CRITICAL ANALYSIS OF COMPANIES BILL 2011 WITH SPECIAL EMPHASIS ON MERGERS AND AMALGAMATION PROVISIONS

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I. INTRODUCTION

The world as we know it is abundant in its resources. Some areas have the availability of manual labour while some others are characterized by the natural and mineral resources. It is an undeniable fact that the mobilization and integration of both these resources can take forward the process of industrialization. This has been executed perfectly by the globalization process, wherein different segmented areas of the world have been brought into a framework under which these scattered resources are used in an *"integrationist fashion"*. Thomas L. Freidman best analyzed this phenomenon and concluded that *"the world is flat"*,[2] essentially implying a level playing field where all competitors have an equal opportunity. Therefore, it is essential that an organization working in a particular field understands where its maximum potential may be exploited for which it needs to be on a constant *"look out"*. It is only when one has an optimal mix of all the factors of manufacturing, production and distribution it can claim to be on to road to success.

In this background, the authors assert that mergers and acquisitions should be appreciated in the context of globalization, competition and augmentation of existing potential resources. Karl Marx had, over a century ago, remarked that capital will flow everywhere and anywhere, where there is a potential for surplus. Applying the same analogy, instrumentalities of capital and business i.e. corporations will drive down to wherever and whenever there is a potential for surplus. India Inc. presents us with the best example in this regard. With its economy not strained by the recession of the West or the sovereign debt crisis in Europe, it has provided a platform for a booming M&A market. Taking advantage of such potential surplus, Indian private businesses have reached out for cross border acquisitions and have already left an indelible mark in the M&A segment.

For most of 2011, the corporate merger and acquisition (M&A) market in India was hyperactive, with some of the largest deals in the country's corporate history announced and completed.[3] A survey of recent corporate transactions indicates that

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[2]Thomas L. Freidman, *The World Is Flat: A Brief History of the Twenty-first Century* (Farrar, Straus & Giroux ed., 2005)

[3]Mergers and acquisitions (M&As) in India surged a whopping 270% in terms of deal value in the first

the corporate houses in India are showing a renewed interest in escalating their operation, consolidating their market shares, and increasing profitability through M&A activities. In particular, the first and third quarters of 2011 have seen a great deal of activity due to increased liquidity and investor appetite. Indian private businesses have shown more enthusiasm for cross border acquisitions, with a majority of them expecting their deals to be international.[4] In recent years there has also been a significant amount of strategic inward investment into India. The booming M&A market was facilitated by an economy that up until the end of 2011 was growing at a rate in excess of 6% per annum at a time when the performance of other economies of the world was being influenced by external factors like euro zone sovereign debt crisis and rising prices of commodities. It is worthwhile to see that the degree of impact of global economic slowdown has been less on Indian economy, as compared to other countries like U.S., there has been some tapering off in the domestic M&A market in 2011, although this has generally affected the size rather than the number of deals. There is therefore still a considerable amount of M&A activity, but the bulk of these deals can probably be described as mid-market.

Given the continuous growth of M&A transactions in India, this note seeks to discuss and critically examine the current as well as proposed regulatory regime for M&A activities in India. For this purpose, this note has been structured into three parts. Part I would acquaint the reader with the current regulatory framework for M&A and related transactions in India. It would also provide a background to the recently proposed Companies Bill 2011. Part II would critically analyze the different provisions of Bill as regards M&A and at the same time; the proposed provisions would be evaluated at the cornerstone of the present Companies Act. Part III would conclude, inter alia, providing few legislative suggestions.

II. REGULATORY FRAMEWORK FOR M&A TRANSACTIONS IN INDIA

1. Present Regulatory Framework

The basic legislative framework regulating various forms of corporate restructuring (such as mergers, acquisitions, amalgamations and takeovers) in India is set out in

three months of the year as a result of following big-ticket announcements: *Mahindra & Mahindra* acquiring South Korean auto maker *Ssangyong Motor Company Limited (SYMC)* for $ 463M; *Vedanta* acquired *Cairn* India for a $8.6 billion; IT firm *iGate* acquired *Patni Computers* for an $1.2 billion; *Vodafone* Group announced that it would buy 33 percent stake in its Indian joint venture for about 5 billion dollars after the *Essar Group* sold its holding and exited *Vodafone; Reliance Industries* signed a 7.2 billion dollar deal with UK energy giant *BP*, with 30 percent stake in 21 oil and gas blocks operated in India; India's second largest hospital chain, *Fortis Healthcare (India) Ltd*, announced that it will merge with *Fortis Healthcare International Pvt Ltd.*, the promoters' privately held company; *GVK Power* bought out Australia's *Hancock Coal* for about 1.26 billion dollars.

