Chapter-III
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DEFINITIONS OF AMALGAMATION UNDER VARIOUS STATUTES

Definition of amalgamation under various laws: -

i) Under The companies Act, 1956,

ii) Under Income tax Act, 1961

iii) Under AS –14

Under the Companies Act, 1956

The act does not specifically define, but prescribes features of transactions which would qualify for procedure under the act for effecting, amongst others, an amalgamations, reconstruction of Sections 390, 391 & 394 are stated as follows:

Sec 390: expression "arrangement" includes a reorganization of the share capital of the company by consolidation of shares of different classes, or by division of shares into share of different classes or by both those methods

Sec 391: specifies the power to make compromise or arrangement with creditors and members, & where such compromise or arrangement is proposed between a company & its creditors or any class of them or between a company and its members or any class of them

The court may on the application of the company Or of any creditor or member of the company, Or in case of the company which is being wound up of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such a manner as the court directs.
Sec 394: provisions for facilitating reconstruction and amalgamation of companies.

Under the Income Tax Act, 1961

SEC 2(1) DEFINES AMALGAMATIONS AS UNDER: -
In relation to companies means, merger of one or more company with another company or merger of two or more companies to form one company. In such a manner that: -

- All the properties of the amalgamating company become that of the amalgamated company by virtue of amalgamation.
- All liabilities of amalgamating company become that of the amalgamated company.
- Shareholders not holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than the shares already held therein immediately before amalgamation. By, or by a nominee for the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation. 5

Under ACCOUNTING STANDARD 14:
Amalgamation is in the nature of any of the following: -
(a) Merger
(b) Purchase
An Amalgamation would qualify to be in the nature of Merger if all the conditions stated in the standard are satisfied. Even any one condition is not satisfied; it will be treated in the nature of purchase.

All the assets & liabilities of the transferor company become, after amalgamation, the assets & liabilities of the transferee company.

Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (Other than the equity shares already held therein, immediately before the amalgamation, by the transferee or its subsidiaries or their nominees) become equity shareholders in the transferee company by virtue of amalgamation.

Amalgamation consideration receivable by those shareholders of the transferee company. Who agree to become equity shareholders of the transferee company is discharged by the transferee company Wholly by the issue of equity shares in the transferee company, Except that cash may be paid in respect of any fractional shares.

After amalgamation the transferee company must intend to continue the business of the transferor company. No adjustments are intended to be made to the book values of the assets and liabilities of the transferee company. When they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.
Comparative definition of amalgamation under various laws:

It will be interesting to note from above that there are substantial differences between definition as given under various laws. The companies Act definition is widest definition and cover all types of restructuring. Definition under Income Tax act and AS 14 is also quite different and various differences are listed below:

I) Under Income Tax act, now after amendment in the Budget, the only 75% of shareholders of Transferor Company should become shareholders of transferee company which under AS 14 requirements is 90%.

II) AS 14 requires consideration to be discharged in the form of equity shares only. While The Income tax Act allows discharge of consideration by way of equity or preference.

III) AS 14 requires that business of the Transferor Company must be continued, while there is no such requirements under the income tax Act.

IV) As 14 does not allow any adjustment to be done to book value of assets taken over, but there is no such requirements under the income tax Act.
Methods of Consummating Transactions

Purchase of Assets

The acquiring institution buys all or a portion of the assets of the acquired organization, using either cash or its own stock. The acquired institution distributes the cash or stock to its shareholders in the form of liquidating dividend and the acquired organization is then dissolved.

Purchase of Stock

Cash may be used to settle wither type of merger transaction A stock transaction, it has the advantage of not being subject to taxation until the stock is sold while cash payments are usually subject to immediate taxing.

Selecting a Suitable Merger Partner

Merger is beneficial if it increases shareholder value or, more simply, increases the market value of the common stock. Market value is the net present value of the dividend stream discounted by the opportunity cost of capital. Market value will increase if either dividend stream increases, or opportunity cost of capital decreases.

A post-merger earnings per share (EPS) is major criteria used to evaluate merger candidates. If resulting EPS is higher, then market should value the stock more highly, once Merger is consummated.\textsuperscript{15}
LEGAL/ STATUTORY APPROVALS

The process of mergers or amalgamations is governed by sections 391 to 394 of the Companies Act, 1956 and requires the following approvals:

Shareholder approval

The shareholders of the amalgamating and the amalgamated companies are directed to hold meetings by the respective High Courts to consider the scheme of amalgamation. The scheme is required to be approved by 75% of the shareholders, present and voting, and in terms of the voting power of the shares held (in value terms).

