohibits the abuse of dominance by an enterprise or a group.
- Section 5 and 6 provides for regulation of the combinations beyond the prescribed threshold.
- Section 5 provides the financial thresholds and all combinations exceeding these financial thresholds are required to be mandatorily approved by the Commission.
- Section 6 provides that no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.
- Combination means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses, mergers and amalgamations between or amongst enterprises.
- Any person or enterprise, who or which proposes to enter into any combination, shall give a notice to the Commission disclosing details of the proposed combination, in the form, prescribed and submit the form together with the fee prescribed by regulations. Such intimation should be submitted before consummation of the proposed combination.
- The Competition Commission of India has been empowered to deal with Form I or Form II in accordance with provisions of sections 29, 30 and 31 of the Act. Section 29 prescribes procedure for investigation of combinations.
- Section 32 of the Competition Act, 2002 extends the extra territorial jurisdiction of the Competition Commission of India to enquiry and pass orders in accordance with the provisions of the Act into an agreement, dominant position and regulates combinations i.e. mergers and acquisitions with a view to ensure that there is no adverse effect on competition in India.

GLOSSARY OF TECHNICAL WORDS

Acquisition: Acquisition means, directly or indirectly, acquiring or agreeing to acquire (i) shares, voting rights or assets of any enterprise; or (ii) control over management or control over assets of any enterprise.

Combination: An acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises if the thresholds prescribed under Section 5 of the Act are met.

Group: Two or more enterprises which, directly or indirectly, are in a position to —

(i) exercise fifty per cent or more of the voting rights in the other enterprise; or

(ii) appoint more than fifty per cent of the members of the board of directors in the other enterprise; or

(iii) control the management or affairs of the other enterprise.

Control: It includes controlling the affairs or management by (i) one or more enterprises, either jointly or singly, over another enterprise or group or; (ii) one or more groups, either jointly or singly, over another group or enterprise.

Relevant Market: Relevant market to mean the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets.

Relevant geographic market: A market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas.

Relevant product market: A market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

SUGGESTED READINGS

1. Merger Control in India by Tarun Mathur, EBC Publications
2. Competition Law in India by T. Ramappa, Oxford Publications
3. Competition Law in India by Roy and Kumar, 2nd Edition, Eastern Law House
4. Competition Act, 2002.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is a combination in terms of the Competition Act, 2002?
2. What parameters are applied by the Competition Commission of India to determine if the proposed combination is likely to have appreciable adverse effect on competition in relevant market in India?
3. What factors are considered by the Competition Commission of India to determine the relevant market?
4. Discuss about the thresholds limits of Combination.
5. What are the powers of the Competition Commission of India to penalise the parties who have given effect to a combination without seeking approval of the Commission?
6. What is the procedure for investigation of combinations?
7. What do you understand by extra territorial jurisdiction of the Commission?

Lesson 10
Regulatory Approvals of Scheme

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Regulatory approvals from Competition Commission of India (CCI), Income Tax Authorities, Stock Exchange, SEBI
- Regulatory approvals from RBI, RD, ROC and Official Liquidator
- Approvals from Sector Regulators such as IRDA, TRAI, etc.

LEARNING OBJECTIVES

The merger and takeover involves various issues and compliance not even of the Companies Act, 2013, but from the other Regulators also depending upon the nature of business of the company and sector under which it is operating.

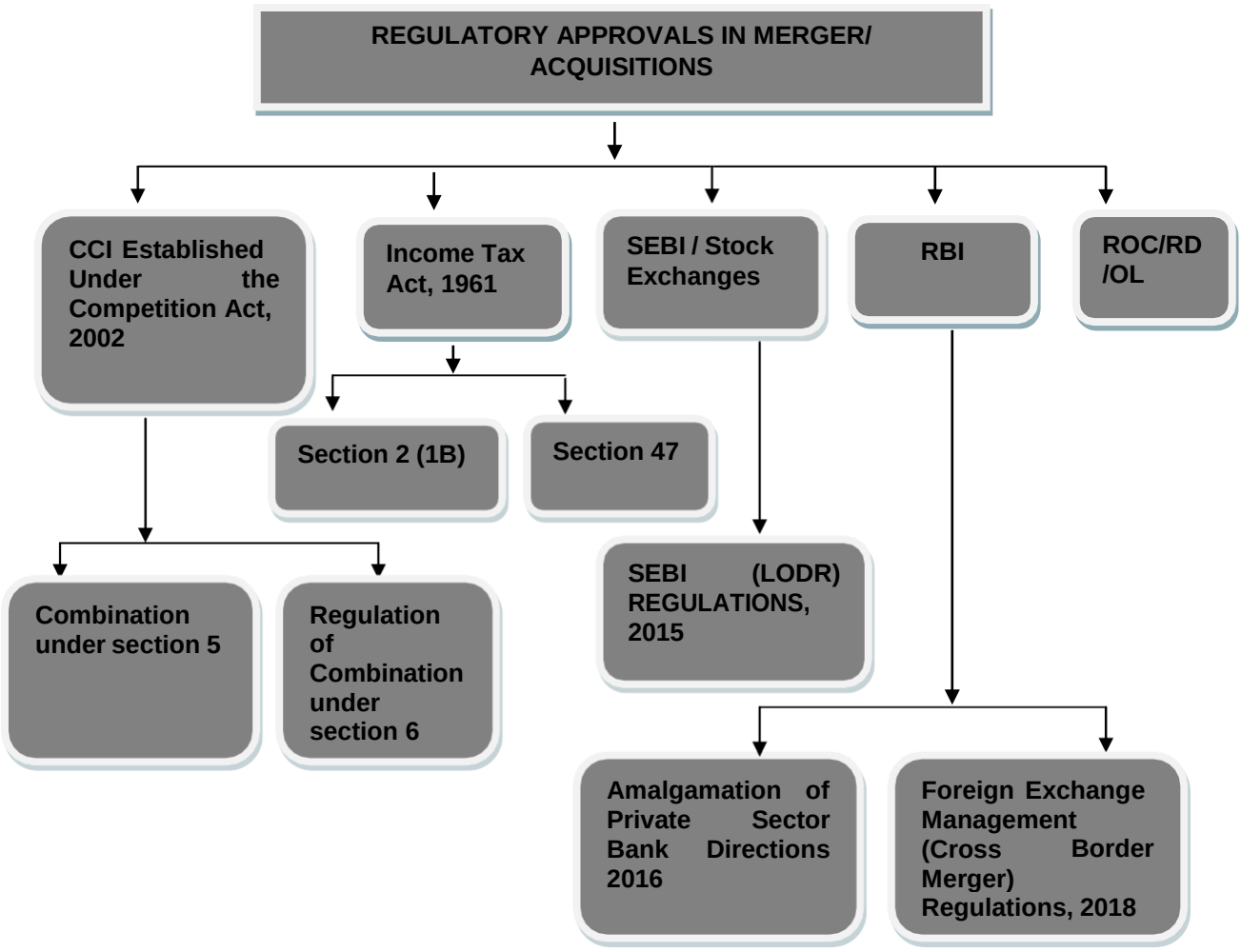
These may include SEBI, RBI, CCI, Stock Exchanges, IRDAI, TRAI, etc.

After reading this lesson the students will be able to understand regulatory requirements in the matter of merger or amalgamation of companies.

INTRODUCTION

The Companies Act, 2013 requires that notice of the Merger be sent along with such other documents as the Scheme and valuation report, not only to shareholders and creditors, but also to various regulators like the Ministry of Corporate Affairs, the Reserve Bank of India (in cases, where non-resident investors are involved), SEBI and Stock Exchanges (for listed companies), Competition Commission of India (in cases where the prescribed fiscal thresholds are being crossed and the proposed merger could have an adverse effect on competition), Income Tax authorities and any other relevant industry regulators or authorities which are likely to be affected by the merger. This ensures compliance of the Scheme with any and all other regulatory and statutory requirements that need to be followed by the merging entities. The Act also prescribes a 30-day period for the regulators to make representations, failing which the right would cease to exist. The Companies Act, 1956 provided no such period, leading to considerable delays in the court proceedings since it was mandatory to receive approvals from all relevant authorities before proceeding.

Merger or amalgamation of companies involves various issues including the regulatory approvals. These regulatory approvals are to be obtained not only from the sector in which the company is operating (for example in case of merger of two banks, RBI's approval is needed) but from other departments like Income Tax, SEBI, ROC, etc. In this chapter, we shall discuss the various regulatory requirements which are needed for the smooth merger/ takeover.



Regulatory approvals from Competition Commission of India (CCI), Income Tax Authorities, Stock Exchange, SEBI

Approval under Competition Act, 2002

Combination (Section 5 of Competition Act, 2002)

The Competition Act 2002 is the principal legislation that regulates combinations (acquisitions, mergers, amalgamations and de-mergers) in India. Sections 5 and 6 of the Competition Act, which deal with the regulation of combinations, have been in force since 1st June 2011. Prior to this date there was no statutory obligation to notify to any antitrust authority before completing merger and amalgamations.

Section 5 of the Act prescribes the jurisdictional thresholds limits (based on asset and turnover of combining companies) for transactions that must be notified to CCI prior to implementation of merger and acquisition.

Meaning of Combination for the purpose of Competition Act, 2002

Any acquisition, merger or amalgamation that meets the following jurisdictional thresholds limits, as provided in Section 5 of the Competition Act, 2002, is a "combination" for the purpose of the Act.

The thresholds relate to the assets and turnover of the parties to the combination, i.e., target enterprise and acquirer (or acquirer group) / merging parties (or the group to which merged entity would belong).

Mandatory or voluntary

If the jurisdictional thresholds are met and exemptions are unavailable, it is mandatory to notify the Competition Commission of India (CCI) of the combination. Approval of CCI is must. CCI will consider whether proposed Combination is having any appreciable adverse impact on competition in India or not.

Regulatory Authority for Notifying Combinations

The Competition Commission of India (CCI) is the statutory authority responsible for reviewing combinations and assessing whether or not they cause or are likely to cause an appreciable adverse effect on competition within the relevant market(s) in India. CCI approval is required for combinations where the parties involved exceed the assets/turnover thresholds set out in section 5 of the Competition Act.

Triggering events

Any one of the following events requires approval of Regulatory Authority:

1. The acquisition of
    - shares,
    - voting rights,
    - assets or
    - control in one or more enterprises,

    or
2. A merger or amalgamation of enterprises,

that meets the thresholds constitutes a combination and must be pre-notified to Competition Commission of India (CCI), and the approval of the Competition Commission of India (CCI) is required before the transaction can be completed.

Types of Notifiable Transactions

Section 5 of the Competition Act, 2002 covers three broad categories of combinations:

1. The acquisition by one or more persons of control, shares, voting rights or assets of one or more enterprises, where the parties, or the group to which the target will belong post-acquisition, meet the specified assets/turnover thresholds.

2. The acquisition by a person of control over an enterprise where the person concerned already has direct and indirect control over another enterprise with which it compete, where the parties, or the group to which the target will belong post-acquisition, meet the specified assets/turnover thresholds.

3. Mergers or amalgamations, where the enterprise remaining, or enterprise created, or the group to which the enterprise will belong after the merger/amalgamation, meets the specified assets/turnover thresholds.

Time Period for CCI for giving Approval

The Combination Regulations provide that the CCI will "endeavour" to pass an order or issue directions within a period of 180 days from the date of notification. The Competition Act provides for a deemed clearance if the CCI does not pass an order within 210 days from the date of notification.

Section 6 deals with the Regulation of combinations:

No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be *void*.

Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, *shall* give notice to the Commission, in the form[1] as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within [2]*thirty* days of—

(a) approval of the proposal relating to merger or amalgamation, referred to in clause (*c*) of section 5 by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

The Commission shall, after receipt of notice under sub-section (2), deal with such notice in accordance with the provisions contained in sections 29, 30 and 31.

The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.

The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011

- **Regulation 5(9):** Where, in a series of steps or individual transactions that are related to each other,

1 Form II

2 Vide notification no. SO 2039(E), dated 29th June, 2017 exemption has been given to person or enterprise(s) who is a party to combination from giving notice within 30 days.

assets are being transferred to an enterprise for the purpose of such enterprise entering into an agreement relating to an acquisition or merger or amalgamation with another person or enterprise, for the purpose of section 5 of the Act, the value of assets and turnover of the enterprise whose assets are being transferred shall also be attributed to the value of assets and turnover of the enterprise to which the assets are being transferred.

- **Regulation 9(3):** In case of a merger or an amalgamation, parties to the combination shall jointly file the notice in Form I or Form II, as the case may be, duly signed by the person(s) as specified under regulation 11 of the Competition Commission of India (General) Regulations, 2009. Provided that in case of a company, apart from the persons specified under clause (c) of sub-regulation (1) of regulation 11 of the Competition Commission of India (General) Regulations, 2009, Form I or Form II may also be signed by any person duly authorised by the company.
- **Schedule I-Para 9:** A merger or amalgamation of two enterprises where one of the enterprises has more than fifty per cent (50%) shares or voting rights of the other enterprise, and/or merger or amalgamation of enterprises in which more than fifty per cent (50%) shares or voting rights in each of such enterprises are held by enterprise(s) within the same group: Provided that the transaction does not result in transfer from joint control to sole control.
- **Schedule II-Para 6.5:** Furnish copies of approval of the proposal relating to merger or amalgamation by the board of directors of the enterprise(s) concerned referred to in clause (a) of sub- section (2) of section 6 of the Act and/or agreement /other document executed in relation to the acquisition or acquiring of control referred to in clause (b) of sub-section (2) of section 6 of the Act along with the supporting documents as listed in the Notes to Form I, if applicable.
- **Form I**: Registration No: (to be assigned by the Competition Commission of India) Information required to be filled in by the notifying party(ies).
- **Form II**: Form of filing notice with the Competition Commission of India under sub-section (2) of section 6 of the Competition Act, 2002.
- **Form III:** Form for filing of details of acquisition under sub-section (5) of section 6 of the Competition Act, 2002.

Approval under Income Tax Act, 1961

The Income Tax Act, 1961 contemplates and recognizes the following types of merger and acquisition activities:

- Amalgamation;
- Demerger or spin-off;
- Slump sale/asset sale; and
- Transfer of shares

Merger has not been defined under the Income Tax Act, 1961 but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger, it has been given a special treatment in the Income-tax Act, 1961 since the beginning. The Finance Act, 1999 clarified many issues relating to business reorganizations thereby facilitating and making business restructuring tax neutral. Certain provisions of Income Tax Act, 1961 applicable to mergers/demergers are as under:

Every scheme involving restructuring is required to be submitted to jurisdictional assessing officer and no-objection is required from income-tax department before a scheme is approved by NCLT.

Meaning of Amalgamation [Section 2(1B)]

"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 the amalgamating company or companies and the company with which they merge or which is formed as a 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-fourths 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;

Section 45 of the Income Tax Act, 1961 levies tax on capital gains arising on the transfer of a capital asset. Section 2(47) of the Act defines the term 'transfer' in relation to a capital asset. If a merger or any other kind of restructuring results in a transfer of a capital asset for a resident or a capital asset that is situated in India for a non-resident, it would lead to a taxable event.

Section 47 of the Act sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are mentioned in Lesson 8 of this Study Material.

Approval from SEBI / Stock Exchange(s)

Securities Contracts (Regulation) Rules, 1957: Sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957 provides that Securities and Exchange Board of India (SEBI) may, at its own discretion or on the recommendation of a recognised Stock Exchange, waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by these rules.

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Regulation 11: Scheme of Arrangement

The listed entity shall ensure that any scheme of arrangement /amalgamation /merger /reconstruction /reduction of capital etc. to be presented to any Court or Tribunal does not in any way violate, override or limit the provisions of securities laws or requirements of the stock exchange(s):

Provided that this regulation shall not be applicable for the units issued by Mutual Funds which are listed on a recognised stock exchange(s).

Regulation 37: Draft Scheme of Arrangement & Scheme of Arrangement

(1) Without prejudice to provisions of regulation 11, the listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before Tribunal under Sections 230-234 and Section 66 of Companies Act, 2013, *along with a non-refundable fee as specified in Schedule XI,* with the stock exchange(s) for obtaining Observation Letter

or No-objection letter, before filing such scheme with any Court or Tribunal, in terms of requirements specified by the Board or stock exchange(s) from time to time.

(2) The listed entity shall not file any scheme of arrangement under sections 230-234 and Section 66 of Companies Act, 2013, with Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

(3) The listed entity shall place the Observation letter or No-objection letter of the stock exchange(s) before the Tribunal at the time of seeking approval of the scheme of arrangement:

Provided that the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Court or Tribunal.

(4) The listed entity shall ensure compliance with the other requirements as may be prescribed by the Board from time to time.

(5) Upon sanction of the Scheme by the Court or Tribunal, the listed entity shall submit the documents, to the stock exchange(s), as prescribed by the Board and/or stock exchange(s) from time to time.

(6) Nothing contained in this regulation shall apply to draft schemes which solely provide for merger of a wholly owned subsidiary with its holding company:

Provided that such draft schemes shall be filed with the stock exchanges for the purpose of disclosures.

(7) The requirements as specified under this regulation and under regulation 94 of these regulations shall not apply to a restructuring proposal approved as part of a resolution plan by the Tribunal under section 31 of the Insolvency Code, 2016 subject to the details being disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

Regulation 94: Draft Scheme of Arrangement & Scheme of Arrangement

(1) The designated stock exchange, upon receipt of draft schemes of arrangement and the documents prescribed by the Board, as per sub-regulation (1) of regulation 37, shall forward the same to the Board, in the manner prescribed by the Board.

(2) The stock exchange(s) shall submit to the Board its Objection Letter or No-Objection Letter on the draft scheme of arrangement after inter-alia ascertaining whether the draft scheme of arrangement is in compliance with securities laws within thirty days of receipt of draft scheme of arrangement or within seven days of date of receipt of satisfactory reply on clarifications from the listed entity and/or opinion from independent chartered accountant, if any, sought by stock exchange(s), as applicable.

(3) The stock exchange(s), shall issue Observation Letter or No-objection letter to the listed entity within seven days of receipt of comments from the Board, after suitably incorporating such comments in the Observation Letter or No-objection letter:

Provided that the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance.

(4) The stock exchange(s) shall bring the observations or objections, as the case may be, to the notice of Court or Tribunal at the time of approval of the scheme of arrangement.

(5) Upon sanction of the Scheme by the Tribunal, the designated stock exchange shall forward its recommendations to the Board on the documents submitted by the listed entity in terms of sub-regulation (5) of regulation 37.

[For further details please refer SEBI circular No. CFD/DIL3/CIR/2017/21 March 10, 2017 - All Listed Entities who have listed their equity and convertibles/ All the Recognized Stock Exchanges and modified vide circular No. CFD/ DIL3/CIR/2018/2January 03, 2018]

Regulatory approvals from RBI, Regional Director (RD), ROC, Official Liquidator (OL)

Regulatory approvals from RBI

Master Direction – Amalgamation of Private Sector Banks, Directions, 2016

The RBI vide its circular No. RBI/DBR/2015-16/22 Master Direction DBR. PSBD.No. 96/16.13.100/2015-16, dated April 21, 2016 has issued the Master Direction relating to the amalgamation of Private Sector Banks, Directions, 2016. The salient feature of the directions are given in **Annexure I** at the end of this chapter.

Foreign Exchange Management (Cross Border Merger) Regulations 2018

Section 234 of the Companies Act, 2013 deals with the merger or amalgamation of company with foreign company. Sub-section (1) provides that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply *mutatis mutandis* to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government:

Provided that the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

(2) Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or *vice versa* and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

Explanation.—For the purposes of sub-section (2), the expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or not.

Further Rule 25A was added by the Companies (Compromise, Arrangements & Amalgamation) Amendment Rules 2017.

The said rule deals with the merger or amalgamation of a foreign company with a Company and *vice versa* and provides as under:

(1) A foreign company incorporated outside India may merge with an Indian company after obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and these rules.

(2) (a) A company may merge with a foreign company incorporated in any of the jurisdictions specified in Annexure B after obtaining prior approval of the Reserve Bank of India and after complying with provisions of sections 230 to 232 of the Act and these rules.

(b) The transferee company shall ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to Reserve Bank of India for obtaining its approval under clause (a) of this sub-rule.

(3) The concerned company shall file an application before the Tribunal as per provisions of section

230 to section 232 of the Act and these rules after obtaining approvals specified in sub-rule (1) and sub-rule (2), as the case may be.

Explanation 1. For the purposes of this rule the term "company" means a company as defined in clause (20) of section 2 of the Act and the term "foreign company" means a company or body corporate incorporated outside India whether having a place of business in India or not:

Explanation 2. For the purposes of this rule, it is clarified that no amendment shall be made in this rule without consultation of the Reserve Bank of India."

RBI's Guidelines: As mentioned in the proviso to section 234 that Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations, the RBI *vide* its Press Release dated 20th March, 2018 placed on its website the regulations on cross border merger transactions pursuant to the Rules notified by Ministry of Corporate Affairs through Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2017 on April 13, 2017. The regulations are attached as **Annexure** at the end of Chapter 13 of this Study Material.

Regulatory approvals from RD / ROC/ OL

Section 233[3] deals with the merger or amalgamation of certain companies. It provides as under:

(1) Notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidator where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

(2) The transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government[4] Registrar and the Official Liquidator where the registered office of the company is situated.

(3) On the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to

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3 Enforced with effect from 15-12-2016. *See* also Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (Division Two).

4 Powers are delegated to Regional Directors at Mumbai, Kolkata, Chennai, New Delhi, Ahmedabad, Hyderabad and Shillong.

the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

(4) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days:

Provided that if no such communication is made, it shall be presumed that he has no objection to the scheme.

(5) If the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

(6) On receipt of an application from the Central Government[3] or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

Provided that if the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

(7) A copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

(8) The registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding up.

(9) The registration of the scheme shall have the following effects, namely:—

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

(d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

(10) A transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

(11) The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital:

Provided that the fee, if any, paid by the transferor company on its authorised capital prior to its merger or

amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

(12) The provisions of this section shall *mutatis mutandis* apply to a company or companies specified in sub-section (1) in respect of a scheme of compromise or arrangement referred to in section 230 or division or transfer of a company referred to clause (*b*) of sub-section (1) of section 232.

(13) The Central Government may provide for the merger or amalgamation of companies in such manner as may be prescribed.

(14) A company covered under this section may use the provisions of section 232 for the approval of any scheme for merger or amalgamation.

Provisions under the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016[5]

Merger or Amalgamation of certain companies (Rule 25)

(1) The notice of the proposed scheme, under clause (*a*) of sub-section (1) of section 233 of the Act, to invite objections or suggestions from the Registrar and Official Liquidator or persons affected by the scheme shall be in Form No. CAA.9.

(2) For the purposes of clause (c) of sub-section (1) of section 233 of the Act the declaration of solvency shall be filed by each of the companies involved in the scheme of merger or amalgamation in Form No. CAA.10 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, before convening the meeting of members and creditors for approval of the scheme.

(3) For the purposes of clause (b) and (d) of sub-section (1) of section 233 of the Act, the notice of the meeting to the members and creditors shall be accompanied by –

(a) a statement, as far as applicable, referred to in sub-section (3) of section 230 of the Act read with sub-rule (3) of rule 6 hereof;

(b) the declaration of solvency made in pursuance of clause (*c*) of sub-section (1) of section 233 of the Act in Form No. CAA.10;

(c) a copy of the scheme.

(4)(*a*) For the purposes of sub-section (2) of section 233 of the Act, the transferee company shall, within seven days after the conclusion of the meeting of members or class of members or creditors or class of creditors, file a copy of the scheme as agreed to by the members and creditors, along with a report of the result of each of the meetings in Form No. CAA.11 with the Central Government, along with the fees as provided under the Companies (Registration Offices and Fees) Rules, 2014.

