



# MERGERS & AMALGAMATIONS

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# What is merger/ amalgamation/ demerger/ re-construction?

- Not defined under the Companies Act, 1956
- **What is defined under Companies Act?**
  - **Arrangement-** includes a re-organisation 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, by both those methods
- **What is defined under Income Tax Act?**
  - **Amalgamation** [sec. 2(1B)]
  - **Demerger** [2(19AA)]
- **Meaning of the terms in common parlance:**
  - **Amalgamation** - combination of two or more independent business corporations into a single enterprise
  - **Demerger** – transfer and vesting of an undertaking of a company into another company
  - **Reconstruction-** re-organisation of share capital in any manner; varying the rights of shareholders and/or creditors
  - **Arrangement-** All modes of reorganizing the share capital, including interference with preferential and other special rights attached to shares



# [ Regulatory Framework ]

- Applicable Indian Laws
  - Companies Act, 1956 – [Sec 391-394]
  - Listing Agreement
  - Accounting Standard - 14
  - SEBI Takeover Code (in case of acquisition by/of a listed company)
  - Company Court Rules
  - FEMA (in case of merger of companies having foreign capital)
  - Competition Act, 2002
  - Income Tax Act, 1961
  - Indian Stamp Act

# Definition of “company” for the purpose of Sec 391- 394

- Sec 390- ‘company’ means any “company liable to be wound up under this Act”:
  - Landmark ruling in *Khandelwal Udyog Ltd. and ACME Mfg. Ltd., Re*, (1977) 47 Com Cases 503 clarifies the meaning of above phrase
    - all companies registered under the provisions of the Companies Act, 1956
    - all unregistered or other companies in respect of which winding-up orders can be made by a court under the provisions of the Companies Act
- Under Sec 394 (4)-
  - Amalgamation can be done under Sec 391 where the transferor company is a foreign company
  - There cannot be an amalgamation where the transferee company is a foreign company

# Provisions in the Companies Act, 1956- Compromise or Arrangement

- Coverage:
  - Compromise & Arrangement between a company and its creditors or any class of them; or
  - Compromise & Arrangement between a company and its members or any class of them;
- Who can apply:
  - company itself
  - creditors
  - members
  - in the case of a company which is being wound-up, the liquidator.
- Approvals and sanctions required from:
  - Dual criteria for approval from members- more than a special resolution
    - majority of members/creditors, as the case may be, in number
    - representing three-fourth in value
  - Sanction from the High Court

# Company Court Rules- Procedure (R 67 to 87)

## ■ Rule 67:

- An application for obtaining judge's summons for directions to convene a meeting shall be in *Form No. 33*, and shall be supported by an affidavit in *Form No. 34*.
- A copy of the proposed scheme of compromise or arrangement is also required to be annexed thereto.

## ■ Rule 68: where the company is not the applicant

- A copy of the summons and affidavit is required to be served on the company, or, where the company is being wound up on its liquidator, not less than 14 days before the date fixed for the hearing of the summons

## ■ Rule 69:

- Upon the hearing of the summons, the Judge gives directions (*Form No. 35*) in respect of the following matters:-
  - determining the class or classes of creditors and/or of members whose meeting or meetings have to be held
  - the time and place of such meeting(s)
  - appointing a chairman for the meeting(s)
  - fixing the quorum and the procedure to be followed at the meeting(s)
  - notice of the meeting and the advertisement of such notice
  - the time within which the chairman of the meeting is to report to the Court the result of the meeting
  - such other matters as the Court may deem necessary.

# Company Court Rules- Procedure (R 67 to 87)

- **Rule 70: replica of requirements of Companies Act**

- Voting by proxy shall be permitted,
- proxy to be prescribed form duly signed and
- filed with the company at its registered office not later than 48 hours before the meeting.
- Member company/body corporate shall lodge with the company, certified true copy of the resolution under section 187 at its registered office not later than 48 hours before the meeting

- **Rule 73:**

- The notice of the meeting shall be in *Form No. 36*,
- Notice shall be sent by post under certificate of posting not less than 21 clear days before the date fixed for the meeting.
- Notice shall be accompanied by a copy of the proposed Scheme and of the statement required to be furnished under section 393 and a form of proxy in *Form No. 37*.

