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Analysis of noteworthy M&A Ruling in 2015

Introduction:

Corporate restructuring schemes under Section 391-394 of the Companies Act, 1956 are one of the most deliberated topics in the corporate laws. Such scheme includes merger, amalgamation, demerger and arrangements by company with its shareholders or creditors. In 2015, there have been significant and noteworthy rulings on mergers and amalgamations, wherein High Courts ruled on Regional Director's authority to raise income tax related objections in scheme of amalgamation and a critical issue whether Transferee Company should allot shares towards consideration of demerger/amalgamation was taken to a logical end. The High Court also allowed change of name of Transferee Company as a part of amalgamation scheme and without following a separate procedure.

The article contains detailed analysis (broad facts, objections raised) of significant and noteworthy rulings in 2015 on the schemes relating to merger and amalgamation.

Bombay HC: Regional Director has unqualified right to raise income tax related objections in Amalgamation Scheme:

Casby CFS (P.) Ltd., In re: Scheme of amalgamation between Casby CFS Pvt. Ltd. ("Transferor Co.") and Casby Logistics Pvt. Ltd. ("Transferee Co.") and their respective shareholders was submitted to the Bombay HC, whereby the entire business and whole of the undertaking of Transferor Co. was to be transferred to Transferee Co. with effect from the appointed date. Income Tax Officer ('ITO') of Transferor and Transferee companies directed them to furnish certain information and documents. Regional Director ('RD') also issued a letter requesting the companies to provide information to concerned ITO. The companies informed RD that they have provided necessary information to the concerned ITO and at the same time, the official liquidator has filed the Report stating that Scheme was not prejudicial to creditor's interest. However, the RD filed its affidavit raising certain objections.

Bombay HC upheld RD's objection w.r.t. issue of choosing the 'appointed date', stated that if RD has any doubt that the appointed date maybe misused for contravening any other law, then RD is entitled to voice his doubt/apprehension before HC. HC held that it is always open to the Court to consider such doubt/apprehension and pass necessary orders either rejecting the scheme or sanctioning the scheme. HC rejected transferor and transferor companies' contention that RD cannot object to the Scheme on the ground that it violates the provisions of Income Tax Act and it is only Income Tax Authorities who may raise an objection in accordance with the MCA Circular[1]. HC held that the Court is required to ensure that the amalgamation scheme does not contravene any provision of law, and therefore, RD is not only entitled to but is duty bound to bring to the Court's attention of any provision in scheme which may contravene/circumvent provisions of any law including law pertaining to Income Tax.

HC perused Sec. 394 and 394A of Companies Act, 1956 and held that the RD has adequate right/duty to make representation and offer his comments on the Scheme. HC held that while making observations and comments, RD is entitled to consider the scheme from all aspects and is not restricted in any manner. HC held that if Income Tax Department does not communicate its objection to RD, then RD may presume that the department is not objecting to the scheme, but this does not prevent RD from raising objections or making observations on issues relating to taxation laws.

Bombay HC: Its non-obligatory for Transferee Company to allot shares towards consideration of demerger/amalgamation

[1] MCA Circular dated January 2014

Thomas Cook Insurance Services (India) Ltd., In re: Petition under Sec. 391-394 of Companies Act, 1956 was filed with Bombay HC for seeking sanction of composite scheme of arrangement and amalgamation of Sterling Holiday Resorts (India) Ltd. (Transferor Co., 'SHRIL') with Thomas Cook Insurance Services (India) Ltd. (Resulting Company No. 1, 'TCISIL'), and Thomas Cook (India) Ltd. (Resulting Company No. 2, 'TCIL'), and their respective shareholders and creditors. The Scheme consisted of three parts: (i) Demerger of SHRIL's undertaking pertaining to time share and resort business on a going concern basis and its transfer and vesting in TCISIL, (ii) Amalgamation of residual undertaking of SHRIL with TCIL as a going concern, (iii) After demerger and amalgamation, scheme envisages dissolution of SHRIL with effect from effective date. The consideration of demerger and amalgamation, respectively, was allotment of 116 equity shares of TCIL of Re.1/- fully paid up for every 100 equity shares of SHRIL of Rs.10/- fully paid up and 4 equity shares of TCIL of Re. 1/- to be paid up for every 100 equity shares of SHRIL of Rs.10/-.

