CROSS BORDER MERGER AND ACQUISITION AS PER COMPANIES ACT 2013

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This dissertation is submitted in partial fulfillment of the degree of

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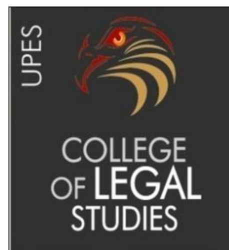

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CERTIFICATE

This is to certify that the research work entitled **"*CROSS BORDER MERGE RAND ACQUISITION AS PER COMPANIES ACT 2013*"**is the work done by **Mr. Shashwat Nigam** under my guidance and supervision for the partial fulfillment of the requirement of the degree of B.B.A., LL.B. (Hons)with Specialization in Corporate Lawsat College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled **"*CROSS BORDER MERGERRAND ACQUISITION AS PER COMPANIES ACT 2013*"** is the outcome of my own work conducted under the supervision of **Dr. Sujata Bali,** at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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- **SHASHWAT NIGAM**

LIST OF ABBREVIATIONS

- MCA – MINISTRY OF CORPORATE AFFAIRS
- M&A – MERGERS AND ACTUISITIONS
- XV – 25
- NLCT – NATIONAL LAW COMPANY TRIBUNAL
- HC –HIGH COURT
- CDR – CORPORATE DEBT RESTRUCCTURING
- CCI – COMPETITION COMMISSION OFINDIA
- MCR – MERGER CONTROL REGULATIONS
- SEBI – SECURITY AND EXCHANGE BOARD OF INDIA
- RBI – RESERVE BANK OF INDIA
- ROC – REGISTRAR OFCOMPANIES
- SAST – SUBSTANTIAL ACQUISITION OF SHARES
- OL – OFFICCIAL LIQUIDATOR
- UK – UNITED KINGDOM
- US – UNITRED STATES
- FEMA –FOREIGN EXCHANGE MANAGEMENT ACT
- IDR – INDIAN DEPOSITORY RECEIPTS

- ADR – ADDITIONAL DISPUTE RESOLUTION
- PF – PROVIDENT FUND
- EPF – EMPLOYMENT PROVIDENT FUND
- WHO – WORLD HEALTHORGANISATION
- UN – UNITED NATIONS
- CPC – CIVIL PROCEDURE COCDE
- CRPC-CRIMINAL PROCEDURE CODE
- CSR – CORPORATE SOCIAL RESPONSIBILITY
- CCD – COMPANY CONVERTIBLE DEBENTURES
- DVR – DIFFERENTIAL VOTING RIGHTS
- AP- ANDHRS PRADESH
- BOM- BOMBAY
- COMP. – COMPANY
- JV – JOINT VENTURE

CHAPTER 1

INTRODUCTION

The initial euphoria regarding the recent Indian Companies Act, 2013 will mellow down with passage of time. The pragmatic implications both, long term and short term of any newly enacted legislation is actually felt and understood by the stakeholders and the regulators on basis of the problems which emerge post enactment with which they have to be grapple. However, this does not undermine the significance of analysing its provisions at this juncture to offer timely insights as to their strengths and weaknesses.

It might also provide an opportunity to the legislators to again contemplate on some of the provisions of the Companies Act so as to suggest some suitable amendments. This paper may also provide some food for thought to the Ministry of Corporate Affairs (MCA) while formulating rules, under the Act, on the imperative issue of cross border merger and acquisition.[1]

The Companies Act, 2013 (2013 Act) has seen the light ofday and replaced the 1956 Act with some sweeping changes including those in relation to mergers and acquisitions (M&A). The new Act has been lauded by corporate organizations and lawyers for its business-friendly corporate regulations, enhanced disclosure norms and providing protection to investors and minorities, among other factors, thereby making M&A smooth and efficient. Its recognition of interse shareholder rights takes the law one step forward to an investor-friendly regime. While the 2013 Act is appreciated by many, it poses some practical difficulties for companies in structuring their transactions. This article focuses on

[1]www.indialawjournal.com/volume7/issue-1/article2.html

some of the sections (notified or not notified), which may have an impact on how M&A transactions are undertaken and structured in India.

CHAPTER 2

THE FRAMEWORK

Chapter XV of the 2013 Act deals with "Compromises, Arrangements and Amalgamations." In this chapter, the Act consolidates the applicable provisions and related issues of compromises, arrangements and amalgamations; however, other provisions are also attracted at different stages of the process. Amalgamation means an amalgamation pursuant to the provisions of the Act. In an amalgamation the undertaking comprising of property, assets and liabilities, of one (or more) company are absorbed by and transferred either to an existing company or a new company. Simply put, the transferor integrates with the transferee and the former loses its entity and dissolves without winding-up. The 2013 Act creates a new regulator, the National Law Company Tribunal ("Tribunal") who, upon its constitution, will assume jurisdiction (the High Courts will no longer have any jurisdiction) of the court for sanctioning mergers. Once the Tribunal is constituted, expected to be formed sometime this year, and related rules finalized, the provisions under the 2013 Act would be implemented.

Before detailing the key changes under the new law, a brief overview of the existing process will be useful. Under the 1956 Act, companies which have reached a consensus to merge must prepare a "scheme" of amalgamation/merger ("Scheme"). The lenders (financial institutions or banks) of the transferor and the transferee must approve1 the Scheme in-principle, followed by the subsequent approval of the respective Board of Directors of the merging entities. If the merging entities are listed companies, then the listing agreements executed with the stock-exchanges require the company to communicate price-sensitive information to the stock exchange immediately, to seek an approval from the capital market

The merger provisions are contained in Chapter XV, containing Sections 230 to 240, which deals with '**Compromises, Arrangements and Amalgamations**.' **Section 234**

specifically deals with the cross-border mergers concerning merger or amalgamation of an Indian company with foreign company. The analysis of merits and demerits will be done with a view to examine the possible implications of the relevant provisions on cross-border mergers[2] .

[2]India breaks into top 10 M&A league, Economic Times, April 12, 2014

CHAPTER 3

AN INSIGHT INTO CERTAIN GENERAL PROVISIONS OF CHAPTER XV[3]

Sub-section (2) of Section 230 at the onset makes the reporting to the tribunal for purpose of calling a members or creditors meeting more comprehensive than prescribed by Rule 67 of the Companies Court Rules, 1959, by filing an affidavit in Form No. 34, as required on an application made under Section 391(1) of the Companies Act, 1956. Most notable changes are the disclosure regarding the **Corporate Debt Restructuring** (CDR) Scheme to the tribunal; and filing of a share and property valuation report before the tribunal.

3.1 NOTICE TO THE REGULATORS AND EXAMINING THE ROLE OF CCI:

Sub-section (5) of Section 230 provides for sending sub-section (3) notice and other prescribed documents to the sectoral regulators and other authorities who are likely to be affected by the compromise or arrangement, to enable these regulators and authorities to make any representations on the proposals within the prescribed 30 days period. Competition Commission of India (CCI), which is arguably the Indian super-regulator, is expressly to be provided with the said notice and documents, if necessary. [4]

The circumstances amounting to the 'necessity' of the notice to CCI are nowhere delineated in the Act. Perhaps, the asset and turnover thresholds prescribed under Section 5 of the Competition Act, 2002 will be looked into to determine such a necessity, in

[3]Companies Act, 2013, http://www.mca.gov.in/Ministry/companies_Act.html.
[4]Companies Act 2013, New rules of the Game. KPMG, October 2014

absence of an express provision in the Companies Act in this regard.

As far as providing notice to the CCI is concerned, we should not forget that the Competition Act, 2002 provisions, along-with the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ('Merger Control Regulations') already prescribes for obtaining mandatory approval of certain combinations, where prescribed thresholds are met.

Even the Company (High) Courts are taking note of these Competition Law provisions in their orders approving schemes of mergers. This entails substantial costs including, high filing fee with attendant delay. This dual requirement of allowing CCI to make representations before the tribunal, and under the Competition Act to seek mandatory sanction is unnecessary, and cumbersome for the companies concerned. Further an anomalous situation may be created, if the CCI does not object or make any representation before the tribunal and later on declines to grant sanction, as required under Section 31(1) of the Competition Act. Instead, representations by CCI should be omitted in the sub-section (5) of Section 230, as it will have authority to block the merger when the 'combination' proposal comes for its approval.