(b) Copy of the scheme shall also be filed, along with Form No. CAA. 11 with :

(i) the Registrar of Companies in Form No. GNL-1 along with fees provided under the Companies (Registration Offices and Fees) Rules, 2014; and

(ii) the Official Liquidator through hand delivery or by registered post or speed post.

(5) Where no objection or suggestion is received to the scheme from the Registrar of Companies and Official

5 Came into force with effect from 15th December, 2016.

Liquidator or where the objection or suggestion of Registrar and Official Liquidator is deemed to be not sustainable and the Central Government is of the opinion that the scheme is in the public interest or in the interest of creditors, the Central Government shall issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12.

(6) Where objections or suggestions are received from the Registrar of Companies or Official Liquidator and the Central Government is of the opinion, whether on the basis of such objections or otherwise, that the scheme is not in the public interest or in the interest of creditors, it may file an application before the Tribunal in Form No. CAA.13 within sixty days of the receipt of the scheme stating its objections or opinion and requesting that Tribunal may consider the scheme under section 232 of the Act.

(7) The confirmation order of the scheme issued by the Central Government or Tribunal under sub-section (7) of section 233 of the Act, shall be filed, within thirty days of the receipt of the order of confirmation, in Form INC-28 along with the fees as provided under Companies (Registration Offices and Fees) Rules, 2014 with the Registrar of Companies having jurisdiction over the transferee and transferor companies respectively.

(8) For the purpose of this rule, it is clarified that with respect to schemes of arrangement or compromise falling within the purview of section 233 of the Act, the concerned companies may, at their discretion, opt to undertake such schemes under sections 230 to 232 of the Act, including where the condition prescribed in clause (*d*) of sub-section (1) of section 233 of the Act has not been met.

Approvals from Sector Regulators such as IRDA, TRAI, etc.

When arrangement, amalgamation or merger involves companies being regulated by a sectoral regulator like IRDA, TRAI, RBI, etc. then approval of such Regulators is also required in addition to compliance with Companies Act, 2013. Further these Regulators have issued detailed guidelines to be complied with while amalgamation/ merger between such companies.

Approvals from Insurance Regulatory and Development Authority (IRDA)

Section 30 of the Insurance Regulatory and Development Authority Act, 1999 has amended The Life Insurance Act, 1938 which has been mentioned in the First Schedule to this Act. Section 36, 37 and 37A deals with the matter relating to arrangements, which are appended below:

Section 36[6] of the Insurance Act, 1938 deals with the sanction of amalgamation and transfer by Authority.

When any application under sub-section (3) of section 35 is made to the Authority, the Authority shall cause, a notice of the application to be given to the holders of any kind of policy of insurer concerned along with statement of the nature and terms of the amalgamation or transfer, as the case may be, to be published in such manner and for such period as it may direct, and, after hearing the directors and considering the objections of the policyholders and any other persons whom it considers entitled to be heard, may approve the arrangement, and shall make such consequential orders as are necessary to give effect to the arrangement.

Section 37 of the Insurance Act, 1938 deals with the statements required after amalgamation and transfer

Where an amalgamation takes place between any two or more insurers, or where any business of an insurer is transferred, whether in accordance with a scheme confirmed by the Authority or otherwise, the insurer carrying on the amalgamated business or the person to whom the business is transferred, as the case may

6 Substituted by the Insurance Laws (Amendment) Ordinance, 2014, w.e.f. 26-12-2014.

be, shall, within three months from the date of the completion of the amalgamation or transfer, furnish in duplicate to the Authority-

(a) a certified copy of the scheme, agreement or deed under which the amalgamation or transfer has been effected, and

(b) a declaration signed by every party concerned or in the case of a company by the chairman and the principal officer that to the best of their belief every payment made or to be made to any person whatsoever on account of the amalgamation or transfer is therein fully set forth and that no other payments beyond those set forth have been made or are to be made either in money, policies, bonds, valuable securities or other property by or with the knowledge of any parties to the amalgamation or transfer, and

(c) where the amalgamation or transfer has not been made in accordance with a scheme approved by the Authority under Section 36:

(i) balance-sheet in respect of the insurance business of each of the insurers concerned in such amalgamation or transfer, prepared in the Form set forth in Part II of the First Schedule and in accordance with the regulations contained in Part I of that Schedule, and

(ii) certified copies of any other reports on which the scheme of amalgamation or transfer was founded.

Section 37A of the Insurance Act, 1938 deals with the power of the authority to prepare scheme of Amalgamation

(1) If the Authority is satisfied that-

(i) in the public interest; or

(ii) in the interests of the policy-holders; or

(iii) in order to secure the proper management of an insurer; or

(iv) in the interests of insurance business of the country as a whole;

it is necessary so to do, it may prepare a scheme for the amalgamation of that insurer with any other insurer (hereinafter referred to in this section as the transferee insurer):

Provided that no such scheme shall be prepared unless the other insurer has given his written consent to the proposal for such amalgamation

(2) The scheme aforesaid may contain provisions for all or any of the following matters, namely:

(a) the constitution, name and registered office, the capital, assets, powers, rights, interests, authorities and privileges, and the liabilities, duties and obligations of the transferee insurer;

(b) the transfer to the transferee insurer the business, properties, assets and liabilities of the insurer on such terms and conditions as may be specified in the scheme;

(c) any change in the Board of Directors, or the appointment of a new Board of directors of the transferee-insurer and the authority by whom, the manner in which, and the other terms and conditions on which such change or appointment shall be made, and in the case of appointment of a new Board of Director or of any director, the period for which such appointment shall be made;

(d) the alteration of the memorandum and articles of association of the transferee insurer for the purpose of altering the capital thereof or for such other purposes as may be necessary to give effect to the amalgamation**;**

(e) subject to the provisions of the scheme, the continuation by or against the transferee insurer, of any actions or proceedings pending against the insurer;

(f) the reduction of the interest or rights which the shareholders, policy holders and other creditors have in or against the insurer before the amalgamation to such extent as the Authority considers necessary in the public interest or in the interests of the shareholders, policy-holders and other creditors or for the maintenance of the business of the insurer;

(g) the payment in cash or otherwise to policy-holders, and other creditors in full satisfaction of their claim,-

(i) in respect of their interest or rights in or against the insurer before the amalgamation; or

(ii) where their interest or rights aforesaid in or against the insurer has or have been reduced under clause (f), in respect of such interest or rights as so reduced;

(h) the allotment to the shareholders of the insurer for shares held by them therein before the amalgamation Whether their interest in such shares has been reduced under clause (f) or not] of shares in the transferee insurer and where any shareholders claim payment in cash and not allotment of shares, or where it is not possible to allot shares to any sharp holders the payment in cash to those shareholders in full satisfaction of their claim—

(i) in respect of their interest in shares in the insurer before the amalgamation; or

(ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced;

(i) the continuance of their services of all the employees of the insurer(excepting such of them as not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentionedin the scheme) in the transferee insurer at the same remuneration and on the same terms and conditions of service, which they were getting or, as the case may be, which they were being governed, immediately before the date of the amalgamation:

Provided that the scheme shall contain a provision that the transferee insurer shall pay or grant not later than the expiry of the period of three years, front the date of the amalgamation, to the said employees the same remuneration and the same terms and conditions of service as are applicable to the other employees of corresponding rank on status of the transferee insurer subject to the qualifications and experience of the said employees being the same as or equivalent to those of such other employees of the transferee insurer:

Provided further that if in any case any doubt or difference arises as to whether the qualification and experience of any of me said employees are the same as or are equivalent to the qualifications and experience of the other employees of corresponding rank or status of the transferee insurer, the doubt or difference shall be referred to the Authority whose decision thereon shall be final;

(j) notwithstanding anything contained in clause (i), where any of the employee, of the insurer not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme under clause (i) or where any employees of the insurer have by notice in writing given to the insurer or, as the case may be, the transferee insurer at any time before the expiry of one month next following the date on which the scheme is sanctioned by the Central Government, intimated their intention of not becoming employees of the transferee insurer, the payment to such employees of compensation, if any, to which they are entitled under the Industrial Disputes Act, 1947, and such pension, gratuity, provident fund, or other retirement benefits ordinarily admissible to them under the rules or authorizations of the insurer immediately before the

date of the amalgamation;

(k) any other terms and conditions for the amalgamation of the insurer;

(l) such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

(3) (a) A copy of the scheme prepared by the Authority shall be sent in draft to the insurer and also to the transferee insurer and any other insurer concerned in the amalgamation, for suggestions and objections, if any, within such period as the Authority may specify for this purpose.

(b) The Authority may make such modifications, if any, in the draft scheme as he may consider necessary in the light of suggestions and objections received from the insurer and also from the transferee insurer, and any other insurer concerned in the amalgamation and from any shareholder, policyholder or other creditor of each of those insurers and the transferee insurer.

(4) The scheme shall thereafter be placed before the Central Government for its sanction and the Central Government may sanction the scheme without any modification or with such modifications as it may consider necessary, and the scheme as sanctioned by the Central Government shall come into force on such date as the Central Government may notify in this behalf in the Official Gazette:

Provided that different dates may be specified for different provisions of the scheme.

(4A) Every policyholder or shareholder or member of each of the insurers, before amalgamation, shall have the same interest in, or rights against the insurer resulting from amalgamation as he had in the company of which he was originally a policyholder or shareholder or member:

Provided that where the interests or rights of any shareholder or member are less than his interest in, or rights against, the original insurer, he shall be entitled to compensation, which shall be assessed by the Authority in such manner as may be specified by the regulations.

(4B) The compensation so assessed shall be paid to the shareholder or member by the insurance company resulting from such amalgamation.

(4C) Any member or shareholder aggrieved by the assessment of compensation made by the Authority under sub-section (4A) may within thirty days from the publication of such assessment *prefer an appeal to the Securities Appellate Tribunal.*

(5) The sanction accorded by the Central Government under sub-section (4) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied with and a copy of the sanctioned scheme certified in writing by an officer of the Central Government to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise) be admitted as evidence to the same extent as the original scheme.

(6) The Authority may, in like-manner, add to, amend or vary any scheme made under this section.

(7) On and from the date of the coming into operation ofthe scheme or any provision thereof; the scheme or such provision shall be binding on the insureror, as the case may be, on the transferee-insurer and any other insurer concerned in the amalgamation and also on all the shareholders, policy-holders and other creditors and employees of each of those insurers and of the transferee insurer, and on any other person having any right or liability in relation to any of those insurers or the transferee insurer.

(8) On and from such date as may be specified by the Central Government in this behalf, their properties and assets of the insurer shall, by virtue of and to the extent provided in the scheme, stand transferred to, and

vest in, and the liabilities of the insurer shall, by virtue of and to the extent provided in the scheme, stand transferred to and become the liabilities of, the transferee insurer.

(9) If any difficulty arises in giving effect to the provisions of the scheme the Central Government may by order do anything not inconsistent with such provisions which appears to it necessary or expedient for the purpose of removing the difficulty.

(10) Copies of every scheme made under this section and of every order made under sub-section (9) shall be laid before each House of Parliament, as soon as may be, after the scheme has been sanctioned by the Central Government or, as the case may be, the order has been made.

(11) Nothing in this section shall be deemed to prevent the amalgamation with an insurer by a single scheme of several insurers.

(12) The provisions of this section and of any scheme made under it shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force.

(13) The provisions of section 37 shall not apply to an amalgamation given effect to under provisions of this section.

Approvals from Telecom Regulatory Authority of India (TRAI)

The Department of Telecommunications, Govt. of India vide its circular No. 20-281/2010-AS-I (Volume-VII) dated 20th February, 2014 issued 'Guidelines for Transfer/ Merger of various categories of Telecommunication service licenses / authorisation under Unified Licence (UL) on compromise, arrangements and amalgamation of the companies'. The details of these guidelines are mentioned in Annexure II at the end of this chapter.

The TRAI on 30th November, 2017 has released 'Recommendations on Ease of Doing Telecom Business'. The Chapter-I provides background to the subject. Inputs received from the stakeholders have been analysed in detail and recommendations on identified issues have been given in Chapter-II. The list of recommendations has been summarized in Chapter-III.

Annexures

Annexure I

RBI/DBR/2015-16/22
Master Direction DBR.PSBD.No. 96/16.13.100/2015-16

April 21, 2016

Master Direction – Amalgamation of Private Sector Banks, Directions, 2016

Chapter I
PRELIMINARY:

1. Short Title and Commencement.

   a. These Directions shall be called the Reserve Bank of India (Amalgamation of Private Sector Banks) Directions, 2016

   b. These directions shall come into effect on the day it is placed on the official website of the Reserve Bank of India (RBI).

2. Applicability

a. The provisions of these Directions shall apply to all private sector banks licensed to operate in India by the RBI and to the Non-Banking Financial Companies (NBFC) registered with the RBI.

b. The principles underlying these Directions would be applicable, as appropriate, to public sector banks.

3. Definitions

(i) In these Directions, unless the context otherwise requires, the terms herein shall bear the meanings assigned to them below

a. "Private Sector Banks" means banks licensed to operate in India under Banking Regulation Act, 1949, other than Urban Co-operative Banks, Foreign Banks and banks licensed under specific Statutes.

b. "Amalgamated Company" means the company which is proposed to transfer its business to another company under the scheme of amalgamation.

c. "Amalgamating Company" means the company which is to acquire the business of the amalgamated company under the scheme of amalgamation.

(ii) All other expressions unless defined herein shall have the same meaning as have been assigned to them under the Banking Regulation Act, 1949 or the Reserve Bank of India Act, 1934 or as used in commercial parlance, as the case may be.

4. Scope: These guidelines shall cover the undernoted situations

a. An amalgamation of two banking companies.

b. An amalgamation of an NBFC with a banking company.

5. Statutory Provisions

a. The Reserve Bank has discretionary powers to approve the voluntary amalgamation of two banking companies under the provisions of Section 44A of the Banking Regulation Act, 1949.

b. Voluntary amalgamation of a NBFC with a banking company is governed by sections 232 to 234 of the Companies Act, 2013 in terms of which, the scheme of amalgamation has to be approved by the Tribunal.

CHAPTER II
APPROVAL BY BOARD OF DIRECTORS

6. Boards of the banks concerned shall play a crucial role in the process, while dealing with the amalgamation proposals between two banking companies or between a banking company and a NBFC. The decision of amalgamation shall be approved by two-third majority of the total Board members and not just of those present and voting. Further, in view of the importance of the responsibility implicit in such merger decisions, it shall be ensured that the Deeds of Covenants as recommended by Ganguly Working Group on Corporate Governance, as per circular DBOD.No.BC.116/08.139.001/2001-02 dated June 20, 2002 have been obtained from all independent and non-executive directors who participate in the said meetings.

CHAPTER III
AMALGAMATION BETWEEN TWO BANKING COMPANIES

7. In terms of Section 44A of the Banking Regulation Act, 1949, the draft scheme of amalgamation shall be approved by the shareholders of each banking company by a resolution passed by a majority in number representing two-thirds in value of the shareholders, present in person or by proxy at a meeting called for the purpose. Ceiling on voting rights under section 12(2) would apply in the context of section 44A, when there is a poll, to determine whether the resolution has been passed by required majority.

8. Before convening the meeting for the purposes of obtaining the shareholders' approval, the draft scheme of amalgamation shall be approved by the Boards of Directors of the two banking companies separately.

9. While according this approval, the Boards of the banks shall give particular consideration to the following matters:-

a. The values at which the assets, liabilities and the reserves of the amalgamated company are proposed to be incorporated into the books of the amalgamating company and whether such incorporation will result in a revaluation of assets upwards or credit being taken for unrealized gains.

b. Whether due diligence exercise has been undertaken in respect of the amalgamated company.

c. The nature of the consideration, which, the amalgamating company will pay to the shareholders of the amalgamated company.

d. Whether the swap ratio has been determined by independent valuers having required competence and experience and whether in the opinion of the Board such swap ratio is fair and proper.

e. The shareholding pattern in the two banking companies and whether as a result of the amalgamation and the swap ratio, the shareholding of any individual, entity or group in the amalgamating company will be violative of the Reserve Bank guidelines or require its specific approval.

f. The impact of the amalgamation on the profitability and the capital adequacy ratio of the amalgamating company.

g. The changes which are proposed to be made in the composition of the board of directors of the amalgamating banking company, consequent upon the amalgamation and whether the resultant composition of the Board will be in conformity with the Reserve Bank guidelines in that behalf.

10. In terms of Section 44A of the Banking Regulation Act, 1949, after the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of the Section, it shall be submitted to the Reserve Bank for sanction.

CHAPTER III A
PROCEDURE FOR APPLICATION FOR AMALGAMATION OF TWO BANKING COMPANIES

11. To enable the Reserve Bank to consider the application for sanction, the amalgamating and the amalgamated banking companies shall submit to the Reserve Bank the information and documents specified in the Schedule to these Directions

CHAPTER III B
ENTITLEMENT OF DISSENTING SHAREHOLDERS

12. In terms of Section 44A (3), a dissenting shareholder is entitled, in the event of the scheme being

sanctioned by the Reserve Bank, to claim within 3 months from the date of sanction, from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares to be paid to the dissenting shareholders shall be final for all purposes.

13. To enable the Reserve Bank to determine such value, the amalgamating / amalgamated banking company shall submit the following: -

a. A report on the valuation of the shares of the amalgamating / amalgamated company made for this purpose by the valuers appointed for the determination of the swap ratio.

b. Detailed computation of such valuation.

c. Where the shares of the amalgamating / amalgamated company are quoted on the stock exchange:-

   i. Details of the monthly high and low of the quotes on the exchange where the shares are most widely traded together with number of shares traded during the six months immediately preceding the date on which the scheme of amalgamation is approved by the Boards.

   ii. The quoted price of the share at close on each of the fourteen days immediately preceding the date on which the scheme of amalgamation is approved by the Boards.

(d) Such other information and documents as the Reserve Bank may require.

CHAPTER IV

AMALGAMATION OF AN NBFC WITH A BANKING COMPANY

14. Where a NBFC is proposed to be amalgamated with a banking company, the banking company shall obtain the approval of the Reserve Bank of India after the scheme of amalgamation is approved by its Board and the Board of NBFC, but before it is submitted to the Tribunal for approval.

15. When according its approval to the scheme, the Board of the banking company shall give consideration to the matters listed in paragraph 9, Chapter III above.

16. In addition, the Board shall examine whether: -

a. The NBFC has violated / is likely to violate any of the RBI / SEBI norms and if so, shall ensure that these norms are complied with before the scheme of amalgamation is approved.

b. The NBFC has complied with the "Know Your Customer" norms for all the accounts, which will become accounts of the banking company after amalgamation.

c. If the NBFC has availed of credit facilities from banks / FIs, whether the loan agreements mandate the NBFC to seek consent of the bank / FI concerned for the proposed merger / amalgamation.

CHAPTER IV A

PROCEDURE FOR APPLICATION FOR AMALGAMATION OF AN NBFC WITH A BANKING COMPANY

17. To enable the Reserve Bank of India to consider the application for approval, the banking company shall furnish to Reserve Bank of India information as specified in the Schedule to these Directions (excluding item 4) and also the information and documents listed in paragraph 13 at Chapter III B above.

CHAPTER VA

MALGAMATION OF A BANKING COMPANY WITH AN NBFC

18. The provisions of Chapter IV / IVA above will also apply mutatis mutandis in the cases where a banking company is amalgamated with an NBFC.

CHAPTER VI

NORMS FOR BUYING/ SELLING OF SHARES BY PROMOTERS

19. Norms for promoter buying or selling shares directly / indirectly, before, during and after discussion period.

SEBI regulations on Prohibition of Insider Trading shall strictly be complied with, as the information relating to takeover / merger and transfer of shares of listed banks / NBFCs are price sensitive. Even in cases of amalgamation of unlisted banks / companies, the SEBI guidelines should be followed in spirit and to the extent applicable.

CHAPTER VII
REPEAL AND OTHER PROVISIONS

20. With the issue of these Directions, the instructions / guidelines contained in the following circular issued by the Reserve Bank stand repealed:DBOD.No.PSBS.BC.89/16.13.100/2004-05 dated May 11, 2005 on Guidelines for Merger / Amalgamation of Private Sector Banks.

21. All approvals given under the above circular shall be deemed as given under these Directions.

SCHEDULE

Information and Documents to be furnished along with the Application of Scheme of Amalgamation

1. Draft scheme of amalgamation as placed before the shareholders of the respective companies for approval.

2. Copies of the notices of every meeting of the shareholders called for such approval together with newspaper cuttings evidencing that notices of the meetings were published in newspapers at least once a week for three consecutive weeks in two newspapers circulating in the locality or localities in which the registered offices of the companies are situated and that one of the newspapers was in a language commonly understood in the locality or localities.

3. Certificates signed by each of the officers presiding at the meeting of shareholders certifying the following:

a. A copy of the resolution passed at the meeting;

b. The number of shareholders present at the meeting in person or by proxy;

c. The number of shareholders who voted in favour of the resolution and the aggregate number of shares held by them;

d. The number of shareholders who voted against the resolution and the aggregate number of shares held by them;

e. The number of shareholders whose votes were declared as invalid and the aggregate number of

shares held by them;

f. The names and ledger folios of the shareholders who voted against the resolution and the number of shares held by each such shareholder;

g. The names and designations of the scrutineers appointed for counting the votes at the meeting together with certificates from such scrutineers confirming the information given in items (c) to (f) above;

h. The name of shareholders who have given notice in writing to the Presiding Officer that they dissented from the scheme of amalgamation together with the number of shares held by each of them.

4. Certificates from the concerned officers of the companies giving names of shareholders who have given notice in writing at or prior to the meeting to the banking company that they dissented from the scheme of amalgamation together with the number of shares held by each of them.

5. The names, addresses and occupations of the Directors of the amalgamating company as proposed to be reconstituted after the amalgamation and indicating how the composition will be in compliance with Reserve Bank regulations.

6. The details of the proposed Chief Executive Officer of the amalgamating company after the amalgamation.

7. Copies of the reports of the valuers appointed for the determination of the swap ratios.

8. All relevant information for consideration of the scheme of amalgamation including the following particulars:

- annual reports of each of the banking companies for each of the three completed financial years immediately preceding the Appointed Date for amalgamation;
- financial results, if any, published by each of the banking companies for any period subsequent to the financial statements prepared for the financial year immediately preceding the Appointed Date;
- pro-forma combined balance sheet of the amalgamating company as it will appear as of the Appointed Date consequent on the amalgamation;
- computation based on such pro-forma balance sheet of the following :
    i. Tier I Capital
    ii. Tier II Capital
    iii. Risk - Weighted Assets
    iv. Gross and Net NPAs
    v. Ratio of Tier I Capital to Risk-Weighted Assets
    vi. Ratio of Tier II Capital to Risk Weighted Assets
    vii. Ratio of Total Capital to Risk Weighted Assets
    viii. Tier I Capital to Total Assets
    ix. Ratio of Gross and Net NPAs to Advances

9. Information certified by the valuers as is considered relevant to understand the proposed swap ratio including the following particulars:

a. the methods of valuation used by the valuers;

b. the information and documents on which the valuers have relied and the extent of the verification, if any, made by the valuers to test the accuracy of such information;

c. if the valuers have relied upon projected information, the names and designations of the persons who have provided such information and the extent of verification, if any, made by the valuers in relation to such information;

d. details of the projected information on which the valuers have relied;

e. detailed computations of the swap ratios containing explanations for adjustments made to the published financial information for the purposes of the valuation;

f. if these adjustments are made based on valuations made by third parties, details regarding the persons who have made such valuations;

g. capitalization factor and weighted average cost of capital (WACC)

h. used for the purposes of the valuation and justification for the same;

i. if market values of shares have been considered in the computation of the swap ratio, the market values considered and the source from which such values have been derived;

j. if there are more than one valuer, whether each of the valuers have recommended a different swap ratio and if so, the above details should be given separately in respect of each valuer and it may be indicated how the final swap ratio is arrived at.

