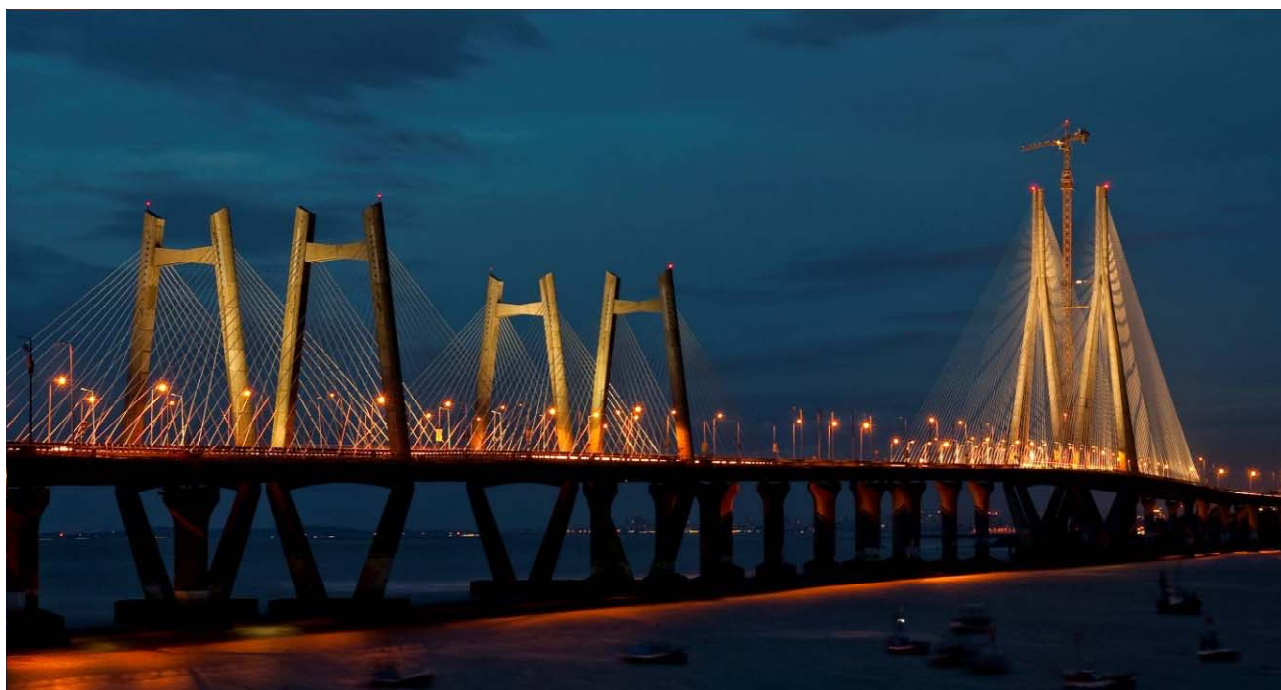


## New Companies Act, 2013 - Insight Series

23 August 2013



### Vol-I : Compromise/Arrangements/Amalgamations/Demerger (Restructuring)

#### Executive Summary

- The Companies Bill 2012 awaiting President's assent to become 'The Companies Act, 2013'
- Draft Rules to be published for comment.
- Separate procedures prescribed for 'Compromise or Arrangement' and 'Amalgamation or Demerger'
- National Company Law Tribunal (NCLT) to assume jurisdiction of the High Court as sanctioning authority in relation to Restructuring.
- Absence of Transitional Provisions – No clarity with respect to Restructuring in process at the time of New Companies Act becoming operational.
- New concept of Fast Track Restructuring, without NCLT approval, introduced.
- Amalgamation of / Demerger from Foreign Company incorporated in a notified jurisdiction and vice versa allowed subject to approval of Reserve Bank of India (RBI).

- Compromise or Arrangement :
  - Power of NCLT to dispense with the creditors meeting restricted.
  - Auditor's certificate to the effect that the accounting treatment specified in the Scheme is in conformity with the prescribed Accounting Standard is required to be submitted to NCLT.
  - Disclosures in and attachment with notice calling meeting substantially increased.
  - Circulation of notice convening the meeting widened and requirement of issue of such notice to all concerned statutory and other authorities included.
  - Voting allowed at the meeting as well as through postal ballot.
  - Minimum shareholding / debt ownership limit provided for objecting to the Scheme.
  - Sanction of buy-back, variation of rights etc. being part of the Scheme can be sanctioned only if in accordance with the provisions governing such processes.
- Amalgamation/ Demerger:
  - Treasury stock, holding the shares in the name of transferee company, prohibited.
  - Yearly statement confirming implementation of the Scheme to be in accordance with the Order required to be submitted till completion of the Scheme.