Further, Section 395 of the Companies act stipulates that the shareholding of dissenting shareholders can be purchased provided 90% of the shareholders, in value terms, agree to the scheme of amalgamation. In terms of section 81(lA) of the Companies Act, the shareholders of the "amalgamated company" also are required to pass a special resolution for issue of shares to the shareholders of the "amalgamating company".

Creditors/Financial Institutions/Banks approval

Approvals from these are required for the scheme of amalgamation in terms of the agreement signed with them.
High Court approvals

Approvals of the High courts of the States in which registered offices of the amalgamating and the amalgamated companies are situated are required.

Reserve Bank of India approval

In terms of section 19 of FERA, 1973 Reserve Bank of India permission is required when the amalgamated company issues shares to the nonresident shareholders of the amalgamating company or any cash option is exercised.

SEBI’s Takeover Code for substantial acquisitions of shares in Listed companies

In India takeovers are controlled on 4th November 1994, SEBI announced a take-over code for the regulation of substantial acquisition of shares, aimed at ensuring better transparency and minimizing the occurrence of clandestine deals. In accordance with the regulations prescribed in the code, on any acquisition in a company, which makes acquirer’s aggregate shareholding exceed 15%, the acquirer is required to make a public offer. The take-over code covers three types of takeovers-negotiated takeovers, open market takeovers and bailout takeovers.12
TAX ASPECTS / BENEFITS UNDER THE INCOME TAX LAW.

Definition

Out of the various terms concerning combinations and acquisition, only the term ‘amalgamation’ has been defined under the Income-tax Act, 1961 in section 2 (1B). The salient aspects emerging from this definition are as under:

- All the amalgamating entities should be companies within the meaning of section 2(17) of the Act.

- All the properties and all the liabilities of the amalgamating company or companies immediately before the amalgamation should become the property and liabilities of the amalgamated company.

- Shareholders holding not less than nine-tenths in value of the shares in the amalgamating company (other than shares already held therein immediately before the amalgamation by the amalgamated company or by its nominee or by its subsidiary) should become shareholders of the amalgamated company.

- The property should be obtained, the liabilities should be taken over and the shareholders in one company should become shareholders of another company by virtue of amalgamation and not as a consequence of:

  a) Purchase of property of one company by another company;
b) Distribution of property by a company being wound up to another company.

The foregoing account would show that the definition as contained in sub-section (1B) of section 2 is narrower than the ordinary meaning of the term 'amalgamation'.

**Taxation aspects**

When companies amalgamate/merge or are taken over a number of issues having tax implication arise, the IT Act, however, specifically deals with the concept of amalgamation. The object sought to be achieved with the assistance of tax benefits as originally contemplated is to facilitate merger of uneconomic units (companies) with other financially sound companies to ensure proper utilization of national assets and employment force and in the process avoid unemployment and waste of resources by closure of financially weak but otherwise viable units. Though the new clause (1B) [clause (1A) when introduced] of section 2 corresponded to the definition in the Explanation to section 33(3), as it then stood, it was made clear that the term 'amalgamation' included not only the merger of two or more companies to form one company but also the merger of one or more companies with another existing company. Again, the then existing definition of the term 'amalgamation' in the Explanation to section 33(3) contained a condition that shareholders holding not less than nine-tenths in value of the shares in the amalgamating company should become shareholders of the amalgamated company by virtue to the amalgamation. This condition excluded from the purview of the
term 'amalgamation' the case of a merger of a subsidiary company with its parent company in as much as, upon such merger, the above, provides that, in computing the nine-tenths in value of the shares for the purposes of this provision, the shares already held by, or by a nominee for, the amalgamated company or its subsidiary in the amalgamating company immediately before the amalgamation, will be excluded. Because of this situation, the specific provisions relating to merger of subsidiaries in Explanation to section 33(3) that amalgamation would include merger of a subsidiary company in the holding company is held by the holding company or its nominees became superfluous and hence was omitted.

