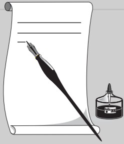

Corporate Restructuring under the Companies Bill, 2008 - A Critical Analysis

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Some radical changes have been proposed in the provisions of existing company law relating to restructuring including amalgamations, compromises, arrangement, etc. This article initially examines these proposals.

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INTRODUCTION

Companies Act, 1956 (the Act) is the largest Act in India comprising of 658 sections and 15 Schedules. In addition thereto, there are various Rules & Regulations notified by the Government under the Act. The Act has been amended from time to time in order to address the issues raised by the corporate sector and to protect the interests of the investors. The last major amendments were made in the year 2002 by the Companies (Second Amendment) Act, 2002 which became effective from 13th January, 2003.

The Central Government had prepared a "Concept Paper on New Company Law" in August, 2004 for discussion and inviting comments from the corporate sector and the professional bodies. The suggestions received from various quarters were reviewed and thereafter, the Government constituted an expert committee, under the Chairmanship of Dr. J.J. Irani, in December, 2004 for a comprehensive review of the Act. The said Committee submitted its Report to the Government on 31st May 2005. The Companies Bill, 2008 (the Bill) has been drafted after taking into account the recommendations of the said Committee and the deliberations on critical issues between various Ministries, Departments, Regulatory Authorities & the professional bodies. The Bill comprising of 426 clauses was introduced in Lok Sabha by Mr. Prem Chand Gupta, the Hon'ble Minister of Corporate Affairs on 23rd October, 2008. Consequently, the Companies (Amendment) Bill, 2003 which was introduced in Rajya Sabha on 7th May, 2003 was withdrawn on 21st October, 2008. The Bill has proposed some far reaching changes in the statutory and regulatory framework for corporate entities and once it is enacted, it will replace the existing Companies Act, 1956 in *toto*.

HIGHLIGHTS OF THE BILL

- Concept of One Person Company (OPC Limited) and Small Companies has been introduced.
- Unlisted public companies, as may be prescribed by the Central Government, shall also be required to appoint independent directors.
- Casting of votes by members at General Meetings through electronic means.
- Stringent conditions for acceptance of public deposits viz., special permission under the Acts before inviting deposits providing deposit insurance; creation of charge on company's assets etc.
- Key Managerial Personnel (KMP) to include CEO, CFO & CS.
- Making Insider Trading in shares a criminal offence.
- Consolidation of financial statements of subsidiary companies with the holding company has been made mandatory.
- Investors claim for unclaimed dividend, deposits etc. shall not be extinguished even after transfer to the Investor Education & Protection Fund. The Fund would be administered by a statutory authority.
- More stringent requirements in case dividend is to be paid out of past profits.
- Provision has been made for class action suits.
- The entire rehabilitation & liquidation process has been made time bound.
- Revised frame work for corporate restructuring.

The Indian economy is making rapid strides ahead to catch up with the developed economies and in this backdrop the term "Corporate Restructuring" has become a buzz word today in the business world. This Article exclusively focuses on the provisions of the Companies Bill, 2008 dealing with corporate restructuring and an attempt has been made to do an in-depth critical analysis of the proposed provisions.

COMPETENT AUTHORITY FOR CORPORATE RESTRUCTURING MATTERS

At present Sections 390 to 396A of the Companies Act, 1956 deal with Compromises, Arrangements and Reconstruction of Companies. The Companies (Second Amendment) Act, 2002 has substituted the word "Tribunal" in place of the words "High Court" appearing in the aforesaid sections of the Act. In other words, the Amendment Act proposed to constitute and empower a separate Tribunal namely, National Company Law Tribunal (NCLT) to deal with the matters relating to Corporate Restructuring. However, ever since the Amendment Act was enacted, the provisions of the Companies Act,1956 relating to constitution and functioning of the Tribunal became subject matter of controversy.

