

Corporate Mergers and Acquisitions (M&A): Judicial Response

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Abstract: Never regard study as a duty but as an enviable opportunity to learn to know the liberating influence of beauty in the realm of the spirit for your own personal joy and to the profit of the community to which your later works belong - Albert Einstein.

Mergers and Acquisitions have been over a great extent used in developed economies as a growth strategy and is now increasingly getting accepted by Indian businesses as a critical tool of business strategy.

The doctrine of merger and acquisition of companies is neither a doctrine of constitutional law nor a doctrine as such statutorily recognized. It is a common law doctrine founded on the principle of property in the hierarchy of Justice delivery system. It should be noted that law is not what is being legislated within the four wall of the parliament but also what the Judiciary decides as according to realist school of Jurisprudence.

Introduction

The core goal of the any corporate is to maximize its wealth¹ and shareholder's value. This objective can be achieved internally either through the process of introducing new products or by enlarging the capacity of the existing products. On the other hand, the growth process can be facilitated externally by acquisitions, takeovers, mergers and so on. There are strengths and weaknesses of both the processes of achieving goals.

According to the Oxford Dictionary, the expression "merger" or "amalgamation" means "combining of two commercial companies into one" and "merging of two or more business concerns into one" respectively. Merger is a fusion between two or more enterprises, whereby the identity of one or more is lost and the result is a single enterprise. Amalgamation signifies blending of two or more existing undertakings into one undertaking, the blended companies losing their identities and forming themselves into a separate legal identity.

Mergers, Acquisitions and Takeovers: Meaning and Types

Mergers, Acquisitions and Takeovers etc. are terms that are commonly used interchangeably² but often differ by situation. Merger generally refers to unification of two equal players into one unit, while Acquisition refers to one competitor buying out another to combine the bought entity with itself.

A takeover may be defined as obtaining of control over management of a company by another. A company may have effective control over another company by holding minority ownership. As per Accounting Standard 14³ which is for the purpose of amalgamations and mergers, the exhaustive classification of these terms is provided as:

- Transfer of all the assets and liabilities from the transferor to the transferee,
- Acceptance of shareholding in the transferee company by at least 90% of the shareholders of the transferor by exchange of equity shares,
- Intention to carry on the transferor's business after amalgamation and
- Non-adjustment in the value of assets and liabilities other than to ensure uniform accounting policies.

Notwithstanding terminological differences, mergers can be usefully distinguished in to three kinds

1. **Horizontal Merger** takes place when two or more corporate firms dealing in comparable lines of activity combine together due to variety of reasons such as reduction in competition, putting an end to price cutting and to get the advantages of economies of scale in production, research and development and marketing and management.
2. **Vertical Merger** is a grouping of two or more corporate firms involved in different stages of production or distribution. When electronic goods manufacturing company and electronic goods marketing company merged with each other.
3. **Conglomerate merger** is a combination of corporate firms engaged in unmatched and unrelated lines of business activity. Diversification of risk constitutes the rationale for such kind of mergers. The mergers of L&T and Voltas Ltd. is the model of conglomerate companies.

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¹ Machhi Hetal K. and Menon Preeti V., 2004 : Corporate Merger & Acquisition, Indian Journal of Accounting Vol.XXXV(1), PP. 7-12.

² ICFAI - ARF GROUP, 2004 : Procedure for Merger and Amalgamation, The Chartered Accountant, PP. 1234- 1239.

³ Issued by Chartered Accountants of India, New Delhi.

Legal Framework for Mergers & Acquisitions

The beginning to amalgamation may be made through common agreements between the transferor and the transferee but plain agreement does not provide a legal cover to the transaction unless it carries the sanction of company court for which the procedure laid down under section 232⁴ of the Companies Act, 2013.

Procedure for merger and amalgamation is different from takeover. Formers are regulated under the provisions of the Companies Act, 2013 whereas takeovers are regulated under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations.

A. THE COMPANIES ACT, 2013

The following is the outline of legal procedures for merger or acquisition laid down in the said Act-

- Two or more companies can only be amalgamated if memorandum of association of such companies is permitted to do so. In the absence of this, permission of the shareholders, board of directors and the Company Law Board should be taken before affecting the merger.
- Both the companies should inform the stock exchanges where they are listed about the merger.
- The board of directors (BOD)⁵ of the individual companies should approve the draft proposal of mergers.
- A copy of draft proposal approved by the BOD of both the companies should be submitted to high court. High Court would convene a meeting of shareholders and creditors to approve the mergers but the notice of such meeting should be sent to them at least 30 days in advance⁶.
- The individual companies should hold the meeting and at least, 75% of shareholders and creditors should approve the scheme⁷.
- After the approval of shareholders and creditors, on the petitions of the companies the high court will pass order to sanction the merger scheme.
- The true copies of high court's order will be submitted to the Registrar of Companies.
- Transfer of assets and liabilities of acquired company will take place as per approved scheme and
- As per scheme the acquiring company will exchange share or debentures or cash for the shares and debentures of the acquired company.