10. Such other information and explanations as the Reserve Bank may require.

[1] "Tribunal" means the National Company Law Tribunal constituted under section 408 of the Companies Act, 2013.

Annexure II

Merger and Acquisition Guidelines 2014

Government of India
Ministry of Communications and Information Technology
Department of Telecommunications
Sanchar Bhawan, 20 Ashok road, New Delhi
(AS-I Division)

No. 20-281/2010-AS-I(Volume –VII) 20th February, 2014

Subject: Guidelines for Transfer / Merger of various categories of Telecommunication service licenses / authorisation under Unified Licence (UL) on compromises, arrangements and amalgamation of the companies.

1. National Telecom Policy-2012 envisages one of the strategy for the telecom sector to put in place simplified Merger & Acquisition regime in telecom service sector while ensuring adequate

competition. This sector has been further liberalised by allowing 100% FDI. Further, it has been decided in principle to allow trading of spectrum. The Companies Act, of 1956 has also been amended by Companies Act of 2013 and the amendments have been made in reference to compromise / arrangements and amalgamations of companies. SEBI has also prescribed procedure for IPO.

2. The Scheme of compromise, arrangements and amalgamation of companies is governed by the various provisions of the Companies Act, 2013 as amended from time to time. Such scheme is to be approved by National Company Law Tribunal to be constituted under the provisions of Companies Act, 2013. Consequently, the various licences granted under section 4 of the Indian Telegraph Act, 1885 to such companies need to be transferred to the resultant entity (ies). It is also noted that such schemes may comprise of merger by formation or merger by absorption or arrangements or amalgamation etc. of company (ies) and thereafter merging/transferring such licences / authorisation subject to the condition that the resultant entity being eligible to acquire such licence /authorisation in terms of extant guidelines issued from time to time.

3. Earlier department has issued Guidelines for intra service area Merger of Cellular Mobile Telephone Service (CMTS) / Unified Access Services (UAS) Licences vide Office Memo No. 20-232/2004-BS-III dated 22nd April, 2008. Taking into consideration the TRAI's Recommendations dated 11.05.2010 and 03.11.2011 and National Telecom Policy 2012, in supersession of these guidelines, it has been further decided that Transfer / Merger of various categories of Telecom Services Licences/ authorisation under UL shall be permitted as per the guidelines mentioned below for proper conduct of Telegraphs and Telecommunication services, thereby serving the public interest in general interest in particular:-

    a) The licensor shall be notified for any proposal for compromise arrangements and amalgamation of companies as filed before the Tribunal or the Company Judge. Further, representation / objection, if any, by the Licensor on such scheme has to be made and informed to all concerned within 30 days of receipt of such notice.

    b) A time period of one year will be allowed for transfer / merger of various licences in different service areas in such cases subsequent to the appropriate approval of such scheme by the Tribunal /Company Judge.

    c) If a licensee participates in an auction and is consequently subject to a lock-in condition, then if such a licensee propose to merger/ compromise/ arrange/amalgamate into another licensee as the provisions of applicable Companies Act, the lock-in period would apply in respect of new shares which would be issued in respect of the resultants company (transferee Company). The substantial Equity/ Cross Holding clause shall not be applicable during this period of one year unless extended otherwise. This period can be extended by the Licensor by recording reasons in writing.

    d) The merger of licensee/ authorisation shall be for respective service category. As access service license/ authorisation allows provision of internet services, the merger of ISP license/ authorisation shall also be permitted.

    e) Consequent to transfer of assets/ licences/ authorisation held by transferor (acquired) company to the transferee (acquiring) company, the licences / authorisation of transferor (acquired) company will be subsumed in the resultant entity. Consequently, the date of validity of various licences / authorisation shall be as per licenses/ authorisation and will be equal to the higher of the two period on the date of merger subject to prorate payments, if any, for the extended period of the licence / authorisation for that service. However, the validity period of the spectrum shall remain unchanged subsequent to such

transfer of asset/ licences/authorisation held by the transferor (acquired) company.

f) For any additional service or any licence area/ service area, Unified Licence with respective authorisation is to be obtained.

g) Taking into consideration the spectrum cap of 50% in a band for access services, transfer/merger of licences consequent to compromise, arrangements or amalgamation of companies shall be allowed where market share for access services area of the resultant entity is upto 50%. In case the merger or acquisition or amalgamation proposals results in market share in any service area(s) exceeding 50%, the resultant entity should reduce its market share to the limit of 50% within a period of one year from the date of approval of merger or acquisition or amalgamation by the competent authority. If the resultant entity fails to reduce its market share to the limit of 50% within the specified period of one year, then suitable action shall be initiated by the licensor.

h) For determining the aforesaid market share, market share of both subscriber base and Adjusted Gross Revenue (AGR) of licensee in the relevant market shall be considered. The entire access market will be relevant market for determining the market share which will included wire line as well as wireless subscribers. Exchange Data Records (EDR) shall be used in the calculation of wire line subscribers and Visitor Location Register (VLR) data of equivalent, in the calculation of wireless subscribers for the purpose of computing market share based on subscriber base. The reference date for taking into account EDR/ VLR data of equivalent shall be 31st December or 30th June of each year depending on the date of application. The duly audited AGR shall be the basis of computing revenue based market share for operators in the relevant market. The date for duly audited AGR would be 31st March of the preceding year.

i) If a transferor (acquired) company holds a part of spectrum, which (4.4 MHz/2.5 MHz) has been assigned against the entry fee paid, the transferee (acquiring) company (i.e. resultant merged entity), at the time of merger, shall pay to the Government, the differential between the entry fee and the market determined price of spectrum from the date of approval of such arrangements by the National Company Law Tribunal / Company Judge on a pro-rate basis for the remaining period of the license(s). No separate charge shall be levied for spectrum acquired through auctions conducted from year 2010 onwards. Since auction determined price of the spectrum is valid for a period of one year, thereafter, PLR at State Bank of India rates shall be added to the last auction determined price to arrive at market determined price after a period of one year. In the event of judicial intervention in respect of the spectrum holding beyond 4.4 MHz in GSM band / 2.5. MHz in CDMA band before merger in respect of transferee (i.e. acquiring entity) company, a bank guarantee for an amount equal to the demand raised by the department for one time spectrum charge shall be submitted pending final outcome of the court case.

j) The Spectrum Usage Charge (SUC) as prescribed by the Government from time to time, on the total spectrum holding of the resultant entity shall also be payable.

k) Consequent upon the implementation of scheme of compromises, arrangements or amalgamations and merger of licenses in a service area there upon, the total spectrum held by the Resultant entity shall not exceed 25% of the total spectrum assigned for access services and 50% of the spectrum assigned in a given band, by way of auction or otherwise, in the concerned service area. The bands will be as counted for such cap in respective NIAs for auction of spectrum. In respect of 800 MHz band, the ceiling will be 10 MHz. Moreover, the relevant conditions pertaining to auction of that spectrum shall apply.

In case of future auctions, the relevant conditions prescribed for such auction shall be applicable. However, in case transferor and transferee company had been allocated one block of 3G spectrum through the auction conducted for 3G/ BWA spectrum in 2010, the resultant entity shall also be allowed to retain two blocks of 3G spectrum in respective service areas as a result of compromise, arrangements and amalgamation of the companies and Transfer / Merger of various categories of Telecommunication service licences / authorisation under Unified License (UL), being within 50% of spectrum band cap.

l) If, as a result of merger, the total spectrum held by the relevant entity is beyond the limits prescribed, the excess spectrum must be surrendered within one year of the permission being granted. The applicable Spectrum Usage Charges on the total spectrum holding of the resultant entity shall be levied for such period. If the spectrum beyond prescribed limit is not surrendered by the merged entity within one year, then, separate action in such cases, under the respective licenses/ statutory provisions, may be taken by the Government for non surrender of the excess spectrum. However, no refund or set off of money paid and / or payable for excess spectrum will be made.

m) All demands, if any, relating to the licences of merging entities, will have to be cleared by either of the two licensees before issue of the permission for merger/ transfer of licenses/ authorisation. This shall be as per demand raised by the Government / licensor based on the returns filed by the company notwithstanding any pending legal cases or disputes. An undertaking shall be submitted by the resultant entity to the effect that any demand raised for pre-merger period or transferor or transferee company shall be paid. However, the demand except for one time spectrum charges of transferor and transferee company, stayed by the Court of Law shall be subject to outcome of decision of such litigation. The one time spectrum charge shall be payable as per provisions in para 3(i) above of these guidelines.

n) If consequent to transfer / merger of licenses in a service area, the Resultant entity becomes a 'Significant Market Power' (SMP), then the extant rules & regulations applicable to SMPs would also apply to the Resultant entity. SMP in respect of access services is as defined in TRAI's 'The Telecommunications Interconnect (Reference Interconnect Offer) Regulations, 2002 (2 of 2002)' as amended from time to time.

4. The dispute resolution shall lie with Telecom Dispute Settlement and Appellate Tribunal as per TRAI Act, 1997 as amended from time to time.

5. LICENSOR reserves the right to modify these guidelines or incorporate new guidelines considered necessary in the interest of national security, public interest and for prpper conduct of telegraphs.

LESSON ROUND UP

- Merger or amalgamation of companies involves various issues and compliance not even of the Companies Act, 2013, but from the Regulators also depending upon the nature of business of the company and sector under which it is operating. These may include SEBI, RBI, CCI, Stock Exchanges, IRDAI, TRAI, etc.
- Section 5 of the Competition Act 2002 deals with the Combination and section 6 with the Regulation of combinations. The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 prescribes the procedure and relevant forms for taking approvals in case of such combinations.
- To encourage restructuring, merger and demerger, it has been given a special treatment in the Income-tax Act,

1961 since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. Section 47 of the Income Tax Act, 1961 deals with the transactions which are not regarded as transfer.

- The unlisted companies are to follow the provisions of the Companies Act, 2013. Whereas a listed company has to comply with the guidelines contained in the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 in addition to the Companies Act, 2013.
- Regulatory approval of the RBI is required for the merger /amalgamation of the Banking companies. The Master Direction on amalgamation of Private Sector Banks, Directions, 2016 issued by the RBI vide its Circular No. RBI/DBR/2015-16/22 Master Direction DBR.PSBD.No. 96/16.13.100/2015-16, dated April 21, 2016 provides the detailed issues relating to the amalgamation of Private Sector Banks. The provisions of these Directions shall apply to all private sector banks licensed to operate in India by the RBI and to the Non-Banking Financial Companies (NBFC) registered with the RBI. The principles underlying these Directions would be applicable, as appropriate, to public sector banks.
- Similarly the merger and amalgamation of the insurance companies requires the regulatory approvals from the IRDA and the telecom companies require approval from TRAI.

LIST OF FURTHER READINGS

1. Hand book on Mergers and Amalgamation and Takeovers- ICSI Publication
2. Mergers/ Amalgamation, Takeovers, Joint ventures, LLP and Corporate Restructure: Snow White Publication
3. www.rbi.org
4. www.cci.gov.in
5. www.irdai.gov.in
6. www.trai.gov.in

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. In the matter of merger/ takeover of the listed companies, they are required to comply with the provisions of the Companies Act as well as of SEBI guidelines. List out relevant provisions of the Companies Act and the SEBI Guidelines in this respect.
2. Mention the merger and acquisition cases in which approval from the CCI is required. Discuss the relevant provisions of the Competition Act, 2002.
3. Describe in detail the regulatory requirements in case of merger/ takeover of insurance companies.
4. Write down the procedure to be followed in brief for the amalgamation of private sector banks.
5. The Department of Telecommunications and TRAI has issued detailed guidelines relating to the merger/ takeover of Telecom companies. Discuss the same in brief.

Lesson 11

Appearance before NCLT/ NCLAT

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Constitution of NCLT/NCLAT
- Powers and jurisdiction
- Brief about NCLT Rules
- Brief about NCLAT Rules
- Appearance of Authorised Representative
- Scope for PCS under NCLT
- Dress Code
- Etiquettes
- Court craft
- Schedule of Fees
- Recent Judgments

LEARNING OBJECTIVES

The objective of setting up of NCLT is to substitute the CLB, BIFR and company court, so that the powers and functions derived from the relevant provisions of the Companies Act, 2013 are effectively handled by one specialized and centralized institution/ agency.

The setting-up of NCLT and NCLAT is expected to resolve disputes arising under the Companies Act at a faster pace and is expected to reduce the burden on courts.

NCLT has powers relating to provisions of company law pertaining to compromise & arrangement, winding-up, oppression and mismanagement, compounding of offences, etc.

Constitution of NCLT provides various opportunities for CS/CA/CWA professionals to appear and represent before the Tribunal in case of mergers / amalgamation / demerger / reduction of share capital, winding-up proceedings, oppression and mismanagement, conversion of a company from public to private, etc. Practicing Company Secretaries render services in preparing schemes, appearing before NCLT/NCLAT for approval of schemes and post-merger formalities.

In view of the available opportunities, Practicing Company Secretaries should enhance their competencies to provide value added services in assisting Tribunal in dispensation of justice and speedy disposal of various matters under Companies Act and allied laws.

This lesson will help students to learn the basic requirements and skills required to appear and represent before NCLT/NCLAT.

INTRODUCTION

The Ministry of Corporate Affairs on 1st June 2016 notified the constitution of National Company Law Tribunal ('NCLT') and National Company Law Appellate Tribunal ('NCLAT') in exercise of powers conferred under sections 408 and 410 of the Companies Act, 2013.

Based on the recommendations of Eradi Committee, this notification was first introduced by the Companies (Second Amendment) Act, 2002 and the same has been kept in abeyance for almost 14 years for legal tangle. Establishment of NCLT and NCLAT is part of legal reforms and changes carried out by the government. The NCLT started with 11 benches including two benches in the national capital, New Delhi.

A constitution bench of the Supreme Court of India in its judgment in *Madras Bar Association vs. Union of India and Another* (Writ Petition (C) No. 1072 of 2013) has paved the way for the establishment of the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) under the provisions of the Companies Act, 2013.

The NCLT and the NCLAT will act as a comprehensive and overarching quasi-judicial body which will adjudicate all disputes relating to companies in India. The establishment of NCLT and NCLAT as specialized Tribunals with professional approach towards corporate dispute settlement will have the following beneficial effects:

(i) reduce pendency of winding-up cases and shorten the period of winding-up process;

(ii) avoid multiplicity and levels of litigation before High Courts and quasi-judicial Authorities like Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) as all such matters will be heard and decided by NCLT;

(iii) the appellate procedure will be streamlined with an appeal against order of the NCLT lying before NCLAT and with further appeal against the order of NCLAT lying with the Supreme Court only on points of law, thereby reducing the delay in appeals; and

(iv) the burden on High Courts will be reduced.

Regulatory Framework before NCLT/NCLAT

1. The Companies Act, 2013
2. National Company Law Tribunal Rules, 2016.
3. National Company Law Appellate Tribunal Rules, 2016.
4. Companies (Compromise, Arrangements and Amalgamations) Rules, 2016
5. Insolvency and Bankruptcy Code, 2016

National Company Law Tribunal (NCLT)

The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 w.e.f. 1st June 2016 consisting of a President and such number of Judicial and Technical members, as the Central Government may deem necessary, to be appointed by it by notification, to exercise and discharge such powers and functions as are, or may be, conferred on it by or under this Act or any other law for the time being in force.

National Company Law Appellate Tribunal (NCLAT)

National Company Law Appellate Tribunal (NCLAT) was constituted under Section 410 of the Companies Act, 2013 for hearing appeals against the orders of National Company Law Tribunal(s) (NCLT), with effect from 1st June, 2016.

NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by NCLT(s) under Section 61 of the Insolvency and Bankruptcy Code, 2016 (IBC), with effect from 1st December, 2016. NCLAT is also the Appellate Tribunal for hearing appeals against the orders passed by Insolvency and Bankruptcy Board of India under Section 202 and Section 211 of IBC.

NCLAT is also the Appellate Tribunal to hear and dispose of appeals against any direction issued or decision made or order passed by the Competition Commission of India (CCI) as per the amendment brought to Section 410 of the Companies Act, 2013 by Section 172 of the Finance Act, 2017, with effect from 26th May, 2017 or of the National Financial Reporting Authority w.e.f. 7th May, 2018.

Constitution of NCLAT

The Central Government constituted National Company Law Appellate Tribunal consisting of a Chairperson and such number of Judicial and Technical Members, not exceeding eleven, as the Central Government may deem fit, to be appointed by it by notification, for hearing appeals against,—

(a) the order of the Tribunal or of the National Financial Reporting Authority under this Act; and

(b) any direction, decision or order referred to in section 53N of the Competition Act, 2002 in accordance with the provisions of that Act.

Order of Tribunal (Section 420)

(1) The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit.

(2) The Tribunal may, at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties:

Provided that no such amendment shall be made in respect of any order against which an appeal has been preferred under this Act.

(3) The Tribunal shall send a copy of every order passed under this section to all the parties concerned.

Appeal from Orders of Tribunal (Section 421)

(1) Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.

(2) No appeal shall lie to the Appellate Tribunal from an order made by the Tribunal with the consent of parties.

(3) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days from the date aforesaid, but within a further period not exceeding forty-five days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

(4) On the receipt of an appeal under sub-section (1), the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal.

Appeal to Supreme Court (Section 423)

Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Procedure before Tribunal and Appellate Tribunal (Section 424)

(1) The Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice, and, subject to the other provisions of this Act or of the Insolvency and Bankruptcy Code, 2016 and of any rules made thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

(2) The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act or under the Insolvency and Bankruptcy Code, 2016 the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:—

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document from any office;

(e) issuing commissions for the examination of witnesses or documents;

(f) dismissing a representation for default or deciding it *ex parte;*

(g) setting aside any order of dismissal of any representation for default or any order passed by it *ex parte*; and

(h) any other matter which may be prescribed.

(3) Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal in the same manner as if it were a decree made by a court in a suit pending therein, and it shall be lawful for the Tribunal or the Appellate Tribunal to send for execution of its orders to the court within the local limits of whose jurisdiction,—

(a) in the case of an order against a company, the registered office of the company is situate; or

(b) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.

(4) All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, 1860, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Powers and Jurisdiction of NCLT

Tribunal and its Jurisdiction

In the first phase the Ministry of Corporate Affairs have set up eleven Benches, one Principal Bench at New Delhi and one each Regional Benches at New Delhi, Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Jaipur, Kolkata and Mumbai.

S.NO.	Name of Bench	Location	Territorial Jurisdiction of the Bench
1	(a) National Company Law Tribunal, Principal Bench. (b) National Company Law Tribunal, New Delhi Bench.	New Delhi	(1) Union territory of Delhi.
2	National Company Law Tribunal, Ahmedabad Bench.	Ahmedabad	(1) State of Gujarat. (2) Union territory of Dadra and Nagar Haveli. (3) Union territory of Daman and Diu.
3	National Company Law Tribunal, Allahabad Bench.	Allahabad	(1) State of Uttar Pradesh. (2) State of Uttarakhand.
4	National Company Law Tribunal, Bengaluru Bench.	Bengaluru	(1) State of Karnataka.
5	National Company Law Tribunal, Chandigarh Bench.	Chandigarh	(1) State of Himachal Pradesh. (2) State of Jammu and Kashmir. (3) State of Punjab. (4) Union territory of Chandigarh. (5) State of Haryana.
6	National Company Law Tribunal, Chennai Bench.	Chennai	(1) State of Tamil Nadu. (2) Union territory of Puducherry.
7	National Company Law Tribunal, Cuttack Bench.	Cuttack	(1) State of Chattisgarh (2) State of Odisha
8	National Company Law Tribunal, Guwahati Bench.	Guwahati	(1) State of Arunachal Pradesh. (2) State of Assam. (3) State of Manipur. (4) State of Mizoram. (5) State of Meghalaya.

			(6) State of Nagaland. (7) State of Sikkim. (8) State of Tripura.
9	National Company Law Tribunal, Hyderabad Bench.	Hyderabad	(1) State of Telangana.
10	National Company Law Tribunal, Jaipur Bench.	Jaipur	(1) State of Rajasthan.
11	National Company Law Tribunal, Kolkata Bench.	Kolkata	(1) State of Bihar. (2) State of Jharkhand. (3) State of West Bengal. (4) Union territory of Andaman and Nicobar Islands.
12	National Company Law Tribunal, Mumbai Bench.	Mumbai	(1) State of Goa. (2) State of Maharashtra
13	National Company Law Tribunal, Kochi Bench.	Kochi	(1) State of Kerala (2) Union Territory of Lakshadweep
14	National Company Law Tribunal, Indore Bench.	Indore	(1) State of Madhya Pradesh
15	National Company Law Tribunal, Amravati Bench.	Amravati	(1) State of Andhra Pradesh

Powers of National Company Law Tribunal

The National Company Law Tribunal has the powers to entertain and adjudicate upon matters pertaining to the following Sections of the Companies Act, 2013:

1. Section 7(7): Incorporation
2. Sections 14(1) & Sec14(2) : Alteration of articles
3. Sections 55(3): Issue and redemption of preference shares
4. Sections 61(1): Approval for consolidation and division of shares which results in changes in the voting percentage of shareholders of the limited company
5. Sections 62 (4) to (6): Further issue of share capital
6. Sections 71 (9) to (11): Debentures issues
7. Sections 75: Damages for fraud
8. Sections 97, 98, and 99: To call meetings of members
9. Sections 119 (4): Inspection of minutes books
10. Sections 130, 131: Reopening of accounts, revision of financial statements
11. Sections 140 (4) & (5): Removal of auditors
12. Sections 169 (4): Removal of directors
13. Sections 213, 216 (2), 218, 221, 222, 224 (5): Investigation into company's affairs

14. Sections 241, 242 except (1) (b), (2) (c) and (g) : Relief in cases of oppression, etc. and powers of Tribunal
15. Sections 243, 244, 245: Oppression and mismanagement and Class Action suits
16. Section 252: Revival of strike-off companies
17. Sections 399(2): Production of documents
18. Sections 415 to 433: Functioning of NCLT
19. Sec 434 (1) (a) and (b), 434 (2): To hear the matters on transfer of pending proceedings before High Court, BIFR and Company Law Board (The Ministry of Corporate Affairs Notification No. 1936 (E) dated 01.06.2016 under sec 434 issued the Notification for transferring all matters or proceedings or cases pending before the Board of Company Law Administration to NCLT to dispose of all matters as per provisions of NCLT)
20. Sec 441: Compounding
21. Sec 466: Dissolution of CLB

National Company Law Tribunal Rules, 2016

In exercise of the powers conferred by section 469 of the Companies Act, 2013, the Central Government notified the National Company Law Tribunal Rules, 2016 w.e.f. 21st July, 2016, some of the rules are mentioned below:

Sitting hours of the Tribunal

The sitting hours of the Tribunal shall ordinarily be from 10:30 AM to 1: 00 PM and 2:00 P.M. to 4:30 PM subject to any order made by the President.

Working hours of the Tribunal

(1) Except on Saturdays, Sundays and other National Holiday, the office of the Tribunal shall remain open on all working days from 09.30 A.M. to 6.00 P.M.

(2) The Filing Counter of the Registry shall be open on all working days from 10.30 AM to 5.00 P.M.

Inherent Powers

Nothing in the NCLT rules shall be deemed to limit or otherwise affect the inherent powers of the Tribunal to make such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process of the Tribunal.

Calendar

The calendar of days of working of Tribunal in a year shall be as decided by the President of the Tribunal.

Listing of cases

An urgent matter filed before 12 noon shall be listed before the Tribunal on the following working day, if it is complete in all respects as provided in these rules and in exceptional cases, it may be received after 12 noon but before 3.00 P.M. for Listing on the following day, with the specific permission of the Bench.

Power to exempt

The Tribunal may on sufficient cause being shown, exempt the parties from compliance with any requirement

of these rules and may give such directions in matters of practice and procedure, as it may consider just and expedient on the application moved in this behalf to render substantial justice.