3.2 RESTRICTING THE SCOPE OF OBJECTIONS TO MERGERS BY SHAREHOLDERS AND CREDITORS:[5]

There been instances in past of unscrupulous shareholders who bought just a few shares solely with a view to object to the mergers and attempt to block and delay the process. Proviso to sub-section (4) to Section 230 appears to rule out such frivolous and vested objections to the compromises or arrangements by prescribing, that 'the objection to the

[5] Companies Act 2013, Key Highlights and Analysis. PWC

compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt.' Such a positive change can have negative implications for protecting the rights of the genuine minority shareholders and small creditors. Instead, a summary procedure could be prescribed for such objections, a time frame could be laid down for dealing with such objections, and tribunal should be permitted to impose heavy penalty on such unscrupulous objectors.

3.3 MORE ELABORATE PROVISIONS :

It can be noticed, that the 2013 Act has much elaborate provisions and procedure to deal with several issues related to forming a more objective view of the scheme and deal with the stakeholders interests when compared to the provisions under the Companies Act, 1956. One such provisions is Section 236, which prescribes for 'purchase of minority shareholding'. This provision should be distinguished from the preceding section dealing with the acquisition of shares of dissenting shareholders. Though, inadvertently in Section 236 the Explanation which follows sub-section (8) erroneously refers to Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 [SEBI (SAST) Regulations, 1997] when SEBI (SAST) Regulations, 2011 are already in force. This drafting error could have been detected and removed in the Parliament itself.

3.4SIMPLIFIED IN CERTAIN PROVISIONS IN CERTAIN CASES :

One salient provisions of the 2013 Act is Section 233, which prescribes for bypassing the tribunal in case of merger or amalgamation of two or more small companies or between a holding company and its wholly-owned subsidiary, apart from other prescribed companies. Section 233 involves the Registrar (RoC) and Official Liquidators (OLs) in such mergers and amalgamations. This simplification of the process should expedite such

mergers apart from reducing the transaction costs.

CHAPTER 4

SECTION 234: CROSS BORDER MERGER AND ACQUISITON

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The Companies Act, 1956 due to Section 394(4)(b) restricts cross-border mergers to the Indian transferee companies. This legislative policy was a unusually restrictive and parochial, and ostensibly existed to protect Indian companies. This neo-colonisation mindset viewing business with foreign entities with suspicion should have been long sacrificed in this era of economic liberalisation, where the Indian government is slowly and cautiously moving towards an open door policy for inbound foreign investment, with progressive relaxation on capital account transactions (in a rather flip-flop manner); and the benefits of comparative advantage are quite well established for trade and commerce. Indian Government is arguably moving towards a freer capital account convertibility. In such an environment the restriction on cross-border mergers imposed by the Section 394(4)(b) should not be countenanced. It should also be appreciated, that such restrictive protectionist condition is not there in many advanced jurisdictions like, the U.K. and the U.S., otherwise previous cross-border mergers with U.K. Companies e.g., in the 1976 E.I.D. Parry Ltd. Case and the U.S. companies e.g., the year 2003 amalgamation of Verasity Technologies Inc. with Moschip Semiconductor Technology Ltd. would not have been possible. No adverse effects have been demonstrated on the U.S. and U.K. companies due to permissive regime in their jurisdictions.

Thus, the introduction of Section 234 in the 2013 Act is a welcome step. However, a regressive restriction of allowing such cross-border mergers only with the foreign companies incorporated in the Central Government notified jurisdictions nullifies the progressiveness which was apparent in Section 234. It is just anybody’s guess that which jurisdictions will be notified in due course, and on what basis. Will this policy be formed on basis of reciprocity or, on some other criterion, like restricting mergers from tax and

treaty havens? Notably, the Companies Act, 1956 provisions do not restrict cross border mergers on basis of the nationality of the transferor foreign company. Thus, there is a need to further examine two issues pertaining to this restriction. Will this restriction in the 2013 Act actually make it even more regressive than the 1956 Act? This question can only be addressed after the relevant notification is issued, which will enable examination of its scope and contents; and its impact on cross-border M&As is seen with passage of time. The second concern relates to the (in) appropriateness of addressing issues concerning other areas like, international taxation and its avoidance through the instrument of companies legislation. This complicates these existing problems further, without effectively addressing them, and has unnecessary adverse implications on the company's law regime.

4.1 ROLE OF THE RESERVE BANK IN THE APPROVAL: ONEROUS CONDITION.

Sub-section (2) of Section 234 requires a prior Reserve Bank approval in the cross-border mergers. This is unusual and should be left to the wisdom of the authorities managing Foreign Exchange Management Act, 1999 and its Regulations, prescribing the exchange control laws in India. It should be noticed, that even under the current framework, Regulation 7 of the FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ('FEMA 20') mere reporting to the Reserve Bank by the transferee or the new company within the 30 days period in the manner prescribed is the general norm to be followed. Only respite is, that sub-section (2) is 'subject to any other law for time being in force'. Thus, Regulation 7 of FEMA 20 should override the prior approval requirements. A corresponding overriding provision will have to be introduced in the FEM (Transfer or Issue of any Foreign Security) Regulations, 2004 ('FEMA 120') for the benefit of cross border mergers involving a foreign transferee company.

4.2 CENTRAL GOVERNMENT FORMING RULES IN CONSULTATIONS WITH THE RESERVE BANK:

Proviso to sub-section (1) of Section 234 provides, 'that the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.' The coverage, consistency (both within and with other existing laws), and clarity of such rules will be important criteria. The Companies (Cross-Border Mergers) Regulations, 2007 (U.K.) may be instructional in this regard, as it exhibits considerable foresight in dealing with even (traditionally) offshoot issues like, protection of employees. The consultations with other stakeholders and experts are suggested before formulating such rules.

4.3 DEPOSITORY RECEIPTS AS PAYMENT OF CONSIDERATION TO THE SHAREHOLDERS OF THE MERGING COMPANY: .

One radical feature of sub-section (2) of Section 234 is allowing Depository Receipts (DRs) as payment of consideration to the shareholders of the merging company. Thus, there can be a case of issuance of Indian Depository Receipts (IDRs) by the foreign company as payment of consideration to the shareholders of the Indian merging company. IDRs have been an unpopular and problematic security, which seems to have fell into disfavour after the Standard Chartered Bank's IDR issue. The RBI and SEBI as regulators have created unnecessary restrictions, and have been sceptical in crucial areas like redemption, which has only been slowly yet not fully relaxed, to the inconvenience of the foreign companies issuing such IDRs through depositories. We should not also forget the Central Government's intervention in form of Companies (Issue of Indian Depository Receipts) Rules, 2004. This makes the whole IDR Regime unnecessarily complex and unattractive. If the IDRs are to be made an attractive security, like ADRs and GDRs, then simplification and unification of the IDR legal regime needs to be done with an open mind by the regulators concerned. Otherwise, such enabling provisions permitting issuance of IDRs carry little meaning.

CHAPTER 5

INNOVATIONS MADE THROUGH NEW PROVISIONS

5.1 STRICTER RULES ON COMPANY GOVERNANCE:

“The current style of tea, occasional and cashew meeting can flee, and that they can take their job seriously,” Among the maximum of 15 (fifteen) administrators, one of the administrator will be a girl. The new rules request to encourage larger shareowner responsibility in company boardrooms. third of a company’s board should currently be independents, with no money interest within the company. the administrators have conjointly been created in charge of selections created by the board, that ought to encourage them to become over a rubber stamp for the businesses. [6]

5.2 FREELANCE ADMINISTRATORS DISH OUT TO 2 CONSECUTIVE FIVE-YEAR TERMS :

Company finances must certanly be audited frequently and auditors should make the modification sporadically. The company's chief money handler happens to be in control of the contents of economic statements.

[6]Company finances {should be|mustcertanlybe|ought to be|mustbe|should really be} audited frequently and auditors should modification sporadically. {The company's|Thebusiness's|Their} chief money handler {is currently|happens to be|is} control {in charge of|responsiblefor|in control of} the contents of economic statements.

The legislation conjointly discourages confusing company structures that create it exhausting for authorities to know however funds area unit being affected or to identify attainable concealing. Now, “you can’t have investment through over 2 layers of corporations,” said Ms. Mittal, the lawyer.