[4]Rajiv K. Luthra and G.R. Bhatia, *Chapter 16: India*, in THE MERGER CONTROL REVIEW 157 (I.K. Gotts ed., 2011)

the Companies Act, 1956. As per the relevant provisions, the process of corporate restructuring involves the formation of a scheme that is to be presented to the High Court for approval[5], and requires approval from three-quarters of the total shareholder strength as well as from the majority of the creditors.[6] Parties to the merger transaction are also required to comply with the regulations laid down by Securities and Exchange Board of India ('SEBI'), which governs all listed companies. In particular, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation 2011, popularly known as Takeover Code, mandates that any person acquiring shares or securities representing 25% of the voting rights in a listed Indian company must necessarily offer existing shareholders an opportunity to exit the company[7] by extending an offer to purchase an additional 26% shareholding from them at the same price or a higher price.[8] The Takeover Code also applies to certain unlisted companies, including a body corporate incorporated outside India, to the extent that the proposed acquisition leads to the transfer of control of a listed company to the acquirer. Apart from the Companies Act, 1956 and the Takeover Code, the Merger Control Provisions under the Competition Commission Act, 2002, popularly known as *'Combination Regulations'*, cover the acquisition of shares, voting rights, assets or control, mergers and amalgamations which are of certain notified thresholds.[9] These provisions have added a significant new layer to the myriad of merger control laws and regulations already in force in India.[10]

2. *Proposed Regulatory Framework*

In order to modernize the structure for corporate regulation in India and to infuse best international practices that foster entrepreneurship, investment and growth, the much-awaited Companies Bill, 2008 was introduced by the Central Government in the LokSabha on 23 October 2008.[11] The House referred the Bill to the *'Department-Related Standing Committee on Finance'* for examination and report. However, by the time the report was submitted, Parliament had been dissolved and consequently the 2008 Bill lapsed. In August 2009, the government introduced the Companies Bill, 2009 to Parliament. In the wake of 'technical' objections by the opposition, the same was referred to the Committee again which submitted its report on 31 August 2010. Subsequent to the introduction of the Companies Bill, 2009 in the LokSabha, the Central Government received several suggestions for amendments

[5]Section 391(1) of the Companies Act 1956
[6]Section 391(2) of the Companies Act 1956
[7]Regulation 3(1) of the Takeover Code 1956
[8]Regulation 7(1) of the Takeover Code 2011
[9]The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations 2011.
[10]Supranote 3.
[11]'Ministry of Corporate Affairs, Companies Bill 2008 Introduced in LokSabha,Press Information Bureau, Government of India'(23 October 2008)<http://pib.nic.in/newsite/erelease.aspx?relid=44114>accessed 18 April 2012

in the said Bill. The Parliamentary Standing Committee on Finance also made numerous recommendations in its Report. The Central Government has accepted in general the recommendations of the Standing Committee and also considered the suggestions received by it from various stakeholders.[12] In view of large amendments to the Companies Bill, 2009 arising out of the recommendations of the Parliamentary Standing Committee on Finance and suggestions of the stakeholders, the Central Government decided to withdraw the Companies Bill, 2009 and introduce a fresh Bill incorporating therein the recommendations of Standing Committee and suggestions of the stakeholders.[13] Companies Bill 2011[14] was scheduled to be tabled in Parliament during Budget Session but it could not be. The proposed Chapter XV in the 2011 Bill deals with compromises, arrangements and amalgamations. Under the 2011 Bill, the scope of Clauses 201 to 205 of the Bill, which corresponds with Sections 391 to 394 of the Act, have been enlarged.

