Governance in Mergers and Amalgamations

The Companies Act is classic example of inbuilt Good Governance practices. Even 100 years before, the Companies Act, 1913 was having provisions for approval of Court to reduce capital etc. The principles behind drafting any provisions for Governance are same even today. The structure and the language may be different. Logic is said to be the basic language of mathematics, but we experience that Logic is the basic language of any law too. If we take any provision, we will find logic in it. Some transactions are beyond approval of even owners of the Company. If we look back 100 years, we shall see the logic is same, the process and methods might have changed as per the economic and social environmental progress. Few procedural changes that evolved are, instead of High Courts it is now National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) for approval of reduction of share capital or compromise or arrangement with shareholders /creditors. Securities and Exchange Board of India (SEBI) came in existence from 1992 and it was a major step in ensuring Governance for listed Companies.

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INTRODUCTION

It is always said that the Governance is the responsibility of both i.e. administrator and people. The Companies Act is classic example of inbuilt good Governance practices. Even 100 years before, the Companies Act, 1913 was having provisions for approval of Court to reduce capital etc. The principles behind drafting any provisions for Governance are same even today. The structure and the language may be different. Logic is said to be the basic language of mathematics, but we experience that Logic is the basic language of any law too. If we take any provision, we will find logic in it. Some transactions are beyond approval of even owners of the Company. If we look back 100 years, we shall see the logic is same, the process and methods might have changed as per the economic and social environmental progress. Few procedural changes that evolved are, instead of High Courts it is now National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) for approval of reduction of share capital or compromise or arrangement with shareholders /creditors. Securities and Exchange Board of India (SEBI) came in existence from 1992 and it was a major step in ensuring Governance for listed Companies. Further, any corporate action like reduction of capital, compromise or arrangement etc. involving a listed entity requires approval of even SEBI.

Governance is no Longer the Luxury of Compliance, it's an expectation of the regulator and the stakeholders of the Company.

WHY SOME TRANSACTIONS REQUIRE JUDICIAL APPROVALS?

The Corporate transactions can be bifurcated into two categories: -

(a) Internal, which requires approval of Committee/ Board and shareholders if they cross certain prescribed thresholds. For example - Buyback, Issue of securities, Variation of Shareholder's Rights etc.

(b) External, which has impact on company as well as other stakeholders, and which requires approval of Quasi-Judicial or Judicial bodies. For example, Merger and Amalgamations, Demerger and Capital Reductions, etc.

Voting requirements are set for internal and external transactions as follows: -

Nature of Transaction	Internal / External	Min % Votes Required in Favour
Issue of Securities	Internal	75% (Special Resolution)
Buy Back of Securities	Internal	75% (Special Resolution)
Variation of Shareholder's Rights	Internal	75% (Special Resolution)
Capital Reduction	Internal + External	75% (Special Resolution)
Merger/Demerger	Internal + External	¾ in Majority and 50% in Person

The voting Requirement by shareholders for passing resolution for Internal Corporate transactions are Ordinary resolutions in some cases and Special Resolutions in some cases, i.e. 50% or 75% votes in favour. However, in case of External Corporate transactions, like Compromise and arrangement with member or creditors i.e. merger and amalgamations and Demerger

the voting requirement under Companies Act, 1913, 1956 and 2013 has always been majority representing three fourth in value. This gives us a clear highlight that Voting criteria for External Corporate transactions i.e. M&A Transactions were always thought at a level ahead that of other transactions and should be at higher governance level above all.

The concept of Judicial approval for Compromise and arrangement with members and creditors (Merger and Amalgamations, Demergers, Capital Reductions, and other scheme of Arrangements etc.) strikes back from the Companies Act, 1913 under section 153 and was continued in the Companies Act, 1956 under sections 390 to 393 and still continues in Companies act, 2013 under Sections 230 to 233.

The importance of judicial approval over and above the shareholder approval is the best example of Governance. We need to understand the logic behind requirement of approval of Court / NCLT in such transactions. The logic is explained in plenty landmark judgements pronounced by Hon'ble Courts and Hon'ble NCLT bench.

HON'BLE COURTS' /NCLT APPROACH

a. **Public Interest**

Hon'ble Courts, over the period of time, have been firstly looking into whether the transaction is in public interest? Various courts have set various benchmarks in various landmarks Judgements passed related to public interest.

Courts have always been ensuring that the Public Interest is first served in any scheme of arrangement, and it shall not violate any provisions of law. For eg: ***Gujrat High Court in Union of India vs Ambalal Sarabhai Enterprises Ltd*** had rejected the scheme on the grounds of not being in public interest.