5.3 A LOT OF PROTECTION FOR INVESTORS:

In an exceedingly bid to maneuver Indians off from finance in gold and towards money markets, Republic of India has tried to guard investors from fraud. These efforts embrace the capitalist Education and Protection Fund, established twelve years past to market capitalist awareness regarding scams.

The new corporations law takes those efforts a step more by giving teams of investors to charm to a National Company Law court, whose president are somebody with a minimum of 5 years of expertise as a judicature choose. The court are the most implementing authority underneath the new company law, taking the place of the present Company Law Board. Its selections is appealed in Associate in Nursing proceeding court. The Supreme Court is that the final court of charm for court selections.[7]

Some companies and news reports have hailed the new “class action” provision as a daring new step, however a version of that provision already existed Investors will already confederate to hunt a legal order to prevent a corporation from taking action they reckon to be financially harmful.

The new law clarifies the types of remedies they'll enkindle, and conjointly permits them

[7] Asian Journal of Multidisciplinary Studies, 3(2) February, 2015

to hunt compensation from company management for any money losses faced as a result of management actions, or from the company's auditing firm.

These changes seem to be a minimum of partially drawing on lessons learned from the Satyam fraud, within which the Hyderabad-based firm's chairman Ramalinga Raju confessed in 2009 to overstating the school company's money position for years. school Mahindra Ltd. noninheritable the firm in Gregorian calendar month of that year in an exceedingly government-led auction and renamed the corporate Mahindra Satyam.

"Defrauded investors are sceptered to assert, and get, damages or compensation from people who have committed fraud or indulged in unfair apply," aforesaid Virendra religious belief, founding father of ability Investors Association, a Kanpur-based capitalist support cluster, in an exceedingly statement.

Consultants and auditors might want to require note although. The collective demand for compensation can even be created against "any skilled or consultant or advisor or the other person for any incorrect or dishonest statement created to the corporate," in keeping with the Bill.

5.4 SUPPLEMENTAL PROTECTION FOR WHISTLE-BLOWERS:

The businesses Bill 2012 needs publically listed companies in addition as others, nonetheless to be outlined, to line up a "vigil mechanism" in order that staff discomposed by however the business is running will report their considerations through this technique.

"**The vigil mechanism shall give for adequate safeguards against victimization of persons World Health Organization use such mechanism**," says the legislation.

A description of this technique is meant to be denote on a business's web site once it's been established, in addition as enclosed within the company's money report. Among different duties, the freelance administrators mentioned higher than area unit meant to form certain the whistle-blowing system is functioning, which nobody World Health Organization has used it's faced retribution, that may be a large order and one which will be tough to enforce.[8]

5.5 CROSS-BORDER MERGERS:

Section 234 of the law says that, "A foreign company, might with the previous approval of the banking company of Republic of India, merge into a corporation registered underneath this Act or contrariwise."

5.6CLOSING A BUSINESS:

In 2013, Republic of India born seven spots on the planet Bank's "resolving insolvency" indicator, one amongst the 9 business activities the many-sided agency uses to live the

[8] http://blogs.wsj.com/indiarealtime/2013/08/12/new-corporate-law-what-you-need-to-know/

convenience or issue of in operation in a specific country.

The indicator, that wont to be referred to as “closing a business,” measures, among different things, however long it takes to recover cash from a bankrupt firm. In India, this method is ruled by a rather prolonged section of the company law referred to as, fittingly enough for those conversant in British slang, “winding up.”

There area unit such a large amount of stages and steps during this method, that in keeping with the planet Bank, it takes a mean of four.3 years in Republic of India for a person to recover funds from Associate in Nursing insolvent business, compared to a few years within the remainder of South Asia and one.7 years in developed countries.

Section 273 states that a company affairs court should take action among ninety days on a petition from a person seeking the motion down of a business that's late on its debts.

Once the court problems Associate in Nursing order for proceedings to maneuver forward, the indebted company is meant to produce an announcement of its accounts among thirty days to sixty days. If it doesn’t try this, it forfeits the proper to oppose the efforts to shut it down.[9]

5.7 CLASS ACTION SUIT

Though arguments have been made in the past that class action suits have always been permissible under India’s Code of Civil Procedure, 1908, the 2013 Act now specifically provides for class action suits brought by: (i) members; or (ii) depositors of a company, where they are of the opinion that the management or conduct of the affairs of the company is being conducted in a manner prejudicial to the interests of the company or its members or depositors. The Indian understanding still appears to be narrower than a US view on class action where groups of similarly aggrieved persons institute suits with a primary objective of recovering damages from a defendant. However, foreign investors

[9] The Wall Street Journal India version 02.06.2014

will still be required to play a more active day-to-day role in their Indian investments to ensure Indian companies do not violate corporate governance norms and respect member and depositors interest alike.

5.8 BUY BACK OF SHARES

Under the 1956 Act, companies could do multiple buy-backs of shares in the same financial year except in certain specific facts where there was a cooling off period of one year. However, now the 2013 Act requires a mandatory one-year time period between any type of buy-back, even if the buy-back was achieved through a scheme approved by an Indian court. The 2013 Act also stipulates that a buy-back is not possible if the company has made any default in the repayment of deposits or interest, or redemption of debentures, or preference shares, or payment of dividend, or in the repayment of a term loan to a bank or financial institution. However, the buy-back may be possible if the defect is remedied, and a three-year time period has elapsed.

The earlier common practice of a back-to-back shareholder-approved buy-back following a board mandated buy-back is no longer possible under the 2013 Act, and this is likely to significantly delay and adversely impact investor exit options. It is noteworthy that with the introduction of a non-creditable tax on buy-back distributions under tax law, this route had already become less attractive.

5.9 LAYERED INVESTMENTS THROUGH SUBSIDIARIES

The 2013 Act makes a significant departure from the 1956 Act by specifically mandating that investments can no longer be made through more than two layers of investment companies, except in certain specified circumstances. Although this appears to have been enacted with a view to prevent convoluted structures and diversion of financial assets, this provision is likely to affect complex cross border merger and acquisition activity. Two

specific exemptions have been provided in the 2013 Act, i.e.,

(i) an offshore acquisition is possible if the offshore target has investment subsidiaries of more than two levels as per the local laws of such foreign country; and

(ii) an investment subsidiary may exist in order to comply with regulatory requirements or other laws in force at the time.

An “investment company” has been defined as a company whose principal business is the acquisition of shares, debentures or other securities, and it remains unclear whether or not the two layer restriction is meant to apply only to investment “subsidiaries”. The two layer restriction takes away some structuring flexibility and genuine special purpose vehicles for a large corporation’s varying business interests may become a thing of the past. Compliance costs of ensuring the existence of operating companies between investment companies is also expected to be weighty. [10]

5.10 SQUEEZE OUT PROVISIONS

The 2013 Act has introduced new provisions for enabling the acquirer of a company (holding 90% or more shares) by way of amalgamation, share exchange, etc to acquire shares from the minority holders subject to compliance with certain conditions. This has also introduced the requirement for ‘registered valuers’, since the price to be offered by majority shareholder needs to be determined on the basis of valuation by a registered valuer (section 236 of the 2013 Act).

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[10] http://indiacorplaw.blogspot.in/2008/09/cross-border-mergers.html

5.11 ENFORCEMENT OF SHAREHOLDERS AGREEMENT AND ENTRENCHMENT

Under the 1956 Act, the articles of association of a company could only be altered by a resolution passed by three-fourth of its shareholders. In practice, however, in order to attract foreign investors, existing Indian shareholders would still grant investors higher rights in the form of veto rights for amending important provisions in a company's articles. The 2013 Act has now specifically validated the idea of entrenchment, and therefore, all such contractual agreements by shareholders now have legislative recognition. This will provide much-needed flexibility for investors to specify that certain provisions of the articles of a company may only be altered if special conditions or procedures are complied with.