III. MERGERS AND ACQUISITIONS - CRITICAL ANALYSIS OF COMPANIES BILL, 2011

Often referred as a complete code in itself, Sections 391 to 394 of the Companies Act contain an elaborate framework, both procedural and substantive, that enables companies to give effect to arrangements and compromises with their shareholders and creditors. Although specifically defined under Section 390(b), Indian Courts while interpreting the omnibus term *'arrangement'* opined that it is of wide import[15] and includes an array of corporate transactions, such as mergers, demergers and other forms of corporate restructuring (including debt restructuring). So far, this framework has worked beyond satisfaction and the corporate giants, from time to time, have taken recourse to these provisions for restructuring their business model. While adjudicating the scope and ambit of the jurisdiction of the Court under Section 391, the Supreme Court after surveying authorities both from the judicial side as well as from legal text side, earmarked the broad contours within which schemes of arrangement may be presented, approved and sanctioned by the court. A perusal of the text of the decisions of the Supreme Court in the cases of *Miheer Mafatlal*[16] and *Hindustan Lever*[17] will clarify the judicial reasoning on this point.

As discussed above, the Central Government in order to import international best

[12]The Companies Bill 2011, Statement of Objects and Reasons.

[13]HrishikeshDatar, 'The Companies Bill, 2011 - A Critical Analysis' *Business Line* (15 December 2011) <http://www.thehindubusinessline.com/industry-and-economy/article2717904.ece>accessed 24 March 2012

[14]The Companies Bill 2011 [Bill No. 121 of 2011].

[15]*Hindustan Commercial Bank Ltd. v. Hindustan General Electrical Corporation Ltd* AIR 1960 Cal 637; *In Re Navjivan Mills Co. Ltd., Kalol,* (1972) 42 Com Cases 265 (Guj.); *Vodafone Essar Gujarat Limited v. Respondents,* Comp. Petition 183/2009, decided on 9 December 2010

[16]*Miheer H. Mafatlal v. Mafatlal Industries* AIR 197 SC 506

[17]*Hindustan Lever Employees' Union v. Hindustan Lever Ltd* [1995] 83 CompCas 30

practices in current corporate regime in India comprehensively reviewed Companies Act 1956 and presented it in the form of the Companies Bill 2011. The Bill, *inter alia*, seeks to carry out a variety of reforms to this framework which will, in long run, have an impact on mergers and acquisitions (M&A) transactions involving Indian Inc. While some of the proposals are intended to make it easier for companies to implement schemes of arrangement, others impose checks and balance to prevent possible abuse of these provisions by companies.[18] Following are the major changes which have been brought into existence by the newly-drafted Companies Bill, 2011.

1. Jurisdiction of the High Court transferred to the NCLT

Under the provisions of the Companies Act 1956, where a scheme of arrangement is proposed, it is incumbent on the company to obtain the sanction of the High Court having jurisdiction over it and seek proper directions for convening meetings of those affected by the proposed amalgamation and obtaining the approval of statutory majority at the meetings.[19] Judicial supervision over the scheme on one hand imports the element of fairness while on the other, it adds on the procedural delays as regards implementation of the scheme. A perusal of petitions presented by the companies before the High Court will highlight that on an average, the High Court takes minimum six months to sanction the scheme, which may run as long as two years. It was a much needed reform to shift the jurisdiction of the High Court to a specialized body. The Companies Bill tribunalised the jurisdiction of the High Court in National Company Law Tribunal, a quasi-judicial body, for speedy disposal of company cases. It is submitted that this move of the legislature is a welcome step and if implemented, with its original wisdom, it will take away the elements of delays in such matters.