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## Background

On 8 August 2013 Rajya Sabha passed the Companies Bill, 2012 (the Bill) which was already passed by Lok Sabha on 18 December 2012. Though the President's assent to the Bill, which will make it an Act, is still pending, the blessing of both houses of Parliament has put an end to prolonged uncertainty regarding the revamp of the Companies Act, 1956 (the existing Act)

Upon receipt of the President's assent, the Bill will become 'the Companies Act, 2013' (New Act). However, the New Act will become operational and replace the Companies Act, 1956 from a future date to be notified by the Government. The Government may notify a single date for the entire New Act, or different dates for different parts of the New Act.

The New Act has introduced many new concepts as compared to the existing Act and made material changes to the provisions under the existing Act before adopting the same.

In this bulletin, we have dealt with the new concepts [marked as (new) at the appropriate places] introduced and the changes made to existing provisions relating to Compromise, Arrangements, Amalgamations/Mergers and Demergers (collectively referred to as 'Restructuring'). We have also discussed certain other provisions included in the New Act, but only to the extent that they impact the Restructuring.

## Overview

- The existing Act was self-contained and almost all processes, timelines, etc., were specified under the existing Act itself. In contrast, the New Act does not contain provisions dealing with processes; time lines, etc., but provide that the same will be prescribed. It is expected that the Ministry of Corporate Affairs (MCA) will issue draft rules (the Rules) for public consultation soon. Therefore, the discussion in this Bulletin is subject to the Rules.

MCA is targeting to complete the consultation process and implement the New Act by 1 April 2014.

- Another major concern is an absence of transitional provisions. A Scheme of Restructuring typically takes a time of 3 to 6 months to complete. Therefore, any new enactment needs to provide for transitional provisions to deal with Restructuring initiated prior to the enactment, but which will continue and be completed post enactment. The New Act does not provide for any transitional provisions to govern Restructuring in progress at the time of the replacement of the existing Act with the New Act. Therefore there is no clarity:
  - Whether such process will be continued and completed under the provisions of the existing Act or under the provisions of the New Act, and
  - If the restructuring is to be continued under the New Act, then how to deal with any non-conformity, of the portion of the process completed under the existing Act, with the provisions of the New Act.

- The New Act proposes constitution of a 'National Company Law Tribunal' (NCLT) to replace the 'Company Law Board' (CLB) and also assume the jurisdiction of the High Court, inter alia, as the sanctioning authority in relation to Restructuring. The proposal for this change was already inserted in the existing Act, but this proposal never became operational. Further, even under the New Act there is no clarity as to how long it will take the NCLT to be constituted and become operational. This is another factor which creates a lot of uncertainties, especially regarding Restructuring.

The New Act provides that all Restructuring in progress, at the time when the NCLT becomes operational, shall be transferred from High Court to NCLT and NCLT will continue from the stage before transfer and complete it, however, the New Act has not specified that NCLT will complete it under the provisions of the New Act. Therefore, two issues raised in 2 above will apply even in relation of transfer of cases to NCLT.

- Another major issue arises from the 'Repeals and Savings' provisions. It is provided that, once the New Act becomes operational, the existing Act will be repealed, meaning that the existing Act will no longer apply. However, it is also clarified that in spite of this repeal, until the time when the NCLT becomes operational, the provisions of the existing Act regarding the 'jurisdiction, powers, authority and functions' of the CLB and the Court shall continue to operate. This raises the issue of whether the provisions of the existing Act are to be applied only for providing jurisdiction, power etc. to the Court or whether the entire Restructuring will be governed by the provisions of the existing Act. To be precise, until the NCLT becomes operational, the issue is whether, in relation to Restructuring, an application to the Court should be filed under Section 391 of the existing Act or under Section 230 of the New Act, both of which deal with Restructuring.

Until clarity is provided on these issues, the implementation of restructuring will entail significant practical difficulties, possibly leading to unnecessary litigation.

It is expected that the Rules may provide clarity on the above issues. The Rules are subordinate legislation that can provide clarity regarding the provisions of the relevant statutes or set out operational processes relating thereto, but the Rules cannot prescribe/set out something for which base is not provided in the Statute. The Rules cannot result in any modification to or expansion of the scope of the provisions in the statute. For example, the Rules may not be able to specify that,

until the NCLT becomes operational, the Court will operate u/s. 391 of the existing Act, because that would require an amendment to the Repeal and Saving provisions.

