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Articles

Changing contours of mergers and acquisitions under Companies Act, 2013

By **Anup Koushik Karavadi**

The task of enacting a new law to regulate companies in India is complete. The Companies Act, 2013, ("New Act") in its new avatar, mirrors several changes when compared to the law contemplated under the Companies Act, 1956 ("Old Act"). It brings in a whole new set of expected and unexpected changes to the existing regime governing Indian company law. Under the Old Act, sections 391 to 396 deal with Compromises, Arrangements and Amalgamation, whereas Chapter XV of the Old Act encompasses Sections 230 to 240 governing Compromises, Arrangement and Amalgamations. This article highlights a few key changes made in the New Act on mergers and amalgamations and the likely impact on industry.

Retained provisions

Although substantial changes have been incorporated in the New Act, several key provisions remain unchanged. For example, the acceptance of a scheme or merger or amalgamation by three-fourths of the shareholders, like in Section 391(2) of the Old Act, is still a pre-condition to a merger or amalgamation. The power of the Central Government to order a merger or amalgamation in the interest of the nation is untouched and is placed in Section 237. Further, the obligation to maintain records of the mergers/amalgamations is retained in Section 239 as its importance cannot be ignored. Other matters like convening meetings, obtaining the permission of the regulatory authorities and the Central Government in cases of mergers or amalgamations remain unaltered.

Mergers and Amalgamations: The distinction remains unexplained

While the Income Tax Act 1961 ("IT Act") distinguishes clearly between mergers and amalgamations, the Old Act and the New Act the two are used interchangeably and the procedures for both are identical. Section 234 of the New Act states that the provisions of the New Act shall apply *mutatis mutandis* to both mergers and amalgamations, thus acknowledging that a merger and amalgamation may be conceptually different but are deemed to be the same for all purposes. As a result, no statute, except the IT Act, exists to differentiate a merger from an amalgamation, and the reason explained in the IT Act, shall remain to be the sole provision explaining the distinction between a merger and an amalgamation.

National Company Law Tribunal to perform erstwhile functions of High Courts

Under the Old Act, the High Courts were endowed with the power to sanction a scheme of merger/amalgamation. However, as per the provisions of the New Act the power given to the High Courts would be invested with the National Company Law Tribunal (NCLT). This change should help in shortening the time taken in obtaining sanctions in cases of mergers and amalgamations.

Voting through postal ballot

Under the Old Act, the shareholders or the creditors, as the case may be, may be present

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either in person or in proxy for approving the scheme of amalgamation/merger. The New Act goes a step further and provides another mode of voting. Sub-clause (4) of Section 230 envisions adoption of a scheme under Chapter XV by postal ballot.

Notice of the meetings

Sub-clause (5) of Section 230 of the New Act obligates companies to send a notice of meeting to approve a merger/amalgamation to various government authorities such as Central Government, the Income Tax Department, SEBI, RBI, Registrar of Companies, the respective stock exchanges, the official liquidator, the Competition Commission of India, and if the need be, to any other regulatory authority likely to be affected by the merger/amalgamation for seeking representations from the respective authorities if any within a period of 30 days from the date of receipt of such notice.

Under the Old Act, notices are to be sent mandatorily to the Central Government, Registrar of Companies and Official Liquidator and the concerned stock exchanges. Further, under the Old Act if no report is provided by the authorities then it is not deemed to have been approved. Whereas, as per the New Act, if the representations are not provided within 30 days from the date of receipt of the notice then, it is presumed that the authorities have no representations to make on the proposals.

Further, the 'thirty days' requirement might spring up a few procedural inconsistencies For instance, Section 6(2a) of the Competition Act, 2002 allows 210 days for the CCI to pass an order after verifying the proposed merger, whereas the New Act gives only a time period of thirty days to reply for any authority likely to be affected.

Objections to mergers/amalgamations

Sub-clause (4) of Section 230 of the New Act provides that only persons holding not less than 10% of the shareholding; or having not less than 5% of the total outstanding debt can object to a merger/amalgamation. In stark contrast, the Old Act specifies no minimum-ownership-condition to object to a merger/amalgamation. The impact of the New Act is two-fold: genuine claims of shareholders may go unrepresented, while mala fide and frivolous claims will no longer act as dampeners.