2. Objection to the scheme - Threshold Limits Prescribed

The present regulatory regime provides the shareholder, creditor or '*any person interested in the affairs of the company*' with a right to object the Scheme at two levels. The stakeholders get the right to object at the first instance when the meeting is being held for the consideration of the scheme under Section 391 of the Act. As laid down by the Courts in numerous cases, objections could also be filed before the Court when the Scheme is approved by the requisite majority at the meeting and presented to the Court for approval.[20] The reason that the Scheme, once approved by the Court, would be binding on all the parties necessitated the legislature to provide

[18]V. Umakanth, 'Companies Bill, 2011: Amalgamation and Corporate Restructuring' *Indian Corporate Blog* (21 December 2011); Amrish Shah, 'Companies Bill to cushion ride for M&As; implementation holds the key' *The Economic Times*(22 December 2011)

[19]*Bank of India v. Ahmedabad Mfg. & Calico Printing Co. Ltd* (1972) 42 Comp Cases 211 (Bom.); *In Re, Ahmedabad Mfg. & Calico Printing Co. Ltd* (1972) 42 Comp Cases 493 (Guj.)

[20]*In Re Essar Oil Ltd.* [2005] 62 SCL 345 (Guj); *Shri Rama Multitech Ltd.* [2005] 62 SCL 539 (Guj.).

the affected parties with a right to object. Marking a sharp departure from such a sound rationale, the Companies Bill, 2011 provides that only those persons who hold at least 10% of the shareholding or at least 5% of the total outstanding debt in the company can object to the scheme.[21] This change has attracted debate from both the sides. The proponents of this change argue that this operates as a required restriction against frivolous litigation and thus, it seeks to fasten the process of sanctioning of Scheme. On the other hand, the critics are of view that this requirement takes away the shield provided to minority shareholders and creditors. However, if we look at the provisions in totality, it appears to be a matter of some relief for minority shareholders that schemes can provide for exit to dissenting shareholders.

3. Prohibition on Treasury Stocks on Mergers

Although practiced widely, the concept of *'treasury shares'* does not find any statutory cognizance in Indian corporate jurisprudence. In simple terms, these shares are acquired through a buy-back arrangement and held by a company.[22] Though the Act permits buy back of shares,[23] there is no statutory provision that permits a company to hold such shares. Instead, the Act mandates that the bought-back securities shall be extinguished or physically destroyed by the company within seven days of the completion of the buy-back.[24] This leads to a conclusion that under the present framework of law, Indian companies cannot hold treasury stock. But as a matter of practice, the companies going for a merger within their group, instead of extinguishing the shares that came because of cross-holdings, preferred to create a trust to hold these shares.[25] This practice, in turn, not only provided the promoters with indirect control but also with the flexibility to the management to raise funds by selling them in the open market without seeking approval of shareholders.[26]

The Companies Bill 2011 has correctly addressed the issue arising out of intragroup restructuring process, by prohibiting Transferee Company from holding treasury shares in any manner whatsoever. It goes on to the specifics by providing 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*

[21]Proviso to Clause 230(4) of the Companies Act 2011

[22]Asish K Bhattacharyya, 'Accounting for treasury stock'*Business Standard* (Nov. 14, 2011) <http://www.business-standard.com/india/news/accounting-for-treasury-stock/455366/> accessed 4 April 2012

[23]Section 77A of the Companies Act, 1956 read with Securities Exchange Board of India (*Buy Back of Securities*) Regulations, 2004.

[24]Section 77A (7) of the Companies Act 1956

[25]V. Umakanth, 'Companies Bill, 2011: Amalgamation and Corporate Restructuring' (December 21, 2011) <http://indiacorplaw.blogspot.in/2011/12/companies-bill-2007-amalgamation-and.html>accessed 4 April 2012

[26]ParthaSinha, 'Cos bill opposes new treasury stocks' *The Times of India*(Dec 19, 2011) <http://timesofindia.indiatimes.com/business/india-business/Cos-bill-opposes-new-treasury-stocks/articleshow/11172393.cms> accessed 4 April 2012

associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation".[27] According to the transactional lawyers, this change in the law was much needed in the light of India's commitment to move to International Financial Reporting Standards (IFRS), a global accounting practice, which does not recognize creation of treasury stocks.

It is a much appreciated step by the Legislature as this move would infuse a much needed degree of transparency and protect the interest of small shareholders as creation of trust shares will henceforth be barred, which are otherwise freely transferable as per the whims and fancies of the Board. In essence, the new provision with such prohibition *'will tighten the loose ends'*. In long run, this would mean that post-merger within the same group of companies; the company will have lower equity capital and thus, the earning per share of the shareholder would increase significantly.