Subject to the absence of clarity on the above issues, we have dealt with specific issues relating to provisions dealing with Restructuring at relevant places.

The New Act has different provisions in relation to different types of restructuring processes, as follow:

- Compromise or Arrangements - Section 230-231
- Amalgamations including Demergers - Section 232
- Amalgamations of small Companies - Section 233
- Amalgamations of Foreign Companies - Section 234

In this bulletin, we have discussed only the variations/changes made or new concepts introduced, in the provisions dealing with Restructuring, in the New Act as compared to the provisions dealing with Restructuring in the existing Act. Unless it was felt necessary for proper understanding, we have not dealt with the Restructuring related provisions under the existing Act which are not changed and have been adopted in the New Act. Also note that until the NCLT becomes operational, any references to the NCLT in the following discussion should be read as references to the High Court.

## Compromise or Arrangement

Compromise or Arrangement mean Compromise or Arrangement between a company and its members / creditors, which is same meaning as was under the existing Act.

The following are key changes in the provisions dealing with Compromise or Arrangement:

- Applicant to disclose in the Affidavit to the NCLT:
  - Any investigation against the company. Use of word 'any' suggests that investigations even under statutes other than the New Act also need to be disclosed. Under the existing Act requirement was restricted to the extent of investigations under the existing Act.
  - Any provision for reduction of capital included in the arrangement. **(new)**

➤ Details of Corporate Debt Restructuring, if any, with secured creditors (CDR), including funds required post-implementation of the CDR, valuation report on shares and all of the assets of the Company, etc. **(new)**

- NCLT may dispense with holding of meeting of creditors only if creditors holding 90 percent in total value of creditors file affidavit confirming their approval to sanctioning of the Scheme of Compromise or Arrangement (Scheme). **(new)** Hitherto, the Courts had the discretion to order convening of a meeting or to grant dispensation from convening the meeting on production of such consent letters (not Affidavits) as the Court may require. Different High Courts prescribed different requirements. Some High Courts did not even require consent letters.
  - Therefore, *prima facie*, obtaining dispensation of Creditor's meeting would be difficult and most arrangements, if not all, will involve convening of creditor meetings.
  - This provision is applicable to creditors meeting only and not to members meeting.
- Notice to members / creditors to be accompanied by :
  - (i) A statement disclosing the details of the Compromise or Arrangement,
  - (ii) Valuation Report, if any **(new)**,
  - (iii) Proxy form,
  - (iv) Postal ballot form **(new)**,
  - (v) A statement explaining impact of Compromise or Arrangement and Valuation Report on **(new)**:
    - Creditors, key managerial personnel, promoters and non-promoter members and debenture holders.
    - Material interests of directors or debenture trustees (whether different from others or not)
    - Such other matters as may be prescribed. (Notice along with attachment (i) to (v) is hereinafter referred to as 'Notice')

- Circulation of Notice – New Act provides for a wider circulation of Notice as can be seen from the ensuing list of persons / entities to whom the notice is to be sent:
  - Once a meeting is ordered, notice of the meeting is to be sent individually to all the members, creditors and debenture holders.
  - Prima facie the notice is to be sent to all, irrespective of the fact that the meeting in relation to that class is dispensed with. e.g. the meeting of creditors is ordered and meeting of members is dispensed with, still the Notice should be sent to all members.
  - To be placed on website of the company, if any, **(new)**
  - In the case of a listed company, the Notice should be sent to the stock exchanges where the securities of the company are listed, for display on the Stock Exchange website and also to SEBI. **(new)**
  - To be published in a newspaper, as may be prescribed.
  - Notice shall also be sent to the Central Government, Income tax Authorities, Reserve Bank of India, SEBI, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India, if necessary, and other sector regulators or authorities which are likely to be affected by the compromise or arrangement. **(new)**
  - Addition of “if necessary” creates a confusion as to whether sending of the Notice to all these authorities is mandatory or it is required only if applicable.
  - These authorities have to make representations, if any, within 30 days, failing which it shall be presumed that they have no representations to make on the proposed Compromise or Arrangement.
  - There is no provision to deal with such representations, which may be prescribed in the Rules.
- Timing for circulation of Notice yet to be prescribed:
  - Voting at the meeting is allowed either in person or through proxy or through postal ballot.
  - It seems that both physical meeting and postal ballot processes will be required and that the combined results will have to be considered.
  - Voting is allowed within 30 days from date of receipt of the Notice.
  - Unless a mechanism specifying deemed date of receipt is prescribed, there may be litigation on votes casted late through postal ballots.
  - It provides that objections shall only be made by persons holding at least a 10 percent in the shareholding or having outstanding debt of at least 5 percent of the total outstanding debt as per the latest audited financials. **(new)**
  - The placement of proviso under the section dealing with voting seems to suggest that the negative votes can be casted only by members/creditors complying with the above. However, it may be unintended and, therefore it should be read as applicable only for objections to be raised at the time of hearing of the Petition.
- Where a meeting is held, the arrangement is required to be approved by a majority of persons, representing 3/4th in value of creditors/members/or any class thereof:
  - Condition of ‘present and voting’ is replaced by ‘voting’.
  - Present and voting means that the majority is to be computed with reference to number of persons who have voted and value of shares held by such persons/credit balance on account of such person.
  - The replacement seems to be for covering voting through postal ballot and not to change the computation of majority.