- **Rule 74:**

- The notice to be advertised in such newspapers and in such manner as the Judge may direct, not less than 21 clear days before the date fixed for the meeting in *Form No. 38*.

# Company Court Rules- Procedure (R 67 to 87)

## ■ Rule 75:

- Every creditor or member entitled to attend the meeting shall be furnished by the company, free of charge and within 24 hours of a requisition being made for the same, with a copy of the proposed compromise or arrangement together with a copy of the statement required to be furnished under section 393, unless the same had been already furnished to such member or creditor.

## ■ Rule 76:

- The Chairman to file affidavit of service proving dispatch of individual Notices to the shareholders and publication of the Notice in newspapers with respective Court, at least 7 days prior to the date of the shareholders' meeting

## ■ Rule 77:

- The decisions of the meeting(s) held in pursuance of the order made under rule 69 on all resolutions shall be ascertained only by taking a poll.

## ■ Rule 78:

- The chairman of the meeting(s) shall submission its Report within 7 days after the conclusion of the meeting to the Court in *Form No. 39*.



# Company Court Rules- Procedure (R 67 to 87)

- **Rule 79:**
  - The Company shall file petition for confirmation of the Scheme in *Form No. 40* within 7 days of filing the Chairman's Report
- **Rule 80:**
  - The Court shall fix a date for the hearing of the petition,
  - notice of the hearing shall be advertised in the same papers in which the notice of the meeting was advertised, or in such other papers as the Court may direct,
  - not less than 10 days before the date fixed for the hearing
- **Rule 81:**
  - The order sanctioning the Scheme shall include
    - such directions in regard to any matter and such modifications in the compromise or arrangement as the Judge may think fit to make for the proper working of the compromise or arrangement.
    - The order shall direct that a certified copy of the same shall be filed with the Registrar of Companies within 14 days from the date of the order, or such other time as may be fixed by the Court.
    - The order shall be in *Form No. 41*, with such variations as may be necessary.
- **Rule 84:**
  - Upon hearing of the Petition, the Court shall make such order or issue such directions as it thinks fit.
  - An order made under section 394 shall be in *Form No. 42* with such variation as the circumstances may require

# [ Contents of the Scheme ]

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- Appointed Date (controversy as regards Appointed Date was set to rest by the Supreme Court in Marshall Sons & Co case)
- Effective Date
- Capital Structure
- Objective of Amalgamation
- Vesting of property from the Appointed Date
- Share Exchange ratio
- Manner of conduct of business of Transferor Companies between the Appointed Date and Effective Date
- Effect of amalgamation on contracts/litigations of the Transferor Companies
- Service of Employees of Transferor Companies
- Dissolution of Transferor Companies

# Accounting Standard 14 – Types of merger

- AS 14 recognizes two types of amalgamation:
  - ***Amalgamation in the nature of merger*** has been defined to mean an amalgamation which satisfies all the following conditions.
    - All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company
    - Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become equity shareholders of the transferee company by virtue of the amalgamation
    - The consideration for the amalgamation 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
    - The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company
    - 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
  - ***Amalgamation in the nature of purchase*** is an amalgamation which does not satisfy any one or more of the conditions specified above.

# [ Methods of Accounting ]

- The pooling of interests method (for Amalgamation in the nature of merger)
  - The assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts
  - Reserves of the transferor company 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.