B. SEBI GUIDELINES

Securities Exchange Board of India (SEBI) has provided guidelines for takeover only. The prominent features of the guidelines are:

- When an individual or a company acquires five per cent or more of the voting capital of a company then Target Company and the concern stock exchange shall be notified immediately.
- There is a limit in acquiring shares of another company without making any offer to other shareholders that is ten per cent of the voting capital.
- If the holding of the acquiring company exceeds ten per cent, a public offer to purchase a minimum of twenty per cent of the shares shall be made to the remaining shareholders by a public announcement.
- If offer is made to the shareholders the minimum offer price shall not be less than the average of the weekly high and low of the closing prices during the last six months before the date of announcement of such offer.
- The offer should disclose the detailed terms of the offer, identity of the offerer, details of the offerer's existing holdings in the offeree company etc. and this information should be made available to all the shareholders at the same time and in the same mode.

The main objective of the Companies Act and the SEBI guidelines for takeovers are to ensure full disclosure about the mergers and takeovers and to protect the interests of the shareholder especially the small shareholders.

Judicial Response as per Apex Courts in India

1. National Company Law Tribunal can reject expert's opinion if he acts negligently.

In *Mihir Chakraborty. vs. Multi Technology Computers*,⁸ It was held that values is an expert, he cannot claim if he acts negligently in making valuation. He can be sued for negligence.

In *Sugar cane Growers. Shakti Sugar Ltd.*,⁹ Madras High Court held that if valuation is found to be erroneous National Company Law Tribunal is not bound to accept expert's opinion.

2. Absence of company's power to amalgamation memorandum of association.

In *Armco Pesticides Ltd., In.re.*¹⁰ Bombay High Court held that there exists statutory power of amalgamation under the act even if the objects of the company are construed as not specifically empowering companies to amalgamate.

⁴ Corresponds in Section 392 of the company Act, 1956

⁵ See Sec.232(2) of Company Act, 2013

⁶ See Sec.230(4) of Company Act, 2013

⁷ See Sec.230(2)(c) of Company Act, 2013

⁸ (2001) 43 CLA 259.

⁹ (1998) 93, Comp Case 646 (Mad), *Indo continental Hotels, Inre*, (1990) 3 Camp. LJ 150 (Raj) *Coimbatore Cotton Mills, Inre* (1980) 50 Comp Case 623 (Mad)

¹⁰ (2001) 103 Comp Case 416 (Bom)

In feedback Reach consultancy services (Pvt) Ltd., In.re,¹¹ Delhi High Court held that if power of amalgamation is contained in memorandum of company it need not seek the permission and approval of Court.

3. Court is authorized to reject the scheme when it is unfair against majority decision and public interest as well as oppressive to minority interests.

In Lanco Kalahasthi casting Ltd, In.re,¹² and Gernman Remedies Ltd., In.re.¹³ It was held that Court has limited Jurisdiction that lies in checking whether the exchange ratio was so wrong or erroneous as would make the scheme of amalgamation unfair or oppressive to the minority members or any class of them.

4. Notice to the Central Government under section 394-A.

In YKIN Holdings Pvt. Ltd., In.re, Delhi High Court held that notice is required to be given to the Central Government under section 394 –A if an application is made under section 391 (2) and 394 but not required to be given at the initial stage of an application U/s. 391(1).

In Eita organic Ltd., vs. Narayan Prasad Lohia,¹⁴ Calcutta High Court held that while considering an application for sanction under section 391(2) of Act, 1956 following have to be considered.

- Whether statutory requirement under sections 391-394 has been complied with
- Whether meeting duly convened and scheme approved by requisite majority so that section 391(2) can be applied.
- That the fact that transferor and Transferee Company carry on dissimilar business is no ground why the Court should not sanction scheme of amalgamation.
- In the absence of objection from shareholders the central government has no right to raise the point.

In another case of Vikram Organics Pvt. Ltd., vs. Anirox pigments Ltd., Calcutta high court held that one notice is sufficient to be given to the central government under section 394-A of companies Act, 1956 and companies (Court) Rules 1959, at the stage of an application for grant of sanction to a proposed scheme of amalgamation and also a prayer for dissolution of a transferor company to be dissolved without winding up.

5. Power of Reserve Bank of India in case of amalgamation of Banks.

In Bank of Madura Shareholders Association vs. Reserve Bank of India,¹⁵ Madras High Court held that section 44A of Banking regulation Act empower Reserve Bank of India to grant approved for scheme of merger of the Banking companies and determining market value of shares hence NCLT won't express its opinion on valuation of shares for swap ratio.

6. SEBI Takeover regulation not applicable in case of scheme of amalgamation

In Eaton Corporation vs. Chairman SEBI¹⁶, it was held that SEBI Takeover Regulations are not applicable in case of amalgamation or merger under any law or regulation, Indian or foreign. Hence the exemption is available even when foreign company due to which there exists change in ownership of Indian subsidiary company.