An important feature that may delay the merger process is the provision allowing all statutory authorities to intervene in the NCLT process and use this tactic effectively to seek payment of all pending demands, even the disputed amounts.

Indian companies allowed merging into foreign companies

The Old Act allows domestic companies to merge into each other, besides allowing foreign companies to merge into Indian companies. The New Act goes a step further, as it allows foreign companies to merge into Indian companies and *vice-versa*, meaning Indian companies wanting to merge into foreign companies may press ahead with their intention. The approval of the RBI is a pre-requisite in the both the cases. However, by virtue of Section 234 of the New Act, the license to merge into foreign companies comes with a rider that Indian companies can only merge into foreign companies domiciled in any of the jurisdictions notified by the Central Government.

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Fast Track Mergers

Under the Old Act, mergers/amalgamations between group companies and subsidiaries are placed on the same pedestal on which mergers/amalgamations between entirely unrelated companies are placed. This meant that, mergers between group companies, and subsidiaries have to also conform to the normal procedure.

However, under the New Act, Section 233 allows mergers between two small companies and holding companies and their wholly owned subsidiaries may not have to go through the normal procedure. Mergers/amalgamations may be completed, if the official liquidator and the members approve, and if sanctioned by the Central Government, without having to wait for the order of the NCLT confirming the merger/amalgamation. This leeway helps cut costs involved in complying with the procedures, saves time and simplifies the procedure of mergers between two small companies or wholly owned subsidiaries and their parent companies.

Takeover offers

Under the Old Act, no takeover can be a part of any Compromise or Arrangement involving a merger or amalgamation. But, under the New Act, a scheme of compromise or arrangement involving a merger/amalgamation may include a takeover offer. Thus, the Central Government is to promulgate rules to govern the takeover offers that may be announced as a part of a merger/amalgamation or change the Takeover Code to suitably govern the takeover offers that may be made under this section.

Conclusion

It appears that the New Act can help deal with the challenges and complexities that the current procedures faces in relation to procedures that were contemplated under the Old Act. The New Act has incorporated various provisions to tackle the problems actually faced in the process of mergers, by taking into consideration the practical aspects of the process. It is an attempt to fine tune the process by making it more efficient and in-turn effective. The New Act no doubt has some ambiguities attached to it, which would need to be sorted out in order to reduce any complexity in the process. It would need to reduce reliance on rules to be specified later and also ameliorate provisions that contravene other legislations.

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'Flying solo' with one person companies

By Kritika Krishnamurthy

Introduction

Adam Smith in the 'Wealth of Nations' (1776) declared *"Individuals always weigh their own interest more than the group"*. He made this statement at a time when tradesmen in Europe were organizing themselves into groups to enhance their scale of business and leverage potential markets available for their goods in exotic, far away colonies. This organized trade would later be christened as a 'joint stock company' and lead to the birth of company law.

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However, with the passage of time, it appears legislative draftsmen paid heed to what the Father of Economics had contemplated then and the outcome is the legal acceptance of the concept of a 'One Person Company'- now part of the Companies Act, 2013 (2013 Act) in India.

Concept under the 2013 Act

A One Person Company (OPC) under the Act means a company that has only one person as the member.[1] An OPC formed under the 2013 Act has been accorded the status of a private company[2] and shall be treated accordingly except for certain explicit exemptions or restrictions. Such an OPC may be limited by shares or guarantee or may even be an unlimited company.

OPC may be formed only by a natural person who is a citizen and resident of India[3] by subscribing to the Memorandum of Association (MOA) of the company. The single member is required to nominate another natural person meeting the criteria as his nominee who shall continue the business of the company in the event of the member's death or incapacity to contract.[4] The single shareholder is also required to take the written consent of the nominee before including his name as the nominee in the MOA. The nominee may further withdraw his consent or the member may change the nominee by informing the Registrar of Companies (ROC) of the change and following the prescribed procedure. As per the Draft Companies Rules, 2013 (Draft Rules) circulated by the Ministry of Corporate Affairs, a single individual cannot incorporate or become member in more than five OPCs.[5]

The name of the OPC shall be followed by the suffix 'One Person Company'.[6] The individual member of the OPC shall be deemed to be its first director until the director or directors are duly appointed by the member.[7] Although not specifically provided, as per Section 5, the OPC may adopt all or any of the regulations contained in the model articles provided under Table F to J in Schedule I of 2013 Act.