# [ Methods of Accounting ]

- The purchase method (for Amalgamation in the nature of purchase)
  - The transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation
  - There is no question of bringing to the books of the transferee the profits/reserves of the transferor
  - The amount of the consideration is deducted from the net assets of the transferor company acquired by the transferee company and the difference, if any, is debited to goodwill or credited to Capital Reserve, as the case may be. Goodwill arising on amalgamation is treated as an asset and amortized over a period of five years.

# [ Amalgamation after the Balance Sheet Date ]

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- When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party,
  - Disclosure should be made in accordance with AS 4, 'Contingencies and Events Occurring After the Balance Sheet Date',
  - The amalgamation should not be incorporated in the financial statements.

# IFRS 3 – Accounting for Business Combinations

- IFRS 3 have followed acquisition method of accounting for business combinations.
- “Business Combination” defined as a transaction or other event in which an acquirer obtains control of one or more businesses.
- One of the entities in business combination is identified as the acquirer.
- Assets acquired and liabilities assumed are measured at fair value on acquisition date.
- If consideration paid to acquire net assets exceeds fair value of net assets (assets - liabilities) acquired, it shall constitute goodwill.
- If consideration paid to acquire net assets is less than fair value of net assets acquired, the acquirer shall make a gain on bargain purchase. Gain on bargain purchase is recognized in profit or loss (current period earnings) on the acquisition date

# Additional requirements for Listed Companies- clause 24

- File the scheme with the SE, for approval, at least a month before it is presented to the Court
- Explanatory statement u/s 393 should contain
  - pre and post-arrangement or amalgamation (expected) capital structure
  - shareholding pattern
- Obtain “fairness opinion” from an Independent merchant bankers on valuation of assets / shares done by the valuer
- While submitting the scheme with the SE, also submit an auditors’ certificate to the effect that the accounting treatment contained in such schemes is in compliance with all the applicable Accounting Standards (added vide Amendment dated April 5, 2010)



# [ Takeover Code ]

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- Exempted under regulation 3(j) of SAST Regulations
  - pursuant to a scheme:
    - framed under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986);
    - of arrangement or reconstruction including amalgamation or merger or demerger under any law or regulation, Indian or foreign;

# Sec 391 to 394- “A complete code” or “Single Window Clearance System”

- When the scheme envisages various incidental proposals as an integral part of the scheme, the procedures prescribed under the Companies Act, need not be separately undertaken.
  - Procedure for change in object clause need not be separately followed-
    - *PMP Auto Industries Ltd.*, (1994) 80 Com Cases 289 (Bom).
    - *Rangkala Investments Ltd., Re*, (1997) 89 Com Cases 754
    - *Liqui Box India P. Ltd., In re*, (2006) 131 Com Cases 645 (P&H).
  - The Court can sanction reduction of capital as a part of the scheme.
    - *Cooper. Cooper and Johnson Ltd., Re*, (1902) WN 199
    - *Stephon Walters & Sons Ltd.*, (1926) WN 236
    - *Durairajan (T.) v. Waterfall Estates Ltd.*, (1972) 42 Com Cases 563 (Mad)
    - *Asian Investments Ltd., Re*, (1992) 73 Com Cases 517, 523 (Mad).

## Sec 391 to 394- “A complete code” or “Single Window Clearance System”

- No need to comply with the provisions of Sec 293(1)(a) for sale, lease, etc., of the company’s property
  - *HCL Infosystems Ltd. Re*, (2004) 121 Com Case 861 (Del).
- Change of name can be carried out as a part of the Scheme
  - *Jaypee Cement Ltd. Re*, (2004) 122 Com Cases 855 (All) : 2004 CLC 1031