- Use of word Voting alone also seems to suggest the same meaning of computing the majority in number and value with reference to persons who have voted and not the total numbers and values with reference to entire population of that class.
- In other words, this does not mean that the majority needs to be achieved, irrespective of the fact that persons have not casted their vote.
- The Company needs to file a certificate from its auditor to the effect that the accounting treatment, if any, specified in the Scheme is in conformity with the prescribed accounting standards. **(new)**
- In the case of arrangements involving a reduction of capital, the provisions relating to reduction provided in the New Act should not be applicable. **(new)**
- It is provided that in case of arrangements involving takeover offers for unlisted companies, an aggrieved party may apply to the Tribunal. **(new)**
- Order of NCLT to provide for :
  - In case of arrangements involving the conversion of Preference shares into equity shares, there should be an option to preference share holders to obtain arrears of dividends in cash or in the form of equity. **(new)**
  - Protection of any class of creditor. **(new)**
  - Variations of rights should be in accordance with s.48 dealing with variations of rights. **(new)**
  - Exit to dissenting shareholders.
  - Sanction of buyback included in the Scheme, only if such buyback is in accordance with buyback provisions under Section 68 of the New Act. (Buy-back provisions are discussed in detail in next bulletin). **(new)**
- The existing Act provided that every order in relation to Restructuring should be attached to every copy of Memorandum of Association of the Company. The New Act has not prescribed for such a requirement.

- If, after passing the order sanctioning the Scheme, the NCLT is satisfied that either the scheme cannot be implemented or the company is unable to pay debts as per the Scheme, the NCLT is empowered to pass an order for the winding up of the Company.
- The existing Act did not have any such provision regarding the inability to pay debt.
- Provisions are also applicable to orders sanctioning the Scheme passed even before the New Act becomes operational.

## Amalgamations/Demergers (Amalgamation)

There is a paradigm shift in provisions relating to Amalgamations

- The New Act provides for entirely separate procedures for Compromise or Arrangements involving Amalgamation. Once an application under Section 230 dealing with an Compromise or Arrangement involving an Amalgamation is made, the process prescribed under Section 232 needs to be followed and orders are to be passed under Section 232 and not under Section 230 as in the case of Arrangements not involving Amalgamation.
- There is no clarity about how to deal with a composite Scheme involving Arrangements being subject matter of Section 230 and Amalgamations being subject matter of Section 232. MCA needs to clarify whether such Scheme will be governed under both the sections or it will be governed only under Section 232.
- The existing Act provided certain additional procedures, documentation requirements etc. to be followed in case of Scheme involving Amalgamation, however, the order was passed under the provisions dealing with Compromise and Arrangements.

The following are key changes in the provisions dealing with Amalgamation:

- The Amalgamation needs approval in Board Meeting. **(new)** Hitherto, this was not mandatory and approval through a circular resolution could have been considered.