The important aspect in amalgamation is that in amalgamations the assets are transferred, by what is described as the amalgamating company in section 2(1B) to the amalgamated company, without any payment to the said amalgamating company. In actual fact, the assets belong to the shareholders of the amalgamating company. The effect of the amalgamation is that the assets come to the amalgamated company, which in turn, issues a fresh share capital to the amalgamated company is involved in the amalgamation as far as the amalgamated company is concerned. [See the decision in CIT v. Bharat Development (p) Ltd., (1962) 135 ITR 466 (Del.)].
The following issues concerning taxation liability arise for consideration when amalgamations/mergers are affected:

i) Taxation liability of amalgamating company

Normally, the scheme provides the date of the coming into force of the amalgamation. Hence the amalgamating company should be assessable on profits only up to the date when it had its own existence. But the amalgamation becomes effective only from the date of its sanction by the High Court under section 394 of the Companies Act. There has been divergence of view in judicial thinking on this matter. The Madras HC in its decision in the case of United India Life Assurance Co. LTD, v CIT, (1963) 49 IT 965 [subsequently followed in Marshall Sons & Co. India Ltd. v. ITO, (1992) 195 ITR 417] has taken the view that there is no transfer from the date fixed in the scheme and amalgamating company continues as an independent entity during the period up to which the High Court's sanction is received and is taxable on its income during the said period.

However, the other view, which seems to be correct and a reasonable view, is that the approvals cannot postpone the date of amalgamation considering the fact that court generally approves the amalgamation from the date mentioned in the scheme i.e. from the appointed date. Moreover for the purposes of income tax, what is crucial is the date on which the assets and liabilities vest in the amalgamated company. Accordingly, the appointed date on which the assets and liabilities vest in the amalgamated company is the actual date of amalgamation and the income up to that date only is taxable in the hands of amalgamating company. This view has been taken by the
Bombay Bench of the ITAT in the case of CIT v. Swastik Rubber Products Ltd. Application of the IT Department under section 256 (2) of the IT Act in this case was not accepted by the Bombay HC and SLP against that order was dismissed by the High Court [see 140 ITR 304 & 140 ITR (St.2) for the Supreme Court's order]. However it would be advisable to mention the appointed date in the scheme of amalgamation to avoid controversy in this regard as in the first case before the Madras, HC no particular date was mentioned in the HC's order. Hence the court, during the course of hearing on the amalgamation matter should be requested to mention about the appointed date as given in the schemes of amalgamation in its order.

ii) Previous year of the amalgamating company

There would be no change in it (which would end on 31st March in the year in which amalgamation takes place even if the appointed date happens to be a date earlier to this date -- say 31st December).

iii) Whether amalgamation involves transfer of capital assets

Whether amalgamation involves 'transfer of assets' in terms of section 2(47) of the IT Act and whether a business undertaking could be considered as 'capital asset' in terms of section 2(14) is an important question. It has been held in decided cases that business is property and the undertaking of a business is a capital asset [see CIT v. Maugneram Bangur & Co. (Land Development, (1965) 57 ITR 299 (SC)]. Likewise the
The definition of ‘transfer’ in section 2(47) is very wide and includes in its ambit all types of movable and immovable properties including a business undertaking. Thus capital gains arising from the transfer of a capital asset are assessable under section 45. However, section 47, which deals with the transaction not considered a transfer, provides vide clause (vi) that any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company is not to be considered as a ‘transfer’ and hence not liable to tax as capital gains.

iv) Liability of capital gain in the hands of the shareholders of the amalgamating company in regard to shares received from the amalgamated company

There would be no liability for tax on capital gains in such situation also in view of section 47(vii) which provides that allotment in such cases would not be considered as a ‘transfer’ and hence section 45 shall not apply in such cases.

In a case where a company (amalgamated company) amalgamates with and merges into another company (amalgamating company) and the shareholders of amalgamated company are allotted shares in amalgamating company in their own right, shareholders of amalgamated company are not liable to tax under the head ‘capital gains’ because, apart from the express ex emption in section 47(vii), such amalgamation or merger does not also involve, within the meaning of section 52.
2(47), a transfer, a sale an exchange, a relinquishment of the asset or the extinguishments of any rights therein.

v) Cost of the assets taken over by the amalgamated company

Under section 49(i)(iii)(e) of the Income-tax Act, cost of acquisition of capital assets taken over by the amalgamated company from the amalgamating company under a scheme of amalgamation must be taken to be the same as the cost (or wdv) thereof of the amalgamating company.

vi) Amalgamation does not result in any income in the hands of the amalgamated company.

vii) Transferee company can continue proceedings in respect of income-tax assessment of the transferor company.