Power to extend time

The Tribunal may extend the time appointed by the NCLT rules or fixed by any order, for doing any act or taking any proceeding, upon such terms, if any, as the justice of the case may require, and any enlargement may be ordered, although the application therefore is not made until after the expiration of the time appointed or allowed.

Institution of proceedings, petition, appeals etc.

Procedure (Rule 20)

(1) Every appeal or petition or application or caveat petition or objection or counter presented to the Tribunal shall be in English and in case it is in some other Indian language, it shall be accompanied by a copy translated in English and shall be fairly and legibly type written, lithographed or printed in double spacing on one side of standard petition paper with an inner margin of about four centimeter width on top and with a right margin of 2.5. cm, and left margin of 5 cm, duly paginated, indexed and stitched together in paper book form;

(2) The cause title shall state "Before the National Company Law Tribunal" and shall specify the Bench to which it is presented and also set out the proceedings or order of the authority against which it is preferred.

(3) Appeal or petition or application or counter or objections shall be divided into paragraphs and shall be numbered consecutively and each paragraph shall contain as nearly as may be, a separate fact or allegation or point.

(4) Where *Saka* or other dates are used, corresponding dates of Gregorian Calendar shall also be given.

(5) Full name, parentage, age, description of each party and address and in case a party sues or being sued in a representative character, shall also be set out at the beginning of the appeal or petition or application and need not be repeated in the subsequent proceedings in the same appeal or petition or application.

(6) The names of parties shall be numbered consecutively and a separate line should be allotted to the name and description of each party.

(7) These numbers shall not be changed and in the event of the death of a party during the pendency of the appeal or petition or matter, his Legal heirs or representative, as the case may be, if more than one shall be shown by sub-numbers.

(8) Where fresh parties are brought in, they may be numbered consecutively in the particular category, in which they are brought in.

(9) Every proceeding shall state immediately after the cause title the provision of law under which it is preferred.

Particulars to be set out in the address for service (Rule 21)

The address for service of summons shall be filed with every appeal or petition or application or caveat on behalf of a party and shall as far as possible contain the following items namely:

(a) the name of the road, street, lane and Municipal Division or Ward, Municipal Door and other number of the house;

(b) the name of the town or village;

(c) the post office, postal district and PIN Code, and

(d) any other particulars necessary to locate and identify the addressee such as fax number, mobile number, valid e-mail address, if any.

Initialling alteration in the Petition (Rule 22)

Every interlineations, eraser or correction or deletion in any appeal or petition or application or document shall be initialled by the party or his authorised representative presenting it.

Presentation of petition or appeal (Rule 23)

(1) Every petition, application, caveat, interlocutory application, documents and appeal shall be presented in triplicate by the appellant or applicant or petitioner or respondent, as the case may be, in person or by his duly authorised representative or by an advocate duly appointed in this behalf in the prescribed form with stipulated fee at the filing counter and non-compliance of this may constitute a valid ground to refuse to entertain the same.

(2) Every petition or application or appeal may be accompanied by documents duly certified by the authorised representative or advocate filing the petition or application or appeal duly verified from the originals.

(3) All the documents filed in the Tribunal shall be accompanied by an index in triplicate containing their details and the amount of fee paid thereon.

(4) Sufficient number of copies of the appeal or petition or application shall also be filed for service on the opposite party as prescribed under these rules.

(5) In the pending matters, all applications shall be presented after serving copies thereof in advance on the opposite side or his authorised representative.

(6) The processing fee prescribed by these rules, with required number of envelopes of sufficient size and notice forms shall be filled alongwith memorandum or appeal.

Presentation of joint petition (Rule 23A)

(1) The Bench may permit more than one person to join together and present a single petition if it is satisfied, having regard to the cause of action and the nature of relief prayed for, that they have a common interest in the matter.

(2) Such permission shall be granted where the joining of the petitioners by a single petition is specifically permitted by the Act.

Number of copies to be filed (Rule 24)

The appellant or petitioner or applicant or respondent shall file three authenticated copies of appeal or petition or application or counter or objections, as the case may be, and shall deliver one copy to each of the opposite party.

Endorsement and Verification (Rule 26)

(1) At the foot of every petition or appeal or pleading there shall appear the name and signature of the authorised representative.

(2) Every petition or appeal shall be signed and verified by the party concerned in the manner provided by these rules.

Calling for records (Rule 30)

On the admission of appeal or petition or application the Registrar shall, if so directed by the Tribunal, call for the records relating to the proceedings from any adjudicating authority and retransmit the same.

Production of authorisation for and on behalf of an association (Rule 31)

Where an appeal or application or petition or other proceeding purported to be instituted by or on behalf of an association, the person or persons who sign (s) or verify (ies) the same shall produce along with such application, for verification by the Registry, a true copy of the resolution of the association empowering such person(s) to do so:

Provided that the Registrar may at any time call upon the party to produce such further materials as he deems fit for satisfying himself about due authorization:

Provided further that it shall set out the list of members for whose benefit the proceedings are instituted.

Interlocutory applications (Rule 32)

Every Interlocutory application for stay, direction, condonation of delay, exemption from production of copy of order appealed against or extension of time prayed for in pending matters shall be in prescribed form and the requirements prescribed in that behalf shall be complied with by the applicant, besides filing an affidavit supporting the application.

General Procedure

In a situation not provided for in these rules, the Tribunal may, for reasons to be recorded in writing, determine the procedure in a particular case in accordance with the principles of natural justice.

Rule 34(2)

The general heading in all proceedings before the Tribunal, in all advertisements and notices shall be in Form No. NCLT. 4.

Rule 34(3)

Every petition or application or reference shall be filed in form as provided in Form No. NCLT. 1 with attachments thereto accompanied by Form No NCLT.2 and in case of an interlocutory application, the same shall be filed in Form No. NCLT. 1 accompanied by such attachments thereto along with Form No NCLT. 3.

Rule 34(4)

Every petition or application including interlocutory application shall be verified by an affidavit in Form No. NCLT.6. Notice to be issued by the Tribunal to the opposite party shall be in Form NCLT-5.

Registration of proceedings admitted.-

On admission of appeal, the same shall be numbered and registered in the appropriate register maintained in this behalf and its number shall be entered therein.

Notice to Opposite Party (Rule 37)

(1) The Tribunal shall issue notice to the respondent to show cause against the application or petition on a

date of hearing to be specified in the Notice. Such notice in Form No NCLT.5 shall be accompanied by a copy of the application with supporting documents,

(2) If the respondent does not appear on the date specified in the notice in Form No. NCLT.5, the Tribunal, after according reasonable opportunity to the respondent, shall forthwith proceed ex-parte to dispose of the application.

(3) If the respondent contests to the notice received it may either in person or through an authorised representative, file a reply accompanied with an affidavit and along with copies of such documents on which it relies, with an advance service to the petitioner or applicant, to the Registry before the date of hearing and such reply and copies of documents shall form part of the record.

Service of Notices and processes (Rule 38)

(1) Any notice or process to be issued by the Tribunal may be served by post ["or by courier"] or at the e-mail address as provided in the petition or application or in the reply;

(2) The notice or process if to be served physically may be served in any one of the following modes as may be directed by the Tribunal; -

(a) by hand delivery through a process server or respective authorised representative;

(b) by registered post or speed post with acknowledgment due 1["or by courier"]; or

(c) service by the party himself.

[*Explanation.*- the term “courier” means a person or agency which delivers the document and provides proof of its delivery.]

(3) Where a notice issued by the Tribunal is served by the party himself by hand delivery, he shall file with the Registrar or such other person duly authorised by the Registrar in this behalf, the acknowledgment together with an affidavit of service and in case of service by registered post or by speed post, file with the Registrar, or such other person duly authorised by the Registrar in this behalf, an affidavit of service of notice alongwith the proof of delivery.

(4) the Tribunal may after taking into account the number of respondents and their place of residence or work or service could not be effected in any manner and other circumstances, direct that notice of the petition or application shall be served upon the respondents in any other manner, including any manner of substituted service, as it appears to the Tribunal just and convenient.

Production of Evidence by Affidavit (Rule 39)

(1) The Tribunal may direct the parties to give evidence, if any, by affidavit.

(2) Where the Tribunal considers it necessary in the interest of natural justice, it may order cross-examination of any deponent on the points of conflict either through information and communication technology facilities such as video conferencing or otherwise as may be decided by the Tribunal, on an application moved by any party.

(3) Every affidavit to be filed before the Tribunal shall be in Form No. NCLT.7.

Filing of Reply and other Documents by the Respondents (Rule 41)

(1) Each respondent may file his reply to the petition or the application and copies of the documents, either in person or through an authorised representative, with the registry as specified by the Tribunal.

(2) A copy of the reply or the application and the copies of other documents shall be forthwith served on the applicant by the respondent.

(3) To the reply or documents filed the respondent shall specifically admit, deny or rebut the facts stated by the applicant in his petition or application and state such additional facts as may be found necessary in his reply.

Filing of Rejoinder (Rule 42)

Where the respondent states such additional facts as may be necessary for the just decision of the case, the Bench may allow the petitioner to file a rejoinder to the reply filed by the respondent, with an advance copy to be served upon the respondent.

Power of the Bench to call for further information or evidence (Rule 43)

(1) The Bench may before passing orders on the petition or application, require the parties or any one or more of them, to produce such further documentary or other evidence as it may consider necessary-

(a) for the purpose of satisfying itself as to the truth of the allegations made in the petition or application; or

(b) for ascertaining any information which, in the opinion of the Bench, is necessary for the purpose of enabling it to pass orders in the petition or application.

(2) the Bench may, for the purpose of inquiry or investigation, as the case may be, admit such documentary and other mode of recordings in electronic form including e-mails, books of accounts, book or paper, written communications, statements, contracts, electronic certificates and such other similar mode of transactions as may legally be permitted to take into account of those as admissible as evidence under the relevant laws.

(3) Where any party preferring or contesting a petition of oppression and mismanagement raises the issue of forgery or fabrication of any statutory records, then it shall be at liberty to move an appropriate application for forensic examination and the Bench hearing the matter may, for reasons to be recorded, either allow the application and send the disputed records for opinion of Central Forensic Science Laboratory at the cost of the party alleging fabrication of records, or dismiss such application.

Hearing of petition or applications (Rule 44)

(1) The Tribunal shall notify to the parties the date and place of hearing of the petition or application in such manner as the President or a Member may, by general or special order, direct.

(2) Where at any stage prior to the hearing of the petition or application, the applicant desires to withdraw his petition or application, he shall make an application to that effect to the Tribunal, and the Tribunal on hearing the applicant and if necessary, such other party arrayed as opposite parties in the petition or the application or otherwise, may permit such withdrawal upon imposing such costs as it may deem fit and proper for the Tribunal in the interests of the justice.

Rights of a party to appear before the Tribunal (Rule 45)

(1) Every party may appear before a Tribunal in person or through an authorised representative, duly authorised in writing in this behalf.

(2) The authorised representative shall make an appearance through the filing of *Vakalatnama* or Memorandum of Appearance in Form No. NCLT.12 representing the respective parties to the proceedings.

(3) The Central Government, the Regional Director or the Registrar of Companies or Official Liquidator may authorise an officer or an Advocate to represent in the proceedings before the Tribunal.

(4) The officer authorised by the Central Government or the Regional Director or the Registrar of Companies or the Official Liquidator shall be an officer not below the rank of Junior Time Scale or company prosecutor.

(5) During any proceedings before the Tribunal, it may for the purpose of its knowledge, call upon the Registrar of Companies to submit information on the affairs of the company on the basis of information available in the MCA21 portal, Reasons for such directions shall be recorded in writing.

(6) There shall be no audio or video recording of the Bench proceedings by the parties or their authorised representatives.

Consequence of non-appearance of applicant (Rule 48)

(1) Where on the date fixed for hearing of the petition or application or on any other date to which such hearing may be adjourned, the applicant does not appear when the petition or the application is called for hearing, the Tribunal may, in its discretion, either dismiss the application for default or hear and decide it on merit.

(2) Where the petition or application has been dismissed for default and the applicant files an application within thirty days from the date of dismissal and satisfies the Tribunal that there was sufficient cause for his non-appearance when the petition or the application was called for hearing, the Tribunal shall make an order restoring the same:

Provided that where the case was disposed of on merits the decision shall not be re-opened.

***Ex-parte* Hearing and disposal (Rule 49)**

(1) Where on the date fixed for hearing the petition or application or on any other date to which such hearing may be adjourned, the applicant appears and the respondent does not appear when the petition or the application is called for hearing, the Tribunal may adjourn the hearing or hear and decide the petition or the application *ex-parte*.

(2) Where a petition or an application has been heard *ex-parte* against a respondent or respondents, such respondent or respondents may apply to the Tribunal for an order to set it aside and if such respondent or respondents satisfies the Tribunal that the notice was not duly served, or that he or they were prevented by any sufficient cause from appearing when the petition or the application was called) for hearing, the Tribunal may make an order setting aside the *ex-parte* hearing as against him or them upon such terms as it thinks fit.

Provided that where the *ex-parte* hearing of the petition or application is of such nature that it cannot be set aside as against one respondent only it may be set aside as against all or any of the other respondents also.

Registry to send certified copy (Rule 50)

The Registry shall send a certified copy of final order passed to the parties concerned free of cost and the certified copies may be made available with cost as per Schedule of fees, in all other cases.

Application for execution (Rule 56)

For execution of order passed by the Tribunal, the holder of an order shall make an application to the Tribunal in Form NCLT.8.

Issuance of Orders and Disposal of Cases

Matters relating to the Judgments or Orders of the Tribunal (Rule 60)

(1) Once the final text of the judgment has been approved and adopted, the judgment shall be signed and dated by the President or the concerned Members or Member and the Registrar, and shall contain the names of the Members who have taken part in the decision.

(2) Any Member differing as to the grounds upon which the judgment was based or some of its conclusions, or dissenting from the judgment, may append a separate or dissenting opinion.

(3) In case the members who have heard the case are equally divided in passing the order or judgment, then the President shall constitute a Bench as referred in sub-section (5) of section 419 of the Act.

Procedures in respect of matters earlier dealt by other quasi-judicial bodies, courts and tribunals

Matter earlier dealt by Company Law Board (Rule 64)

(1) Notwithstanding anything contained in any other law for the time being in force, an original civil action or case arising out of the Act, or any other corresponding provision of the Companies Act, 1956 or Reserve Bank of India Act, 1934 is filed or pending before the Company Law Board on the date on which the Tribunal is constituted, and the relevant provisions of the Act dealing with the Tribunal have been given effect, or the Company Law Board has been dissolved in pursuance of the provisions of the Act, then all the cases on such date pending with the Company Law Board or such Benches shall stand transferred to the respective Benches of the Tribunal exercising corresponding territorial jurisdiction as if the case had been originally riled in the Tribunal or its Bench to which it is transferred on the date upon which it was actually filed in the Company Law Board or its Bench from which it was transferred:

Provided that the Tribunal shall consider any action taken under the regulations of the Company Law Board as deemed to have been taken or done under the corresponding provisions of these rules and the provisions of the Act, and shall thereupon continue the proceedings, except in a case where the order is reserved by the Company Law Board or its Bench and in such a case, the Tribunal shall reopen the matter and rehear the case as if the hearing had not taken place:

Provided further that the Tribunal is at liberty to call upon the parties in a case to produce further evidence or such other information or document or paper or adduce or record further depositions or evidence as may deem fit and proper in the interest of justice.

(2) It shall be lawful for the President or such Member to whom the powers are so delegated, to provide that matters falling under all other sections of the Act, shall be dealt with by such Benches consisting of one or more members as may be constituted in exercising of such power as enshrined in the Act:

Provided that matters pending before the Principal Bench of the Company Law Board as on the date of constitution of Tribunal shall continue and be disposed of by a bench consisting of not less than two Members of the Tribunal having territorial jurisdiction.

(3) It shall be lawful for the Tribunal to dispose of any case transferred to it wherever the Tribunal decides that further continuance of such application or petition transferred before the Tribunal shall be an unnecessary proceeding on account of changes which have taken place in the Act either upon an application filed by either of the parties to the proceedings or *suo motu*.

(4) A fresh petition or an application may also be filed in Form NCLT 1 corresponding to those provisions of

the Act, if both the parties thereto so consent with the approval of the Tribunal while withdrawing the proceedings as already continued before the Company Law Board and serve a copy of the petition on the parties thereto including the Central Government, Regional Director, Registrar of Companies, Official Liquidator or Serious Fraud Investigation Office, as the case may be, as provided in the Act, in the manner as provided under Part

(5) Upon an application to the Tribunal if the permission is granted to file a petition or an application in physical form, then the same shall be filed accompanied with the documents or papers to be attached thereto as required to prove the case subject to the provisions of the Act, and rules hereto.

(6) The same procedure shall also apply to other parties to application or petition for filing reply or counter thereto.

(7) Notwithstanding the above and subject to section 434 of the Act, the Tribunal may prescribe the rules relating to numbering of cases and other procedures to be followed in the case of transfer of such matters, proceedings or cases.

Petition or Application under sub-section (2) of section 45QA of the Reserve Bank of India Act, 1934 (Rule 65)

Provisions of the NCLT rules 2016 shall apply, *mutatis mutandis*, to the application or petition made under sub-section (2) of section 45QA of the Reserve Bank of India Act, 1934 (2 of 1934) or under such other analogous provision of the other Act(s).

CAUSE LIST

Preparation and publication of daily cause list (Rule 89)

(1) The Registry shall prepare and publish on the notice board of the Registry as well as in the website of the Tribunal before the closing of working hours on each working day the cause list for the next working day and subject to the directions of the President, listing of cases in the daily cause list shall be in the following order of priority, unless otherwise ordered by the concerned Bench; namely;-

(a) Cases for pronouncement of orders;

(b) Cases for clarification;

(c) Cases for admission;

(d) Cases for orders or directions;

(e) part-heard cases, latest part-heard having precedence; and

(f) cases posted as per numerical order or as directed by the Bench;

(2) The title of the daily cause list shall consist of the number of the appeal or petition, the day, date and time of the court sitting, court hall number and the coram indicating the names of the President, Judicial Member and Technical Member constituting the Bench.

(3) Against the number of each case listed in the daily cause list, the following shall be shown, namely;-

(a) Names of the legal practitioners appearing for both sides and setting out in brackets the rank of the parties whom they represent;

(b) Names of the parties, if unrepresented, with their ranks in brackets.

(4) The objections and special directions, if any, of the Registry shall be briefly indicated in the daily cause list in remarks column, whenever compliance is required.

Carry forward of cause list and adjournment of cases on account of non-sitting of a Bench (Rule 90)

(1) If by reason of declaration of holiday or for any other unforeseen reason, the Bench does not function for the day, the daily cause list for that day shall, unless otherwise directed, be treated as the daily cause list for the next working day in addition to the cases already posted for that day.

(2) When the sitting of a particular Bench is cancelled for the reason of inability of a Member of the Bench, the Registrar shall, unless otherwise directed, adjourn the cases posted before that Bench to a convenient date and the adjournment or posting or directions shall be notified on the notice board of the Registry.

Service of Process / Appearance of Respondents and Objections

Issue of notice (Rule 105)

(1) Where notice of an appeal or petition for caveat or interlocutory application is issued by the Tribunal, copies of the same, the affidavit in support thereof and if so ordered by the Tribunal, the copy of other documents filed therewith, if any, shall be served along with the notice on the other side.

(2) The aforesaid copies shall show the date of presentation of the appeal or petition for caveat or interlocutory application and the name of the authorised representative, if any, of such party with his full address for service and the interim order, if any, made thereon.

(3) The Tribunal may order for issuing notice in appropriate cases and also permit the party concerned for service of the said notice on the other side by *Dasti* and in such case, deliver the notice to such party and it is for such party to file affidavit of service with proof.

(4) Acknowledgement shall be filed by the party with the Registry before the date fixed for return of notice.

Summons (Rule 106)

Whenever summons or notice is ordered by private service, the appellant or applicant or petitioner, as the case may be, unless already served on the other side in advance, shall arrange to serve the copy of all appeals or petition or application by registered post or courier service and file affidavit of service with its proof of acknowledgement before the date fixed for hearing.

Steps for issue of fresh notice (Rule 107)

(1) If any notice issued is returned unserved, that fact and the reason thereof shall be notified immediately on the notice board of the Registry.

(2) The applicant or petitioner or his authorised representative shall within seven days from the date of the notification, take steps to serve the notice afresh.

Consequence of failure to take steps for issue of fresh notice (Rule 108)

Where, after a summon has been issued to the other side, and returned unserved, and the applicant or petitioner or appellant, as the case may be, fails to take necessary steps within a period as ordered by the

Tribunal from the date of return of the notice on the respondent, the Registrar shall post the case before the Bench for further directions or for dismissal for non-prosecution.

Entries regarding service of notice or process (Rule 109)

The judicial branch of the Registry shall record in the column in the order sheet Notes of the Registry, the details regarding completion of service of notice on the respondents, such as date of issue of notice, date of service, date of return of notice, if unserved, steps taken for issuing fresh notice and date of completion of services, etc.

Default of appearance of respondent and consequences (Rule 110)

Where the respondent, despite effective service of summons or notice on him does not appear before the date fixed for hearing, the Tribunal may proceed to hear the appeal or application or petition ex-parte and pass final order on merits:

Provided that it is open to the Tribunal to seek the assistance of any counsel as it deems fit in case the matter involves intricate and substantial questions of law having wide ramifications.

Filing of objections by respondent, form and consequences (Rule 111)

(1) The respondent, if so directed, shall file objections or counter within the time allowed by the Tribunal.

(2) The objections or counter shall be verified as an appeal or petition and wherever new facts are sought to be introduced with the leave of the Tribunal for the first time, the same shall be affirmed by a supporting affidavit.

(3) The respondent, if permitted to file objections or counter in any proceeding shall also file three copies thereof after serving copies of the same on the appellant or petitioner or their Counsel on record or authorised representative, as the case may be.

Fee on Petition or Appeal, Process Fee and Award of Costs

Fees (Rule 112)

In respect of the Application or petition for several matters mentioned in the table below, there shall be paid fees as prescribed in the Schedule of Fees appended to the NCLT rules;

Provided, no fee shall be payable or shall be liable to be collected on a petition or application filed or reference made by the Registrar of Companies, Regional Director or by any officer on behalf of the Central Government.

(2) In respect of every interlocutory application, there shall be paid fees as prescribed in Schedule of Fees of these rules:

Provided that no fee shall be payable or shall be liable to be collected on an application filed by the Registrar of Companies, Regional Director or by an officer on behalf of the Central Government..

(3) In respect of a petition or appeal or application filed or references made before the Principal Bench or the Bench of the Tribunal, fees referred to in this Part shall be paid by means of an Indian Postal Order or by a bank draft drawn in favour of the Pay and Accounts Officer, Ministry of Corporate Affairs, New Delhi/Kolkata/Chennai/Mumbai, as the case may be or as decided by the President.

Appearance of authorised representative

Appearance of authorised representative (Rule 119)

Subject to as hereinafter provided, no legal practitioner or authorised representative shall be entitled to appear and act, in any proceeding before the Tribunal unless he files into Tribunal vakalatnama or Memorandum of Appearance as the case may, duly executed by or on behalf of the party for whom he appears.

Consent for engaging another legal practitioner (Rule 120)

A legal practitioner proposing to file a *Vakalatnama* or Memorandum of Appearance as the case may be, in any pending case or proceeding before the Tribunal in which there is already a legal practitioner or authorised representative on record, shall do so only with the written consent of the legal practitioner or the authorised representative on record or when such consent is refused, with the permission of the Tribunal after revocation of *Vakalatnama* or Memorandum of Appearance as the case may be, on an application filed in this behalf, which shall receive consideration only after service of such application on the counsel already on record.