Similarly, while under the 1956 Act share transfer restrictions in investor agreements between shareholders of a public company were not expressly permitted, the 2013 Act has now legitimatised arrangements in respect of the transfer of securities, which shall be enforceable as a contract. The change finally settles the position on enforceability of agreements with investors providing for pre-emptive rights inter-se shareholders of a public company such as the lock-in period, right of first refusal and tag-along and drag-along rights. This importantly takes these issues out of potential litigation in Indian courts[11]

5.12 MINORITY SQUEEZE OUT

The 2013 Act now explicitly deals with the issue of buying out the minority shareholders of a company. In a situation where an acquisition results in the acquirer holding 90 percent of the issued share capital of the company, it shall be obliged to inform the company of its

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[11] : http://forbesindia.com/article/real-issue/key-implications-of-the-companies-act-2013-on-board-room-decision-making/38170/1#ixzz3WkH2QsiY

desire to purchase the minority shareholding of that company at a price determined according to the provisions of the 2013 Act. This is a key change and significant departure from the 1956 Act, which did not have such a provision. From a minority protection perspective, it is welcome that the minority buy out is not limited to the dissenting shareholders, but available to the minority as a whole. This means that a minority might be able to share the upside of a deal and the entire process of squeeze out could take place without intervention by the court. Further, the 2013 Act also makes the formula to determine the exit price clear and removes the ambiguity that existed under the 1956 Act. [12]

5.13 INTER-CORPORATE LOANS

The 2013 Act has imposed several onerous conditions for inter-corporate loans. Under the 2013 Act, a special resolution (requiring a three-fourth majority of shareholders) is required for a loan exceeding the prescribed threshold of 60 percent of the paid-up share capital, free reserves and securities premium account of the company, or 100 percent of free reserves and securities premium account of the company, whichever is higher. Further, now unanimous approval of all directors present at the board meeting is required. This will apply to private companies as well, and therefore, make it more cumbersome for a private company to give loans to its affiliate companies. The 2013 Act also prescribes some enhanced disclosure requirements for loans, investments, guarantees and securities.

5.14 CAPITAL RAISING

For new businesses in India, private companies used to be the preferred business vehicle

[12] http://indianlawyer250.com/features/article/180/proposed-new-corporate-law-framework-impact-cross-border-business/

due to a lesser compliance burden. However, several of those advantages have been obliterated by the 2013 Act. For instance, there were no restrictions on private companies issuing shares with differential rights and creating multiple classes. However, under the 2013 Act, they must now comply with certain statutory requirements. Further, in the earlier regime, as long as there was enough headroom in the authorised share capital, private companies' boards could themselves issue shares (regardless of whether it was a rights' issue or a preferential allotment). However, now other processes have been prescribed.

Under the 1956 Act, in the case of preferential allotment, unlisted public companies needed shareholder sanction and private companies needed board sanction, and there were scant other compliances. However, under the 2013 Act, these companies must also prepare an offer letter which will require some financial and other information to be included. In the context of the rights issue process, the pricing of resultant securities would need to be determined upfront even in the case of private companies. There is ambiguity over this pricing, which appears to be in conflict with current Indian foreign exchange laws.[13]

5.15 CONSTITUTION OF THE BOARD

The 2013 Act has made a significant change in the manner in which boards of companies must be constituted. It is mandatory that at least one director must be a resident in India for a minimum period of 182 days during the preceding calendar year. Moreover, all listed companies and certain other classes of companies as prescribed under delegated legislation would also need to have at least one woman director on their boards.[14]

All listed Indian companies and unlisted companies satisfying certain conditions are now

[13] http://www.grantthornton.in/service-areas/assurance/companies-act-2013/
[14] www.indialawjournal.com/volume7/issue-1/article2.html

required to have at least one third of their board comprising of "independent directors". In this context, the 2013 Act prescribes stringent criteria for qualification of persons as independent directors and makes it explicitly clear that a nominee director would not be considered "independent". In the context of legal responsibility, the 2013 Act has enlarged the scope of the expression "officer in default", which now includes directors of boards who do not object to decisions taken at board meetings. Therefore, existing and potential foreign investors would need to significantly restructure their board compositions and bring about a higher degree of care in order to comply with provisions of the 2013 act.

5.16 DECISION MAKING POWER OF THE BOARD

Unlike under the Indian Companies Act 1956 ("1956 Act"), where an ordinary resolution (requiring a simple majority of shareholders) was sufficient, under the 2013 Act, certain powers of the board of directors can now only be exercised subject to a favourable special resolution (requiring a three-fourth majority of shareholders) being passed. These include important subjects such as the right to sell a substantial part of the undertaking or borrow money above certain specified thresholds. Special resolutions may also include conditions and the applicability of the provision has been extended to private companies as well. Further, there have been several important additions to the list of powers which are to be exercised by board of directors only at a meeting of the board, and cannot therefore be delegated. These include things such as the approval of financial statements, diversification of business and the approval of mergers and takeovers. Additionally, although the 2013 Act recognises and permits board meetings to be conducted via video conference, certain decisions, including those relating to the approval of financial statements and mergers, cannot be made via video conference. Foreign investors ought to be wary of these changes, as they significantly curtail the decision-making power of the board and require increased shareholder support for positive company outcomes. [15]

[15] indiamicrofinance.com/companies-act-2013-mergers-acquisitions-2014

5.17 RELATED PARTY TRANSACTION

The range of related party transactions under the 2013 Act has been significantly widened compared to the provisions of the 1956 Act. Under the 2013 Act, a shareholder of the company, who is a related party vis-à-vis a counter party in such a transaction, is not permitted to vote while approving the transaction. However, "arm's length transactions" entered into by the company in its "ordinary course of business" are exempt from the related party rule. "Arm's length transaction" is defined to mean "a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest".[16]

The expression "ordinary course of business" has not been defined in the 2013 Act, and will have to be determined on a case-to-case basis. The 2013 Act importantly now includes an "associate company" within the ambit of the term related party. An associate company in relation to a company is a company, other than a subsidiary, in which the first mentioned company has "significant influence", i.e., controls at least 20 percent of the share capital or business decisions under an agreement, and it specifically includes a joint venture company. Given that the 2013 Act mandates that no related party can vote on several important company resolutions, it is possible that in certain cases, the "majority" related party shareholders could be prevented from voting and minority shareholders would in effect get decision-making power. An interested director cannot be present at the company's board meeting when a related party transaction is under discussion and vote.

[16]http://www.academia.edu/6704826/Critical_Evaluation_of_the_Provisions_Relating_to_Cross_Border_Merger_under_Companies_Act

Further, the exemption under the 1956 Act for interested directors of private companies has been done away with, thereby extending the application of the provision to all private companies as well.[17]

The 2013 Act also specifically prohibits forward contracts and put or call options between the directors/key managerial personnel of a company and the company or any holding subsidiary, or associate company

5.18 CORPORATE SOCIAL RESPONSIBILITY

The 2013 Act has ushered in certain innovative provisions relating to corporate social responsibility. A company that has a net worth of at least Rs 5 billion or a turnover of at least Rs 10 billion or a net profit of at least Rs 50 million during any financial year will be required to constitute a "Corporate Social Responsibility Committee" with three or more directors to frame and oversee the company's general policy and specific corporate social responsible activities.

The 2013 Act mandates that every such company must spend at least two percent of its average net profits in every financial year on corporate social responsibility activities. However, any profits arising from overseas operations conducted through foreign branches or subsidiaries and dividend received from other companies in India will be excluded. In the event that a company does not comply with its corporate social responsibility, the board of directors of the company will be required to explain their reasons for this along with the company's yearly financial statements.