In the year 2004, Madras Bar Association through its President Mr. R. Gandhi filed a writ petition before the Madras High Court challenging the provisions of the Act relating to establishment of NCLT and certain other provisions guiding it. The Court has allowed the petition and held that " *Until the provisions in parts 1B and 1C of the Companies Act introduced by the Companies (Amendment) Act, 2002, which have been found to be defective in as much as they are in breach of the basic constitutional scheme of separation of powers and independence of the judicial function, are duly amended, by removing the defects that have been pointed out, it would be unconstitutional to constitute a Tribunal and Appellate Tribunal to exercise the jurisdiction now exercised by the High Courts or the Company Law Board."*. The Central Government has filed a Special Leave Petition with the Supreme Court seeking a stay against the aforesaid High Court order. The matter is yet to be decided by the Supreme Court. Hence the NCLT and the Appellate Tribunal, to take over the functions hitherto being performed by the Company Courts, BIFR, AAIFR and CLB, have not yet been established.

In view of this the matters relating to corporate restructuring continue to be under the jurisdiction of the concerned High Courts. However, Companies Bill, 2008 has once again specified that NCLT shall be the competent authority to deal with compromises, arrangements and amalgamations. From a perusal of Chapter XXVI of the Bill, it becomes clear that the Ministry has made some changes in the provisions relating to the Constitution of Tribunal etc. as compared to the provisions contained in parts 1B and 1C of the Companies Act, 1956. However, only time would tell us whether the NCLT will be able to have a smooth sailing or once again it would get struck in rough weather.

PROVISIONS RELATING TO COMPROMISES & ARRANGEMENTS

Clause 201(2) prescribes the procedure for compromises and arrangements between a Company and its creditors and / or the members. The procedure for compromise or arrangement, in brief, is as under:-

(1) An application has to be filed with NCLT by way of an affidavit.

(2) The said application/affidavit has to be supported by:-

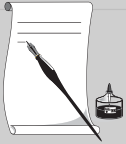
- All material facts and latest financial position of the Company, Auditors' Report and the pendency of any investigation or proceedings against the Company.
- Details of Reduction of Share Capital, if any.
- Detailed Scheme of Corporate Debt Restructuring (CDR). The CDR scheme should have been consented by not less than 75% of the secured creditors in value and application should be supported by creditors responsibility statements, Auditors Certificate regarding fund requirements and liquidity. In case the company proposes to adopt the CDR guidelines specified by RBI, a statement to that effect and Valuation Report in respect of shares and the property and all assets by a registered valuer should also be submitted.

(3) If the application filed with the Tribunal is found to be complete in all respects, the Tribunal would order holding of separate meetings of the creditors and members. The notice of meeting can be given to the creditors and the members either individually or by an advertisement. The Notice shall be accompanied by a statement disclosing the details of the Compromise or Arrangement and the Valuation Report, if any. The notice shall also explain the effect of the compromise on creditors, members and the debenture holders as well as the interest of the directors of the Company.

Thus it is has been proposed to deviate from the present system in as much as at present the Valuation Report is to be submitted only to Stock Exchanges, High Court and the Regional Director(if called for) but it is not sent to the shareholders.

(4) The persons to whom the notice is sent shall intimate in writing their consent to the adoption of the compromise or arrangement within one month of the receipt of the notice. The proviso to clause 201(4) specifically provides that any objection to the compromise or arrangement can be made only by the equity shareholders who hold not less than 10% of the shareholding. In case any creditor wants to object then he should have atleast 5% of the total outstanding debt.

Thus only the shareholders holding atleast 10% of the equity capital can cast their vote of dissent through postal ballot. If the small shareholders, want to vote in "Favour" of the Scheme then they can cast their vote through postal ballot but if they want to vote "Against" the Scheme, they cannot cast their vote through postal ballot. They can do so only at the meeting by attending it personally or through proxy. This does not seem to be appropriate because if postal ballot is allowed then the shareholders should have complete freedom to vote and the law should not compel them to exercise their vote in "Favour" of the Scheme.



Only then, the ultimate goal of shareholders' democracy can be achieved.

(5) A Copy of notice together with the requisite documents has to be sent to the Central Government, RBI, SEBI, ROC, the concerned Stock Exchanges, Official Liquidator and the Competition Commission of India, if necessary. The aforesaid Regulatory authorities will have to submit their representations within one month of the receipt of notice. It may be noted here that the Competition Act, 2002 has not yet been fully notified since the constitutional validity of some of the provisions of the Act and the rules framed there under have been challenged in the case of *Brahm Dutt* v. *Union of India*.

(6) At the meeting of the members/creditors, the Scheme has to be approved by a majority of members/creditors, representing three-fourths in value of the members/ creditors, present and voting in person or by proxy or by postal ballot.