Restrictions on appearance (Rule 121)

A legal practitioner or the authorised representative as the case may be, who has tendered advice in connection with the institution of any case or other proceeding before the Tribunal or has drawn pleadings in connection with any such matter or has during the progress of any such matter acted for a party, shall not, appear in such case or proceeding or other matter arising therefrom or in any matter connected therewith for any person whose interest is opposed to that of his former client, except with the prior permission of the Tribunal.

Restriction on party's right to be heard (Rule 122)

The party who has engaged a legal practitioner or authorised representative to appear for him before the Tribunal may be restricted by the Tribunal in making presentation before it.

Empanelment of special authorised representatives by the Tribunal (Rule 123)

(1) The Tribunal may draw up a panel of authorised representatives or valuers or such other experts as may be required by the Tribunal to assist in proceedings before the Tribunal.

(2) The President may call upon any of the persons from panel under sub-rule (1) for assistance in the proceedings before the Bench, if so required.

(3) The remuneration payable and other allowances and compensation admissible to such persons shall be specified in consultation with the Tribunal.

Professional dress for the authorised representatives (Rule 124)

While appearing before the Tribunal, the authorised representatives shall wear the same professional dress as prescribed in their Code of Conduct.

Affidavits

Title of Affidavits (Rule 125)

Every affidavit shall be titled as 'Before the National Company Law Tribunal, followed by the cause title of the

appeal or application or other proceeding in which the affidavit is sought to be used.

Form and contents of the Affidavit (Rule 126)

The affidavit shall conform to the requirements of order XIX, rule 3 of Civil Procedure Code, 1908 (5 of 1908).

Persons Authorised to Attest (Rule 127)

Affidavits shall be sworn or affirmed before an advocate or notary, who shall affix his official seal.

Affidavits of illiterate, visually challenged persons (Rule 128)

Where an affidavit is sworn or affirmed by any person who appears to be illiterate, visually challenged or unacquainted with the language in which the affidavit is written, the attester shall certify that the affidavit was read, explained or translated by him or in his presence to the deponent and that he seemed to understand it, and made his signature or mark in the presence of the attester in Form NCLT-14.

Identification of Deponent (Rule 129)

If the deponent is not known to the attester, his identity shall be testified by a person known to him and the person identifying shall affix his signature in token thereof.

Annexures to the Affidavit (Rule 130)

(1) Document accompanying an affidavit shall be referred to therein as Annexure number and the attester shall make the endorsement thereon that this is the document marked putting the Annexure number in the affidavit.

(2) The attester shall sign therein and shall mention the name and his designation.

Disposal of cases and pronouncement of Orders

Disposal of Cases (Rule 146)

On receipt of an application, petition, appeal etc, the Tribunal, after giving the parties a reasonable opportunity of being heard, pass such orders thereon as it thinks fit:

Provided that the Tribunal, after considering an appeal, may summarily dismiss the same, for reasons to be recorded, if the Tribunal is of opinion that there are no sufficient grounds for proceedings therewith.

Operative portion of the order (Rule 147)

All orders or directions of the Bench shall be stated in clear and precise terms in the last paragraph of the order.

Corrections (Rule 148)

Every Member of the Bench who has prepared the order shall initial all corrections and affix his initials at the bottom of each page.

Power to impose Costs (Rule 149)

The Tribunal may, in its discretion, pass such order in respect of imposing costs on the defaulting party as it may deem fit.

Pronouncement of Order (Rule 150)

(1) The Tribunal, after hearing the applicant and respondent, shall make and pronounce an order either at once or, as soon as thereafter as may be practicable but not later than thirty days from the final hearing.

(2) Every order of the Tribunal shall be in writing and shall be signed and dated by the President or Member or Members constituting the Bench which heard the case and pronounced the order.

(3) A certified copy of every order passed by the Tribunal shall be given to the parties.

(4) The Tribunal, may transmit order made by it to any court for enforcement, on application made by either of the parties to the order or *suo motu*.

(5) Every order or judgment or notice shall bear the seal of the Tribunal.

Pronouncement of order by any one member of the Bench (Rule 151)

(1) Any Member of the Bench may pronounce the order for and on behalf of the Bench.

(2) When an order is pronounced under this rule, the Court Master shall make a note in the order sheet, that the order of the Bench consisting of President and Members was pronounced in open court on behalf of the Bench.

Rectification of Order (Rule 154)

(1) Any clerical or arithmetical mistakes in any order of the Tribunal or error therein arising from any accidental slip or omission may at any time, be corrected by the Tribunal on its own motion or on application of any party by way of rectification,

(2) An application under may be made in Form No NCLT. 9 within two years from the date of the final order for rectification of the final order not being an interlocutory order.

General power to amend (Rule 155)

The Tribunal may, within a period of thirty days from the date of completion of pleadings, and on such terms as to costs or otherwise, as it may think fit, amend any defect or error in any proceeding before it and all necessary amendments shall be made for the purpose of determining the real question or issue raised by or depending on such proceeding.

National Company Law Appellate Tribunal Rules, 2016

In exercise of the powers conferred by section 469 of the Companies Act, 2013, the Central Government notified the National Company Law Appellate Tribunal Rules, 2016 w.e.f. 21st July, 2016, some of the rules are mentioned below:

Sitting of Appellate Tribunal

The Appellate Tribunal shall hold its sitting at its headquarters in New Delhi.

Sitting hours of the Appellate Tribunal

The sitting hours of the Appellate Tribunal shall ordinarily be from 09.30 AM. to 01.00 P.M. and from 2.15 P.M. to 5.00 P.M. subject to any order made by the Chairperson and this shall not prevent the Appellate Tribunal to extend its sitting as it deems fit. 10. Working hours of office. (1) The office of the Appellate Tribunal shall remain open on all working days from 09:30 A.M. to 6.00 P.M.

(2) The filing counter of the Registry shall be open on all working days from 10.30 AM to 5.00 P.M.

Calendar

The Calendar of days of working of Appellate Tribunal in a year shall be as decided by the Chairperson and Members of the Appellate Tribunal.

Listing of cases

All urgent matters filed before 12 noon shall be listed before the Appellate Tribunal on the following working day, if it is complete in all respects as provided in these rules and in exceptional cases, it may be received after 12 noon but before 3.00 P.M. for listing on the following day, with the specific permission of the Appellate Tribunal or Chairperson.

Power to exempt

The Appellate Tribunal may on sufficient cause being shown, exempt the parties from compliance with any requirement of these rules and may give such directions in matters of practice and procedure, as it may consider just and expedient on the application moved in this behalf to render substantial justice.

Power to extend time

The Appellate Tribunal may extend the time appointed by these rules or fixed by any order, for doing any act or taking any proceeding, upon such terms, if any, as the justice of the case may require, and any enlargement may be ordered, although the application therefore is not made until after the expiration of the time appointed or allowed.

Powers of the Registrar

Powers and functions of the Registrar (Rule 16)

The Registrar shall have the following powers and functions, namely:-

(a) registration of appeals, petitions and applications;

(b) receive applications for amendment of appeal or the petition or application or subsequent proceedings.

(c) receive applications for fresh summons or notices and regarding services thereof;

(d) receive applications for fresh summons or notice and for short date summons and notices;

(e) receive applications for substituted service of summons or notices;

(f) receive applications for seeking orders concerning the admission and inspection of documents;

(g) transmission of a direction or order to the civil court as directed by Appellate Tribunal with the prescribed certificate for execution,etc; and

(h) such other incidental or matters as the Chairperson may direct from time to time.

Institution of appeals – Procedure

Procedure for proceedings (Rule 19)

(1) Every appeal to the Appellate Tribunal shall be in English and in case it is in some other Indian language, it shall be accompanied by a copy translated in English and shall be fairly and legibly type-written or printed in double spacing on one side of standard paper with an inner margin of about four centimeters width on top

and with a right margin of 2.5 cm, and left margin of 5 cm, duly paginated, indexed and stitched together in paper book form.

(2) The cause title shall state “In the National Company Law Appellate Tribunal” and also set out the proceedings or order of the authority against which it is preferred.

(3) Appeal shall be divided into paragraphs and shall be numbered consecutively and each paragraph shall contain as nearly as may be, a separate fact or allegation or point.

(4) Where *Saka* or other dates are used, corresponding dates of Gregorian calendar shall also be given.

(5) Full name, parentage, description of each party and address and in case a party sue or being sued in a representative character, shall also be set out at the beginning of the appeal and need not be repeated in the subsequent proceedings in the same appeal.

(6) The names of parties shall be numbered consecutively and a separate line should be allotted to the name and description of each party and these numbers shall not be changed and in the event of the death of a party during the pendency of the appeal, his legal heirs or representative, as the case may be, if more than one shall be shown by sub numbers.

(7) Where fresh parties are brought in, they may be numbered consecutively in the particular category, in which they are brought in.

(8) Every proceeding shall state immediately after the cause title and the provision of law under which it is preferred.

Particulars to be set out in the address for service (Rule 20)

The address for service of summons shall be filed with every appeal on behalf of a party and shall as far as possible contain the following items namely:

(a) the name of the road, street, lane and Municipal Division or Ward, Municipal Door and other number of the house;

(b) the name of the town or village;

(c) the post office, postal district and PIN Code; and

(d) any other particular necessary to identify the addressee such as fax number, mobile number and e-mail address, if any.

Initialling alteration (Rule 21)

Every interlineation, eraser or correction or deletion in any appeal shall be initialled by the party or his authorised representative.

Presentation of appeal (Rule 22)

(1) Every appeal shall be presented in Form NCLAT-1 in triplicate by the appellant or petitioner or applicant or respondent, as the case may be, in person or by his duly authorised representative duly appointed in this behalf in the prescribed form with stipulated fee at the filing counter and non-compliance of this may constitute a valid ground to refuse to entertain the same.

(2) Every appeal shall be accompanied by a certified copy of the impugned order.

(3) All documents filed in the Appellate Tribunal shall be accompanied by an index in triplicate containing their details and the amount of fee paid thereon.

(4) Sufficient number of copies of the appeal or petition or application shall also be filed for service on the opposite party as prescribed.

(5) In the pending matters, all other applications shall be presented after serving copies thereof in advance on the opposite side or his advocate or authorised representative.

(6) The processing fee prescribed by the rules, with required number of envelopes of sufficient size and notice forms as prescribed shall be filled along with memorandum of appeal.

Number of copies to be filed (Rule 23)

The appellant or petitioner or applicant or respondent shall file three authenticated copies of appeal or counter or objections, as the case may be, and shall deliver one copy to each of the opposite party.

Endorsement and verification (Rule 24)

At the foot of every appeal or pleading there shall appear the name and signature of the authorised representative and every appeal or pleadings shall be signed and verified by the party concerned in the manner provided by these rules.

Translation of document (Rule 25)

(1) A document other than English language intended to be used in any proceeding before the Appellate Tribunal shall be received by the Registry accompanied by a copy in English, which is agreed to by both the parties or certified to be a true translated copy by the authorised representative engaged on behalf of parties in the case.

(2) The Registrar may order translation, certification and authentication by a person approved by him for the purpose on payment of such fee to the person, as specified by the Chairperson.

(3) Appeal or other proceeding shall not be set down for hearing until and unless all parties confirm that all the documents filed on which they intend to rely are in English or have been translated into English and required number of copies are filed with the Appellate Tribunal.

Endorsement and scrutiny of petition or appeal or document (Rule 26)

(1) The person in charge of the filing-counter shall immediately on receipt of appeal or document affix the date and stamp of the Appellate Tribunal thereon and also on the additional copies of the index and return the acknowledgement to the party and he shall also affix his initials on the stamp affixed on the first page of the copies and enter the particulars of all such documents in the register after daily filing and assign a diary number which shall be entered below the date stamp and thereafter cause it to be sent for scrutiny.

(2) If, on scrutiny, the appeal or document is found to be defective, such document shall, after notice to the party, be returned for compliance and if there is a failure to comply within seven days from the date of return, the same shall be placed before the Registrar who may pass appropriate orders.

(3) The Registrar may for sufficient cause return the said document for rectification or amendment to the party filing the same, and for this purpose may allow to the party concerned such reasonable time as he may consider necessary or extend the time for compliance.

(4) Where the party fails to take any step for the removal of the defect within the time fixed for the same, the Registrar may, for reasons to be recorded in writing, decline to register the appeal or pleading or document.

Registration of proceedings admitted (Rule 27)

On admission of appeal, the same shall be numbered and registered in the appropriate register maintained in this behalf and its number shall be entered therein.

***Ex-parte* amendments (Rule 28)**

In every appeal or application, arithmetical, grammatical, clerical and such other errors may be rectified on the orders of the Registrar without notice to Parties.

Calling for records (Rule 29)

On the admission of appeal, the Registrar shall, if so directed by the Appellate Tribunal, call for the records relating to the proceedings from the respective Bench of Tribunal or adjudicating authority and retransmit the same at the conclusion of the proceedings or at any time.

Production of authorization for and on behalf of an association (Rule 30)

Where an appeal purported to be instituted by or on behalf of an association, the person who signs or verifies the same shall produce along with such appeal, for verification by the Registry, a true copy of the resolution of the association empowering such person to do so:

Provided that the Registrar may at any time call upon the party to produce such further materials as he deems fit for satisfying himself about due authorization:

Provided further that it shall set out the list of members for whose benefit the proceedings are instituted.

Interlocutory applications (Rule 31)

Every interlocutory application for stay, direction, condonation of delay, exemption from production of copy of order appealed against or extension of time prayed for in pending matters shall be in Form NCLAT-2 and the requirements prescribed in that behalf shall be complied with by the applicant, besides filing a affidavit supporting the application.

Procedure on production of defaced, torn or damaged documents (Rule 32)

When a document produced along with any pleading appears to be defaced, torn, or in any way damaged or otherwise its condition or appearance requires special notice, a mention regarding its condition and appearance shall be made by the party producing the same in the Index of such a pleading and the same shall be verified and initialed by the officer authorized to receive the same.

Appearance of authorised representative

Appearance of authorised representative (Rule 63)

(1) Subject to provisions of section 432 of the Act, a party to any proceedings or appeal before the Appellate Tribunal may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any other person to present his case before the Appellate Tribunal.

(2) The Central Government, the Regional Director or the Registrar of Companies or Official Liquidator may

authorise an officer or an Advocate to represent in the proceedings before the Appellate Tribunal.

(3) The officer authorised by the Central Government or the Regional Director or the Registrar of Companies or the Official Liquidator shall be an officer not below the rank of Junior Time Scale or company prosecutor.

As per Section 432, a party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, as the case may be, may either appear in person or authorize one or more:

i. Chartered accountants; or
ii. Company Secretaries; or,
iii. Cost accountants; or,
iv. Legal practitioners; or,
v. Any other person like officer of the company.

Proof of engagement (Rule 64)

(1) Where an advocate is engaged to appear for and on behalf of the parties, he shall submit Vakalatnama.
(2) The professionals like chartered accountants or company secretaries or cost accountants shall submit Memorandum of Appearance.

Restriction on party's right to be heard (Rule 65)

The party who has engaged an authorised representative to appear for him before the Appellate Tribunal shall not be entitled to be heard in person unless permitted by the Appellate Tribunal.

Professional dress for the authorised representative (Rule 66)

While appearing before the Appellate Tribunal, the authorised representative shall wear the same professional dress as prescribed in their Code of Conduct.

Affidavits

Title of affidavits (Rule 67)

Every affidavit shall be titled as "Before the National Company Law Appellate Tribunal." followed by the cause title of the application or other proceeding in which the affidavit is sought to be used.

Form and contents of the affidavit (Rule 68)

The affidavit as per Form NCLAT-4 shall conform to the requirements of order XIX, rule 3 of Civil Procedure Code, 1908 (5 of 1908).

Persons authorised to attest (Rule 69)

Affidavits shall be sworn or affirmed before an Advocate or Notary, who shall affix his official seal.

Affidavits of illiterate, visually challenged persons (Rule 70)

Where an affidavit is sworn or affirmed by any person who appears to be illiterate, visually challenged or unacquainted with the language in which the affidavit is written shall be in Form NCLAT-5, the attestor shall certify that the affidavit was read, explained or translated by him or in his presence to the deponent and that he seemed to understand it, and made his signature or mark in the presence of the attestor.

Identification of deponent (Rule 71)

If the deponent is not known to the attestor, his identity shall be testified by a person known to him and the person identifying shall affix his signature in token thereof.

Annexures to the affidavit (Rule 72)

(1) Document accompanying an affidavit shall be referred to therein as Annexure number and the attestor shall make the endorsement thereon that this is the document marked putting the Annexure number in the affidavit.
(2) The attestor shall sign therein and shall mention the name and his designation.

Scope of services for Practicing Company Secretaries under NCLT

With establishment of NCLT and NCLAT opportunities for Company Secretaries has increased. Under section 432 of the Companies Act, 2013, Company Secretaries have been authorized to appear before the Tribunal/ Appellate Tribunal. Before setting-up of the Tribunal, the matters dealt by the Tribunal were dealt by the High Court and so the appearances were taken by only advocates.

Areas of increased scope:

1. Merger/Amalgamation/Compromise
2. Revival of Companies
3. Winding up
4. Reduction of Capital
5. Oppression and mismanagement
6. Insolvency and Bankruptcy cases

Appearance before National Company Law Tribunal: A Practicing Company Secretary has been authorized to appear before National Company Law Tribunal/Appellate Tribunal.

Compromise and Arrangement: With the establishment of NCLT, a whole new area of practice has opened up for Company Secretary in Practice with respect to advising and assisting corporate sector on merger, amalgamation, demerger, reverse merger, compromise and other arrangements right from the conceptual to implementation level. Company Secretaries in Practice will be able to render services in preparing schemes, appearing before NCLT/NCLAT for approval of schemes and post-merger formalities

Winding-up: The National Company Law Tribunal has also been empowered to pass an order for winding-up of a company. Therefore Practicing Company Secretaries may represent the winding-up case before the Tribunal. Unlike the earlier position allowing only government officers to act as Official Liquidators, now professionals like Practicing Company Secretaries have been permitted to act as Liquidator in case of winding-up by the Tribunal.

Insolvency Process: Insolvency practice has opened up a new field of activity for professionals while improving the quality of intervention at all levels during rehabilitation/winding up/liquidation proceedings. Law has recognized the Insolvency Practitioners as Administrators, Liquidators, Turnaround Specialists, Valuers, etc. Greater responsibility and authority has been given to Insolvency Practitioners under the supervision of the Tribunal to maximize resource use and application of skills.

Reduction of capital: As per Section 66 of the Companies Act, subject to confirmation by the Tribunal, a

company limited by shares or a company limited by guarantee and having a share capital may if so authorized by its articles by special resolution reduce its share capital. The Practicing Company Secretaries will be able to represent cases of reduction of capital before the Tribunal.

Oppression and mismanagement: Section 241 and 244 of the Companies Act, 2013 deals with the cases of Oppression and Mismanagement. Section 241 deals with making an application to Tribunal for relief in cases of Oppression, etc. and section 244 describes the Right to apply under section 241.

PCS as Member of NCLT: A Practicing Company Secretary can be appointed as a Technical Member of NCLT, provided he has 15 years working experience as secretary in whole-time practice.

Dress Code

The ICSI has approved the following Guidelines for Professional Dress Code for Company Secretaries to appear before judicial / quasi-judicial bodies and tribunals like NCLT, NCLAT, SAT, etc.

1. For Male Members:
    a. Navy Blue Suit (Coat & Trouser), with CS logo, Insignia
       or
       Navy Blue Blazer over a sober colored Trouser
    b. Neck Tie (ICSI)
    c. White full sleeve Shirt
    d. Formal Black Leather Shoes (Shined)

2. For Female Members:
    a. Navy Blue corporate suit (Coat & Trouser), could be with a neck tie/ Insignia
       or
    b. Saree / any other dress of sober colour with Navy Blue Blazer with CS logo
    c. A sober footwear like Shoes/ Bellies/ Wedges, etc. (shined)

3. Members in Employment – As prescribed in 1 or 2 above

Members are advised to strictly adhere to the Dress Code prescribed by the ICSI.

Etiquettes

Etiquette, couture and attire are subtle indicators of erudition and professionalism, especially for Practicing Company Secretaries. Our appearance strongly influences other people's perception of our authority, trustworthiness, intelligence. Overall appearance and demeanor act as the determining factors for sharing information, developing trust and agreeable to prescribed fee structure.

Practicing Company Secretaries duty towards the Tribunal

1. Act in a dignified manner - During the presentation of the case and also while acting before a Tribunal, an Practicing Company Secretary should act in a dignified manner. He should at all times conduct himself with self-respect.

2. Respect the Tribunal - Practicing Company Secretary should always show respect towards the Tribunal/ court.

3. Not communicate in private - Practicing Company Secretary should not communicate in private to a

Judge/Judicial or Technical Member with regard to any matter pending before the judge or any other Judge. A Professional Practicing Company Secretary should not influence the decision of a Tribunal/court in any matter using illegal or improper means such as coercion, bribe, etc.

4. Refuse to act in an illegal manner towards the opposition - Practicing Company Secretary should refuse to act in an illegal or improper manner towards the opposing counsel or the opposing parties. He shall also use his best efforts to restrain and prevent his client from acting in any illegal, improper manner or use unfair practices in any matter towards the judiciary, opposing counsel or the opposing parties.

5. Refuse to represent clients who insist on unfair means - Practicing Company Secretary shall refuse to represent any client who insists on using unfair or improper means. A Practicing Company Secretary shall excise his own judgment in such matters. He shall not blindly follow the instructions of the client. He shall be dignified in use of his language in correspondence and during arguments in court. He shall not use un-parliamentary language during arguments in the court.

6. Appear in proper dress code - Practicing Company Secretary should appear in Tribunal at all times only in the dress prescribed by the Institute of Company Secretaries of India.

7. Refuse to appear in front of relations–The Practicing Company Secretary should not enter appearance, act, plead or practice in any way before a judicial authority if the sole or any member of the bench is related to the Practicing Company Secretary as father, grandfather, son, grandson, uncle, brother, nephew, first cousin, husband, wife, mother, daughter, sister, aunt, niece, father-in-law, mother-in-law, son-in-law, brother-in-law daughter-in law or sister-in-law, etc.

8. Not appear in matters of pecuniary interest - The Practicing Company Secretary should not act or plead in any matter in which he has financial interests. For instance, he should not act in a bankruptcy petition when he is also a creditor of the bankrupt.

9. Not stand as surety for client - The Practicing Company Secretary should not stand as a surety, or certify the soundness of a surety that his client requires for the purpose of any legal proceedings.

Court craft and pleading skills

It is necessary for Company Secretaries to learn art of advocacy or court craft for effective delivery of results to their clients when they act as an authorized representative before any Tribunal or quasi-judicial body.

For winning a case, art of advocacy is important which in essence means to convince the judge and others that my position in the case is the proper interpretation. Advocacy/court craft is learned when we enter the practicising side of the profession. The aim of advocacy is to make judge prefer your version of the truth.

Apart from the legal side of the profession, advocacy is often useful and sometimes vital, in client interviewing, in negotiation and in meetings, client seminars and public lectures. It is a valuable and lifelong skill worth mastering.

Technical and legal knowledge about the area in which Company Secretaries are acting is essential. Better their knowledge, the better their advocacy skills and the greater their impact. Good advocacy or negotiating skills will not compensate for lack of appropriate knowledge.