The law does not prescribe any sanctions for non-compliance with the obligation to spend the two percent as long as the board records reasons for this. For foreign companies

[17] www.ficci.com/events/21798/ISP/Mergers-and-Restructuring.pdf

present in India, the corporate social responsibility obligations become directly relevant, because delegated legislation under the 2013 Act has mandated that the provisions will also apply to foreign companies having a place of business in India or having any business connection with India in any form. While it is unlikely that this would include foreign companies other than those in which more than 50 percent of the total paid up share capital is held by Indian citizens or Indian companies, in the absence of a clarification, all foreign companies with any presence in India would be required to comply.[18]

5.19 REGULATORY/THIRD PARTY APPROVALS[19]:

As shareholders' and creditors' consents are essential, the 1956 Act, therefore, contemplates issue of a notice to them. The 2013 Act requires service of the notice of the merger along with documents (such as copy of the Scheme and valuation report) not only upon the shareholders and creditors but also on various regulators including the Ministry of Corporate Affairs (through Regional Director, Registrar of Companies and Official Liquidator),[20] Reserve Bank of India ("RBI") (where non-resident investors are involved), SEBI (only for listed companies), Competition Commission of India (where the prescribed fiscal thresholds are crossed and the proposed merger could have an adverse effect on competition), Stock Exchanges (only for listed companies), Income Tax authorities and other sector regulators or authorities which are likely to be affected by the merger.[21] This ensures compliance of the Scheme with other regulatory requirements imposed on the merging entities. In fact, under the 1956 Act the courts have made mergers subject to approval of the regulators. The 2013 Act prescribes a 30 day time frame for the regulators to make representations, failing which the right would cease to exist. This is a positive step because in the 1956 Act no such time frame was provided leading to considerable

[18] http://www.mondaq.com/india/x/289180/Corporate+Commercial+Law/Merger+Regime+Under+The+Companies+Act+2013

[19] SEE SECTION 230(5) OF THE 2013 ACT

[20] UNDER THE 1956 ACT, APPROVAL FROM THE MINISTRY OF CORPORATE AFFAIRS IS TAKEN BUT SUBSEQUENT TO SHAREHOLDERS AND CREDITORS APPROVAL AND BEFORE THE FINAL APPROVAL OF THE HIGH COURT

[21] FOR EXAMPLE, DEPARTMENT OF TELECOMMUNICATIONS IN CASE OF MERGER OF TELECOM COMPANIES

delays in the court proceedings.

5.20 APPROVAL OF THE SCHEME THROUGH POSTAL BALLOT[22]:

The 1956 Act required presence of the shareholders and creditors in the physical meetings, either in person or by proxy, to cast vote for/against the Scheme. In the 2013 Act, the shareholders and creditors also have the option to cast vote through postal ballot while considering a Scheme. The 1956 Act did not allow this and the shareholders and creditors could only cast votes physically. This right will ensure wider participation of the shareholders and creditors, particularly for those who are scattered all over the country and who find it difficult to be either physically present or provide a proxy. Postal ballot, therefore, will offer them a greater flexibility to cast their votes.

5.21 VALUATION REPORT

Though the 1956 Act is silent on disclosing the valuation report to the stakeholders, as a matter of transparency and good corporate governance, the listed companies used to make available the valuation report for inspection and also during the course of the meetings. Courts also required annexing of the valuation report to the application submitted before them. The 2013 Act now mandates annexing of the valuation report to the notices for the meetings to enable ready access to the shareholders and creditors. [23]

[22] SEE SECTION 230(6) OF THE 2013 ACT
[23] forbesindia.com/article/real-issue/key...of...companies-act-2013

5.22 OBJECTIONS[24]

A bane under the 1956 Act was that it permitted the individual shareholders and creditors to raise frivolous objections to arm-twist and unnecessarily harass the companies following the meetings. Such right to object to the Scheme would no longer be available to any and every person. Objections can be raised by shareholders holding 10% or more equity and creditors whose debt represent 5% or more of the total debt as per the last audited financial statements. By raising the bar, the new law aims to ensure that the frivolous objections/litigation can be avoided.

5.23 ACCOUNTING STANDARDS[25]

As a matter of practice, frequently the Scheme provided for accounting treatment that would deviate from the prescribed accounting standards necessitating a note to this effect in the balance sheet of the company. This was frowned upon by the tax authorities. Consequently, in case of listed companies, the listing agreement was amended to provide that an auditor's certificate stating that the accounting treatment is in accordance with the accounting standards was required to be filed for seeking approval of the stock exchanges. The 2013 Act makes such prior certification from an auditor mandatory for both listed and unlisted companies. [26]

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[24] SEE SECTION 232(2) OF 2013 ACT

[25] THIS IS COVERED IN THE PROVISO TO SECTION 230(4) OF THE 2013 ACT

[26] THIS IS COVERED IN THE PROVISO TO SECTION 232(3) OF THE 2013 ACT

5.24 PENALTIES

The penalties for contravention of the provisions under the 1956 Act were a maximum of INR 50,000 (approximately US$ 80617) which apply to the company as well as officer-in-default. However under the 2013 Act, separate penalties have been levied on the company and its defaulting officer. To bring in more accountability, quantum for companies has been increased from the aforesaid sum to a minimum of INR 100,000 (approximately US$ 1,612) and maximum of INR 2,500,000 (approximately US$ 40,322). Defaulting officer(s) will also be punishable with imprisonment up to one year or with a minimum fine of INR 100,000 (approximately US$ 1,612) and maximum INR 300,000 (approximately US$ 4,838) or both.18 Such stringent penal provisions will not apply to mergers of small companies and that of a holding company with its wholly-owned subsidiaries unless their merger is transferred to the Tribunal and approved by it.

CHAPTER 6

IMPACT ON MERGERS AND ACQUISITIONS AS PER COMPANIES ACT 2013

The new Companies Bill proposes seminal changes in the manner in which Companies are governed and regulated in India & brings easy and efficient way of doing business in India, better governance, improves levels of transparency while enhancing accountability, inculcating self compliance and making Corporate socially responsible. The bill could potentially trigger a spate of domestic and cross-border mergers and acquisitions, strategic alliances and make Indian firms more attractive to PE investors. We are briefly discussing the changes impacting Mergers & Acquisitions.[27]

Global integration and cross-border mergers are now permitted by new Bill thereby allowing merger of an Indian company with a foreign company. Earlier, only foreign companies were allowed to merge with Indian companies. Exits will be easier, because the new law allows the consideration on a merger to be settled in the form of cash or depository receipts. [28]

Allows fast & quick merger between two or more "small companies", "holding company and its wholly owned subsidiary" or such other class(es) of companies as may be prescribed by the central government, without the approval of the high court or National Company Law Tribunal (NCLT).

The Companies Bill specifically provides for provisions relating to a merger of a listed company with an unlisted company and gives power to the National Company law Tribunal to order exit of the dissenting shareholders (made easy) of the transferor listed

[27] indiacorplaw.blogspot.com/2008/09/cross-border-mergers.html
[28] www.slideshare.net/.../compromises-arrangements-amalgamations

company in case they opt out of the unlisted transferee company with payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation has been made.

For good governance and investor protection, the new Bill advocates price determination by a registered valuer for any preferential allotment of equity. Such a measure is in sync with the principals set out under the exchange laws and the tax framework. This should prevent the dilution of existing investors' interests at an unfair price.

Prohibits the retaining of any treasury stock, arising on consolidation, pursuant to a merger and requires all such shares to be cancelled or extinguished, thereby restricting trust structure used by listed entities to retain control or future monitization.

Pooling of assets under a single company in any jurisdiction is achievable now by access to large capital without need to go public as number of member restriction under Private limited company increased to 200 from 50.

The bill provides that no civil court shall have jurisdiction over any suit or proceeding in respect of any matter that the NCLT is empowered to determine under the bill. And NCLT along with National Company Law Appellate Tribunal (NCLAT), will replace several existing forums, including the Company Law Board, the BIFR and the Appellate Authority for Industrial and Financial reconstruction.

CHAPTER 7

FDI THROUGH CROSS BORDER

FOREIGN DIRECT INVESTMENT ('FDI') IN INDIA Exchange control regulations which are critical to the India specific cross border M&A are defined under the Foreign Direct Investment (FDI) guidelines. FDI in India are governed by the FDI Policy announced by the Government of India and the provisions of the Foreign Exchange Management Act (FEMA), 1999. Besides, the Ministry of Commerce and Industry issues series of press notes outlining certain criteria‟s for the FDI guidelines. Under the present FDI policy, foreign investments are allowed in an Indian company under the automatic route in almost all sectors except:

(i) Retail Trading (except single brand product retailing)

(ii) Atomic Energy

(iii) Gambling and Betting, Lottery Business

(iv) Certain Financial Entities

(v) Trading in Transferable Development Rights

(vi) Activity/sector not opened to private sector investment

CHAPTER 8

FOR OTHER SECTORS, THERE ARE TWO ROUTES FOR FOREIGN INVESTMENT IN INDIA[29]:

(i) **AUTOMATIC ROUTE** - the foreign investor does not require any approval from the Reserve Bank of India (RBI) or Government of India for the foreign investment.