Each stakeholder may represent different interest in the Company and a M&A Transaction may affect each one of them differently. While conducting M&A Transactions, fair and transparent disclosures with respect to transaction proposed, objective to be achieved, financial position before and after the merger etc., in every possible way is the honest expectations of all the stakeholders and any failure to this can lead failure of entire transaction.

It is said that there are four pillars of corporate governance i.e., Transparency, Accountability, Fairness and Responsibility. Court has been looking into this factor critically and evaluating the schemes and transactions to be in best interest.

Following are some Stakeholders in case of M&A Transactions

Members – Their Interest is at supreme in M&A Transaction, it affects in the form of share exchange, it directly impacts the ownership of the company.

> Governance is no longer the luxury of Compliance, it's an expectation of the regulator and the stakeholders of the Company.

Institutional Investors – This investor always ensures to have a prior approval clause for any M&A Transactions in their Shareholder's Agreement.

Creditors and Bankers – Creditors and Bankers seeks comforts for their repayments, liquidity of the company post transaction is the ultimate point which they may look at.

In Ramco Super Leather Ltd v Dhanalakshmi Bank Ltd (2009) Com Cases 437 (Mad-DB), Loan agreement mentioned prior consent requirement for Amalgamations and such consents were not obtained. The court have passed the merger subject to such secured creditors consents.

Customers – They are the one's getting indirectly impacted /affected by M&A transactions in some cases.

Employees – Scheme of M&A Transactions ideally takes care of Employee's retention of the transferor companies; employment terms which may vary between transferee and transferor company would be one of the important factors to be looked at in case of Mergers or Amalgamations.

In Bank of Baroda v. Mahindra Ugine Steel Co Ltd (1976) 46 Com Cas 227 (Guj) it was held that Company shall ensure employee's interest are not affected.

Courts, over the period of time, have been looking into numerous subjects which may become the matter of concerns, viz

- Fair treatment to minority shareholders or public shareholders over promoters and all classes of members and creditors,
- Retention of Employees of transferor companies,
- Ongoing litigations in the company which may get affected due to sanction of the scheme,
- Liquidity position of the Company post transaction so as to be able to repay to its creditors,
- Transaction is not Violative to any provisions of law.

Supreme Court in Miheer Mafatlal V Mafatlal Industries Ltd has laid down list of factors that ideally court shall look into while approving scheme.

Courts have been pressing one or other Governance angle in various cases up till now and one among it have been **"Prudent Business Management Test".** ***In Hindustan Lever Employees' Union vs Hindustan Lever Limited And Ors on 24 October, 1994*** following is notable

"Section 394 casts an obligation on the court to be satisfied that the scheme for amalgamation or merger was not contrary to public interest. The basic principle of such satisfaction is none other than the broad arid general principles inherent in any compromise or settlement entered between parties that it should not be unfair or contrary to public policy or unconscionable. In amalgamation of companies, the courts have evolved, the principle of, 'prudent business management test' or that the scheme should not be a device to evade law."

b. Meetings vs Consents

Court convened meetings of classes of members and creditors on the directions of Courts have set various precedents in various ways over the period of time. Courts have been dispensing meetings of Members in below cases:

- Where consents have been obtained in full, from members, (Doctrine of Acquiescence),
- Where the merger is between Holding and Wholly owned subsidiaries, and
- Where shareholding structures are same in transferor and transferee companies.

There have been various precedents where court has dispensed the meetings of creditors and shareholders basis the above pointers.

National Company Law Appellate Tribunal, Principal Bench, New Delhi in Company Appeal (AT) No. 19 of 2021 in the matter of Ambuja Cements Limited, Company Appeal (AT) No. 180 of 2019 in the matter of DLF Limited, Company Appeal (AT) No. 148 of 2021 in the matter of Ericsson India Private Limited has allowed the dispensation of meetings of shareholders and creditors Considering the Holding and wholly owned subsidiary merger on the grounds that the existence of transferee company will remain as before any reorganisation, no change in the shareholding pattern of the transferee company and Net worth of both the companies being positive.

Further since Companies Act, 2013 provides under Section 230, Courts have been dispensing the meeting of creditors if 90% in value of creditors agree to scheme by giving consent affidavits. However, such provision was not there in Companies Act, 1956 and courts were at liberty to dispense the meeting of creditors even if less than 90% in value of creditors agreed to the scheme.