Art of Advocacy

- Must File Memorandum of Appearance with Tribunal along with Pleadings
- Dress Code as Prescribed by Institute/ NCLT Rules

- Service of documents to opposite party, if any
- SWITCH OFF Mobile Phone or keep it in silent mode
- Standing position of councils- Petitioner at Left Hand Side of Judge & Defendant at Right Hand Side of Judge
- Case Summery/Fact Sheet of the Case
- Preparation and Rehearsal
- Even when appearing for mentioning or adjournments, to know full facts
- Members to note that even those appearing for mentioning or adjournment shall be holding COP and in dress code
- Use notes – as prompts not to read
- Find Merits – Focus on it
- Body Language – Positive and Respectful
- Make clear brief on law and evidence. Keep focus on main issues
- Avoid frequent interruptions or objections. Wait for your chance
- Knowledge of development of law and background will be helpful
- Do not argue with the Judge, explain with reason.
- Co-operate with opposite counsel or representative….. "The Learned Friend"
- Look previous similar cases and their determination – For Precedents

Basic preparatory Points

There are certain basic preparatory points which a Company Secretary should bear in mind when contacted by a client:

– Take minute facts from the client;

– Lend your complete ears to all that client has to say;

– Put questions to the client while taking facts so that correct/relevant facts can be known – Convey to the client about exact legal position in context of relief sought by the client;

– Give correct picture of judicial view to the problem posed by the client.

Drafting of Pleadings

Pleadings could be both written and oral. Mastering both the kinds of pleadings is must for effective delivery of results to the clients. Some of the important factors which may be borne in mind while making written pleadings are as under:

– Quote relevant provisions in the petition and excerpts of observations made by the Tribunal relevant to the point;

– Draft prayers for interim relief in such a manner which though appears to be innocuous but satisfy your requirements;

– Do not suppress facts;

- Highlight material facts, legal provisions and Court decisions, if any;
- State important points at the outset together with reference to relevant provisions/judgements.

If you are opponent

- File your reply to the petition at the earliest opportunity;
- Take all possible preliminary contentions together with reference to relevant law point and judgements;
- Submit your reply to each paragraph of the petition.

If you are for the petitioner

- File your rejoinder upon receiving the reply at the earliest opportunity;
- Meet clearly with the specific points raised by the opponent in the reply affidavit.

Oral Pleadings

Effective oral pleadings are relevant both at the stage of preparation of the case before actual presentation and also at the stage of actual presenting a case before NCLT or other tribunals. Following aspects could be relevant at both these stages:

- Preparation before presentation of the case;
- Carefully read your petition, provisions of law and judgements;
- Jot down relevant points on a separate sheet of paper together with relevant pages of the compilation;
- Keep copies of judgements to be relied ready for the Tribunal and for your opponent(s).

While presenting your case

- Submit a list of citations to the Court Master before opening of case; Start your address with humble note;
- Refer to the order sought to be challenged or reliefs sought to be prayed;
- State brief facts;
- Formulate issues/points, categorise them and address them one by one;
- Take each point, state relevant facts, provisions of law and relevant binding decisions;
- Handover xerox copies of binding decisions to the Court Master while placing reliance;
- Refer to relevant pages of the compilation, provisions of law and judgements;
- Complete all points slowly but firmly;
- Conclude your arguments by reiterating your points in brief;
- Permit the opponent counsel uninterruptedly. However, if facts are being completely twisted, interrupt depending upon the relevant circumstances;
- Take instructions from client in advance with respect to alternative reliefs.

Company Secretaries should be able to formulate and present a coherent submission based upon facts, general principles and legal authority in a structured, concise and persuasive manner. They should

understand the crucial importance of preparation and the best way to undertake it and be able to demonstrate an understanding of the basic skills in the presentation of cases before the Tribunals. They should be able to:

1. Identify the client's goals;
2. Identify and analyse factual material;
3. Identify the legal context in which the factual issue arises;
4. Relate the central legal and factual issues to each other;
5. State in summary from the strengths and weaknesses of the case from each party's perspective;
6. Develop a presentation strategy;
7. Outline the facts in simple narrative form;
8. Structure and present in simple form the legal framework of the case;
9. Structure the submission as a series of propositions based on the evidence;
10. Identify, analyse and assess the specific communication skills and techniques;
11. Demonstrate an understanding of the purpose, techniques and tactics of examination, cross-examination and re-examination to adduce, rebut and clarify evidence;
12. Demonstrate an understanding of the ethics, etiquette and conventions of advocacy.

Advocacy Tips

Some of the tips given by legal experts which professionals like Company Secretaries should bear in mind while appearing before Tribunals or other quasi-judicial bodies are given herein below. While pleading, a judge in your pleadings looks for:

1. **Clarity:** The judge's time is limited, so make the most of it.
2. **Credibility:** The judge needs to believe that what you are saying is true and that you are on the right side.
3. **Demeanour:** We don't have a phrase "hearing is believing". The human animal which includes the human judge, is far more video than audio. The way we collect most of our information is through our eyesight.
4. **Eye contact:** While pleading, maintain eye contact with your judge.
5. **Voice modulation:** Voice modulation is equally important. Modulating your voice allows you to emphasize the points you want to emphasize. Be very careful about raising your voice. Use your anger strategically. But use it rarely. Always be in control of it.
6. **Psychology:** Understand judge's psychology as your job is to make the judge prefer your version of the truth.
7. **Be likeable:** At least be more likeable than your opponent. If you can convert an unfamiliar Bench into a group of people who are sympathetic to you personally, you perform a wonderful service to your client.
8. Learn to listen.
9. Entertain your judge. Humour will often bail you out of a tough spot.

ANNEXURE – 1
MEMORANDUM OF APPEARANCE

FORM NO. NCLT.12

(See rule 45)

To,
The Registrar,
National Company Law Tribunal…….Bench
In the matter of.....Petitioner

V.

…….Respondent

(C.P. No……of 20.....)

Sir,

Please take notice that I,……..Company Secretary in practice/ practising Chartered Accountant/practising Cost Accountant, duly authorised to enter appearance, and do hereby enter appearance, on behalf of petitioner/ opposite party/Registrar/ Regional Director/ Government of.....in the above-mentioned petition.

*A copy of the resolution passed by the Board of Directors authorising me to enter appearance and to act for every purpose connected with the proceedings for the said party is enclosed, duly signed by me for identification

Yours sincerely,

Dated . . . . . day of.....Address:

Enclosure: as aforesaid Tele No.:

ANNEXURE – 2
PETITION

FORM NO. NCLT. 9

[see rule 72, 76, 82, 84, 88 and 154 and also General Form for all purposes if no specific form is prescribed under these rules and Forms]

BEFORE THE NATIONAL COMPANY LAW TRIBUNAL, BENCH, AT …….

Company Application No ……. of 20….

In the matter of the Companies Act, …..

In the matter of ……..Companies Act, ……..

…….. Pertitoner No….

Address:…….

Versus

……..Respondent No…….

Address:……..

Application /Petition/ Appeal in the form of affidavit under Section of the Act for……

I, ... solemnly affirm and say as follows: 1. I am the Managing Director or Chairman of the Board of Directors/a director/ …… Of the above named company, and I have been a …….. of the company since …… 201.....[the capacity in which the deponent swears to the affidavit should be set out.]

2. I have read the petition now shown to me and state that the statements made in paragraph 1 to thereof are correct and true to my knowledge.

4. Facts of the order against which appeal or review is filed.

5. The facts of the case are given below: (give here a concise statement of facts and other grounds in a chronological order, each paragraph containing as neatly as possible as separate issue, fact or otherwise).

6. Jurisdiction of the Tribunal: The applicant/ petitioner/ appellant declares that the matter of application/petition/ appeal falls within the jurisdiction of the Tribunal.

7. Limitation.- The applicant/ petitioner/ appellant further declares that the application/petition/ appeal is within the limitation as prescribed in the provision of section read with section 433 of the Act.

8. Matter not pending with any other Tribunal etc. - The applicant/ petitioner/ appellant further declares that the matter regarding with this application/ petition/ appeal has been made is not pending before any Tribunal of law or any other authority or any other Tribunal.

9. Particulars in respect of the fee paid in terms of the Schedule of Fees of these rules.-

1. Amount of fees
2. Name of the Bank on which Demand Draft is drawn or Online Payment is made
3. Demand draft number

10. Details of Index.- An index containing the details of the documents to be relied upon is enclosed.

Index

Sl no.	Particulars	Annexure	Page No.

11. List of enclosures.-

12. It is therefore prayed that directions may please be given:

1. Relief(s) sought.- In view of the facts mentioned in paragraph 5 above, the applicant/ petitioner/ appellant prays for the following reliefs) (Specify below the relief(s) sought explained the grounds for relief(s) and the legal provisions, if any, relied upon).
2. Interim order, if prayed for.- Pending final decision of application/ petition/ appeal, the applicant/ petitioner/ appellant prays for the following interim relief: (Give here the nature of the interim relief

prayed for with reasons)

Dated this . . . . . day of.....20

(Signature of the applicant/ petitioner/ appellant)

Solemnly affirmed before me at.....on this (month) … day of .... 20 . . . . . .

Recent Judgments - Mergers and Amalgamations

Case 1

Can an Indian LLP be allowed to amalgamate with an Indian private limited company under a scheme of amalgamation filed before the NCLT?

The National Company Law Tribunal Chennai bench in the order dated 11.06.2018 held that,

"…the legislative intent behind enacting both the LLP Act, 2008 and the Companies Act, 2013 is to facilitate the ease of doing business and create a desirable business atmosphere for companies and...

"For this purpose, both the Acts have provided provisions for merger or amalgamation of two or more LLPs and companies," noted the NCLT bench.

"If the intention of Parliament is to permit a foreign LLP to merge with an Indian company, then it would be wrong to presume that the Act prohibits a merger of an Indian LLP with an Indian company.

"Thus, there does not appear any express legal bar to allow/ sanction merger of an Indian LLP with an Indian company," said the tribunal. It decided the question in a joint company petition moved by M/s Real Image LLP, the transferor LLP proposed to be amalgamated and vested with M/s Qube Cinema...

Both the companies are engaged in business of establishing or acquiring audio and video laboratories for recording, re-recording, mixing, editing, computer graphics and special effects for film, television, video and radio productions etc.

The counsel for the petitioner companies submitted that sections 60 to 62 of the LLP Act and sections 230 to 234 of the Companies Act deal with mergers, amalgamations and arrangements and they empower NCLT to sanction a scheme proposed by a company....

It was further submitted that in the Companies Act, 2013 there was no bar for a transferor in a scheme of amalgamation to be a body corporate, including an LLP. It was, however, also submitted that as per Section 234 of the Companies Act, 2013 a foreign LLP and Indian company can merge with each other but such benefit has not been provided under Section 232 for permitting an Indian LLP to merge with an Indian company. While deciding the anomaly, the NCLT sanctioned the scheme proposed by the petitioner Company. [*In the Matter of Scheme of Amalgamation between Real Image LLP v. QubeCinema Technologies Private Limited]*

Case 2

Whether the Tribunal has powers to grant dispensation of the shareholders' meeting regarding the proposed scheme of amalgamation where all the shareholders have given consent, whereas the Companies Act, 2013

has authorized only for the dispensation of the meeting of the creditors where creditors having at least 90% value agreed and confirmed by way of an affidavit to scheme of compromise or arrangement.

The National Company Law Tribunal Kolkata Bench in the order dated 17.05.2017 held that,

The case of the matter was heard before the bench comprising of Hon'ble Justice Shri Vijai Pratap Singh and Hon'ble Justice Shri S. Vijayraghavan. Both the members of the bench differed on the certain points and on that basis the matter was referred to the Hon'ble President under the provisions of section 419(5) of the Companies Act, 2013.

The Hon'ble Justice Ms. Manorama Kumari passed the order stating that "I have no reason to depart from the precedents created by the Hon'ble High Court to dispense with the requirement of convening the meetings of the shareholders and creditors of the Company, in the instant case both applicant companies have few shareholders and all of them have given their written consent/affidavit and post-merger there shall be positive net worth and creditors are not compromised".

Since, the Judgment passed by the majority will prevail, meeting of the shareholders was dispensed on account of consent of all shareholders. *[In the matter of Scheme of Amalgamation between Jupiter Alloys & Steel (India) Limited v. Jupiter Wagon Limited]*

Case 3

Whether a registered partnership firm, being a body corporate, can be treated as a company for the purpose of section 230-232 of the Companies Act, 2013.

The National Company Law Tribunal Ahmedabad bench in order dated 22.09.2017 held that,

NCLT bench observed that applicant cannot rely on definition of company given under other laws when the same has been specifically defined under section 2(20) of the Act. A company has been defined under the Act as:

"company" means a company incorporated under this Act or under any previous company law.

Section 366 of the Act only contemplates which entities are authorized to register under the Act and unless a partnership firm is registered under the Act, the same cannot be included as a company in section 2(20) of the Act. Further, an unregistered company cannot be called as a company under section 2(20) of the Act. The applicant cannot take benefit of explanation given under section 234(2) of the Act as the same is applicable for foreign companies. *[In the matter of Scheme of Amalgamation between Nidhi Securities Limited v. Kediya Ceramics and Others]*

Case 4

On appeal to National Company Law Appellate Tribunal under Section 421 of the Companies Act. 2013 by the appellants against the impugned order dated 13/07/2017 passed by the National Company Law Tribunal Hyderabad Bench. The appeal was against the rejection of scheme of Amalgamation by the National Company law Tribunal.

National Company Law Appellate Tribunal in the order dated 21.12.2017 held that,

It was also argued that the impugned order of NCLT was based merely on the numbers appearing in the balance sheet of the Transferor Company and failed to take into consideration the potential business model developed by it.

The NCLAT pointed out the disclaimer in the valuation report issued by the independent chartered

accountant, which stated that the entire valuation, provided in the report, was based on the documents provided by the management of the Appellants and the valuer had disclaimed the accuracy and reliability of such information.

The NCLAT held that a scheme should be fair and in the interest of all shareholders and not only for a few among them and thus upheld the decisions of the NCLT. *[In the matter of Scheme of Amalgamation between Wiki Kids Limited v. Avantel Limited*].

LESSON ROUND-UP

- National Company Law Tribunal ('NCLT') and National Company Law Appellate Tribunal ('NCLAT') were constituted on 1st June 2016 in exercise of powers conferred under sections 408 and 410 of the Companies Act, 2013.
- This constitution will avoid multiplicity and levels of litigation before High Courts and quasi-judicial authorities like Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) as all such matters will be heard and decided by NCLT
- The NCLT and the NCLAT will act as a comprehensive and overarching quasi-judicial body which will adjudicate all disputes relating to companies in India.
- NCLT consists of President and such number of Judicial and Technical members, as the Central Government may deem necessary.
- NCLAT consists of Chairperson and such number of Judicial and Technical Members, not exceeding eleven, as the Central Government may deem fit.
- National Company Law Tribunal Rules, 2016 prescribes the procedure to be followed before NCLT.
- National Company Law Appellate Tribunal Rules, 2016 prescribes the procedure to be followed before NCLAT.
- Under section 432 of the Companies Act, 2013, Company Secretaries have been authorized to appear before the Tribunal/ Appellate Tribunal.
- Company Secretaries can undertake Merger/Amalgamation/Compromise, Revival of Companies, Winding-up, Reduction of Capital, Oppression and mismanagement, Insolvency and Bankruptcy cases.
- It is necessary for Company Secretaries to learn art of advocacy or court craft for effective delivery of results to their clients when they act as an authorized representative before any Tribunal or quasi-judicial body.
- The Tribunal may, at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties.
- Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal within 45 days.
- Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order.

GLOSSARY OF TECHNICAL WORDS

Applicant means a petitioner or an appellant or any other person or entity capable of making an application including an interlocutory application or a petition or an appeal under the Act.

Petition means a petition or an application or an appeal or a complaint in pursuance of which any proceeding is commenced before the Tribunal.

Pleadings means and includes application including interlocutory application, petition, appeal, revision, reply, rejoinder, statement, counter claim, additional statement supplementing the original application

and reply statement under these rules and as may be permitted by the Tribunal.

Authorised representative means a person authorised in writing by a party to present his case before the Tribunal as the representative of such party as provided under section 432 of the Act.

Central Registry means the registry in which all the applications or petitions and documents are received by the Registrar for allocation to the concerned Bench of the Tribunal for disposal.

Registry means the Registry of the Tribunal or any of its Benches, as the case may be, which keeps records of the applications and documents relating thereto.

Interlocutory application means an application in any appeal or original petition on proceeding already instituted in the Tribunal, but not being a proceeding for execution of the order or direction of Tribunal.

Rejoinder A written statement/reply of the plaintiff/petitioner by way of defense to pleas' raised in the counter affidavit/written statement from the defendant/respondent, is termed as a rejoinder or replication.

LIST OF FURTHER READINGS

1. Law Practice and Procedure of NCLT by Taxmann's
2. Law and Procedures under NCLT & NCLAT, Second Edition, CCH Publications
3. National Company Law Tribunal (Practice & Procedure) by CS Ajay Kumar, Bharat Law House Pvt. Ltd.
4. NCLT and NCLAT – Law, Practice and Procedure by Prachi Manekar Wazalwar, Bloomsbury Publication

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Constitution of NCLT and NCLAT is a long awaited reform. Discuss.
2. Describe in brief the constitution and jurisdiction of NCLT and NCLAT.
3. What are the powers of NCLT under the Companies Act, 2013?
4. Mention in brief the procedure of institution of proceedings, petition, appeals etc. before Tribunal.
5. What is the scope of services for professionals under NCLT?
6. Mention the etiquettes, court craft and advocay skills required while appearing before the Tribunal?

Lesson 12
Fast Track Mergers

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Introduction
- Legal regime behind fast track mergers
- Small company
- Procedural aspects of fast track mergers
- Steps involved in fast track mergers
- Post-merger effect

LEARNING OBJECTIVES

The introduction of the concept of fast track mergers or FTMs has led to a significant change in the M&A landscape. FTM provides for a simplistic and convenient procedure for mergers between small companies and mergers between holding and subsidiary companies.

Prior to the introduction of FTM *vide* section 233 and Rule 25 of Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 there was one unified merger process for all companies. This process *inter alia* included approval of the merger scheme from the Tribunal. This led to delays and unnecessary complications.

Small companies who have fewer resources at their disposal were deterred from entering into mergers owing to the lengthy process. Hence, FTM is a way to encourage small companies to expand. Moreover, a merger of holding and subsidiary companies does not pose any major market risk and hence should not be subject to such strict scrutiny. Having an alternative procedure which allows parties to the merger to easily get the scheme registered and approved would make the Indian legal environment conducive to business.

After reading this lesson, you shall have a good understanding about concept of fast track merger, procedure involved in fast track merger, etc.

INTRODUCTION

Mergers and amalgamations (M&As) have become the buzzwords in corporate echelons these days. It is the process of amalgamation of two or more entities / companies through inorganic means.

There may be different means and modes to affect this process. As a result of this process, a new entity may be formed or one entity may be subsumed by another. All the assets and liabilities of the amalgamating or the merging entity will transfer to the resultant entity.

Companies Act, 1956 did not provide a simple procedure for mergers and amalgamations of certain type of companies. It prescribed a cumbersome and time-consuming process for all companies irrespective of their size, net worth and turnover. The legal provisions pertaining to merger process were stipulated in sections 391-394 of the Companies Act, 1956. This procedure was perceived to be very confusing, complex and time-taking by all stakeholders involved in the process. The process involved, *inter alia*, drafting a merger scheme, taking judicial approval for the scheme, getting Board and shareholders authorisation, etc. It defeated the very purpose for which mergers were entered into and proved to be a deterrent for companies looking for collaborations, rather than a facilitator.

Small companies with fewer resources were also subject to same complex procedure. This was proving to be an obstacle in the way of their growth and expansion. Having the same procedure for merger for all companies was proving to be counter-productive. The complexities of the earlier regime gave rise to the need for a simplified procedure and a more efficient legal regime for merger process. This need was embedded in the following benefits which a fast track merger offered under Section 233 of the Companies Act, 2013:

- Simplified procedure for merger
- No judicial approval required
- Separate procedures for certain type of companies would enable them to expand without any roadblocks
- Form filings required also significantly reduced

Companies Act, 2013 replaced the earlier tedious process with a new concept called the `fast track mergers'. Fast track mergers have dispensed with Tribunal approval for mergers. Regional Directors, Registrar of Companies (RoC) and Official Liquidator are the authorities whose approval is required. The process has been simplified to a great extent.

However, it is to be noted that this process is applicable only to merger between small companies and holding and subsidiary companies.

A provision allowing the government to notify any other company in this regard has also been made. Before we set out to analyse and understand fast track mergers, it is pertinent to understand the legal framework behind fast track mergers and what is meant by small companies.

Legal Regime behind Fast Track Mergers

Section 233 of the Companies Act, 2013 has introduced the concept of fast track mergers. It carved out an exception from the regular merger procedure. It exempted small companies and holding and subsidiary companies entering into merger arrangements from the regular merger procedure as stipulated under sections 230-232 of the Companies Act, 2013. Section 233 of the Companies Act, 2013 along with Rule 25

of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 lay down the entire legal framework of fast track mergers.

Merger or amalgamation of certain companies – Section 233

(1) Notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely: —

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent. of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

(2) The transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

(3) On the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

(4) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days:

Provided that if no such communication is made, it shall be presumed that he has no objection to the scheme.

(5) If the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under subsection (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.

(6) On receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit: Provided that if the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

(7) A copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

(8) The registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding-up.

(9) The registration of the scheme shall have the following effects, namely: —

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and (d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

(10) A transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

(11) The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital: Provided that the fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

(12) The provisions of this section shall *mutatis mutandis* apply to a company or companies specified in sub-section (1) in respect of a scheme of compromise or arrangement referred to in section 230 or division or transfer of a company referred to clause (b) of subsection (1) of section 232.

(13) The Central Government may provide for the merger or amalgamation of companies in such manner as may be prescribed.

(14) A company covered under this section may use the provisions of section 232 for the approval of any scheme for merger or amalgamation”

Therefore, as it can be seen, section 233 outlines a list of conditions which companies proposing to enter into fast track mergers are required to follow:

- A notice of the proposed scheme soliciting objections or suggestions from the Registrar and the official liquidators to be issued by the transferor or the transferee companies within thirty (30) days.
- If any objections or suggestions are received, then the same are considered in their respective general meetings and approved/disapproved by their respective members.
- A declaration of solvency is required to be filed by both the companies involved in the merger.
- The scheme has to be approved by majority of creditors representing nine-tenths in value of the creditors or class of creditors of the respective companies.

- The transferee company is required to file a copy of the approval in the prescribed manner, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.
- On receiving the said scheme, if the Registrar or the Official Liquidator does not have any objections or suggestions to the scheme, the Central Government shall register the said scheme and issue a confirmation thereof to the companies.
- If the Registrar or Official Liquidator has any objections or suggestions, the same may be communicated to the Central government within a period of thirty days. In the absence of any such communication, it would be presumed that no objections were raised.
- If the Central Government after receiving the objections or suggestions or for any other reason forms the opinion that the said scheme is not in public interest or in the interest of the creditors, it can file an application before the Tribunal within a period of sixty days.
- After filing of such application, the Tribunal has to render its judgment. If it is of the opinion (with reasons recorded in writing) that the scheme should be considered as per the procedure laid down in section 232, it may give directions accordingly.

Relevant Provisions for Merger & Amalgamation

Under Companies Act, 2013, the provisions of section 230 provide the additional disclosure if the proposed scheme involves; Reduction of Share Capital or the scheme is of Corporate Debt restructuring; consented by not less than 75% in value of secured creditors, every notice of meeting about scheme to disclose valuation report explaining effect on various shareholders. Further, no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the Accounting Standards prescribed under section 133 of the Companies Act, 2013. Apart from this, dealing with the Arrangements; notice of meeting to consider compromise or arrangement to be given to Central Government, Income Tax Authorities, Reserve Bank of India, Securities Exchange Board of India, Registrar of Companies, respective Stock Exchange, Official Liquidator, Competition Commission of India and other Authorities likely to be affected by the same. So, these Authorities can voice their concern within 30 days of receipt of notice, failing which it will be presumed that they have no objection to the scheme.