(ii) Prior government approval route for foreign investment, in the following circumstances, needs approval:

a) Activities which require prior government license

b) Proposal exceeding the sectoral caps or where provisions of Press Note 1 (2005 Series) issued by the Government of India are attracted;

c) Where more than 24 per cent foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector

d) Proposal for acquisition of shares of an Indian company in Financial Sector and where the transactions attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

[29] www.thehindubusinessline.com/features/...mergers/article5276090.ece

8.1 RESTRICTION ON MULTI-LAYERED STRUCTURES

(NOT NOTIFIED)

In the 1956 Act, there are no provisions regarding restrictions on multi layered structures. Accordingly, several multi- layered structures have been set up for holding investments in operating entities to suit business or commercial needs. However, the 2013 Act has imposed a restriction of two layers for investment companies. "Investment companies" have been defined as enterprises whose principal business is acquisition of shares, stocks, debentures or other securities.[30]

The requirement mentioned above does not affect the following:

• A company from acquiring another enterprise that is incorporated outside India if it has investment subsidiaries beyond two layers according to the law of the particular country

• A subsidiary company with investment subsidiaries for meeting statutory requirements The rationale behind this change could be to limit diversion of funds and possible tax avoidance through the webs of complex corporate structures. However, this change could have an impact on structuring downstream foreign investments through holding companies in India. Furthermore, the requirement for demonstration of the operations of subsidiaries leads to operation- and compliance-related costs.

[30]unctad.org/en/publicationslibrary/wir2013_en.pdf

Furthermore, there is no guidance in the 2013 Act on determination of the principal business of an investment company in defining it. This has been the subject of debate under the legal regime of non-banking financial companies governed by the RBI. In the absence of any statutory clarity in this regard, deal structures will need to be looked into carefully to ensure their compliance with this restriction. [31]

Private equity investors prefer to invest in holding companies to realize increased returns from the entire group through a single investment rather than multiple investments in subsidiaries. This reduces flexibility in structuring investments, and particularly affects sectors such as infrastructure and mining, where it is common to have multiple subsidiaries to implement projects and raise funds. There is no clarity on whether existing structures will be required to comply with the new regime.[32]

For this provision not to become a deterrent for M&A, the regulator should consider allowing exceptions for genuine multilayered corporate structures.

8.2 ACCEPTABILITY OF CONTRACTUAL RIGHTS (NOTIFIED)

It is common practice for transacting shareholders to enter arrangements involving "put and call" options and other preemption rights including ROFR, tag along /draft along, etc. While transfer restrictions are enforceable in the case of private companies, their enforceability in relation to the shares of a public company has not been established conclusively. Historically, this practice has been subject to scrutiny, since such arrangements involving listed and unlisted public companies were restricted under the

[31] ssrn.com/abstract=2254314
[32]www.iflr.com/Article/.../Indias-new-era-of-cross-border-mergers.html

Securities Contract Regulation Act, 1956 (SCRA). The 1956 Act provided that the shares and any interest in itof a public company are freely transferable, and therefore, any restrictions on the transferability of shares cannot be enforced against it.

Conflicting judgements prevail, leading to further ambiguity. Clause 58(2) of 2013 Act seems to provide a respite to such commercial practices and prescribes that a contract or arrangement between two or more persons in respect of transfer of securities will be enforceable as a contract. Furthermore, SEBI and the RBI have issued separate notifications permitting put and call options on shares, CCDs, etc., subject to fulfilment of certain conditions.

The amendments mentioned above settle this issue, and thereby provide legal sanctity or validity of the restrictive rights of the parties in relation to transfer of securities of a company.

8.3 CHANGE IN TREATMENT TO PRIVATE COMPANIES AND ITS IMPACT ON M&A

Since the overarching theme of the 2013 Act seems to be protection of minorities, it has resulted in curbing the flexibilities available to private companies under the 1956 Act.

Various provisions introduced in the statute effectively nullify the advantages of incorporating a private company over a public one. Some of these may impact M&A.

8.4 PRIVATE PLACEMENT (NOT NOTIFIED)

Under the 1956 Act, preferential allotment conditions were applicable to public or private companies, which were subsidiaries of public organizations. Under the 2013 Act, these conditions are also extended to private companies. A special resolution is required for any preferential allotment of shares, with the pricing being determined by a registered valuer. In addition to the above, cumbersome requirements (including issuance of a private placement offer letter and filings with the registrar of companies) will have to be adhered to by private companies, even in the case of standalone placements that constitute an offer or invitation to offer. Given that most private companies are closely held, it should be possible to ensure their uninterrupted operations, except for the compliance-related requirements that need to be factored in their transaction timelines.[33]

8.5 DIFFERENTIAL VOTING RIGHTS (DVR) (NOT NOTIFIED)

The 1956 Act permitted a private company to issue shares of various classes, each of which could have different rights in terms of dividend, voting or any other special rights, without needing to satisfy any stipulated conditions, since DVR rules did not apply to a private company.

As the law stands today, the 2013 Act provides that private companies will also have to comply with the rules to be framed by the Government in this regard in order to be able to issue shares with differential rights. There are concerns on the validity and enforceability of the differential rights of the shares of private companies issued under the 1956 Act, especially since such issuances of shares were not subject to any conditions.

[33] www.caclubindia.com/articles/synopsis-of-companies-act-2013-18424.asp

8.6 RESTRICTION ON INSIDER TRADING (NOTIFIED)

Clause 195 of the 2013 Act captures the essence of SEBI's Prohibition of Insider Trading Regulations, 1992, but extends its applicability to unlisted companies. According to the clause, no director or key managerial personnel of a company should engage in insider trading, e.g., subscribing, buying, selling or dealing in securities, if such a person is reasonably expected to have access to any non-public, price-sensitive information in respect of the securities of a company or its procurement processes, or communicate, directly or indirectly, any nonpublic price-sensitive information to any person. This restriction is likely to have an impact on deal structuring, since almost every deal involving an unlisted company involves sharing of information by directors or key managerial personnel, or subscription or sale of shares by promoters, who normally function in an executive capacity within a company.[34]

One possible argument against the applicability of the clause (mentioned above) for private companies could be that for the purposes of the 2013 Act, "securities" has the same meaning as that given to it as in the SCRA, which only applies to marketable securities and it is a settled position in law that the securities of a private company are not marketable. One needs to wait and watch whether this argument will be found convincing by the regulator. A clarification by MCA would be useful.

[34] articles.economictimes.indiatimes.com › ... › Private Equity Investors

8.7 SUBSIDIARY OF A FOREIGN COMPANY (PARTLY NOTIFIED)

Section 4(7) of the 1956 Act sets out that a private company, which is the subsidiary of a foreign company (which if it was incorporated in India would have been a public company), will be considered a private company that is a subsidiary of a public one, and is subject to the same regulatory compliance standards as that applicable to a public company. Clause 2 of the 2013 Act, through various sub- clauses, attempts to incorporate section 4 of the 1956 Act.

However, there is ambiguity surrounding the status of subsidiaries of foreign companies in India. According to the MCA's general circular No. 16/2013, dated 18 September 2013, Section 4 stands repealed. This is a matter that needs clarification, since it will be necessary to understand the status of a private company incorporated in India by foreign corporate organizations.

8.8 TRANSFER OF UNDERTAKING (NOTIFIED)

Under the 1956 Act, an ordinary resolution of shareholders was sufficient for public companies to sell/lease or otherwise dispose of whole or substantially the whole of the undertakings. However, there is ambiguity regarding the definition of the terms "undertaking" and "substantially the whole of undertaking."

In attempting to define an "undertaking," the 2013 Act has introduced the additional restriction of a minimum threshold, which should not be read independent of the primary requirement – that the transfer in question is in actuality that of an undertaking. The 2013 Act defines the following terms as:

• "Undertaking" to mean one in which investment in the company exceeds 20% of its net worth according to its audited balance sheet of the preceding financial year or an undertaking that generated 20% of the company's total income during the previous financial year.

• "Substantially the whole of the undertaking" in any financial year to mean that 20% or more of the value of the undertaking according to its audited balance sheet of the preceding financial year. The shareholders of all companies are required to pass special resolutions for such disposals, irrespective of whether these are private or public organizations.