It is interesting to note that courts have been very cautiously handling the matters of dispensing the meeting of members and creditors and satisfying themselves with reasonable assurance of fairness to the matter. Supreme court in ***BV Gupta v Bangalore Plastics (C.A no. 1676/1981)*** have made it clear that there is no uniform rule in which of the cases meetings shall be ordered or dispensed. Discretion of Court to dispense the meeting shall be exercised only in exceptional circumstances. This clearly highlights how the courts have been ensuring the governance in dispensation of meetings.

c. Publications

Publication of Notices of Court convene meetings and final hearing dates have been one of the important process in M&A Transactions, courts have been looking into the aspects where there have been large shareholders or creditors or other stakeholder likely to get affected by virtue of sanction of the scheme.

Publication of notice in small region is not a compliance of section 391(1) of the Act was held in ***G.V. Films Ltd, In Re (2009) 150 Com Cases 415 (Mad)***

d. Chairman Report and Scrutiniser

While giving the directions of meetings, the Court decides who shall act as Chairman and Scrutiniser of meetings. Courts are at liberty to appoint Independent Chairman and Scrutinisers for the meeting to ensure fairness while conducting the meeting and transparent voting mechanism being followed.

Courts have relied on Independent scrutiniser when Ballot boxes were challenged to be not sealed properly in ***Modern Syntax (India) Ltd,. In Re, (2009) 149 Com Cases 843 (Raj)***

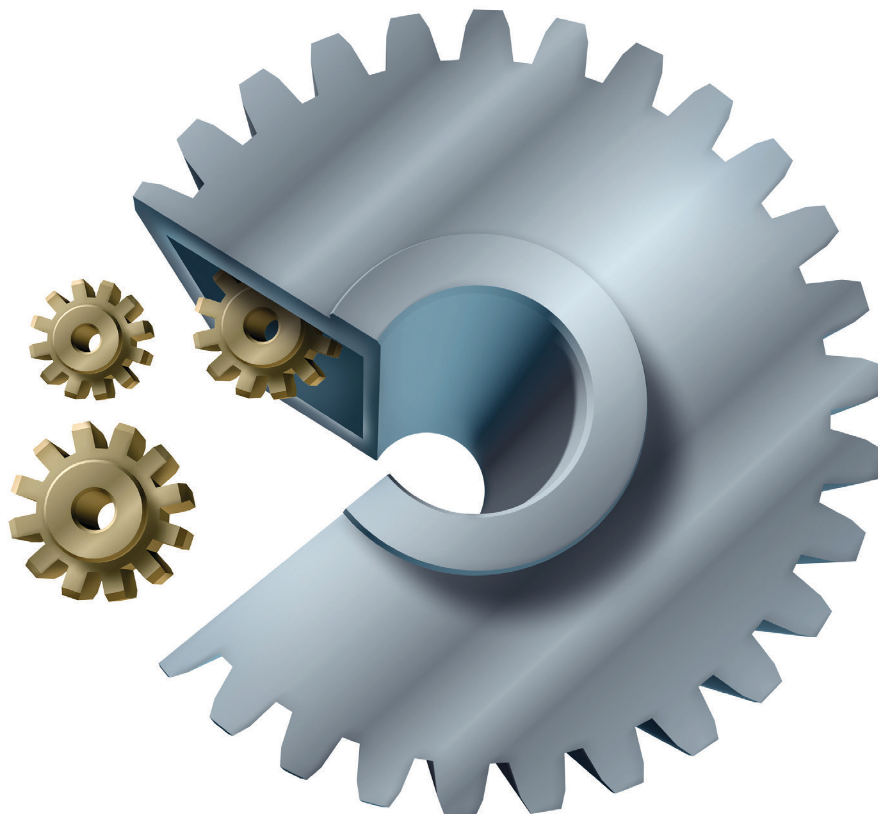
Courts have been placing reasonable expectations from Chairmans of such meetings to ensure that meeting is conducted in fair and transparent manner and voting is taken place without errors and defaults.

Chairman is bound with duty to submit his report to the Court in an affidavit format giving the proceedings and results of the meeting.

Appointment of Independent Chairman and Scrutinisers can be seen as one of the governance pillars in the procedural aspects of M&A transactions.

REGULATORY AND PROFESSIONAL'S REPORTING IN M&A TRANSACTIONS

We can understand that how different regulators and professionals ensure the governance and their responsibilities in case of M&A Transactions. Some perspectives of Regulators are given below:



a. Regional Director (RD)

The Concept of representation by RD for M&A Transaction started with Companies (Amendment) Act, 1965 whereby section 394A was added which required "Courts to give notice to Central Government and consider the representation made by it". The power of Central government was delegated to Regional Director. This amendment brought a major change in M&A Transactions. A real Governance hit got triggered by virtue of this change which can be witnessed in all of the M&A transactions which we see today. Under new law, Section 230 (5) of Companies Act, 2013 requires the Notice to be given to Central Government (Regional Director) for M&A Transactions.