Regional Director objected to the scheme that only Transferee Company can allot shares towards consideration of transfer, and not any other person. HC perused the provisions of Section 394 and held that provisions referred to in clauses (i) to (vi) of sub-section (1) of Sec. 394, which the Court may make while sanctioning the Scheme, are merely 'enabling' provisions and cannot be construed as 'compulsory'. HC held that provisions referred to in the said 6 clauses are not in the nature of conditions for exercise of power of Company Court. HC further held that it is not that in every case, consideration for transfer of an undertaking as part of scheme of arrangement must come in the form of an allotment of shares of Transferee Company. HC held that *"Scheme may not provide for any allotment of shares at all or provide any other appropriate consideration including allotment of shares of a holding company of the transferee company"*. HC further observed that acceptance of any particular consideration is part of commercial wisdom to be exercised by transferor company's shareholders and if the consideration is not against public interest or in any other manner illegal or inappropriate, it is not for Company Court to accept or reject such consideration.

Madras HC: Sanctioned Amalgamation scheme, permitted Transferee Company's name change, held that MCA circulars are 'advisory' in nature

Michelin India (P.) Ltd., In re: The Company petitions were filed under Section 391-394 with Madras High Court, for sanctioning the scheme of amalgamation of Michelin India Private Limited (Transferor Company) with Michelin India TamilNadu Tyres Private Limited (Transferee Company). Para 15 of the Scheme stated that upon its sanctioning, Transferee Company's name shall be deemed to have been changed to 'Michelin India Private Limited' i.e., Transferor Company's name. The Regional Director relied on MCA Circular[2] i.e. Name Availability Guidelines, 2011. Pursuant to the specific clause of MCA Circular, the proposed name of the company was considered to be undesirable if it was identical with or too nearly resembling with name of the company in existence and names already approved by Registrar of Companies. The Regional Director objected to such clause and suggested to follow a separate procedure for name change in accordance with Name Availability Guidelines, 2011 (vide the MCA Circular[3]).

The Madras HC agreed with the submissions of the counsel representing the transferor and transferee companies and held that Circular referred to by the Regional Director does not have any mandatory effect and is merely advisory in character. The HC relied on Apex Court's ruling in Bhagwati Developers v. Peerless General Finance & Investment Co.[4].

Madras HC noted that Section 21 of Companies Act, 1956 (corresponding to Section 13 of Companies Act, 2013) requires special resolution to be passed and Central Government's approval for change in name of the company. HC held that Chapter V of Companies Act, 1956 is a complete code by itself on the subject of arrangement/ compromise and reconstruction and is comprehensive enough to include name change consequent to amalgamation or arrangement. The HC relied on its own ruling in K.P.R. Mill (P.) Ltd[5]. HC approved the scheme, observed that there is no objectionable feature in it that is detrimental either to the employees of Transferor Company or of Transferee Company. HC also

[2] MCA General Circular No.45/2011, dated July 8, 2011
[3] MCA General Circular No.45/2011, dated July 8, 2011
[4] AIR 2005 SC 3345
[5] C.P.Nos.133 to 135 of 2006 dated 19.08.2006

observed that the Scheme is fair, just, sound and is not against any public policy / pubic interest and not violative of any statutory provisions.

Andhra Pradesh HC: Sanctions amalgamation of 14 land development companies with another company for tax planning purpose, upheld public interest

Goman Agro-Farms (P.) Ltd., In re: Company Petition under Sections 391-394 were filed by 14 Transferor Companies (engaged in the business of land development) for amalgamation with Hill County Properties Ltd. ('Transferee Company') for sanction of the amalgamation scheme. The majority equity shareholding of Transferor companies was held by Transferee Company and transferor companies possessed lands which were to be given to transferee companies for development in consideration for share in the development. Objects of the companies were in synchronization and by proposed amalgamation, business of both companies would be streamlined and expenditure would be substantially reduced.