- The existing Act provided that for Amalgamations, the transferor company can be a body corporate and also that the term company includes a company liable to be wound up under the existing Act. Therefore, Amalgamations of certain non-company entities with a company was possible. However, in the absence of similar provisions in the New Act, Amalgamations of non company entities with a company may not be possible.
- Other provisions relating to the disclosures under an Affidavit, circulation of Notices, voting rights, majority approval requirement and submission of auditor's certificate discussed in relation to Compromise or Arrangements would equally apply to Amalgamations.
- Provisions relating to the documents required to be attached to Notice equally apply to Amalgamation, except that the following additional documents also needs to be attached:
  - Draft terms of the Scheme adopted by the board of directors. (BoD)
  - Confirmation that a copy of the Scheme is filed with the Registrar of Companies (ROC). **(new)**
  - Report adopted by the BoD explaining the impact of Scheme on Promoters and non-promoters' shareholdings, laying out the share exchange ratio and difficulties in valuation.
  - Expert Report regarding valuation, if any. **(new)**
  - Supplementary accounts if the last annual accounts relate to a Financial Year ending six months before the date of first Meeting. **(new)**
- There is no change regarding the discretion of the NCLT to dispense with the meeting, as the requirement for approval by 90 percent of creditors' confirmation on the Affidavit is not applicable in the case of Amalgamations.
- Order of NCLT to provide for the following:
  - Transfer of assets and liabilities to the Transferee Company from a date decided by the companies, except where the NCLT decides to change the date, after recording its reasons in writing. **(new)**
  - Allotment/appropriation of shares or other instruments by the Transferee Company.
- However, shares of the transferee company should not be held in the name of the transferee company or under a trust for the benefit of the transferee company or its subsidiary or an associate company, but should be cancelled or extinguished.
- This means the creation of treasury stocks is not allowed.
- Continuation of legal proceedings by or against the transferee company.
- Dissolution of transferor company without winding up.
- Provision for dissenting parties.
- Manner of allotment of shares in transferee company to the non-resident shareholders of the transferor companies. **(new)**
- Employees transfer. **(new)**
- In the case of Amalgamation of a listed transferor company into an unlisted transferee company:
  - The payment of the value of shares to the shareholders of the listed transferor company who decide to opt out of the transferee company. The price to be paid should not be less than any SEBI formula.
  - Prima facie it seems that such shareholder can exercise the option even if the transferee company gets listed.
  - In other words the New Act allows such unlisted company to remain unlisted by giving exit to the dissenting shareholders.
- The New Act allows the offsetting of fees paid on authorised capital by the transferor company, against fees payable on authorised capital by the transferee company post amalgamation
  - Hitherto the Courts allowed the merger of the authorised capital of the transferor company with that of the transferee company.

- That means under the provisions of the New Act, the benefit of set-off of fees actually paid is allowed however, the benefit of stamp duty paid by the Transferor company on authorised capital is lost.
- Appointed date to be specified in the Scheme, and the Scheme cannot be deemed to be effective from any subsequent date. **(new)**
- Following the order and prior to the completion of the Scheme, every company being party to the order shall file a statement, certified by a chartered accountant/cost accountant/company secretary, that the Scheme is being complied with in accordance with the order of the Tribunal or not. **(new)**
- Shareholders' approval is required for investment of consideration received as a result of any merger or amalgamation. This provision is under Section 180 of the New Act dealing with 'Restrictions on powers of Board'. There is no clarity on its applicability, i.e. whether it applies only in relation to transferee company or even in case of corporate shareholders of transferor company.

The New Act has defined the term 'free reserves' and provides that the same should not include any change in carrying amount of an asset or of a liability recognised in equity. Therefore, in the case of a transferee company recording amalgamation under purchase method of accounting as permitted under Accounting Standard on Amalgamation, prima facie it seems that the resulting reserve generated as a result of such recording may not be considered as free reserve. Consequently such reserve should not be available for declaration of dividend, issue of bonus shares, buyback of shares, etc.

### **Fast track Arrangements/Amalgamations /Demergers (Short form mergers) (new)**

The New Act has also introduced a new concept of a Short form merger which, at the option of the companies involved, can be used for:

- The merger of two or more small companies, or
- The merger between holding company and its wholly owned subsidiary company, or
- Such other classes of companies as may be prescribed.

The New Act has introduced the new concept of a Small Company, which is defined as follows:

- A non-public company
- Not being a holding/subsidiary company/ company established for charitable purposes/company established under special Act.
- Having paid-up capital < INR 5 million (the amount can be prescribed up to INR 50 million) or turnover < INR 20 million (the amount can be prescribed up to INR 200 million) as per the last audited financials.

The New Act has amended the definition of subsidiary company. Besides other changes, it provides that a company in which the holding company holds >50 percent of the total share capital. The existing Act provided for holding > 50 percent of the equity share capital. This is a major shift in the definition.

The principal benefits of the Short form merger over Amalgamation are:

- Approval of NCLT is not required
  - As a consequence, the companies may not be required to file documents required to be filed under clause 24(f) of the listing agreement, in the case of listed companies
- Notice is not required to be given to various authorities.
- Shorter timeline.
- Auditor's certificate of compliance with applicable accounting standards is not required.