Where the paid up share capital of an OPC exceeds fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees, it shall cease to be entitled to continue as an OPC. An OPC which exceeds the said prescribed limits is mandated to convert itself within six months to a private company with minimum two members or a public company with seven members or more and appoint requisite number of directors by following the procedure under Section 18 of the 2013 Act.

The definition of 'Small Companies' under the 2013 Act is also a new concept and it provides for the same restrictions[8], hence , an OPC will also come within its purview. The

1 Section 2(62)
2 Section 3(1)(c)
3 Para 2.1(1), Draft Companies Rules, 2013
4 Section 3
5 Para 2.1(2)
6 Section 12(3)
7 Section 152
8 Section 2(85)

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exemptions and restrictions on OPCs and Small Companies is almost the same but this inclusion of OPCs as Small Companies may impact OPCs with regard to any future notifications regarding Small Companies.

Where an OPC limited by shares or guarantee enters into a contract which is not in writing with the sole member of the company who is also its director, the company shall, ensure that the terms of the contract or offer are contained in the memorandum or are recorded in the minutes of the first Board meeting held after entering into the contract. The company shall inform the Registrar of Companies about every contract (whether written or otherwise) entered into by the company and recorded in the minutes.[9]

Relaxations

An OPC is eligible for the following procedural and compliance related relaxations:

- The Annual Returns of OPC may be signed only by the director where there is no Company Secretary.[10]
- Not required to hold Annual General Meetings.[11] Required to conduct only one board meeting every six months in a year with gap between both meetings not less than ninety days (in cases where the sole member is not the only director) and not required to hold Board Meetings where the member is the only director of the OPC.[12]
- Resolutions to be passed at general meetings and board meetings (in case the sole member is also the only director) is only required to be communicated to the company and further signed, dated and entered into the minutes book of the company.[13]
- Need not prepare a detailed Board Report. Is only required to explain or comment on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.[14]
- Need not include a cash flow statement in its financial statement.[15]

Reflections

Due to acknowledgement of the OPC as a body corporate under the 2013 Act, the definition of the term body corporate under Section 2(11) now does not exclude a ‘Corporation Sole’ from its scope. Although an OPC is now a body corporate, treating a ‘one member enterprise’ as an artificial person separate from its member may have its own problems. If the sole shareholder and/or the OPC becomes insolvent, its impact on those who dealt with the business on a corporate basis and those who dealt with the sole shareholder as an individual, the liabilities will be different for both. The equities of the former are no greater than those of the latter. The former will

9 Section 193
10 Section 92
11 Section 96(1)
12 Section 173(5)
13 Section 122(3) and (4)
14 Section 134(4)
15 Section 2(40)

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be limited to the corporate assets; the latter, to the individual assets. Moreover, no special provision has been made for winding up of OPCs and the creditors and members shall be bound to follow the tedious winding up process prescribed for all companies in general under the 2013 Act.

Also, as Lord Acton pointed out: 'Power corrupts, absolute power corrupts absolutely'. When the sole shareholder is separate from the OPC, the sole shareholder may lend money to the business and share as a corporate creditor upon the subsequent insolvency of the venture. Indeed, the sole or principal shareholder may become a secured corporate creditor and thus acquire priority over the unsecured corporate creditors and history shall repeat itself as in the case of the famed House of Lords decision of Solomon v. Solomon & Co.[16]

However, all is not lost. Generally, courts have allowed the concept of corporate personality to sustain only so long as it is invoked and employed for legitimate purposes. Courts will probably not sanction a perversion of the concept to improper uses and as a device to perpetuate fraud, to evade the law, or to escape obligations and will in rare circumstances lift the corporate veil.

