Implications of Companies Act, 2013
Mergers and Restructuring
The Companies Act, 2013: An overview

The Companies Act, 2013 (‘2013 Act’), enacted on 29 August 2013 on accord of Hon’ble President’s assent, has the potential to be a historic milestone, as it aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers. The new law will replace the nearly 60-year-old Companies Act, 1956 (‘1956 Act’).

The 2013 Act provides an opportunity to catch up and make our corporate regulations more contemporary, as also potentially to make our corporate regulatory framework a model to emulate for other economies with similar characteristics. The 2013 Act is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation will be in the form of rules. There are over 180 sections in the 2013 Act where rules have been prescribed and the draft rules were released by the MCA in three batches. It is widely expected that the 2013 Act and indeed the rules will provide for phased implementation of the provisions and in line with this, 98 sections of the 2013 Act have been notified and consequently the corresponding section of the 1956 Act cease to be in force.

The 2013 Act contains a number of provisions which have implications on Mergers and Restructurings. In this bulletin we analyse some of the key provisions and also identified certain action steps and challenges associated with the implementation of these provisions for companies to consider.

"There are some pragmatic reforms such as: fast-track schemes, which being cost and time effective will encourage corporate restructurings for small and group companies; merger of an Indian company into a foreign company should give impetus to cross-border M&A activity; introducing the threshold for raising objections to a scheme would deter frivolous objections and postal ballot approval would ensure a wider participation of the stakeholders. However, multi-authority appraisal of the restructuring scheme in the 2013 Act may be a dampener, considering that the present framework envisages a single-window clearance."

- Pallavi J Bakhru
Partner & Practice Leader
Tax & Regulatory Services
Walker, Chandiok & Co.
Mergers and restructuring

### Key changes and requirements

#### Notice of meeting

The 2013 Act requires that notice of meeting for approval of the scheme of compromise or arrangement along with other documents shall be sent to various other regulatory authorities in addition to Central Government such as:

- Income Tax authorities
- Reserve Bank Of India
- SEBI
- the Registrar
- the Stock Exchanges
- the official liquidator
- the Competition Commission of India, if necessary
- Other sector regulators or authorities which are likely to be affected by the compromise or arrangement

The existing simple procedure of submitting documents with Court will become multi-party with the inclusion of various regulatory authorities. It will increase the paperwork and the process may become more cumbersome with the direct involvement of other regulatory authorities.

#### Treasury shares

The 2013 Act specifically stipulates that any intercompany investment would have to be cancelled in a scheme and holding shares in the name of transferee through a trust would not be allowed.

The 2013 Act will abolish the practice of companies to hold their own shares through a trust, which could provide them liquidity in future, while still allowing the promoters to retain a controlling stake over the company.

#### Approval of scheme through postal ballot

Under the 1956 Act, scheme of compromise / arrangement needs to be approved by majority representing 3/4th in value of the creditors and members or class thereof present and voting in person or by proxy.

The 2013 Act additionally allows the approval of the scheme by postal ballot.

This will involve wider participation of the shareholders of the company in voting and will protect shareholders interest.

### Analysis and implications

### Action steps

#### Notice of meeting

Process will slow down and more planning would be required with respect to time as well as strategy for pre-scrutiny by various regulators.

#### Treasury shares

The companies have to look for other option to retain control and to maintain liquidity as post-merger all the intercompany investment will be cancelled and no further shares will be issued in lieu of the intercompany investment.

#### Approval of scheme through postal ballot

Companies while approving scheme through postal ballot should ensure that all the regulations relating to postal ballot are being complied with and the facility can be availed by all the parties whose interest is likely to be affected by the proposed scheme.
## Mergers and restructuring