(7) After the meeting, the Tribunal shall, if thought fit, pass an order approving the Scheme which may provide for:-

- Conversion of preference shares into equity with an option to the preference shareholders to obtain arrears of dividend in cash or accept equity shares.
- Protection of any class of creditors.
- Variation in the rights of the shareholders.
- If agreed by the creditors, abatement of any proceeding pending before the Board for Industrial and Financial Reconstruction.
- Buy back of securities is not permitted under this section.
- Compromise/arrangement may include takeover offer as prescribed.

(8) The order of the Tribunal shall be filed with the ROC within 30 days. Section 391(4) of the Act provides that a copy of every such order has to be annexed to every copy of the Memorandum of Association of the Company that is issued after the Certified copy of the order has been filed with ROC. However, there is no such provision in the Companies Bill, 2008.

Clause 202 provides that the Tribunal shall have the power to supervise the implementation of the compromise or arrangement, which is similar to Section 392 of the Companies Act, 1956.

PROVISIONS RELATING TO MERGERS & AMALGAMATIONS

Clause 203 deals with the mergers and amalgamations of two or more companies. The application has to be made to the Tribunal in accordance with the procedure prescribed under Clause 201. Where it is shown to the Tribunal that the compromise or arrangement proposed involves merger or amalgamation of two or more companies and that under the Scheme the whole or any part of the undertaking, property or liabilities of one or more companies are to be transferred to another company or the same is proposed to be divided among and transferred to two or more companies, the Tribunal may order holding of a meeting of the members/ creditors as the case may be. Provisions specified under Sub-clause (3) to sub-clause (6) of Clause 201 have to be followed in respect of such meetings.

The following documents are to be circulated along with the notice of the meeting :-

(a) Scheme of Amalgamation approved by the Board of Directors.

(b) Confirmation that a copy of the draft Scheme has been filed with ROC.

(c) A report of Directors of merging company explaining effect of compromise/merger on the shareholders, laying out the share exchange ratio and specifying any special valuation difficulties.

(d) Report of the expert on valuation, etc.

(e) Supplementary accounting statement where the last audited accounting statement is more than six months old before the first meeting of the company summoned for the purposes of approving the Scheme.

(f) Approval of the draft of the proposed terms by an ordinary resolution of the transferor company(ies) in the case of merger by formation of a new company.

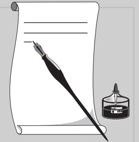
Thereafter, the Tribunal after satisfying itself that the prescribed procedure has been complied with, may sanction the merger & amalgamation and such order may provide for any of the following matters:-

- Transfer of employees of the transferor company to transferee company.
- Where transferor company is a listed entity and transferee company is an unlisted entity;
  - Transferee company shall continue to be an unlisted company.
  - Exit opportunity for the shareholders of the transferor company shall be provided for, in case they wish to opt out.
  - Where transferor company is not dissolved, it shall become unlisted and if left with small portion of assets, exit opportunity shall be provided to the public shareholders.

The order of the Tribunal has to be filed with ROC within 30 days of the receipt of the certified copy of the order from Tribunal.

PENALTY

Clause 203(6) provides that in case of default in compliance with any of the provisions specified in Clause 203, the transferor company or the transferee company or both shall be punishable with fine which shall not be less than Rs. 1,00,000/- but which may extend to Rs. 25,00,000/- and every officer in default shall be punishable with imprisonment upto one year or with fine of not less than Rs. 1,00,000/- but which may extend to Rs. 3,00,000/-. As compared to this, Section 391(4) of the Act, does not contain any provision with respect to imprisonment and the penalty



provided is meagre amount extending up to Rs. 50,000/- on the company and on every officer of the company who is in default.

INCREASE OF AUTHORISED CAPITAL OF TRANSFEREE COMPANY ON MERGER

Clause 203(3)(i) provides that, "where the transferor company is dissolved, the fee, if any, paid by the transferor company *(wrongly stated in the Bill as 'transferee 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."

It may be noted that so far there is lot of controversy on this issue and whenever any Scheme of Amalgamation is filed with the concerned Regional Director(RD) for clearance, then the RD usually puts forth the following objections :-

(a) The authorised capital is not a liability like other liabilities which are to be returned or refunded and hence the Authorised Capital cannot come within the purview of the liabilities that are to be transferred pursuant to the Scheme.