Further, the OPC regime may face practical difficulties in implementation. The 2013 Act categorizes an OPC as a private company from the beginning. The Draft Rules further provide that upon exceeding a limit of share capital or turnover, the OPC shall again have to follow procedural requirements and convert to a private or public company. The caps placed are also stringent considering the scale of businesses being conducted presently. OPCs shall be forced to convert to private or public companies upon exceeding the prescribed limits or receiving investment from investors upon expansion of business. Hence, many entrepreneurs may prefer to establish a private company from the start to avoid such compliance hassles.

No special provisions related to amalgamation and restructuring of OPCs has been provided in the 2013 Act or the Draft Rules circulated as of now. Hence, the transactions shall be governed by the general procedure applicable to companies under the 2013 Act. Also, since OPCs come within the definition of 'Small Companies', any merger or amalgamation of OPCs with any other small company may be governed by the simpler procedure prescribed under Section 233 of the 2013 Act.

Tax-wise, since the OPC is taxed as a company, it shall be liable to pay income tax at 30.9% or Minimum Alternate Tax (MAT) as may be applicable. Any dividend paid may also be subject to dividend distribution tax. On the other hand, sole proprietors have the advantage of the tax slabs prescribed for individuals. Hence, whether individual entrepreneurs shall prefer stability of form over income tax benefit is something which remains to be seen.

It must be acknowledged that the legal sanctity given to OPC's will allow small sole proprietorship firms to shift to this new concept of corporatization.

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[16] [1897] AC 22

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Notifications & Circulars

RBI defines 'Group Company' for the purpose of FDI: 'Group company' has been defined under the FDI Policy. As per Reserve Bank of India's A.P. DIR Circular No. 68, dated 1-11-2013, group company means two or more enterprises which are (directly or indirectly) in a position to exercise 26% or more of voting rights in other enterprise, or appoint more than 50% of the members of board of directors in other enterprise. Accordingly, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 have also been amended last month. *See Corporate Amicus – June 2013 for such changes made by Press Note dated 3-6-2013 of the Department of Industrial Policy and Promotion, in the Consolidated FDI Policy contained in Circular No. 1 of 2013, effective from 5-4-2013.*

Third party payments allowed for import and export transactions: Reserve Bank of India has allowed third party payments for import and export transactions, taking into account the evolving international trade practices. As per A.P. DIR Circular No. 70, dated 8-11-2013 such transactions shall be subject to the conditions such as availability of tripartite agreement, declaration in Export Declaration Form, mention in bill of entry and invoice, reporting of outstandings, etc. These third party payments further should come from, or made to, a Financial Action Task Force (FATF) compliant country and through the banking channel only.

Disclosure of investor complaints: In order to bring more transparency in the disclosure of complaint redressal status of the stock brokers on the website of stock exchange, 'Report 1C' prescribing the format for disclosure of redressal of complaints lodged by clients against stock brokers during the financial year has been revised. Henceforth, stock exchanges shall also disclose separately in a prominent manner (i) total number of complaints received against all the stock brokers of the exchange, number of their active clients and its percentage and (ii) overall market redressal rate by dividing total number of complaints redressed with total number of complaints received against all stock brokers of the exchange. SEBI Circular No. CIR/MIRSD/11/2013, dated 28-10-2013 issued in this regard notes that above information will indicate the efficiency of complaint redressal process.

Listing of small and medium enterprises without initial public offer: SEBI has prescribed procedure for listing and trading of specified securities of Small and Medium Enterprises (SMEs) including start-up companies, without an Initial Public Offer, on Institutional Trading Platform (ITP) in SME Exchanges. As per SEBI Circular No. CIR/MRD/DSA/33 /2013, dated 24-10-2013, ITP shall be accessible only to informed investors and the minimum trading lot shall be Rs. 10 lakh. The circular also prescribes a long list of conditions which a company seeking such listing needs to comply with, including condition of absence of any admission of winding up petition against the company. Companies listed on ITP can exit the platform after getting approval from its shareholders and SME Exchange.

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SEZ – Permission for sub-contracting in DTA to be given for period up to 3 years: Larger manufacturing units in SEZ can now be permitted for a period up to 3 years to sub-contract production or any production process in DTA. Hitherto, permission for such sub-contracting was being given by the specified officers on annual basis. Ministry of Commerce & Industry, Department of Commerce (SEZ Division) Instruction No. 78, dated 11-10-2013 specifies 11 conditions for such prior permission. Unit has to be a manufacturing unit with average annual exports of Rs. 1000 crore or more in atleast two out of current plus last three years.