Basically, the role played by Regional Director in M&A Transactions is the second most important role after Court/NCLT, as he has to ensure to bring out any of the lapses, non-compliances, faults in the scheme, or any inferior motive of the scheme in front of NCLT by way of his report (representation). RD has been seen raising concerns on various grounds in the interest of stakeholders. Before RD submits the report/ representation to Courts, Registrar of Companies in turn submits his findings of the M&A Transactions to RD.

Considering the concerns raised by RDs, Courts / NCLTs have been approving the M&A Transactions only after concerns being reasonably satisfied or assured to be taken care by the companies involved. This makes it clear that the weightage of RD's Reports/ representation have been enough space to include governance points and Courts/ NCLTs would duly considers it in public interest.

b. Official Liquidator Reports

In case of M&A Transactions, wherein transferor company gets merged with transferee company and loses its existence, it can be said to have dissolved without following the process of winding up. If we refer Proviso to section 394(1) of Companies Act, 1956, and under section 230 (5) of Companies Act, 2013 we understand that the NCLT's power to pass such order of dissolution without winding up comes on the basis of report or clearance from Official Liquidator who has, on scrutiny of the books and papers of the company, made a report to the NCLT that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members.

Procedure for winding up of the company falls under the domain of the Official Liquidator. In cases of amalgamation where the company is ceasing to exist, the role of Official liquidator becomes more important and has powers to make representation. Official Liquidator, ideally through Chartered accountants, conduct Due Diligence of last 5 years of transferor companies and on the basis of this due diligence,

makes his report /representation to NCLT. This due diligence of transferor companies by professionals shows how governance is taken care while the transferor company gets merged with Transferee Company.

c. Other Regulators (IRDA, RBI, MIB etc)

In case of companies which are highly regulated, viz, Insurance companies, banks, non-banking finance companies, media companies; the industry specific regulator ensures to protect the interest of stakeholders in case of M&A transactions under the specific acts, rules and regulations applicable to the industry and also by various guidelines and bye laws. In some cases, prior approval of specific regulator is required, and this in turn ensures the governance part of such companies.

A point worth noting is that the process of M&A transactions before NCLT keeps moving ahead even though the specific regulatory approval is pending and the matter before NCLT may get disposed off subject to effective date that may be a later date, i.e., on the date of approval from industry specific regulator. But there may occur a scenario where Industry Specific regulator may not be comfortable with the transaction/scheme or may suggest some material modification in the transaction/scheme and in such case, the transaction/scheme may have to be routed to NCLT again. In case of such companies, proper planning helps for timely success of M&A Transactions. Ideal governance would be to have an approval from Industry Specific regulator before initiating the M&A Transactions.

d. Valuation Certificates

Valuation is very critical part of any transaction, and entire success depends on fair valuation. In many cases, valuation reports have been seen getting opposed especially when public is largely involved or where minorities are getting affected by valuations. Courts have been raising concerns on valuation over a period of time.

Valuation report by Registered valuer got mandatory by law under Companies Act, 2013 adding up one more level of governance backed with law. Earlier requirement of valuation report was at discretion of Courts and there was no specific requirement of law that there should be valuation report from chartered accountants (*Gulmohar Finance Ltd,. In re (1995) 5 SCL 207 (Del).)* However, valuation report backed with proper workings of share exchange was seen giving more confidence to Courts in their decision of M&A Transactions in various cases.

One important factor that always gives a concern is the time between the valuation date agreed upon and date of actual sanction of M&A Transaction. There may be events affecting the valuation directly or indirectly during that period and that's where the Courts ensure the fairness of the schemes or transactions and the consideration arrived at while delivering the judgements.

e. Accounting treatment Certificates

Accounting treatment certificate from Statutory auditors of the Company was a new certification requirement under Companies Act, 2013 under section 232 (3), for the purpose of assuring the accounting part of the M&A Transactions adding one more governance step in process of M&A Transactions.

OPPRESSION AND MISMANAGEMENT – TOOL FOR HALTING M&A TRANSACTIONS

In case of M&A Transactions where there are minority shareholders, it is often seen that their interest comes to argument on some complaints or objections raised by them on the basis of fair valuation or loss of shares in case of fractional entitlement or scheme not being in their interest and here is where the entire transactions come to halt unless their interest is being taken care in the best way.

Courts in such scenarios has been looking into compliance of law from every angle and whether the scheme has been fair in best possible way to every member.