Following are the benefits of section 233 or fast track mergers:

- No requirement to apply to the National Company Law Tribunal
- No requirement to get a special audit conducted for the transferor company
- No requirement to issue public advertisements announcing the merger
- Less cost intensive and less time consuming

Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 reads as under:

(1) The notice of the proposed scheme, under clause (a) of sub-section (1) of section 233 of the Act, to invite objections or suggestions from the Registrar and Official Liquidator or persons affected by the scheme shall be in Form No. CAA.9.

(2) For the purposes of clause (c) of sub-section (1) of section 233 of the Act the declaration of solvency

shall be filed by each of the companies involved in the scheme of merger or amalgamation in Form No. CAA.10 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, before convening the meeting of members and creditors for approval of the scheme.

(3) For the purposes of clause (b) and (d) of sub-section (1) of section 233 of the Act, the notice of the meeting to the members and creditors shall be accompanied by –

(a) a statement, as far as applicable, referred to in sub-section (3) of section 230 of the Act read with sub-rule (3) of rule 6 thereof;

(b) the declaration of solvency made in pursuance of clause (c) of sub-section (1) of section 233 of the Act in Form No. CAA.10;

(c) a copy of the scheme.

(4) (a) For the purposes of sub-section (2) of section 233 of the Act, the transferee company shall, within seven days after the conclusion of the meeting of members or class of members or creditors or class of creditors, file a copy of the scheme as agreed to by the members and creditors, along with a report of the result of each of the meetings in Form No. CAA.11 with the Central Government, along with the fees as provided under the Companies (Registration Offices and Fees) Rules, 2014.

(b) Copy of the scheme shall also be filed, along with Form No. CAA. 11 with –

(i) the Registrar of Companies in Form No. GNL-1 along with fees provided under the Companies (Registration Offices and Fees) Rules, 2014; and

(ii) the Official Liquidator through hand delivery or by registered post or speed post.

(5) Where no objection or suggestion is received to the scheme from the Registrar of Companies and Official Liquidator or where the objection or suggestion of Registrar and Official Liquidator is deemed to be not sustainable and the Central Government is of the opinion that the scheme is in the public interest or in the interest of creditors, the Central Government shall issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12.

(6) Where objections or suggestions are received from the Registrar of Companies or Official Liquidator and the Central Government is of the opinion, whether on the basis of such objections or otherwise, that the scheme is not in the public interest or in the interest of creditors, it may file an application before the Tribunal in Form No. CAA.13 within sixty days of the receipt of the scheme stating its objections or opinion and requesting that Tribunal may consider the scheme under section 232 of the Act.

(7) The confirmation order of the scheme issued by the Central Government or Tribunal under sub-section (7) of section 233 of the Act, shall be filed, within thirty days of the receipt of the order of confirmation, in Form INC-28 along with the fees as provided under Companies (Registration Offices and Fees) Rules, 2014 with the Registrar of Companies having jurisdiction over the transferee and transferor companies respectively.

(8) For the purpose of this rule, it is clarified that with respect to schemes of arrangement or compromise falling within the purview of section 233 of the Act, the concerned companies may, at their discretion, opt to undertake such schemes under sections 230 to 232 of the Act, including where the condition prescribed in clause (d) of sub-section (1) of section 233 of the Act has not been met.

Small Company

The Companies Act, 2013 introduced the concept of small company. This new category of company was

introduced in order to provide certain advantages to businesses operating with a small capital and scale.

In the wake of the rising start-up culture in India, it was imperative that certain benefits be given to small enterprises and businesses allowing them to grow organically or inorganically. Such small companies form the backbone of an economy and encourage entrepreneurship and, therefore, lesser stringent legal procedures pertaining to mergers and acquisitions would act as an incentive encouraging more people to start such businesses.

"Small Company" under section 2(85) of the Companies Act, 2013 is defined as:

"Small company'' means a company, other than a public company, -

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to,

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(C) a company or body corporate governed by any special Act;

On an analysis of the aforementioned provision, it is clear that the following are the features of a small company:

- A small company is essentially a private limited company and not a public company.
- Paid-up share capital does not exceed 50 lakh rupees
- Turnover does not exceed 2 crore rupees
- It is not a holding or subsidiary company
- A company or body governed under any special Act
- A company formed for charitable purposes (company within the meaning of section 8 of the Companies Act, 2013).

There are various advantages of being a small company. Some of these are:

- **Filing Annual Return**

  The procedure of filing annual returns of a small company is comparatively easier than that of other private limited companies. The annual return of a small company can be signed by either its company secretary or its director, whereas an annual return of a private limited company other than a small company has to be necessarily signed by both the company secretary and the director.

- **Board Meeting**

  Small companies are required to conduct only 2 board meetings in a year whereas private limited companies not classified as small companies have to conduct four board meetings in a year.

- **Cash Flow Statement**

  A small company is not required to prepare a cash flow statement as a part of its financial statement unlike other private limited companies.

- **Rotation of Auditors**

  A small company is not required to rotate its auditors unlike other private limited companies who are required to rotate their auditors every 5 or 10 years.

Procedural Aspects of Fast Track Mergers

Section 233 of the Companies Act, 2013 along with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 lay down the procedure for fast track mergers. The table given below explain the process, forms required and the stipulated timelines involved in a fast track merger:

Procedure	**Timeline**	**Forms required**	**Who shall be required to comply**
Convene a Board Meeting: The board meeting shall approve the scheme and pass resolutions for holding and fixing date and time for a shareholder and a creditors meeting.	NA	NA	Both the transferor and the transferee companies are required to comply.
Notice of the Proposed Scheme: The notice of the proposed scheme is to be sent to the Registrar where registered offices of both the companies are situated. The notice shall invite objections/ suggestions, if any, from the respective registrars.	To be done after the Board meeting.	Form CAA 9	Both the transferor and the transferee companies are required to comply.
Declaration of solvency: Both the companies are required to file a declaration of solvency with the ROC of the place where their registered offices are situated.	This is to be done before the meeting of shareholders or the meeting of creditors is convened.	Form CAA 10	Both the transferor and the transferee companies are required to comply.
Convening a Meeting of	Notice should be sent	NA	Both the transferor and

Members: A notice convening a meeting of the members or shareholders of the company should be sent to all the members. This notice should contain, the details of the merger, copy of the scheme and a copy of the declaration of solvency. The objections/suggestions received by the company from the registrar would be discussed and voted upon in this meeting.	21 days prior to the meeting.		the transferee companies are required to comply.
Convening a Meeting of Creditors: A notice convening a meeting of the creditors of the company should be sent to all the creditors. This notice should contain, the details of the merger, copy of the scheme and a copy of the declaration of solvency. The scheme is to be approved by a majority that is nine-tenths in value of the creditors or class of creditors of the respective companies.	Notice should be sent to the creditors 21 days before the meeting.	NA	Both the transferor and the transferee companies have to comply.
Filing of the Scheme: A copy of the scheme along with the results of all the meetings shall be filed with the regional director. A copy of the scheme along with Form CAA 11 is also required to be formed with the ROC and the Official Liquidator. The former shall be filed in	Within 7 days of the meeting of creditors.	Form CAA 11 Form GNL 1	Only transferee company is required to comply.

Form GNL1 and the latter shall be hand-delivered or sent through speed post or registered post.			
Approval of the Scheme by Regional Director: If the ROC or the Official Liquidator approves the scheme then the regional director shall register the same and issue a confirmation. If the ROC or Official Liquidator have objections then they may communicate the same to the Regional Director. The Regional Director, if is of the opinion that the scheme is not in public interest then it may file an application in Form CAA 12 before the Tribunal, to consider the scheme under section 232 (regular merger process). If the Tribunal is of the opinion that the scheme should be considered under section 232 it should direct accordingly otherwise the scheme shall be approved.	NA	NA	NA
Filing the confirmation order with the ROC: A copy of the confirmation of the scheme approved by the ROC or the Official Liquidator should be sent to the Registrar where the transferee's registered office is situated. The registrar shall register the scheme and issue a confirmation which shall	Within 30 days of the receipt of the confirmation of the scheme.	Form INC-28	Both the transferor and the transferee companies are required to comply.

then be filed with ROC of the place where the transferor's registered office is situated.			

Steps involved in Fast Track Mergers

The following steps need to be followed in a fast track merger:

1. First of all, both the companies need to check their Articles of Association (AoA) and assess if they have the requisite authority under them to enter into a merger. If no, then the AoA need to be amended before such merger can take place.
2. Convene the Board Meeting and prepare a draft scheme of merger or amalgamation.
3. Prepare a financial statement of assets and liabilities and get an auditor's report prepared.
4. Get the draft scheme approved in the Board Meeting.
5. Both the companies need to send a notice to the Registrar of Companies (RoC) and Official Liquidator (OL) of their respective regions inviting suggestions/objections to the scheme, if any within 30 days of issuing the notice.
6. Such notice to the RoC should be in Form CAA 9 and have the following attachments:
    - Copy of the scheme
    - Shareholding pattern of the transferee pre and post-merger
    - Last 3 years audited financial statements
    - Memorandum and Articles of Association
    - Board Resolution
    - Valuation Report
7. Both the companies are required to file a declaration of solvency with their respective ROCs. This declaration of solvency shall be accompanied by the following:
    - Board Resolution
    - Statement of Assets and Liabilities
    - Auditors Report
8. Sending notice of shareholders' meeting and creditors' meeting.
9. Conducting the shareholders' meeting and getting the scheme approved.
10. Conducting creditors' meeting and getting the scheme approved.
11. Filing of the results of each meeting with the Regional Director and the Official Liquidator by the transferee company.
12. Objections/Suggestions to be sent to the Regional Director by the RoC/Official Liquidator.

13. Regional director may file an application with the Tribunal if he is of the opinion that the scheme is against public interest.
14. The Tribunal can approve or disapprove the scheme.
15. If approved it shall be filed with the RoC of the transferee company and the transferor company respectively.

So far, we have discussed the procedure as mandated by law and the steps required to enter into a fast track merger. However, from a practical standpoint, it is also imperative to know what are the ingredients / contents one should include in a scheme of merger. These ingredients are:

- Preamble
- Definitions of the terms used in the scheme
- A detailing of the pre-merger and the post-merger capital
- The way the assets and liabilities shall be transferred
- Appointed and effective date of the scheme
- Tax treatment of the scheme
- Benefits to be given to the staff
- Consolidation of the authorised share capital
- Dissolution without resorting to winding-up
- Notice of approval of the scheme
- Any amendments or modifications to the scheme

Post-Merger Effect

The following consequences shall result out of the merger:

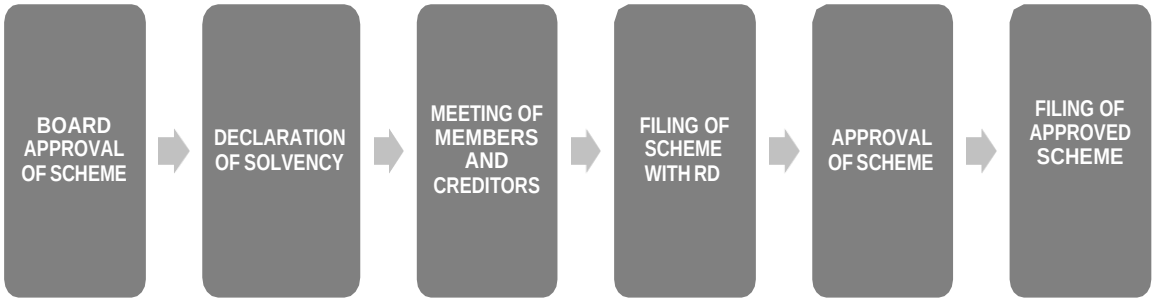
- The transferor company shall stand dissolved on the registration of the scheme. No winding-up shall be required for the same.
- All the assets and liabilities of the transferor company shall be transferred to the transferee company.
- Any charge on the transferor's property shall stand transferred to the transferee.
- Payment of social security benefits of employees will now be the responsibility of the transferee company.

Despite, fast track mergers being an innovative and convenient concept it poses certain practical difficulties. These practical difficulties are:

- Merging the authorised capital of all companies in the transferee company may not be practically viable.
- Form INC 28 which finally registers the scheme does not provide for the following:
    - A separate drop-down menu for Section 233
    - Change in the status of the transferor company

- There is doubt regarding whether the Regional Director can suggest changes to the scheme. It appears that if the ROC, Official Liquidator does not have objections to the scheme, the Regional Director has to confirm without any suggestions of his own.

The following flowchart would help understand the procedure of fast track merger better:



Practical Insights

Knowing and learning the basic theoretic concepts around fast track mergers is important. However, one also must know how to use this theory in practice. Whenever asked to render a legal opinion on fast track mergers or if your firm is entering into one, keep in mind the following practical steps:

(a) Assess whether the merger is beneficial before entering into one.

(b) Conduct due diligence on the firm sought to be merged with.

(c) Remember both the companies need to be small companies for FTM to apply.

(d) Have a prescribed timeline and a strategy in place in order to avoid undue delay.

(e) Think of all the possible objections you may receive from ROC and already keep solutions ready so as to save time.

LESSON ROUND UP

- Fast track mergers have been introduced in order to encourage small companies to grow and expand. Small companies should not be dissuaded from entering into mergers just because the process is long, tedious and complicated.
- Section 233 of the Companies Act, 2013 provides for a simplistic procedure without the requirement of Tribunal approval for mergers.
- Section 233 of the Companies Act, 2013 lays down the legal framework for fast track mergers.
- Fast track mergers are applicable only to small companies, holding and subsidiary companies and any other company as may be prescribed by the government.
- A small company is defined as a private limited company with paid-up capital less than INR 2 lakh or turnover less than INR 2 crore.
- The following is the procedure for a fast track merger:
  - Convening a board meeting for approval of the draft scheme of merger.
  - Sending a notice of the proposed scheme inviting objections or suggestions from the Registrar and the Official Liquidator.

- Declaration of solvency by each party to the merger.
- Approving/disapproving/modifying the scheme in the general meeting of shareholders and the meeting of creditors.
- Filing of the result of each meeting with the ROC and regional directors.
- If the ROC/Official Liquidator has any objections the same may be sent to the regional director.
- If the regional director thinks that the scheme is opposed to public interest, he may file an application before the Tribunal.
- The Tribunal may approve or disapprove the scheme. If the former happens, the scheme shall be registered, if the latter happens the scheme will have to seek approval through the procedure mentioned in section 232 of the Companies Act, 2013.

GLOSSARY OF TECHNICAL WORDS

Turnover: Section 2(91) of the Companies Act, 2013 describes turnover as:

"the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year".

Private company: Section 2(68) of the Companies Act 2013 defines a private company as a company having a minimum paid-up share capital as may be prescribed, and which by its articles, —

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member.

Holding Company: Section 2(46) of the Companies Act, 2013 describes holding company as:

"holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies."

Explanation: For the purpose of this clause, the expression 'company' includes any body corporate.

Wholly owned subsidiaries (WOS): This is a company whose 100% shares are owned by its holding company.

Appointed Date: This is the date when the scheme comes into effect.

Effective Date: This is the date when the merger gets completed in all respects.

LIST OF FURTHER READINGS

1. A Ramaiya Guide to Companies Act, 18th Edition, Lexis Nexis
2. Company Law and Practice - A Textbook on Companies Act, 2013, G.K. Kapoor and Sanjay Dhamija, 23rd Edition, Taxmann Publications
3. Deepak Verma, "A study of Mergers and Acquisitions in India under Companies Act, 2013", UNI JOURNAL OF RESEARCH, Vol.2 (3), March (2015)
4. Ms. M. Nirmala, "Corporate Restructuring and Companies Act, 2013: An Impact Analysis", International Journal of Management and Social Science Research Review, Vol.1, Issue.5, Nov – 2014

SELF-TEST QUESTIONS)

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is a fast-track merger? Why is it important to have legal framework around a fast track merger in India?
2. What is the procedure of a fast-track merger?
3. Critically analyse the concept of fast track merger in India.
4. Discuss salient features of Section 233 of the Companies Act, 2013.
5. Discuss in brief Rule 25 of Companies (Compromise, Arrangements and Amalgamations) Rules, 2016.

Lesson 13
Cross Border Mergers

LESSON OUTLINE

The objective of this study lesson is to enable the students to understand:

- Introduction
- Type of mergers – inbound and outbound
- Section 234 of Companies Act, 2013
- Rule 25A of the Companies (Compromises, Arrangements and Amalgamation) Rules, 2016
- Drivers and returns behind cross border mergers.
- Valuation of cross border firm
- Regulatory, competition and taxation aspects
- Recent judgements
- Post-merger performance evaluation

LEARNING OBJECTIVES

Cross border mergers are increasing significantly with the shrinking of the globe. Indian economy is getting a boost owing to development-oriented policies of the government and this has left surplus money in the hands of Indian companies so as to focus on their expansion abroad. Moreover, India is gradually climbing the ease of business rankings and is becoming a favoured business destination. Such a conducive economic environment has spurred the growth of cross border mergers.

Companies Act, 1956 dealt with cross border mergers under section 394. Section 394(4)(b) allowed only inbound mergers to happen and not vice versa. This meant that a foreign company and an Indian company on merging could have formed only an Indian company. This was restrictive and parochial in nature. This also curbed opportunities for Indian companies to expand abroad through cross border mergers.

Companies Act, 2013 changed this restrictive outlook by introducing section 234. Section 234 read with Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 provides for both inbound and outbound mergers. An outbound merger results in the resultant company being a foreign company.

After reading this lesson, you shall have a good understanding of concept of cross border mergers, legal framework surrounding cross border mergers, concepts of inbound and outbound mergers, risks and benefits associated with a cross border merger, etc.

INTRODUCTION

Cross-border mergers and acquisitions have been rapidly ascending in quantum and value in recent years. A cross border merger refers to any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 notified under the Companies Act, 2013.

A cross border merger essentially helps in global expansion of companies. If India needs to be put on the global commercial map, it is imperative that a sound and stable legal framework pertaining to cross border mergers be devised. This is the rationale behind the introduction of section 234. The need for a cross border merger stems from the need for economic growth and achieving economies of scale.

Section 234 of the Companies Act, 2013 notified by the Ministry of Corporate Affairs provides the legal framework for cross border mergers in India. This has been brought into effect from 13th April, 2017, hence operationalising the concept of cross border merger.

The following laws, govern cross border mergers in India:

- Companies Act, 2013
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018
- Competition Act, 2002
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- The Department of Industrial Policy and Promotion (DIPP)
- Transfer of Property Act, 1882
- Indian Stamp Act, 1899
- Foreign Exchange Management Act, 1999 (FEMA)
- IFRS 3 Business Combinations

In this lesson we shall holistically examine cross border mergers and would discuss issues such as their valuation, taxation, inbound and outbound mergers, etc.

TYPES OF MERGERS

The most popular types of mergers are horizontal, vertical, market extension or marketing/technology related concentric, product extension, conglomerate, congeneric and reverse. Recently, the concept of inbound and outbound mergers was also introduced in the Companies Act, 2013 as part of Section 234 of the Act.

Inbound Merger

An Inbound merger is one where a foreign company merges with an Indian company resulting in an Indian company being formed. Following are the key regulations which need to be followed during an inbound merger:

Transfer of Securities

Typically, the resultant company of the cross-border merger can transfer any security including a foreign

security to a person resident outside India in accordance with the provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017. However, where the foreign company is a joint venture/ wholly owned subsidiary of an Indian company, such foreign company is required to comply with the provisions of Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004) (**ODI Regulations**).

Branch/Office outside India

An office/branch outside India of the foreign company shall be deemed to be the resultant company's office outside India for in accordance with the Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2015. In case of transfer of securities both Buyer as well as Target can use the service of a Tripartite whose job is to have Securities in the Books and doing all back-office operations (including valuation of the Securities).

Borrowings

The borrowings of the transferor company would become the borrowings of the resulting company. The Merger Regulations has provided a period of 2 years to comply with the requirements under the External Commercial Borrowings (ECB) regime. The end use restrictions are not applicable here. Cross Border Mergers require hedging of External Commercial Borrowings (ECB) as well. An External Commercial Borrowings (ECB) is an arrangement between Indian Buyer and Foreign Bank whereby Foreign Bank is funding to Indian Corporate via Foreign Currency Loan having specific amount, tenor. FEMA does permit hedging of loan taken from outside Bank in Indian Books.

Transfer of Assets

Assets acquired by the resulting company can be transferred in accordance with the Companies Act, 2013 or any regulations framed thereunder for this purpose. If any asset is not permitted to be acquired, the same shall be sold within two years from the date when the National Company Law Tribunal (NCLT) had given sanction. The proceeds of such sale shall be repatriated to India.

Opening of overseas bank accounts for resultant company

The resultant company is allowed to open a bank account in foreign currency in the overseas jurisdiction for a maximum period of 2 years in order to carry out transactions pertinent to the cross-border merger.

Outbound Mergers

An outbound merger is one where an Indian company merges with a foreign company resulting in a foreign company being formed. The following are the major rules governing an outbound merger:

Issue of Securities

The securities issued by a foreign company to the Indian entity, may be issued to both, persons resident in and outside India. For the securities being issued to persons resident in India, the acquisition should be compliant with the ODI Regulations. Securities in the resultant company may be acquired provided that the fair market value of such securities is within the limits prescribed under the Liberalized Remittance Scheme.

Branch Office

An office of the Indian company in India may be treated as the branch office of the resultant company in India in accordance with the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016.

Other changes

(a) The borrowings of the resulting company shall be repaid in accordance with the sanctioned scheme.

(b) Assets which cannot be acquired or held by the resultant company should be sold within a period of two years from the date of the sanction of the scheme.

(c) The resulting foreign company can now open a Special Non-Resident Rupee Account in terms of the FEMA (Deposit) Regulations, 2016 for a period of two years to facilitate the outbound merger.

Section 234 of Companies Act, 2013

"Merger or amalgamation of company with foreign company. —

(1) The provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply *mutatis mutandis* to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government: Provided that the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

(2) Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or *vice versa* and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

Explanation. —For the purposes of sub-section (2), the expression —foreign company means any company or body corporate incorporated outside India whether having a place of business in India or not."

A cross border merger explained in simplistic terms is a merger of two companies which are located in different countries resulting in a third company. A cross border merger could involve an Indian company merging with a foreign company or *vice versa*.

If the resultant company being formed due to the merger is an Indian company, it is termed an inbound merger and if the resultant company is a foreign company, it is an outbound merger. Cross border mergers play a vital role in the commercial growth of the economy. Companies Act, 1956 also dealt with cross border mergers. Sections 391-394 of the Companies Act, 1956 laid down provisions with respect to cross border mergers. However, under the Companies Act, 1956, only inbound mergers were permitted.

The term `transferee company' defined under section 394(4)(b) of Companies Act, 1956 included only Indian companies and hence transfers were not allowed to be made to foreign companies. Companies Act, 2013 brought about a significant change in this position.

Section 234 of the Companies Act, 2013 which was notified in December, 2017 has made provisions for both inbound and outbound mergers. It enables the Central government in consultation with the RBI to make rules pertaining to cross border mergers. In pursuance of the same, the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (Merger Regulations 2018) have been notified and are effective from March 20, 2018, placed at ***Annexure A***.

Mergers which follow the Merger Regulations are deemed to be automatically approved by the RBI and do not require a separate approval. The Merger Regulations are a comprehensive set of rules which deal holistically with cross border mergers.

Cross border mergers are defined under the Merger Regulations as any merger, arrangement or

amalgamation in accordance with the Companies (Compromises, Arrangements and Amalgamations) Rules 2016 ("Companies Amalgamation Rules") notified under the Companies Act, 2013.

A foreign company under the Merger Regulations means a company which is incorporated outside India. Similarly, an Indian company is one which is incorporated in India. Outbound investment is permitted only with companies incorporated in the countries mentioned in the Annexure-B of the Companies Amalgamation Rules.

The company which take over the assets and liabilities of the companies involved in the cross-border merger is called `Resultant Company'. A Resultant Company may be either Indian or foreign.

Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

Rule 25A of the Companies Amalgamation Rules reads as under:

"25A. Merger or amalgamation of a foreign company with a Company and *vice versa*.