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<td><strong>Valuation certificate</strong></td>
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<td>The 1956 Act does not mandate disclosing the valuation report to the shareholders. Though in practice, valuation reports are included in documents shared with the shareholders and also to the Court as part of the appraisal process of the scheme by the Courts.</td>
<td>This will enable the shareholders to understand the business rationale of the transaction and take an informed decision.</td>
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<td>The 2013 Act now mandatorily requires the scheme to contain the valuation certificate. The valuation report also needs to be annexed to the notice for meetings for approval of the scheme.</td>
<td>The valuation report obtained by the company should be robust as the same will now have to stand scrutiny of various stakeholders.</td>
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<td><strong>Compliance with accounting standards</strong></td>
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<td>The 2013 Act has introduced a new requirement, that no scheme of compromise or arrangement, whether for listed company or unlisted company shall be sanctioned unless the company's auditor has given a certificate that the accounting treatment of the proposed scheme is in conformity with the prescribed accounting standards. Further, the application with respect to reduction of share capital has to be sent to the Tribunal along with the auditor's certificate stating it is in compliance with accounting standards.</td>
<td>The 2013 Act aligns the SEBI requirement which existed for listed companies for all companies, to ensure that the scheme aimed to use innovative accounting treatments for financial re-modeling are not sanctioned by the Courts. As the scheme tends to have overriding effect with respect to accounting treatment (specifically mentioned in accounting standard 14 with respect to treatment of reserves), the onus has been shifted on the auditor to confirm that accounting standards have been followed.</td>
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<td><strong>Objection to compromise or arrangement</strong></td>
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<tr>
<td>Under the 1956 Act, any shareholder, creditor or other “interested person” can object to the scheme of compromise or arrangement before a court if such person's interests are adversely affected. The 2013 Act states that the objection to compromise or arrangement can be made only by persons: • Holding not less than 10% of shareholding or; • Having debt amounting not less than 5% of the total debt as per latest audited financial statements</td>
<td>The new threshold limit for raising objections in regard to scheme or arrangement will protect the scheme from small shareholders’ and creditors’ frivolous litigation and objection.</td>
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## Action steps

**Valuation certificate**
Planning would be required for scrutiny of the valuation by all stakeholders

**Compliance with accounting standards**
Auditor will have to be involved to ratify the accounting treatment of the scheme. The Company, whether listed or unlisted, has to obtain an auditor's certificate before proceeding with the filing of scheme with the regulatory authorities.
## Mergers and restructuring

### Key changes and requirements

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<td>The 1956 Act does not contain provisions for merger of Indian company into a foreign company (transferee company has to be an Indian company).</td>
<td>The 2013 Act will provide an opportunity of growth and expansion to Indian Company by permitting amalgamation with foreign company or vice versa. This will provide opportunity to form corporate strategies on a global scale. It has to be seen if the implementation mechanism is smooth enough.</td>
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<td>The 2013 Act states that merger between Indian companies and companies in notified foreign jurisdiction shall also be governed by the same provisions of the 2013 Act. Prior approval of Reserve Bank of India would be required and the consideration for the merger can be in the form of cash and or of depository receipts or both.</td>
<td>The 2013 Act suggests that all cross border merger will now be governed by the said chapter. Presently, its possible for a foreign company of any jurisdiction to merge into an Indian company. This may now be limited to only companies in notified jurisdiction.</td>
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### Merger of a listed company into unlisted company

| The 2013 Act requires that in case of merger between a listed transferor company and an unlisted transferee company, transferee company would continue to be unlisted until it becomes listed. | Listing or delisting regulations, as applicable, under securities laws would still have to be considered. |
| Further, the 2013 Act also proposes that transferee company would have to provide an exit opportunity. | Further, it seems that exit opportunity may have to be provided whether or not the transferor company choses to list. |

### Action steps

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<td>Companies can enter into various arrangement with its foreign related company to increase their market share and efficiency. However, prior approval of RBI has to be sought.</td>
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<td>In a merger of a listed company into an unlisted company, the specific provisions under 2013 Act would also have to be considered apart from the securities law regulations.</td>
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## Mergers and restructuring

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<td><strong>Fast-track merger</strong></td>
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<td>Under the 1956 Act, all mergers and amalgamations require court approval. The 2013 Act requires that mergers and amalgamations between two or more small companies or between holding companies and its wholly-owned subsidiary (or between such companies as may be prescribed) does not require court approval. However, notice has to be issued to ROC and official liquidator and objections / suggestions has to be placed before the members.</td>
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<td>The scheme needs to be approved by members holding at least 90 percent of the total number of shares or by creditors representing nine-tenths in value of the creditors or class of creditors of respective companies.</td>
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<td>Once the scheme is approved, notice would have to be given to the Central Government, ROC and Official Liquidator.</td>
<td>This will reduce the time consumed in court proceedings and will result in faster disposal of the matter.</td>
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<td>It will help remove the bureaucratic barriers involved in court proceedings and in turn simplify the process.</td>
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<td>Presently, it seems that in such fast-track mergers, there is also no requirement for sending notices to RBI or income-tax or providing a valuation report or providing auditor certificate for complying with the accounting standard.</td>
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<td>The 2013 Act does not specify transitional provisions relating to restructuring in progress and presently there is a lack of clarity in this regard.</td>
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