The Regional Director objected to the scheme that intention of the scheme was to only offset the losses being suffered by transferee company against profits that are being made by transferor companies which acquired agricultural land at cheaper cost and receiving huge profits from out of land development provided by transferee company with a view to evade payment of income tax.

Andhra Pradesh HC relied on Union of India Vs Azadi Bachao Andolan[6], Vodafone International Holding B.V. Vs Union of India[7], observed that if a transaction is entered as sham with a view to circumvent tax laws and evade taxation, the Court will not approve such transaction However, if a document or transaction is bona fide and not sham in the traditional sense and even if the purpose or object of a transaction was to avoid tax, such transaction cannot be invalidated unless an anti-avoidance provision to that effect exists. HC observed that neither Income Tax Department nor Regional Director has pleaded that proposed arrangement is sham or is intended to violate any law, but a plea was raised for offsetting the losses suffered by Transferee Company. HC observed that the main purpose of proposed amalgamation is to streamline the affairs of the companies by ensuring that all 14 transferor companies (which have stopped their activities) are wound up. HC held that in such cases, Court has no reason to doubt the *bona fide* nature of the scheme. HC observed that if one of the reasons for proposed amalgamation is tax planning by applying settled legal position, then scheme cannot be invalidated only on that ground. HC held that intention of a party to reduce tax liability cannot be said to be contrary to public interest or against public policy and planning by tax-payer is permissible in law.

Gauhati HC: Directed re-visiting of "illogical, absurd" merger swap-ratio; Upheld Regional Director's objection

Buragohain Tea Co. Ltd., In Re: An application under Sections 391(2) and 394 was filed with Gauhati HC for seeking sanction to the scheme of amalgamation of Buragohain Tea Company Ltd. (Transferor Company) with B&A Ltd. (Transferee Company). The exchange ratio was 786 equity shares of Rs. 10 each of the transferee company against 1 equity share of Rs. 1,000 of the transferor company. The ratio was fixed on fair and reasonable basis based on the valuation report of Chartered Accountants, which was confirmed by an independent Merchant Banker.

The Scheme was objected by the chairman of board of directors of Transferee Company who claimed to hold 38% of shares in Transferee Company. The objector stated that a mala fide attempt had been made to deplete her shareholding in the transferee company and stated that the scheme had been devised as part of such a move and accordingly, she sought rejection of the Scheme. The Regional Director raised objection regarding the exchange ratio of shares between the transferor company and the transferee company.

HC observed that the exchange ratio proposed in the scheme is heavily loaded in favour of Transferor Company's shareholders and the ratio appears to be 'unrealistic' and 'illogical'. HC stated that the shares of a company which was under lock out for long period with accumulated losses with petition filed in HC for voluntary liquidation cannot be valued in the manner projected in the scheme. HC rejected company's explanation to the

[6] [2004] 10 SCC 1 (para 17)

[7] [2012] 6 SCC 613 (para 17)

objection about exchange ratio has been fixed on basis of earning capacity of Transferor Company and not on basis of its net asset value or net worth. HC held that such explanation furnished by companies do not inspire the confidence of the Court and no material has been disclosed for calculating the exchange ratio. HC held that "from the stand point of the commercial strength of the two companies, the exchange ratio does not appear to be sound, the same can also be examined in the light of the recent litigation history of the Transferee Company, vis-a-vis the Objector". HC observed that both - Transferor Company and Transferee Company are under the same management with whom the Objector is locked in a series of legal battles. HC noted there is substantial public interest in Transferee Company as it listed company, however observed that the exchange ratio was unfair and unjust and not based on the market realities. HC directed that Registrar of Companies to examine the matter through experts and determine a fair and just exchange ratio.

Conclusion:

In 2016-2017, the provisions relating to merger, amalgamation and arrangements will be notified and NCLT/NCLAT benches will be constituted. Then, the company application and company petitions relating to corporate restructuring will be filed with NCLT first. However, the important principles laid down by the High Court under Section 391-394 of the Companies Act, 1956 will still prevail even when the corresponding provisions under Companies Act, 2013 are notified and NCLT/NCLAT benches are constituted.