The Process of a Short form merger involves the following steps:

- Transferor and Transferee companies to issue notice within 30 days to ROC/ Official Liquidator (OL) inviting objections/suggestions.
- The starting point of 30 days is not specified.
- Objections received from ROC/OL are considered in the general meeting and the Scheme is approved by members/classes of members holding 90 percent of the total number of shares.
- The concept of members present and voting is not included.



- Approval of holders of 90 percent of the total number of shares is required.
  - No reference to the value of shares, no distinction between partly paid shares and fully paid shares.
  - Scheme is approved by creditors or classes of creditors holding 90 percent in value either at a meeting held or otherwise approved in writing.
  - Each of the companies should file a declaration of solvency with ROC – Timing not specified.
  - The Transferee company should file the approved Scheme with the Central Government (CG), ROC and OL.
  - ROC/OL shall communicate their objections within 30 days,
    - Starting point of 30 days is not specified. Logically, it should be from the receipt of notice.
    - Notice was served on ROC / OL even before members / creditors meetings:
      - There is no clarity about why second notice is required.
      - No provision as to how to deal with the outcome of first notice and second notice.
  - If no communication is received from ROC/OL or they have communicated that they have no objection or CG has not formed an opinion as discussed below, CG shall register the Scheme and issue confirmation to the companies.
  - If in the opinion of the CG, the Scheme is not in the public interest or the interests of creditors, within 60 days of the receipt of the Scheme, CG may file an application with the NCLT requesting NCLT to consider the Scheme under the Amalgamation provisions discussed earlier.
  - On receipt of an application from the CG or another person, the NCLT may confirm the Scheme or, if in its opinion it is necessary, direct that the procedures as per Amalgamation provisions discussed above should be followed.
  - If the Scheme is approved, an order should be communicated to ROC of transferee company who should register the same and issue confirmation to the companies, which should be communicated to the ROCs of transferor companies.
  - Registration of Scheme by CG or ROC should be deemed to have the effect of dissolution of transferor companies without winding up.
  - Provisions of Amalgamation relating to fees on authorised capital and not holding shares in the name of the transferee company etc. apply to Short form mergers also.
  - CG may prescribe manner of the merger of companies.
  - The Registration of Scheme will have following effects :
    - Transfer of assets and liabilities to the transferee company.
    - Enforceability of charges against the transferee company.
    - Legal proceeding by or against the transferor company to continue by or against the transferee company.
    - Purchase of shares of dissenting shareholders or settlement of creditors, if provided, shall become the liability of the Transferee company.
- Issues in the Short form merger which may make it less attractive are:
- CG's power to transfer the Scheme to the NCLT for application of normal Amalgamation provisions.
  - Positive confirmation required from 90 percent of shareholders and creditors holding 90 percent value.
- There is no clarity whether Short Term Merger will be allowed prior to NCLT becoming operational or not.
- ### Foreign Company Amalgamation/ Demerger (Cross Border Merger)
- The existing Act allowed merger of a foreign company with an Indian company, but not vice versa.
- The New Act provides for Amalgamation of/Demerger from a foreign company, whether having its place of business in India or not, with an Indian company and vice versa. The relevant requirements are as follow:
- Cross Border Mergers are allowed between a company under the New Act and a company incorporated in a notified jurisdiction.

- CG may make rules in connection with such Amalgamation.
- All the procedures for Restructuring discussed above will equally apply to Cross Border Merger.
- Prior approval of the Reserve Bank of India is necessary.
- The Scheme may provide for payment in cash or in Depository receipts or both.

## Other Issues

The existing Act had been in force for almost 57 years now. Many other enactments/regulations were created /replaced during that period and cross references were created between the existing Act and those enactments. Unless either it is provided in the New Act that wherever under other statutes reference is made to the existing Act, same should be considered to include reference to relevant provisions of the New Act or respective enactments are amended, operation of provisions under those enactments/regulations may become difficult or impossible or may lead to unwanted litigations. Illustrative list of such provisions is as under:

- Section 2(19AA) of the Income-tax Act, 1961 which defines demerger with reference to order under Section 391 of the existing Act. The tax neutrality to Demerger is linked to this definition.
- Definition of term Conveyance, in relation to stamp duty to be levied on order sanctioning Amalgamation/Demerger, under various Stamp Acts is defined with reference to order under Section 394 of the existing Act. Concessional rate of Stamp Duty is linked to this definition.



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