# Role of Court in sanctioning the Scheme

- Where the scheme is found to be reasonable and fair, it is not the function of the court to substitute its judgment for the collective wisdom of the shareholders of the companies involved
  - *Jaquar Steels P. Ltd. Re*, (2004) 50 SCL 87
- The court must examine the scheme on its own merits and as a man of business would reasonably evaluate it
  - *Re, Kril Standard Products Pvt. Ltd.*, (1976) 46 Com Cases 203, 226 (Guj);
  - *Ahmedabad Mfg. & Calico Printing Co. Ltd. v. Bank of India*, (1972) 42 Com Cases 493 (Guj).
- The scheme has to be examined by the court with a view to see whether it is such as an independent and honest member of the company, while wisely acting in respect of his own interest, can reasonably approve
  - *Patiala Starch & Chemical Works Ltd., In Re*, (1958) 28 Com Cases 111 (P&H)

# Role of Court in sanctioning the Scheme

- Important rules laid down by the Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, AIR 1997 SC 506
  - The merits of the compromise or arrangement have to be judged by the parties who as *sui juris* with their open eyes and fully informed about the pros and cons of the scheme arrive at their own reasoned judgment and agree to be bound by such compromise or arrangement.
  - The court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the scheme by the requisite majority
  - The court cannot, therefore, undertake the exercise of scrutinising the scheme placed for its sanction with a view to finding out whether a better scheme could have been adopted by the parties

# Principles of sanctioning the Scheme

- Principles laid down by the Supreme Court in *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, AIR 1997 SC 506
  - That the provisions of the statute have been complied with.
  - That the class was fairly represented by those who attended the meeting and that the statutory majority are acting *bona fide*
  - That the arrangement is such as a man of business would reasonably approve
  - There should not be any lack of good faith on the part of the majority
  - Scheme not contrary to public interest or any other law

# Whether holding of meeting necessary in all cases?

- In case of amalgamation of the wholly owned subsidiary companies with their holding company, the court dispensed with the requirement of calling meetings
  - *Punjab Chemicals & Crop Protection Ltd., Re*, (2008) 84 CLA 33 (P&H).
  - *Rajasthan Network (P.) Ltd. v. Synergy Entrepreneur Solutions (P.) Ltd.* [2007] 80 SCL 13 ( Raj)
- Where the concerned shareholders gave their written consent to the proposed scheme, their meeting was dispensed with.
  - *Celica Developers P. Ltd., Re (No. 1)*, (2005) 145 Com Cases 154 (Cal).
  - *Dabur Foods Ltd, Re*, (2008) 144 Com Cases 378 (Del)
  - *Balaji Industrial Products Ltd., In re* [2008] 88 SCL 321 (Raj.)
  - *Raj Narain Pratap Narain Rolling Enterprises (P.) Ltd., In re* [2009] 89 SCL 17 (All.)
  - *C.M. Smith & Sons Ltd., In re* [2009] 89 SCL 377 (Guj.)

# To amalgamate is power or object?

- Courts have held that to amalgamate is an inherent power and an express provision in the MOA is not required:
  - Madras High Court in *RBR Knit Process P. Ltd Re*, (2007) 80 CLA 41 (Mad), held that Company Court can sanction scheme of amalgamation regardless of fact as to whether power to amalgamate with another company is contained in memorandum of concerned company or not.
  - The Calcutta High Court supported the above view in
    - *United Bank of India Ltd. v. United India Credit and Development Co. Ltd.* [1977] 47 Comp Cas 689 (Cal)
    - *EITA India Ltd., Re*, AIR 1997 Cal 208
  - The Delhi High Court in *Highland Electro Appliances P. Ltd., In re* [2003] 2 Comp LJ 16 (Delhi) held
    - the powers of the court under Sections 391 to 394 are not circumscribed by or predicated on the applicant-company possessing powers under its objects clause to amalgamate with any other company
  - The Bombay High Court also taken a similar view in a decision reported in *Aimco Pesticides Ltd. In re* [2001] 103 Comp Cas 463.
  - *Karnataka High Court has also similarly held in Hindhivac P. Ltd., Re; Hind High Vacuum Co. P. Ltd., Re*, (2005) 128 Com Cases 266 (Karn).