Calcutta High Court in Maknam Investments Ltd In re (1996) 87 Com Cas 689 (Cal) *said that it is a matter for the shareholders to consider commercially whether amalgamation or merger is beneficial or not. The Court is really not concerned with the commercial decision of the shareholders until and unless the Court feels that the proposed merger is manifestly unfair or is being proposed unfairly and/or to defraud the other shareholders.*

Further ***In Core Health Care Ltd In re Nirma Ltd In re 2007 138 CC 204*** it was read that, *Mere finding of item or details in the scheme which are open to valid criticism is not unfairness. After all a man may have an offer made to him and although he would prefer something better, would be quite prepared to accept it because it was good enough in all the circumstances.*

Courts have been seen to handle the M&A Transactions related to minorities with due caution, and at the same time, also trying to balance out the equation of not letting minority to take control or charge of transactions which ideally may be beneficial to Corporates but are forcibly brought down based on minority objections.

SCHEME CREATIVITY VS GOVERNANCE

Bombay High Court in ***PMP Auto Industries Ltd, S.S. Miranda Ltd and Morarjee Gokuldas spinning and Weaving Co ltd Re (1994) 80 Com Cases 289 (Bom)*** has considered scheme of M&A Transactions can be cleared in Single window mechanism, it means some activities which are related to M&A Transactions can be part of scheme and can be approved all together and separate

procedure need not be followed for the same. However, one should remember that it does not open the doors to do something which appears to be within the scope of law and may not be. One has to make sure that if any compliance is not in purview of the scheme expressly, it should be complied with from a wholistic perspective.

Scheme of Arrangements / M&A Transactions cannot be used as a tool to achieve the objective or do something which otherwise is not possible within scope of law and therefore one must be very careful while strategizing the M&A Transactions. Broadly any transaction should not be unfair or against the law ***(In Re; Aksh Optifibre Ltd (2007) 77 SCL 219(Raj)***

PROCESS TIGHTENING FOR LISTED SEGMENT

SEBI's one of the supreme roles is Investor Protection and with the increase of M&A transactions in case of Listed Companies over the period of time, SEBI has been tightening the process and requirements for M&A Transactions by listed entities. This can be witnessed as per Master Circular dated 23 November 2021 and some recent SEBI Circulars that give detailed requirements to be complied by listed entities while undertaking scheme of arrangements. Stock Exchanges has also started coming out with their requirements and timelines.

Following are some of the recent changes that are brought for M&A Transactions involving Listed Companies:

- Lender's approval (Schedule Commercial Banks / financial Institution) has now been mandated at stock exchange approval level, to have a clarity for the success of transaction.
- Undertaking from Listed Entity that there has been No material event impacting valuation during the Intervening period of filing scheme documents. This has always been point of question and will now give safeguards to NCLTs.
- Declaration from listed entity on past defaults of listed debt obligations, if any of entities forming part of scheme.
- 15 working days timelines from the board meeting has been enforced for making application for No Observation Certificate (NOC) from the Stock Exchange. Prolonged process in obtaining the NOC changes various factors and circumstances.

If we analyse these changes, we can come to conclusion that M&A Transactions are now been looked more from Governance point and SEBI & Stock Exchanges may continue to raise the level.

FUTURE OF M&A IN INDIA

India is growing magnetically and attracting lot of World's best corporates to do business in India, we are moving towards the dream of 5 trillion-dollar economy,

and this would not be possible unless the governance pillars are strong enough to win the confidence of Stakeholders.

With the growing economy, the corporates would grow at much larger pace and would also take the benefits of corporate restructuring techniques permitted in law. With all this, law makers and regulators will ensure to have a better governed economy and governance level will keep on rising.

In future many new sectors will get evolved and more sectoral regulators would get involved in M&A Transactions approvals, as each sectoral regulator will need to ensure the interest of its stakeholders, hence, governance level in M&A Transactions will keep on rising in coming future.

Although governance is important in M&A Transactions, but timing of completion of M&A Transactions is also very important. Members would have approved the scheme based on valuation derived as on a particular date. In today's dynamic world, there are innumerable factors which can affect the valuation within a short span of time. If the entire process of M&A takes 7-8 months or even a year or more, then the whole rationale of undertaking the M&A Transaction may get defeated and the valuation, which would have been the basis of the scheme, may not remain relevant at all.

CONCLUSION

Hence, it is now a high time for limiting the time taken for overall M&A process while ensuring that the governance aspects are not compromised. Off late, the Regulators have been taking steps to reduce the timeline at various stages. In future, let's hope for many more such decisions taken by Regulators and overall time span taken for M&A Transactions will be reduced considerably.

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