Ratio Decidendi

Workmen dues payable till official winding up of company: Bombay High Court has held that dues of workmen have to be paid by the company to be wound up till its official winding up and that the same is not to be limited only up to the time of appointment of Provisional Liquidator. The workers had claimed that dues should be calculated till the date of final winding up order, as that cannot be rescinded or recalled; whereas the Official Liquidator claimed that dues should be calculated till the date of appointment of the Provisional Liquidator, with full powers. The court held that the Companies Act is not the legislation governing the relations between the employer and the employee/workmen and hence severance of relations with workmen has to be governed by appropriate labour laws. It was observed that there is no specific provision in the Act stating that appointment of Provisional Liquidator will bring the service of the employees to an end. It was noted that workmen are not given notice of the application for appointment of Provisional Liquidator and that if such a concept of termination of workmen by implication is to be read in the Companies Act, it would fly in the face of legislative policy. It was held that there is no question of equating provisional liquidation and final liquidation as having the same effect for the purpose of cessation of service. Thus, even though powers are the same, the provisional and the official liquidator are appointed at different stages of winding up procedure and what is relevant is the status of the company as the employer. Observing that Section 445(3) states that, unless the business is continued the order of winding up puts an end to the legal status of the company and such orders will be notice of discharge for all the workmen, it was held that till the order of winding up is passed the company continues as a legal entity and the directors continue. [*Vishwanath Namdeo Patil* v. *The Official Liquidator of M/s Swadeshi Mills* – Bombay High Court Judgement dated 28-10-2013 in Company Application No. 487 of 2012].

Execution proceedings against the partners of debtor's firm: Delhi High Court has held that the appellant (Partner in the firm) continued to remain liable for the acts of the firm, of which he was a partner when the transaction with Union of India took place, which led to firm's liability, crystallizing in the award that later culminated in a decree of the court. Appellant's argument that sub-rule (2), if read as against sub-rule 1, does not refer to partners of the firm, but to

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third persons, was found not acceptable by the court while it observed that clauses (b) and (c) of sub-rule 1 of Rule 50 of CPC Order XXI do not exhaust all categories of partners that may be proceeded against, such that it could be said that sub-rule (2) only deals with third persons. It was noted that, clauses (b) and (c) only concern certain categories of partners, but other individuals, or more specifically, other partners, may be proceeded against under sub-rule (2) after their liability is established in the manner provided for in the sub-section. As regards jurisdiction of the court, it was held that the argument that the proper forum, for the application seeking leave to proceed against the partners of the firm, is the original side of High Court which passed the decree, and not another bench of the High Court hearing execution matters, draws a non-existent distinction. The Court held that Delhi High Court even after transferring the decree to Calcutta High Court for execution, retained the power to grant leave and anything else would be contrary to the express terms of Section 42. [*Satish Kumar Jhunjhunwala* v. *Union of India* – Delhi High Court Judgment dated 10-10-2013 in EFA (OS) 36/2011, C.M. 19322/2011].

Jurisdiction of Central Electricity Regulatory Commission: Central Electricity Regulatory Commission does not have jurisdiction to adjudicate a dispute between two licensees relating to charges for operation and maintenance of a part of inter-State transmission system which is owned by one of the licensees and operated and maintained by the other licensee for or on behalf of the former. The Electricity Appellate Tribunal in one of its recent order has held that the Central Commission does not have jurisdiction over the arrangement that a inter-State transmission licensee has with another licensee or any other entity for providing such services for its transmission system and the rates payable to such licensee. It was observed that relationship between POWERGRID and TNEB with respect to operation and maintenance services provided by TNEB or its successor entity is that of employer and contractor and thus cannot be a subject of regulation by the Central Commission under Section 79 of the Electricity Act, 2003. [*Tamil Nadu Generation and Distribution Corporation Limited* v. *Central Electricity Regulatory* - Appellate Tribunal for Electricity, Order dated 11-11-2013 in Appeal Nos. 51 and 79 of 2013].

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