viii) Depreciation aspects on amalgamation

a) W.D.V. in the hands of the amalgamated company

As far as the amalgamated company is concerned, the written down value of the block of assets acquired from the amalgamating company is the closing WDV at the end of the previous year preceding the previous year in which amalgamation takes place. hence to the extent of depreciation available to the amalgamated company in the year of amalgamation, these is a double deduction as a consequence of the aforesaid interpretation.
b) The general principle is that a successor is not entitled to set-off unabsorbed depreciation of his predecessor [Indian Iron & Steel Co. Ltd. v. CIT, (1943) 11 ITR 328 (PC); Hindustan Aeronautics Ltd. v. CIT, (1984) 149 ITR 795 (Kar.)] Amalgamation being a case of succeeding, the unabsorbed depreciation of the amalgamation company cannot be set-off against the profits and gains of the amalgamated company.

However, in view of section 72A and on satisfying the conditions laid down in that section and on compliance of the procedure prescribed therein, the amalgamated company can avail of the benefit of set off of unabsorbed depreciation, after amalgamation in its own assessment.

ix) Investment allowance

The investment allowance availed of by the amalgamating company is not withdrawn on account of amalgamation in view of the specific exception in section 32A(6) of the IT Act.

Section 32A(6) also provided that the balance of investment allowance, if any, carried forward by the amalgamating company under section 32A(3) can be carried forward by the amalgamated company provided that the total period for which the balance of investment allowance can be carried forward in the assessments of the amalgamating company and the amalgamated company cannot exceed the period of eight year as specified in section 32A(3).
x) Investment Deposit account

Unlike section 32A(6), which provides that the investment allowance allowed to the amalgamating company will not be withdrawn on transfer of the assets to the amalgamated company, section 32AB does not have any such provision. In fact, in the CBDT'S circular explaining the provisions of section 32AB, it is expressly stated that a provision similar to section 32A(6) has not been made "because in the Indian context amalgamations usually arise infrequently and that too only to take care of losing concerns or as device for tax planning [Circular No. 461, dated 9.7.1968].

xi) Unabsorbed expenditure on scientific research

In the hands of amalgamating company cannot be set off in the income computation sin case of amalgamated company. Unabsorbed scientific research expenditure carried forward under section 35(4) is attached to the company and not to the asset. Hence it lapses in view of the fact that it is a consequence of amalgamated itself and not sale or transfer pursuant to amalgamation. This option is also in line with the CBDT Circular NO. 5P dated 9.10.1967, Para 57.3 explaining the provisions of section 35(5). The circular states that by virtue of section 35(5), the amalgamated company will be allowed to carry forward the unabsorbed scientific research expenditure.

Section 72 A benefit is also not available for such unabsorbed expenditure as section 72A covers only unabsorbed losses and depreciation and not unabsorbed scientific research expenditure.
xii) Carried forward losses and their set off

Section 72A provides that where there has been an amalgamation of a company owning an industrial undertaking or a ship with another company and the Central government, on the recommendation of The specified authority, is satisfied that certain conditions specified in this behalf are fulfilled, the Central government may make a declaration to that effect an thereupon, notwithstanding anything contained in any other provision of the Income-tax Act, the accumulated loss of the amalgamating company shall be deemed to be the loss or, as the case may be previous year in which the amalgamation was effected and the other provisions of the Act relating to carry forward and set off of loss and allowance for depreciation shall apply accordingly. It is to be noted that as the unabsorbed losses of the amalgamating company is deemed to be the loss for the previous year in which the amalgamation was effected the amalgamated company will have the right to carry forward the loss for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year in which the amalgamation was effected.

xiii) Expenses concerning amalgamation

Such expenses have been held too not allowable as revenue expenditure. See Addl. CIT v. W.A. Beardsel & Co. Pvt. Ltd., (1981) 130 ITR 159 (Mad) and other decisions where similar view has been taken. The recent decision on this matter is in the case of Lalitmani (P) Ltd. v. CIT, (1997) tax LR 543 (Bom).
xiv) Application of Chapter XXC

Chapter XXC of the Act provides for a preemptive right to the Central government to acquire any immovable property undergoing a transfer for consideration above specified limits. A question that arises is whether Chapter XXC of the Act applies to the vesting of immovable properties from the amalgamating company to the amalgamated company pursuant to the High Court’s order under section 394 of the Companies Act, 1956. However the provisions of this Chapter do not get attracted in the case of amalgamations.

xv) Gift tax liability

The Gift-tax Act, 1958 does not apply to an Indian company in a scheme of amalgamation vide clause (b) of section 45 of the GT Act, 1958.