(b) Upon the Scheme of Amalgamation becoming effective, the transferor company stands dissolved and therefore if the transferee company wants to increase its authorised capital, it has to comply with the provisions of Sections 94 and 97 of the Act by filing necessary forms with ROC together with the requisite registration/filing fee.

Thus when RD files his objections in the concerned High Court, then the High Court has to take a view on the issue. In this respect so far different High Courts have delivered different judgements.The following High Court rulings are worth noting:-

(A) In the matter of Amalgamation of *Jaypee Greens Ltd*. (transferor company) with *Jaypee Associates Ltd.* (transferee company), the Scheme of Amalgamation proposed that the authorised share capital of Rs. 8,000 lacs of the transferor company would be added to the authorised capital of Rs. 98,000 lacs of the transferee company. The Regional Director raised the objection that the transferee company needs to pay the stamp duty for increasing the authorised capital and follow the procedure prescribed under the Act. The Allahabad High Court in its landmark judgement on 8th August, 2006 has held that the whole purpose of Section 391 of the Act, is to reconstitute the company without the company being required to make a number of applications under the Act, for various alterations that may be required in the Memorandum & Articles of Association for functioning as a reconstituted company under the Scheme. Since the combined authorised capital of the amalgamated company does not exceed the authorised capital of the two companies, there is no need for payment of any further registration fees or stamp duty. Thus, the High Court overruled both the objections raised by the Regional Director.

(B) In the Scheme of Amalgamation of *Shubhlaxmi Syntex Pvt. Ltd* . and *Shubhlaxmi Industries Ltd.* (transferor companies) with *Shubhlaxmi Polyesters Limited* (transferee company) also, similar objections were raised by RD. The Gujarat High Court sanctioned the Scheme with the observation that the transferee company would be required to follow the procedure prescribed under Sections 94 & 97 of the Act and the necessary stamp duty for the increase of authorised capital might be required to the paid but after deductions for set-off of stamp duty already paid by the transferor companies.

Thus the proposed Clause 203 is a very welcome move since after the enactment of the Companies Bill, 2008 the controversy with respect to payment of registration fee on increase of authorised capital of the transferee company subsequent to amalgamation would be set at rest.

SIMPLIFIED PROCEDURE FOR MERGER OF SMALL COMPANIES

Clause 204 provides a simplified procedure for mergers and amalgamations of small companies as well as the merger of wholly owned subsidiary(ies) with the holding company. The definition of "small company" given under Section 2(1)(zzzg) is as under :-

"Small company" means a company, other than a public company,-

(i) whose paid-up share capital does not exceed such amount as may be prescribed and the prescribed amount shall not be more than five crore rupees; or

(ii) whose turnover as per its last profit and loss account does not exceed such amount as may be prescribed and the prescribed amount shall not be more than twenty crore rupees;

Provided that nothing in this clause shall apply to –

(A) a holding company or a subsidiary company;

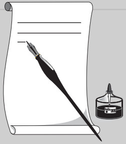
(B) a company registered under Section 4; or

(C) a company or body corporate governed by any special Act;

Thus, it is clear that only two private limited companies can take advantage of the proposed simplified procedure for mergers and amalgamations and that too when the paid-up share capital or the turnover of both the companies is within the limit prescribed by the Government. This does not seem to be appropriate since closely held public limited companies can also be allowed to merge under the simplified procedure. Debarring closely held public companies from this special route does not seem to be justified because some of the private limited companies may be having more share capital and greater turnover as compared to the closely held public companies. Therefore, it is suggested that Clause 204 be amended so as to extend the benefit of the simplified procedure of mergers and amalgamations to closely held public companies also.

The Proposed Simplified Procedure

- Notice of the proposed scheme, has to be issued to the affected persons, by both the transferor and the transferee company. Such affected persons have to submit their objections within 30 days.
- The objections received are to be considered by the companies at their general meetings. Thereafter, the scheme is to be approved by passing special resolutions.
- The creditors of the Company have to be given twenty one



days notice of the meeting, together with a copy of the scheme. Three-fourths in value of the creditors have to approve the scheme at the meeting or in writing.