# Merger of Authorized Capital

- Varied opinion by High Courts as to whether the authorized capital of a transferor company merges into the authorized capital of the transferee company upon the scheme being sanctioned
- Cases decided in negative
  - the Delhi High Court in *Hotline Hol Celdings Pat. Ltd. and Ors* 127 Comp Cas. 165
  - A single bench of Calcutta HC in a scheme presented by *Areva T & D India Limited* (date of judgment- July 7, 2007), decided the issue in negative
- Cases decided in positive
  - In an appeal directed against the said judgment, the division bench of Calcutta High Court **reversed** the above judgment allowing merger of Authorized capital pursuant to the Scheme. *Areva T and D India Limited* [2008] 144 Company Cases 311
  - *Sreeleathers Private Limited & Ors.* (11/11/2008)- Calcutta HC
  - *Surya Commercials Ltd., Re,* (2007) 78 CLA 357 (All);
  - *Om Metals Intraprojects Ltd., Re,* (2007) 80 CLA 143 (Raj)
  - *Ashim Investment Co. Ltd., Re,* (2007) 138 Com Cases 89 (Del).
  - *Ashwin Poultry Farms (India) P. Ltd., Re,* (2007) 138 Com Cases 505 (Mad).

# Valuation of shares

- Principles laid down by the Supreme Court in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, AIR 1995 SC 470
  - Valuation is an art, not an exact science
  - A combination of the yield method, asset value method and market value method was used
  - Courts not to generally question valuation done by independent professional expert and approved by the shareholders
  - Valuation of experts not to be set aside in the absence of fraud or malafides on the part of experts
  
- The Supreme Court in its decision in *Miheer H. Mafatlal (supra)* held that
  - Once the exchange ratio has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies.”
  
- The above principles were uniformly followed by Court while sanctioning a scheme

# [ Tricky issues- how decided? ]

- Stamp duty on mergers:
  - Two school of thoughts prevailing:
    - Transfer of property in a scheme happens by way of vesting, pursuant to a court order, and therefore, cannot be regarded as an instrument.
    - Scheme is a voluntary act by Parties and the court merely puts its stamp of approval on what the parties desire (followed by Maharashtra, Gujarat, Karnataka and Rajasthan)

# Precedent in the matter

- Landmark decision of Supreme Court in *Hindustan Lever & Anr. vs. State of Maharashtra & Anr.* (2004) 9 SCC 438
  - The intended transfer is a voluntary act of the contracting parties. The transfer has all the trappings of a sale. The definition of 'conveyance' in the Act was an inclusive definition and includes within its ambit an order of the High court under section 394 of the Act. It is therefore subject to payment of stamp duty
- Decision of Bombay High Court in *Li Taka Pharmaceuticals Ltd vs State of Maharashtra* [AIR 1997 Bom 7]
  - An order u/s 394 is founded upon compromise between the two companies of transferring assets and liabilities and that order is an instrument as defined u/s 2(I) of Bombay Stamp Act
- Calcutta High Court in *Re: Gemini Silk Limited v. Gemini Overseas Ltd* (2003) 53 CLA 328
  - An order sanctioning a scheme of reconstruction amalgamation under Section 394 is covered by the definition of the words 'conveyance' and 'instrument' under the Indian Stamp Act and therefore liable to stamp duty

# Recent ruling of Delhi High Court

- Delhi HC in *Delhi Towers Ltd v. G.N.C.T. Of Delhi* (Date of decision: December 2009)
  - Upheld the decision of Supreme Court in *Hindustan Lever (supra)*
  - Amendment to Bombay Stamp Act- a mere clarification
  - That the pronouncement of the Apex Court in *Hindustan Lever (supra)* was not placed before the Calcutta HC which considered *Madhu Intra Limited & Anr. Vs. Registrar of Companies & Ors.* (2006) 130 Com Cas 510 (Cal)
  - Stamp duty to be levied only on the value of net assets (i.e. assets less liabilities)