7. Income Tax concessions under the scheme of amalgamation.

In Castrol India Limited vs. State of Tamil Nadu¹⁷ Madras High Court held that 'Stock' transfer between Transferor Company and Transferee Company in amalgamation form transfer date cannot be considered and thus cannot be subjected to sale tax.

Major question arise after Vodafone case in last year about income tax provisions related to cross border mergers in industry. Section 2 (1B) relating to income tax act provide condition to be followed in merger process for tax liabilities on both companies. According to Supreme Courts's recent judgement in this case, liability of \$ 5 billion arise on Vodafone group.

(i) Merger under the Income Tax Act.

In S. Shanmugavel Nadar vs. State of Tamil Nadu¹⁸ following principles emerged with regard to the merger of on order of an inferior authority on that of superior authority.

- A. Application of doctrine of merger cannot be rendered applicable by drawing a distinction between an application for revision and an appeal.
- B. Doctrine of merger doesn't apply where appeal is dismissed¹⁹.
 - a) For default.
 - b) As barred by limitation.
 - c) Having abated by reason of the omission of the appellant to implead.

(ii) The legal presentative of a deceased respondent.

¹¹ (2002) 115 Comp Case. 897 (Delhi)

¹² (2005) 124 Comp. Case 523.

¹³ (2001) 105 Comp. Case 249 (Del HC) In.re Bangshwari Cotton mills Ltd., (1967) 37 Comp. Case. 195 (Cal) In.re. W.A. Bearshell and co. (1968) 38 Comp. Case. 197 (mad).

¹⁴ (2000) 99 Comp. Case 276 (Cal)

¹⁵ (2002) 40 SCL 1 (Mad)

¹⁶ (2001) 43 CLA 249 (SAT)

¹⁷ (1999) 114 STC 468 (Mad)

¹⁸ (2003) 263 ITR 658 ;

¹⁹ V.M. Salgaocar and Bros. Pvt. Ltd. Vs. C.I.T. (2000) 243 ITR 383.

Application of doctrine of merger depends on the nature of appellate or revisional order in each case and on the scope of the statutory provision conferring the appellate or the revisional Jurisdiction.

8. Scheme to be sanctioned even if alteration done in the memorandum of association of the transferee company.

In Asian Investments Ltd., and others; In.re.,²⁰ and Gujarat organic Ltd., Gujarat High Court held that it would be permissible for the Court to accord sanction to a scheme of amalgamation under section 394 of companies Act, 1956, even if the scheme contemplates a consequential alteration in the object clause of memorandum of association of the transferor company²¹.

9. No statutory need for company Judge to decide question relating to allotment of certain shares to the appellant while considering the scheme.

In National Organic Chemical Industries Limited vs. Miheer H.Mafatlal,²² It was held that company Court exercising Jurisdiction under sections 391 to 394 cannot decide on the issue of validity of certain shares allotted to the appellant which were pending adjudication before the Civil Court. No statutory need for the company Judge to decide this question while considering the scheme. It is only city civil Court which could decide the validity of the shares acquired by the appellate during the injunction.

Some Concluding Observations

In real terms, the rationale behind mergers and acquisitions is that the two companies are more valuable, profitable than individual companies and that the shareholder value is also over and above that of the sum of the two companies. Despite negative studies and resistance from the economists, M&A's continue to be an important tool behind growth of a company²³. Reason being, the expansion is not limited by internal recourses, no drain on working capital – can use exchange of stocks, is attractive as tax benefit and above all can consolidate industry- increase firm's market power.

With the FDI policies²⁴ becoming more liberalized, mergers, acquisitions and alliance talks are heating up in India and are growing with an ever increasing cadence. They are no more limited to one particular type of business. The list of past and anticipated mergers covers every size and variety of business – mergers are on the increase over the whole marketplace, providing platforms for the small companies being acquired by bigger ones.

The basic reason behind mergers and acquisitions is that organizations merge and form a single entity to achieve economies of scale, widen their reach, acquire strategic skills, and gain competitive advantage²⁵. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits, which in facade depends on the kind of companies being merged. Indian markets have witnessed burgeoning trend in mergers which may be due to business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition against imports and acquisition activities. Therefore, it is ripe time for business houses and corporate to watch the Indian market, and grab the opportunity.

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²⁰ (1992) 73 Comp. Case 517 (Mad)

²¹ (1997) 86 Comp. Case. 754 (GUJ)

²² (2004) 121 Comp. Case. 5119.

²³ Schweiger David M., 2003 : M&A Integration : A Framework for Executives and Managers, ICFAI Journal of Applied Finance Vol.9, No.2, PP. 71-79.

²⁴ Biswas Joydeep, 2004 : Corporate Mergers & Acquisitions in India, Indian Journal of Accounting Vol.XXXV(I), PP. 67-72.

²⁵ Rathi Amit K., 2004 : M&A - Common Pitfalls and Remedies, The Management Accountant, Vol.39(12), PP. 952-958

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