- The transferee company has to file a copy of the scheme with the Registrar of Companies (ROC) and the Official Liquidator (OL).
- If OL has any objection, he may communicate the same to ROC within 30 days. In case ROC does not receive any communication from OL, it shall be presumed that OL has no objection.
- If ROC and OL have no objections, the ROC shall register the scheme and the amalgamation becomes effective from the date of registration.
- If the ROC after receiving the comments of OL or for any other reason, is of the opinion that the scheme is not in the public interest or in the interest of creditors, he may file an application with the Tribunal within 90 days of receipt of scheme.
- On receipt of the application from ROC, the Tribunal may either confirm the scheme or direct that the scheme ought to be heard in accordance with the procedure laid down in Clause 203 i.e, the normal procedure for mergers and amalgamations.
- A copy of the order of the Tribunal sanctioning the scheme has to be filed with ROC, who shall register the same.
- It has been specifically provided in the proviso to Clause 204(6) that if ROC does not file any application with the Tribunal it shall be deemed that ROC and OL do not have any objection to the scheme.

Thus, the Bill proposes very fast track process for merger of small companies which will be very cost effective also.

MERGER OF AN INDIAN COMPANY AND A FOREIGN COMPANY

The Companies Act, 1956 does not allow merger of an Indian Company with a foreign Company and *vice-versa*. Clause 205 of the Companies Bill, 2008 permits mergers and amalgamations of Indian companies with the foreign companies incorporated in only those countries that may be notified by the Central Government from time to time. Thus, the new Act will permit not only the mergers of foreign companies into Indian Companies but also mergers of Indian Companies into foreign companies. However, procedure for such mergers has not been provided in the Bill. Therefore we can presume that the normal procedure in India as well as the procedure in the foreign country, where the other company has been incorporated, shall have to be complied with in order to give effect to the merger of such companies.

Thus, the new Act will enable the Indian companies, that are carrying on businesses in foreign countries through their subsidiaries abroad to merge these subsidiaries into themselves. The proposed law also allows merger of an Indian company into a foreign company, which may not be in the interest of the Country since the legal entity of the Indian company will come to an end as a result of which the foreign company would be subject to the laws of its country of residence and the government control would get diluted. Moreover the shareholders of the Indian transferor company(ies) who may be issued Indian Depository Receipts will not have any voting rights in the foreign company. Thus IDR holders will not have any say in the management of the foreign company . The effect of this move will become clear in due course of time. Therefore, it would be appropriate if only mergers of the foreign companies into the Indian Companies are allowed in the initial stage and not *vice-versa*.

MISCELLANEOUS PROVISIONS

- Clause 206 provides that where a scheme involves transfer of shares of the transferor company to the transferee company and the offer made by the transferee company has been approved by the shareholders holding nine-tenth in value of the shares, then the transferee company at any time within two months give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares. The said clause prescribes the detailed procedure for acquisition of the shares of such dissenting shareholder(s).
- Clause 207 provides for purchase of equity shares of minority shareholders in case the acquirer becomes holder of more than 90% of the issued equity capital after restructuring.
- Clause 208 empowers the Central Government to order Amalgamation of certain companies in the public interest.
- Clause 209 deals with the circular etc. that is to be issued to the shareholders in respect of the offer to purchase their shares pursuant to Clause 206.
- Clause 210 deals with preservation of books and papers of amalgamated companies.
- Clause 211 provides that the liability of the "Officers in default" for the offences committed prior to merger, amalgamation or acquisition shall continue even after such acquisition, merger or amalgamation.

CONCLUSION

The Companies Bill, 2008 which proposes some far reaching changes in the statutory and regulatory framework for companies is expected to address the business and investor communities' desire for a more contemporary and effective regulatory environment. The Bill *inter alia* has proposed substantial changes in the manner in which the Compromises and Arrangements are being carried out under the existing provisions. The comprehensive revamp of the entire corporate restructuring process is likely to bring about more transparency in the entire process which is likely to go a long way in the interest of investor protection. The Bill would also enable Indian companies to merge into themselves, their foreign subsidiaries as well as other companies incorporated in foreign countries and thus would enable them to become truly global in size to meet the challenges in fiercely competitive global market. However, earlier also the Government has made few attempts to replace the existing Companies Act, 1956 in *toto* with new legislation but the same were not successful. It is hoped that this time, the Companies Bill, 2008 will be able to successfully sail through all the tides and reach its shore. ❑