The foregoing account would indicate that the IT law provides sufficient incentives for mergers/amalgamations. As far as takeovers are concerned, the problem is more complex and is interrelated to the dynamics of the market place. It is, therefore, difficult to devise tax benefits for takeover in such detail to cover the entire range of situations and to ensure that these are not misused to acquire monopoly or hostile control. Justice P.N. Bhagwati Committee has studied the position concerning takeovers and SEBI has considered the takeover code prepared by the Bhagwati Committee. An attempt can be made to study the problem to find out ways and means to give tax benefits to healthy and sound schemes of takeovers like bail out takeovers, which do not fall under the purview of BIFR/SICA.26
LEGAL ASPECTS OF OPEN OFFER

These are exciting times for the corporate sector, with a number of companies in the process of taking over the entities. In recent times, there have been many takeover efforts-some of them are Raasi Cement by India Cement, Merind by Wockhardt and Indian Aluminium by Sterlite Industries. What are the Important attributes in an open offer? The need for an open offer arises when any company is interested in acquiring management control of another firm. The open offer process is regulated by the SEBI (substantial acquisition of shares and takeover) Guidelines 1997.

The principal parties in the takeover process are the target company and the acquirer. The target company must be a listed company in which the acquirer seeks to take control by buying these shares from the existing shareholders – promoters as well as public. An open offer is triggered under two circumstances:

1) When the acquirer picks up a stake of 10% in any company.

2) When there is a change of control.

‘The change in control’ trigger ensures that there is no back-door entry by any new business group. Earlier it was possible to do this by picking up stakes in companies that hold a controlling stake in the listed entity. As such practice places the promoters and the public shareholders on a different pedestal, the open offer is now triggered even if there is change in control.
An open offer can be withdrawn only if there is a competitive bid or statutory approvals have been refused or the acquirer has died (If an individual).

A preliminary trigger: Even before the open offer is required there is yet another trigger that provides a view of any build up of a stake in a company. If any person acquires 5% or more in the equity of another company, the holdings should be disclosed to the company and the stock exchanges. This has to be made within 4 days from the date of acquisition or reaching of the stake.

A public announcement: an acquirer who picks up shares with voting rights exceeding 10% of the equity of the target company must come out with a public announcement to acquire shares in the company. This requirement would also apply where the acquirer gets the control over Target Company even if there had been no acquisition of shares.

A merchant banker (category I) must be appointed before a public announcement is made. The public announcement must be made within 4 days of the acquisition of stake or control or agreement for this purpose. The contents of this public announcement of offer prescribed in the SEBI Guidelines. The public announcement must be made only if the acquirer is in a position to implement the offer.
The contents: The public announcement of offer should have the following information:

- The paid up share capital of the target company and the fully and the partly paid up shares.
- The number of shares and the percentage stake that is proposed to be acquired from the public (the minimum offer should be 20% under normal circumstances).
- The minimum offer price for each category of share.
- The mode of payment of consideration.
- The identity of the acquirer or the person gaining control.

The contents of the public announcement of offer are designed to provide shareholders with an information base about the acquirer's plan, to enable investors take an investment decision.

A specified date: This is the date that is specified in the public announcement of offer. The specified date is the key cut off point as it determines the names of the share holders to whom the letter of offer would be sent. In order to ensure that the process is completed in a time bound manner, as the entire affair has price implication the specified date must be within 30 days of the date of the public announcement. Though shareholders who have registered exposures as of that date would have no problems getting the letter of offer, those holding blank documents would need to intimate the merchant bankers to avail themselves of the offer.
The public announcement of offer usually contains procedures for the acceptance of the offer by a person who owns shares in the target company but whose documents are not registered in his name. Such investors should keep track of the specified date, as otherwise they may miss out an attractive opportunity to exit sometimes of course it may not matter, specially when the market price and the offer price are close to each other or the former runs ahead of the latter in the post offer period.

**Letter of offer:** Within 14 days of the public announcement a draft letter of the must be sent to the target company and the stock exchanges where the shares are listed. This should be placed before the board of directors of the target company. The acquirer should send the final letter of offer to all the shareholders of the target company within 45 Days of the public announcement. The letter of offer would have to be used in the same manner as the one in a rights offer, except that there will be a reverse flow of money and stock.