The following illustrations depict the interpretation in relation to compliance with rules pertaining to special resolutions being obtained in light of the definitions of "undertaking" and "substantially the whole of the undertaking" under 2013 Act.

Case 1: Special resolution

A Co has two units, Unit A (generating 80% of its total income) and Unit B (generating 20% of its total income).

A Co intends to transfer part of Unit B (comprising 20% of the value of Unit B) to B Co.

Based on an initial interpretation of Clause 180 of the 2013 Act, the transfer mentioned above would require a special resolution in spite of the fact that a part of a unit of A Co, which generates only 4% of its total income, is to be transferred.

CHAPTER 9

INVOLVEMENT OF SEBI, COMPETITION COMMISSION OF INDIA & RBI IN COLLABORATION

After the long retirement of Companies Act, 1956 and having crossed the hurdles that were posed in Companies Bill, 2008, we finally have amended corporate laws in the name of Companies Act, 2013. While the MCA has decided for phased transformation from the old Companies Act to the new one, 98 sections of Companies Act, 2013 were made pertinent and replaced from the former legislation.

A positive step has been made in the new Act, towards making of acquisitions, certain type of mergers and restructuring easy for companies. One of the objectives that aim towards is to empower private equity investors to enforce some boundaries in agreements and ensure the malpractices of promoters by escalating the transparency in their operations. The Act also has the prospective to come up with a new era of domestic and cross-border mergers and acquisitions, and make Indian organizations more attractive to foreign investors. However, in the new Act, i.e. Companies Act 2013, does not make any distinction between mergers and amalgamations, as the previous one had, thus leaving only Income Tax Act, which makes such a difference in technicalities.

8.1 National Company Law Tribunal (NCLT) which proposed power need to be watched in the coming days which allows it to assume the jurisdiction of High Courts in context of the company restructuring process. Moreover, a commendable step has been taken towards the simplification of court approvals in case of mergers / acquisitions and

amalgamations and that is the relaxation of authorization in case of mergers of small enterprises, holding companies and their wholly owned subsidiaries etc. where the approval of NCLT has been done away with. This will majorly effect the lengthy implementation timelines, which will now be shortened and the load on regulatory authorities will now be narrowed. This is a noteworthy step in present scenario of strengthened focus on businesses. However, whether NCLT is rapidly made active is a point to be pondered over. Also, whether the speeding up of the process will actually come into practice in real is still need to be seen.[35]

Another one of the major change that needs to be highlighted is that while **SEBI** has introduced a procedure for regularizing the accounting treatment of listed companies, now Companies Act, 2013 also come up with the accounting treatment of the unlisted companies under scanner, as NCLT can no longer approve a scheme unless a certificate from the auditor is received about the exactness of the accounting treatment by the company. In such processes the position of the auditor apparently increases and will result in increased avenues for Chartered Accountants in the field of mergers and acquisitions.

8.2 SEBI introduced the concept of e-voting for listed companies as a part of its modernization process, in the purview of technological advances across the world. The new Act has extended the same concept to unlisted companies as well. Thus it is expected to increase the participation of shareholders and creditors in arrangements, and thereby looking after the rights of all stakeholders. But the question arises, will it really facilitate in increasing the contribution of stakeholders or will result in increased compliances and severe conditions.

Another step that has been taken towards protection of rights of shareholders by the new Act consists of necessary attachment of the copy of valuation report annexed to the notice

[35] www.lexology.com/library/detail.aspx?g=e55e05ba-1363-4300-a981

sent to the shareholders and creditors for the meetings. This aims to add transparency and lessen the scope of unusual practices.[36]

Before the law only allowed foreign companies into India but now global integrations and cross border mergers have also been permitted,. However, a foreign company must be based in a notified jurisdiction for this provision to come up with an outcome. Thus making it possible for an Indian company to streamline its shareholdings and transfer its ownership to an international holding structure, and thereby increase its access to foreign markets. The benefit of this provision however, largely depends upon the jurisdictions which are notified for cross border mergers under the Act. Moreover, the provisions contained under Foreign Exchange management Act and the Income Tax Act also need to be in tune with this forward looking provision of Companies Act, 2013 to make it basically practicable.[37]

Another important aspect in the new Act is that the merger of a listed company with an unlisted company will allow the latter to remain unlisted as long as the shareholders of the merging listed companies are offered an depart option. Expense of the value of shares and additional benefits needs to be in accordance with the programmed price formulae or according to their agreed valuation. [38]

8.3 The new law thus provides that notice of every scheme should be sent to **RBI, CCI, and the Income Tax departmen**t for their illustration. This may have a result on the timeline of the implementation and also effect in increased study by the regulatory authorities.

Thus, the chief procedural changes in mergers and amalgamations in the new Companies Act can be summarized as follows –

[36] www.valserve.in/.../4401651_ValServe_-_Companies_Act_2013_M&A
[37] indianlawyer250.com/.../proposed-new-corporate-law-framework
[38] http://financeonline.in/2014/12/13/mergers-acquisitions-a-new-beginning-under-companies-act-2013/

- The 2013 Act requires service of the notice of the merger along with the attached documents (such as copy of the Scheme and valuation report) not only upon the shareholders and creditors but also to different regulatory authorities as discussed above, including the **MCA** (*through Regional Director, Registrar of Companies and Official Liquidator*), **RBI** (*where non-resident investors are involved*), SEBI (*only for listed companies*), **Competition Commission of India** (*where the prescribed fiscal thresholds are crossed and the proposed merger could have an unfavorable effect on competition*), **Stock Exchanges** (*only for listed companies*), Income Tax authorities and other sector regulators or authorities which are likely to be affected by the merger.[39]

- It also calls for shareholders and creditors to shed their votes through postal ballot while bearing in mind the proposed scheme, which will guarantee a wider participation.

- One of the most significant procedural change is that objections to the system can be raised only by shareholders holding 10% or more equity and creditors whose debt represent 5% or more of the whole debt as per the last audited financial statements. This is going to be a celebratory benefit for the companies as it will result in evasion of frivolous objections / litigations against the company which unreasonably annoy the business prospects.

- Further, the company needs to attain an auditor's certificate regarding the fulfillment of accounting standards as per Section 230 and 232 of the 2013 Act.

- The procedures have also been largely simplified in case of mergers of holding companies with completely owned subsidiaries, which can now be completed on authorization of the members and official liquidator of the company, along with the consent of the Central Government. It would not require the monotonous process of going through NCLT.

[39] www.legalservicesindia.com/.../cross-border-mergers-implications-under-comapnies act 2013

- The procedure for merging of foreign company with an Indian company has also been simplified for the advantage of the Indian companies with a global presence, as they will be allowed to reimburse the consideration for such mergers either in cash or in depository receipts or partly in cash and partly in depository receipts as agreed upon in the scheme of arrangement with previous approval of the Central Government (Section 234 of the 2013 Act).[40]

Meanwhile, the new companies act has opened up new avenues and simplified procedures for mergers, acquisitions and restructuring operations in India, particularly for smaller companies. It is expected to defend shareholders' rights and lessen their litigations. The Act also requires placement with other laws such as Income Tax and exchange control provisions to permit for easier execution and effective results. The Rules, which are yet to be finalized and in the pipeline, will also play a crucial role. The upcoming changes and introductions in the Corporate Laws will be worth keeping an eye on.[41]

[40]https://www.mapi.net/system/files/MAPI-Value_1.pdf
[41]*Inputs from E&Y publication on Mergers and Acquisitions*

CHAPTER 10

JURISDICTION IN CASE OF CROSS BORDER MERGERS

We have already explained the general nature of court‟s jurisdiction in respect of approval of a scheme of merger/amalgamation. however, given the distinct nature of a cross border merger, the courts may look at different parameters in such situations. a brief survey of judicial decisions would proffer a better insight into the issue. at the outset, it is clear that once such kind of merger falls within section 234, the court will have the power to make all orders which it can make in case of merger of two indian companies. specific instances of such orders have been provided under section 234 itself.