4. Cross-Border Mergers – Merger of Indian Company with Foreign Company Allowed

According to Section 394(4) (b) of the Companies Act, 1956, only a company incorporated under this Act, i.e. an Indian Company can be a *'transferee company'*, meaning thereby, only foreign companies can amalgamate into Indian companies and the reverse is not permissible. This provision has also received judicial recognition.[28] In its attempt to provide India Inc. with corporate laws that are able to meet the requirements of a modern, competitive economy, the Indian Legislature made the bold move to finally open India's borders to, the until now forbidden, outbound cross-border mergers between Indian companies and other foreign companies. Clause 234 of the Companies Bill 2011, provides for both inbound and outbound cross-border mergers and amalgamations between Indian and foreign companies.[29] However, such cross-border mergers will be possible with specific countries to be so decided by the Central Government.[30] The phrasing of the draft provisions indicates that they will apply to any and all cross-border transactions and not just to outbound cross-border mergers and, as a result, these qualifications may be viewed unfavourably by India Inc. as they hold the potential of curtailing even the currently possible actions of India Inc.[31] The 2011 version of Companies Bill specifically provides that a foreign company, may with the prior approval of the Reserve Bank of India, merge into an Indian company 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

[27]Clause 233(10) of the Companies Bill 2011
[28]*In Re Moschip Semiconductor,* 2004 120 CompCas 108 AP.
[29]Section 234 of the Companies Bill 2011
[30]Section 234(1) of the Companies Bill 2011
[31]NarendraRohira, *Companies Bill: The Evolution of Indian M&A Horizon* (16 CFO CONNECT 2012)

Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be.[32]

As discussed above, the Bill had two former versions which in similar fashion allowed outbound cross-border mergers. However, a significant change stemming from the previous Standing Committee's review of the 2009 Bill, has been the inclusion of prior approval of Reserve Bank of India to any and all cross border merger transactions. It is the anticipatory notion of the author that this additional requirement could turn into another unwished procedural compliance for the companies, given the lengthy processes and timelines associated with obtaining regulatory approvals. Another area of concern is the government's approach while notifying list of permissible jurisdictions. In the current corporate regime, where the day to day updates are flooded with the regulatory authorities' determination to investigate corporate structures allegedly put together only to take advantage of specific *'tax havens'*, it is unclear which jurisdictions are likely to be notified by the Central Government. However, the list of countries notified by the Central Government will play a critical role in determining whether, or not the intended cross border provisions form the black cloud or the silver lining across the future horizon of corporate India.

5. Fast Track Mergers - Encouraging Out of Court Merger Transactions

Under the present framework as set out by Companies Act, 1956, all forms of mergers including those between group companies or between a parent and a subsidiary require compliance with the entire set of procedures under section 391 to 394. Although the Courts do provide some exemptions from procedural requirements in certain exceptional circumstances, yet the statutory framework had prevented an out-of-court settlement between the company and its stakeholders on the scheme of arrangement or compromise. To address this drawback, the much talked about and reformatory provisions regarding merger or amalgamation of two or more *'small companies'* or between a holding and its wholly-owned subsidiary company were introduced by the Companies Bill, 2008, and reiterated by the 2009 and 2011 Bills. As per Clause 233 of the 2011 Bill, a notice has to be issued to registrar of companies ("ROC") and official liquidator ("OL") first[33] and objections/suggestions have to be placed before the members in the general meeting.[34] The provision also addresses the creditors' interest by mandating that the companies must file a declaration of solvency[35] and the scheme must be approved by at least 90% of the creditors or their classes.[36] Once the scheme is approved by members and creditors, a notice

[32]Section 234(2) of the Companies Bill 2011
[33]Clause 233(1)(a) of the Companies Bill 2011
[34]Clause 233(1)(b) of the Companies Bill 2011
[35]Clause 233(1)(c) of the Companies Bill 2011
[36]Clause 233(1)(d) of the Companies Bill 2011

would have to be given to the central government, the ROC & OL.[37] If the central government has any objections, it may file an application with the tribunal and seek its approval.[38] The limits for considering a company as a *"small company"* have been lowered to a share capital of Rs 50 lakh or a turnover of Rs 2 crore[39] which, under the 2009 Bill, were Rs 5 crore and Rs 20 crore, respectively.