(1) A foreign company incorporated outside India may merge with an Indian company after obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and these rules.

(2) (a) A company may merge with a foreign company incorporated in any of the jurisdictions specified in *Annexure B* after obtaining prior approval of the Reserve Bank of India and after complying with provisions of sections 230 to 232 of the Act and these rules.

(b) The transferee company shall ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to Reserve Bank of India for obtaining its approval under clause (a) of this sub-rule.

(3) The concerned company shall file an application before the Tribunal as per provisions of section 230 to section 232 of the Act and these rules after obtaining approvals specified in sub-rule (1) and sub-rule (2), as the case may be.

Explanation 1. For the purposes of this rule the term "company" means a company as defined in clause (20) of section 2 of the Act and the term "foreign company" means a company or body corporate incorporated outside India whether having a place of business in India or not:

Explanation 2. For the purposes of this rule, it is clarified that no amendment shall be made in this rule without consultation of the Reserve Bank of India.

Rule 25A of the Companies Amalgamation Rules provides for the following:

- A foreign company is defined as a company incorporated outside India. The Companies Amalgamation Rules permit foreign companies to merge with an Indian company subject to obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and the Rules.
- The Companies Amalgamation Rules, 2016 also mandates that the valuation should be conducted by valuers who are members of a recognised professional body and in accordance with the internationally accepted principles.

Additionally, the following would also need to be fulfilled:

- Merger of an Indian company is permitted only with a foreign company, which is incorporated in specified jurisdictions.
- Burden is on the foreign company to ensure valuation is done by a valuer, who is a member of a recognized professional body in its jurisdiction and in accordance with internationally accepted principles on accounting and valuation;

Jurisdictions specified in clause (a) of sub-rule (2) of rule 25A [Annexure-B]

(i) whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with SEBI, or

(ii) whose central bank is a member of Bank for International Settlements (BIS), and

(iii) a jurisdiction, which is not identified in the public statement of Financial Action Task Force (FATF) as:

(a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

(b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

Drivers and returns of Cross Border Mergers

BENEFITS OF CROSS BORDER MERGERS	RISKS ASSOCIATED WITH CROSS BORDER MERGERS
• **DIVERSIFICATION**	• **TAX IMPLICATIONS**
• **COST EFFECTIVENESS**	• **REGULATORY LANDSCAPE**
• **TECHNOLOGICAL ADVANCEMENT**	• **POLITICAL SCENARIO**
• **EFFICIENT DISTRIBUTION**	

The trend of cross border mergers has increased recently. Cross border mergers have opened up vistas of opportunities. It enables an Indian company to utilise sophisticated levels of technical know-how offered by the foreign collaborator whereas enables the latter to utilise the large market and resources of India. The following are the benefits of entering into a cross border merger:

- Diversification: A merger often leads to product diversification, whereas a cross border in addition to offering diversification of products also leads to geographical diversification. This is extremely important for companies which want to make their global presence felt.
- Achieving cost effectiveness: When a company seeks to enter new markets, it takes some resources and money to build capacity. Having an existing infrastructure and resources in the new market helps in achieving cost effectiveness.
- Technological advancement: Mergers enable both the parties to use each other's intellectual properties hence enhancing technical know-how.

- Distribution: Cross border mergers help in creating a large distribution network transcending boundary.

However, with bouquets come brickbats, hence with the benefits also come risks associated with cross border mergers. Some of the risks posed by cross border mergers are:

- Despite Double Tax Avoidance Agreements, the tax implications in the host countries may prove to be complex and tedious. This may increase costs as a local professional is required to be hired.
- Regulatory landscape: The laws and regulations in the host country would be different and may be difficult to comply. An unusable regulatory landscape may pose risks to a cross border merger.
- Political scenario: It is essential to assess the political situation of the country before one enters into a merger with an entity belonging to that country. Unstable politics may lead to difficulties in carrying out business.

Valuation of Cross Border Firm

In cross border acquisitions, there can be factors important for considerations which are not considered at all in domestic acquisitions. Valuation is one such factor which changes with countries due to changes in exchange rate, stock market transactions and other macroeconomic developments**.**

Once identification has been completed, the process of valuing the target begins. A variety of valuation techniques are widely used in global business today each with its relative merits. In addition to the fundamental methodologies of discounted cash flow (DCF) and multiples (earnings and cash flow), there are also a variety of industry-specific measures that focus on the most significant elements of value in business lines.

We shall discuss a few valuation methods below:

- The DCF (Discounted Cash Flow) approach to valuation calculates the value of the enterprise as the present value of all future free cash flows less the cash flows due to creditors and minority shareholders.
- The P/E ratio is an indication of what the market is willing to pay for a currency unit of earnings. It is also an indication of how secure the markets perception is about the future earnings of the firm and its riskiness.
- The market-to-book ratio (M/B) is a method of valuing a firm on the basis of what the market believes the firm is worth over and above its capital, its original capital investment, and subsequent retained earnings. Like the P/E Ratio, the magnitude of the M/B ratio as compared with its major competitors, reflects the market's perception of the quality of the firm's earnings, management, and general strategic opportunities.

The completion of a variety of alternative valuations for the target firm aids not only in gaining a more complete picture of what price must be paid to complete the transaction, but also in determining whether the price is attractive.

Regulatory, competition, accounting and taxation aspects

Taxation of mergers and acquisitions in India

There can be different methods of asset acquisition. Irrespective of the method, the tax losses are not generally transferred to the buyer thereby remaining operating in the domain of the seller. When the

undertaking is acquired *via* slump sale where the particular picking up of assets by the buyer is not possible, some of the tax benefits/deductions of the undertaking are made available to the buyer.

If the transfer is made for inadequate consideration and the tax proceedings are going on against the transferor then the authorities have the power to claim the amount from the transferee on the completion of the proceedings, if the consideration for the transfer is found to be inadequate.

No GST is applicable to a slump sale, *i.e.,* wherein all the assets, rights, property and liabilities are transferred to the transferee. On the other hand, in a situation where particular assets are bought, the GST rate pertaining to the asset is applicable.

When the acquisition is *via* sale of shares, Securities Transition Tax (STT) is payable by both the buyer and when the shares are sold through a recognized stock exchange, STT is imposed on purchases and sales of equity shares listed on a recognized stock exchange in India at 0.1 percent based on the purchase or sale price.

Where a foreign company transfers shares of a foreign company to another company and the value of the shares is derived substantially from assets situated in India, then capital gains derived on the transfer are subject to income tax in India.

Further, payment for such shares is subject to Indian withholding tax (WHT). Shares of a foreign company are deemed to derive their value substantially from assets in India if such Indian assets are valued at a minimum of INR100 million and constitute at least 50 percent of the value of all the assets owned by such foreign company. A tax neutral status is provided where the resultant company is Indian (inbound merger) given that the transfer occurs through a slump sale and shareholders continue holding three-fourths of the shares.

If the foreign company is the parent company and the subsidiary is in India then the merger of the foreign company with another foreign company makes the newly created company, the owner of the Indian company provided that 25% of the shareholders of the amalgamating company remain the shareholders of the amalgamated company as well. Such a situation warrants for tax exemptions.

Regulatory Aspect

We have seen the regulatory framework around cross border mergers in the sections above. Let us now see how other key legislations regulate cross border mergers:

- The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (the FDI Regulations) and Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the ODI Regulations) are extremely important pieces of legislation for allowing foreign investment in India and hence prove to be pertinent to cross border mergers as well. In addition to this, the Reserve Bank of India (the RBI) has notified Foreign Exchange Management (Cross-Border Merger) Regulations, 2018 (the Cross-Border Regulation) under the Foreign Exchange Management Act, 1999. These Regulations specifically deal with cross border mergers and contain provisions pertaining to mergers, demergers, amalgamations and arrangements between Indian companies and foreign companies. These regulations also discuss the concepts of inbound and outbound investments. If the foreign company is a JV/WOS then it is required to adhere to the conditions mentioned in Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. Further, if the inbound merger of the JV/WOS leads to the acquisition of a subsidiary of the JV/WOS, then it is required to comply with the ODI Regulations, specifically regulations 6 and 7. If in an outbound merger, shares are being acquired by a person resident in India, then such acquisition becomes subject to the ODI Regulations as prescribed by the RBI.

- FDI Regulations: Cross border mergers essentially lead to inflow of foreign direct investment in the country and hence would be required to comply with the same. Foreign Direct Investment or FDI as it is called in common parlance is an investment by an entity or person who is resident outside India in the capital of an Indian company. An Indian company for the purposes of FDI would be a company incorporated in India under the applicable Companies Act. FDI can only be made through equity shares (shares which entitle its holder to vote), fully, compulsorily and mandatorily convertible debentures (instruments issued against loans) and fully, compulsorily and mandatorily convertible preference shares (shares which do not give voting rights). The two routes through which foreign investors may enter the country are government approval and automatic route. In a cross-border merger, the companies would have to comply with the FDI regulations as there would be inflow of foreign cash in the economy.
- Takeover Code: These come into picture, if the merger is happening with a listed company in India. If voting rights or control over the company is acquired then these regulations get triggered.

Competition angle

The Competition Commission of India (CCI) regulates the mergers in order to prevent the rise of monopolistic mergers. While mergers help in creating economies of scale and lead to increase in profits, they may also contribute to the creation of monopolistic structure. Hence mergers are made subject to the competition laws of the country.

The CCI has to assess and inquire into any merger which may have an adverse impact on the healthy competition in the market. While making such assessment as to the adverse effects the commission takes account of a number of factors such as actual and potential level of competition through imports in the market, extent of barriers to entry into the market, level of combination in the market etc.

Even a likelihood of causing of adverse impact is adequate for the competition commission to rule that the merger is creating an adverse impact. If the merged enterprise created post a cross-border merger possesses assets worth more than US $ 1 bn, or turnover more than US $ 3 bn; or the group to which the merged enterprise belongs possesses assets worth more than US $ 4 billion, or turnover more than US $ 12 billion then the competition commission is required to examine such combination.

Conflict of Jurisdictions is another such problem wherein whether or not the merger would affect the competition in the market positively or negatively would depend on the market situation which is unique to every country.

Accounting

In merger accounting, all the assets and liabilities of the transferor are consolidated at their existing book values. Under acquisition accounting, the consideration is allocated among the assets and liabilities acquired (on a fair value basis). Therefore, acquisition accounting may give rise to goodwill, which is normally amortized over 5 years.

Further, goodwill arising on merger will not be amortized; instead it will be tested for impairment. The accounting treatment of merger within a group is separately dealt with under the new Ind AS, which requires all assets and liabilities of the transferor to be recognized at their existing book values only.

The new Ind AS are to be implemented in a phased manner. All listed companies and companies with net worth of INR 500 crore or more are required to adopt the Ind AS from 1 April, 2016. Companies with net worth of INR 250 crore or more are required to adopt Ind AS from 1 April, 2017. Other companies will continue to apply existing accounting standards.

Cross Border Mergers – Earnouts: Cross Borders Mergers are subject to earnouts. An earnout is a contingent consideration whereby Buyer of the Target would decide an amount which is to be paid provided certain contingent considerations to happen. Cross Border Mergers specially covering Information Technology (IT), Technological Mergers, Banking Mergers are subject to Contingent Considerations. Earnouts are divided into 3 types:

- Cash Earnouts
- Equity Earnouts
- Stock Compensation Earnouts

Cross Borders Mergers – Carveouts: A Carve out is a Potential divestiture of a Business unit in which a parent company sells minority interest of a Child Company to outside Investors. A Carveout allows a company to capitalize on a Business segment that many not be part of its core operations.

Recent Judgments

Cross border mergers are a recent phenomenon. There have not been many judgements in this regard. However, the Vodafone International Holdings v Union of India decision of 2012 was a landmark decision. This case pertained to taxation of transfer of shares between two non-resident companies by virtue of which the controlling interest of an Indian resident company was acquired. The Supreme Court clarified the doubt over imposition of taxes in such situations and shed light on the following:

- The parameters of tax planning
- Business entities are permitted to structure their transactions in such a way so as to reduce their tax liability, in the absence of any law prohibiting them from doing the same
- Lifting of corporate veil
- Business transactions should be looked at holistically

While commenting upon the creation of subsidiaries through the process of mergers and acquisitions, the SC said that “the legal position of any company incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation. No multinational company can operate in a foreign jurisdiction save by operating as a good local citizen. If the owned company is wound up, the liquidator, and not the parent company, would get hold of the assets of the subsidiary. The difference is between having power or having a persuasive position”.

Post-merger performance evaluation

Cross border mergers can be truly assessed only by evaluating the post-merger performance of the merged entities. The following parameters may be used to assess the post-merger performance:

- Returns: A comparative analysis of the returns being generated by the entity pre and post-merger should be carried out. If the merged entity is earning significantly higher returns than the merger is deemed successful.
- Cash flow and operational efficiency: If post-merger the cash flow significantly increases and this increased cash flow is put to use to obtain operational efficiency, this too shows that the newly created entity is performing well.
- Stock market reaction: If the stock market reaction to the announcement of merger is positive then the merger appears to be a positive step.

Practical Insights

Some practicalities which need to be kept in mind while entering cross border mergers are:

(a) Conduct due diligence on the other firm.

(b) Conduct a risk-benefit analysis before entering into the merger.

(c) Valuation of both the firms is essential so as to predict the competition law treatment of the merger.

(d) Make sure that when you enter into an outbound merger it is with a company from one of the prescribed jurisdictions.

(e) Have an in-depth analysis of the host country's regulatory and political landscape ready before you take the decision of the merger.

Annexure A

Foreign Exchange Management (Cross Border Merger) Regulations, 2018

Notification No. FEMA.389/2018-RB

Dated: March 20, 2018

In exercise of the powers conferred by sub-section (3) of section (6) read with section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank makes the following regulations relating to merger, amalgamation and arrangement between Indian companies and foreign companies:

1. Short title and commencement

(i) These regulations may be called the Foreign Exchange Management (Cross border Merger) Regulations, 2018.

(ii) They shall come into force from the date of their publication in the Official Gazette.

2. Definitions

In these Regulations unless the context requires otherwise, -

(i) 'Act' means the Foreign Exchange Management Act, 1999 (42 of 1999);

(ii) 'Companies Act' means The Companies Act, 2013;

(iii) 'Cross border merger' means any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 notified under the Companies Act, 2013;

(iv) 'Foreign company' means any company or body corporate incorporated outside India whether having a place of business in India or not;

Explanation: for the purpose of outbound mergers, the foreign company should be incorporated in a jurisdiction specified in Annexure B to Companies (Compromises, Arrangements and Amalgamation) Rules, 2016;

(v) 'Inbound merger' means a cross border merger where the resultant company is an Indian company;

(vi) 'Indian company' means a company incorporated under the Companies Act, 2013 or under any previous company law;

(vii) 'NCLT' means National Company Law Tribunal as defined under the Companies Act, 2013 or rules framed thereunder;

(viii) 'Outbound merger' means a cross border merger where the resultant company is a foreign company;

(ix) 'Resultant company' means an Indian company or a foreign company which takes over the assets and liabilities of the companies involved in the cross border merger;

(x) The words and expressions used but not defined in these Regulations shall have the same meanings respectively assigned to them in the Act.

3. Save as otherwise provided in the Act or rules or regulations framed thereunder or with the general or special permission of Reserve Bank, no person resident in India shall acquire or transfer any security or debt or asset outside India and no person resident outside India shall acquire or transfer any security or debt or asset in India on account of cross border mergers.

Explanation: Cross Border Mergers pending before the competent authority as on date of commencement of these regulations shall be governed by these Regulations.

4. Inbound merger: A merger or amalgamation of foreign company with an Indian company

(1) the resultant company may issue or transfer any security and/or a foreign security, as the case may be, to a person resident outside India in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.

Provided that

(i) where the foreign company is a joint venture (JV)/ wholly owned subsidiary (WOS) of the Indian company, it shall comply with the conditions prescribed for transfer of shares of such JV/ WOS by the Indian party as laid down in Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004;

(ii) where the inbound merger of the JV/WOS results into acquisition of the Step down subsidiary of JV/ WOS of the Indian party by the resultant company, then such acquisition should be in compliance with Regulation 6 and 7 of Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004.

(2) An office outside India of the foreign company, pursuant to the sanction of the Scheme of cross border merger shall be deemed to be the branch/office outside India of the resultant company in accordance with the Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015. Accordingly, the resultant company may undertake any transaction as permitted to a branch/office under the aforesaid Regulations.

(3) The guarantees or outstanding borrowings of the foreign company from overseas sources which become the borrowing of the resultant company or any borrowing from overseas sources entering into the books of resultant company shall conform, within a period of two years, to the External Commercial

Borrowing norms or Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 or Foreign Exchange Management (Borrowing or Lending in Rupees) Regulations, 2000 or Foreign Exchange Management (Guarantee) Regulations, 2000, as applicable.

Provided that no remittance for repayment of such liability is made from India within such period of two years;

Provided further that the conditions with respect to end use shall not apply.

(4) The resultant company may acquire and hold any asset outside India which an Indian company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

(5) Where the asset or security outside India is not permitted to be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.

(6) The resultant company may open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross border merger for a maximum period of two years from the date of sanction of the Scheme by NCLT.

5. Outbound merger: A merger or amalgamation of Indian company with a foreign company

(1) a person resident in India may acquire or hold securities of the resultant company in accordance with the Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2004.

(2) a resident individual may acquire securities outside India provided that the fair market value of such securities is within the limits prescribed under the Liberalized Remittance Scheme laid down in the Act or rules or regulations framed thereunder.

(3) An office in India of the Indian company, pursuant to sanction of the Scheme of cross border merger, may be deemed to be a branch office in India of the resultant company in accordance with the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. Accordingly, the resultant company may undertake any transaction as permitted to a branch office under the aforesaid Regulations.

(4) The guarantees or outstanding borrowings of the Indian company which become the liabilities of the resultant company shall be repaid as per the Scheme sanctioned by the NCLT in terms of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

Provided that the resultant company shall not acquire any liability payable towards a lender in India in Rupees which is not in conformity with the Act or rules or regulations framed thereunder.

Provided further that a no-objection certificate to this effect should be obtained from the lenders in India of the Indian company.

(5) The resultant company may acquire and hold any asset in India which a foreign company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be

transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

(6) Where the asset or security in India cannot be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated outside India immediately through banking channels. Repayment of Indian liabilities from sale proceeds of such assets or securities within the period of two years shall be permissible.

(7) The resultant company may open a Special Non-Resident Rupee Account (SNRR Account) in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 for the purpose of putting through transactions under these Regulations. The account shall run for a maximum period of two years from the date of sanction of the Scheme by NCLT.

6. Valuation of companies involved in cross border merger

The valuation of the Indian company and the foreign company shall be done in accordance with Rule 25A of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

7. Miscellaneous

(1) Compensation by the resultant company, to a holder of a security of the Indian company or the foreign company, as the case may be, may be paid, in accordance with the Scheme sanctioned by the NCLT.

(2) The companies involved in the cross border merger shall ensure that regulatory actions, if any, prior to merger, with respect to non-compliance, contravention, violation, as the case may be, of the Act or the Rules or the Regulations framed thereunder shall be completed.

8. Reporting

(1) The resultant company and/or the companies involved in the cross border merger shall be required to furnish reports as may be prescribed by the Reserve Bank, in consultation with the Government of India, from time to time.

9. Deemed approval

(1) Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

(2) A certificate from the Managing Director/Whole Time Director and Company Secretary, if available, of the company(ies) concerned ensuring compliance to these Regulations shall be furnished along with the application made to the NCLT under the Companies (Compromises, Arrangements or Amalgamations) Rules, 2016.

LESSON ROUND UP

- Cross border merger is a recent trend and a very profitable one. If Indian companies have to make their presence felt globally, it is essential for India to have a sound legal framework pertaining to cross border mergers.
- The recent merger regulations, section 234 and the Companies Amalgamation Rules are a step towards

strengthening this legal regime. Apart from the company law, other legislations such as tax and competition laws also play a key role in perpetuating cross border merger transactions.

- Section 234 of the Companies Act, 2013 notified in 2017 is the key legal provision governing cross border mergers.
- Companies Amalgamation Rules and sections 230-234 of the Companies Act, 2013 regulate the procedure of mergers.
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018, have brought the concept of outbound merger in the country as well.
- Discounted cash flow, private equity and market to book ratios are some of the ways in which a cross border firm may be valued.
- Apart from companies Act, other considerations such as tax and competition laws also play a major role in cross border mergers.

GLOSSARY OF TECHNICAL WORDS

Foreign company means company incorporated outside India.

Indian company means company incorporated under Companies Act, 2013.

Inbound merger is a merger wherein as a result of the merger of a foreign entity and an Indian entity an Indian company is formed.

Outbound merger is one wherein as a result of the merger of a foreign entity with an Indian entity a foreign company is formed.

Cross border merger means any merger, amalgamation or arrangement between an Indian company and foreign company under the Act.

Resultant Company means an Indian company or a foreign company which takes over assets and liabilities of the companies involved in a merger.

Earnout is a contingent consideration agreed between both Buyer and Seller at the time of acquisition. It is subject to P&L Impact at the time of Books Close.

LIST OF FURTHER READINGS

1. Guide to Companies Act by A Ramaiya 18th Edition, Lexis Nexis
2. Company Law and Practice - A Textbook on Companies Act, 2013 by G.K. Kapoor and Sanjay Dhamija, 23rd Edition, Taxmann Publications
3. Mergers Acquisitions & Corporate Restructuring, 3rd Edition by Taxmann

SELF-TEST QUESTIONS

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is a cross border merger? Explain the legal regime in India around a cross border merger?
2. What are the changes brought about by the Foreign Exchange Management (Cross Border Merger) Regulations, 2018. Critically analyse the same.
3. Explain the tax implications and the accounting parameters associated with cross border mergers?

4. Discuss the taxation of cross border mergers in India.
5. Mention the jurisdictions specified in Rule 25A of Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING INSOLVENCY, LIQUIDATION AND WINDING UP

PP-CRILW

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet "A Guide to CS Students" providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download it from http://www.icsi.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

PROFESSIONAL PROGRAMME

CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

TEST PAPER

Time Allowed: 3 hours *Maximum Marks: 100*

NOTE: *Answer All Questions.*

(This Test Paper is for recapitulation and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.)

PART I (50 Marks)
(Corporate Restructuring)

1. (a) What aspects are to be considered while planning or implementing a corporate restructuring strategy? *(5 marks)*

(b) State the procedure for investigation of 'combination' by the Competition Commission under the provisions of the Competition Act, 2002. *(5 marks)*

(c) Mergers and acquisitions is a highly regulated activity and various approvals are required for the sanction of a scheme of merger and amalgamation. Briefly mention the various regulatory approvals required. *(10 marks)*

2. (a) Write a note on Foreign Exchange management (Cross Border Merger) Regulations, 2018.

(b) How are mergers and takeovers funded? Explain funding through leveraged buy-outs.

(c) Why is 'valuation' important in merger or amalgamations exercise? Explain 'valuation based on assets' method. *(5 marks each)*

OR

2A. (i) Discuss 'pricing in public issue' under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018?

(ii) State the object and reasons for buy-back of shares. Explain the provisions relating to buy back of shares through book-building route.

(iii) Explain 'Registered Valuer' as a new concept introduced under the Companies Act, 2013.

(5 marks each)

3. (a) Describe legal provisions of Companies Act, 2013 with respect to protection of 'minority interest' in mergers and amalgamation.

(b) The introduction of section 233 (Fast Track Merger) in the Companies Act, 2013 is a much awaited reform as it has eased the process or amalgamation of companies which have limited resources. Describe in brief the salient features of Fast Track Merger.

(c) "Taxation is an important factor while planning for merger and amalgamation. Merger transactions are carried out taking into account the savings on account of taxation." In the light of this statement, discuss the tax advantages of mergers. *(5 marks each)*