Let us begin with the decision of the apex court in *hindustan lever employees union* v. *hindustan lever ltd*.[42] the case involved merger of tata oil mills company ltd, an indian company, with hindustan lever ltd., a subsidiary of foreign company. under the scheme, the shareholders of transferor were to be allotted shares in the transferee company and a preferential allotment at relatively low price was to be made to the foreign parent in order to maintain its shareholding at the level of 51%. moving beyond the settled „prudent business management‟ test, the court added a new ground for review of such a scheme on the ground of public interest by making the following observations:

> "but when the court is concerned with a scheme of merger with a subsidiary of a foreign company then the test is not only whether the scheme shall result in maximizing profits of the shareholders or whether the interest of employees was protected but *it has to ensure that merger shall not result in impeding promotion of industry or shall obstruct growth of national economy*. liberalized economic policy is to achieve this goal. the merger, therefore, should not be contrary to this

[42] AIR 1995 SC 470.

objective. Reliance on english decision for custina re hoare 1933 aerch. 105 and bugle press lic, 1961 chancery division 270 that the power of the court is to be satisfied only whether the provisions of the act have been complied with or that the class or classes were fully represented and the arrangement was such as a man of business would reasonably approve between two private companies may be correct and may normally be adhered to *but when the merger is with a subsidiary of a foreign company then economic interest of the country may have to be given precedence*. the jurisdiction of the court in this regard is comprehensive."

The scheme was objected to on the ground that the assets to be transferred under it had been undervalued. the court held that the objections were to be evaluated in the light of changing economic scenario of liberalization adopted by the government to promote economic growth. it looked at the amendments made in fera, 1973, which reflected the change in economic policy and came to a *prima facie* conclusion that undervaluation did not seem to violate any specific provision of law. it did not go into the question of legality of undervaluation of shares to be allotted under the scheme to the foreign parent in view of a pending petition before the bombay high court specifically on this issue. however, it made the following observations which demonstrate the ambit of court"s jurisdiction:

"*transfer of share to a foreign company on under valuation is of course a matter of concern*. it is true that the transfer of shares by one company to another company is primarily to be determined by the shareholders and, therefore, if the 99% are of the view that the valuation of the shares was reasonable and fair then the court should be slow to interfere with it. but what is necessary to be emphasised is that a shareholder may not be interested in the ultimate effect of allotting shares to a multi-national on a low price valuation, but the court certainly is. for instance, if the value of the share which has been determined at rs. 105 for allotment to hll is hypothetically determined, say at rs. 210, then the result would be that the ul will have to pay more in lieu of getting the shares and that could definitely bring more foreign exchange to the national stream. it is just one illustration to demonstrate

that how low pricing of the valuation of share effects the public interest." thus, in cases involving a foreign element in the scheme, the court gave a wider interpretation to the phrase „public interest" by including the economic interest of the country within it.

In the case of *in re moschip semiconductor technology ltd.*[43], the court was confronted with the question of permissibility of a scheme whereby all the assets of a foreign company were transferred to an indian company in lieu of the latter allotting share to the shareholders of the former. on a plain interpretation of section 394, the court concluded that such cross border mergers were permissible and subject to sanction of the court. it laid down that in a cross border merger the scheme is subject to the laws of both the countries where the companies are incorporated. in that case, the laws of california under which the foreign company was incorporated provided that any merger would be effective the moment certified copy of the order passed by the court having territorial jurisdiction over the indian company is filed within six months from the effective date. the court held that the merger will become effective after complying with the aforesaid condition under the californian law. Interestingly, the court only looked into the issue of whether the scheme was permissible under section 394 and did not apply the public interest test laid down in the *hindustan lever* judgment.

The bombay high court in *bombay gas co. pvt. ltd.* v. *union of india*[44] was confronted with an application challenging a sanctioned scheme of transfer of assets and business of a british company situated in india to an indian transferee company. relying on section 584, it was contended that indian courts do not have jurisdiction to pass a winding up order in respect of a foreign company, which has been dissolved in its country of incorporation, except when it had ceased to carry on business in india. the court held that section 584 provided an additional ground for winding up of foreign companies although dissolved in

[43] [2004] 120 Comp Cas 108 (AP).
[44] 1997] 89 Comp Cas 195 (Bom).

the country of its incorporation and the said section did not restrict the jurisdiction of this court to sanction the scheme of amalgamation of the indian undertaking of a foreign company with an indian company or wind up a foreign company or its business carried on in india as an unregistered company in terms of section 583 of the companies act, 1956[45]. Further, it was held that the court had jurisdiction over a scheme of foreign company by virtue of section 390(a) as it falls within the expression „liable to be wound up under the act‟. lastly, taking a plain interpretation of section 394(4)(b), it was held that a scheme of transfer of assets of foreign company to indian company is permissible and subject to sanction of the court.

In another case of *in re bank muscatsaog*[46], the petition was filed by a bank based in muscat, oman, which had obtained a licence from the reserve bank of india to operate a branch in bangalore. under a scheme of arrangement, the assets of the branch were to be transferred to a transferee company formed and registered under the companies act, 1956. under section 600(4), the registration of a foreign company has to be with the registrar at new delhi while its place of business can be located anywhere in india. the central question which arose was whether the high court having jurisdiction over the principal place of business of a foreign company in india has the jurisdiction to entertain such a petition under section 394. the court answered the question in affirmative on the ground that under section 600 (4) registered office or place of business of foreign company is the determinative factor for jurisdiction. mere registration with the registrar at new delhi is not sufficient to confer jurisdiction but the eterminative factor is the place from which real business is conducted. the actual scheme was approved by the court on merits. it is interesting to note that the cases of *bombay gas* and *in re bank muscatsaog*dealt with limited situations where the indian assets of foreign companies were transferred to indian companies. in these cases, there was no outright amalgamation of a foreign company with an indian company. on the other hand, the case of *hindustan lever* involved a transfer by an indian company to another indian company i.e. a purely domestic scheme with a

[45]In re Travancore National and Quilon Bank, [1939] 9 Comp Cas 14, 21.
[46] [2004] 120 Comp Cas 340 (Kar).

foreign element in form of the parent company of the latter. it is clear that none of the cases deal with situation of transfer of assets of indian company to a foreign company. the jurisdiction of court in such situations, even if permitted, remains a matter of speculation rather than concrete determination at this stage.

CHAPTER 11

CONCLUSION:

Thus, in anticipation this article seeks to examine some salient aspects of Companies Act, 2013 pertaining to the cross-border mergers either, generally or specifically. The merits of some provisions in the new Act are noticeable at the onset. For example, as discussed, Section 230(2) provides for a more comprehensive reporting relatively than the one under the 1956 Act regime. The simplification of procedure of mergers, in certain cases, under Section 233 is also laudatory. However, many of the enactments are criticisable. Notice requirement to the CCI under Section 230(5) should not be provided for due to the current competition law sufficiently addressing that issue. Involvement of too many regulators in the proceedings before the tribunal may unnecessarily complicate and delay the process of a cross border merger. In fact, it is surprising to find the inclusion of CCI in this provision considering the government's efforts on the other hand to simplify the regulatory process by initiating measures like the constitution of the financial sector legislative reforms commission (FSLRC) under the chairmanship of Jistice Shrikrishna.

Furthermore, the restriction contained in Section 234 restricting cross border mergers (both ways) of Indian companies with companies of only notified countries is not only regressive but speaks of the parochial and protectionist mindset of the government in these matters. This restriction in practice may turn out to be more regressive than the corresponding one under the 1956 Act having only one-way prohibition. Thus, this jurisdiction notification requirement should certainly be done away with when the government and parliament seek to liberalise the cross border mergers. If issues like tax avoidance are a problem in cross border deals, the solution should be sought under international tax laws regime not through the Companies Act. The mention in Section 234(2) about seeking RBI approval in cross border mergers, subject to any extant law, is also superfluous in view of the FEMA and the gamut of regulations under it which are meant to act as the foreign exchange control laws. The instance of a drafting mistake in

the explanation to Section 236(8) while referring erroneously to the previous SEBI (SAST) Regulations could have been obviated either at the drafting stage or at the time of passage of the bill by the legislature .

Hopefully, the Government will take timely note of the critique advanced in this article to initiate suitable legislative and executive measures. The other stakeholders are also likely to have more clarity on the issues discussed here enabling them to more objectively assess the provisions pertaining to cross border mergers in the Companies Act, 2013.

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