It is submitted that although on one hand this reform would result into faster decisions on approvals for mergers and amalgamations resulting effective restructuring in companies and growth in the economy on the other it may affect only a small number of transactions without much wider impact.

6. Reverse Mergers - Issues of Backdoor Listing Stands Regulated

A reverse merger is a transaction where a listed company is merged with an unlisted one.[40] Such mergers, usually done through court approved schemes of arrangement under section 391 to 394, are carried out generally to accord the status of *'publicly listed company'* to a private/public unlisted company.[41] This mechanism is popular among small-to-medium-sized privately held companies that propose to raise additional capital without invoking the provisions regulating initial public offer.[42] On one hand, legislative omission to regulate reverse merger is misused by the corporations to gain a back-door entry into the stock exchange without adhering to the process as laid down under the SEBI (ICDR) Guidelines, 2009, Takeover Code and the Listing Agreements, while on the other it takes away the legitimate right of the public shareholder of the listed companies to exit from such a company. Thus, under current regime, the merger of a listed transferor into an unlisted transferee entails listing.

In the wake of these legislative omissions, the Companies Bill 2011 specifically provides that, where the transferor company is a listed company and the transferee company is an unlisted company, the transferee company shall remain an unlisted company until it becomes a listed company.[43] Moreover, it also accords much required protection to the shareholders of the listed company by, *inter alia*, providing that in case of a reverse merger if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value

[37]Clause 233(2) of the Companies Bill 2011
[38]Clause 233(5) of the Companies Bill 2011
[39]Clause 2(85) of the Companies Bill 2011
[40]N Sundaresha Subramanian, 'Reverse mergers: Exit option in New Cos Bill'*Business Standards* (Dec 21, 2011) <http://www.business-standard.com/india/news/reverse-mergers-exit-option-in-new-cos-bill/459179/> accessed 4 April 2012
[41]ibid
[42]A.K. Majumdar and G.K. Kapoor, *Taxman's Company Law and Practice* (15th edn,Taxman Publications: New Delhi, 2010) 1014, ¶ 23.11.
[43]Clause 232(3)(h)(A) of the Companies Bill 2011.

of shares held by them and other benefits in accordance with a pre-determined price formula.[44]

7. Other Key Changes

Some other specific issues where the Bill provides for a different treatment are:

- Notice of the scheme must be provided to various government authorities such as the Income Tax Department, SEBI, RBI, Competition Commission, Official Liquidator such that all of their concerns can be heard by the NCLT before sanctioning the scheme.[45] Although these authorities can object before a court even at present, there is no such notice requirement.
- Power of the Tribunal to grant dispensation to creditors' meeting in case of receipt of consent of at least 90% of creditors in value.[46]
- Participation in meeting of shareholders or creditors permitted through postal ballot.[47] The same is likely to affect increased participation.

IV. CONCLUSION

It is unclear what, if any, changes the new Bill will go through at the hands of the Standing Committee, which is due to take it up soon. However, one thing that will have to be accomplished is a strategic harmonization among the key legislations that work in tandem to regulate the Indian corporate sector. The Takeover Regulations of SEBI, the existing and future Income Tax provisions, the exchange regulations of the RBI, and the FDI regime, will all need to be considered in light of the provisions that will eventually be enacted via the Companies Act, to ensure a seamless and logical regulatory regime. Despite its quiet nature, the Companies Bill 2011 represents a legislature intended to prepare the Indian economy for the next stage of its development. Much like a slumbering giant, once awoken, the reality and impact of the new Bill has the potential to change the Indian corporate landscape for ever more. As India Inc. awaits its new legislation, exactly which version of the Companies Bill will be visited upon us, remains to be seen.

[44]Clause 232(3)(h)(B) of the Companies Bill 2011.
[45]Clause 230(5) of the Companies Bill 2011.
[46]Clause 230(9) of the Companies Bill 2011.
[47]Clause 230(6) of the Companies Bill 2011.