**Offer period:** The offer period is the time horizon between the date of public announcement of the first offer and its date of closure. The date of public announcement of the first offer would be the date on which it actually appears in the media. Keeping track of public announcements is simple as they appear in all editions of any English or a Hindi national daily, as well as regional language daily. Such takeovers are widely tracked and reported in the media. The date of opening of the offer shall be within 60 days from the date of public announcement. The offer to buy shares shall remain open for 30 days (this would be the
offer period). During the offer period the acquirer shall not be entitled to appoint anybody to the board of director of the target company. The acquirer shall also not acquire any shares of the target company from the secondary market (picking up stakes from a fresh issue of securities is allowed). This is mainly to ensure that there is no price manipulation.

Minimum offer price: This would be the highest of the following:

- The negotiated price under the agreement entered into by the acquirer.
- The highest price paid by the acquirer or persons acting in concert by way of the public allotment or rights issue at any time during the 26 weeks preceding the date of public announcement.
- The price paid by the acquirer under a preferential allotment made to him or persons acting in concert during the 12-month period up to the date of the closure of the offer. This ensures that the open offer at a lower when a preferential allotment is picked up even during the offer period at a higher price.
- The average of the weekly high and low of the closing prices of the shares of the target company on the exchange where the shares are most frequently in the 26-weeks preceding the date of announcement of the offer.
Consideration and payment: The consideration can be paid in cash/stock/secured debt instruments with a minimum credit rating of A. The payment can also be by way of a combination of any of the above to ensure that there is some backing for the offer and investors can tender with confidence about the payment. The acquirer is also required to maintain an escrow account. This is a security for discharge of the obligations.

The amount to be deposited in the escrow account would be 25% of the consideration if the offer size is less than RS 100 crores. In case it exceeds RS 100 crores, the escrow account should be for Rs 25 crores plus 10% for the amount in excess of RS 100 crores. If the offer is subject to minimum level of acceptance, that is, it is conditional; the escrow amount shall be 50% of the size of the public offer. This escrow amount can be in the form of cash, bank guarantee in favour of the merchant banker and deposit of securities with appropriate margins. As far as the payment of consideration is concerned, the acquirer must ensure that the securities are actually issued and dispatched to the shareholders. If more shares than the offer prices are tendered, the acceptance would be on proportional basis done in a fare and just manner and should not result in non-marketable lots.

Upward revision of offer: Under the regulatory framework competitive bids are allowed. Such competitive bids are at a higher price than the original offer as otherwise they may find no takers even if there are no competitive bids, the original acquirer can revise upwards the price as well as the numbers of shares that are being picked up. No down wards revision is possible.
Any upward revision would have to be made at any time up to seven working days prior to the date of closure of the offer. Any such increase must be accompanied by another public announcement in the same manner as the original one. Stock exchanges would have to be intimated and the necessary extra sums are deposited in the escrow account to pay the higher prices.\textsuperscript{19}
THE OPEN OFFER TIME TABLE:

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Sources: - www.capitalmarket.com
OPTIONS BEFORE RETAIL INVESTORS IN CASE OF OPEN OFFER

There has been a flurry of activity on the Takeover front ever since the New Takeover Regulations were notified in February 1997. In the last year alone, about 21 open offers were made -- an average of two a month. This is not excluding two others high profile open offers — Wockhardt's for Merind and India Cement for Raasi Cement.

For a capital market, which had hardly any idea, what a transparent takeover meant, or for that matter what a hostile one is, this is quite a dose in a year's time. In fact, investors seem confused when an open offer is made to them, and wonder if the offer is worth accepting or better turned down. Such a decision becomes crucial when the entity making the open offer has acquired more than 75% of the equity, and the open offer would result in the stock being delisted from the bourses. What should an investor do in such a situation?

Price movement of the scrip becomes important when such a decision is to be made. Two situations could arise here.

➢ In the first scenario, where the offer price is higher than the ruling market price, the stock could start moving up as the market players seek to exploit short-term profit potential. But this is subjected to the belief that the offer price is fair and the open offer has a chance of going through successfully.

➢ In the second scenario, the market may be uninterested in what is happening to a stock for which an open offer has been made. This could be because it is unhappy with the offer price
and thinks the stock has been under valued. Such sentiments can lead to the open offer failing to achieve its objective, which would again depress the stock in the market.

Thus it is evident that the era of open offers has brought forth in its wake one more complexity in the overall price discovery process of a stock in the market. It has also complicated the decision of an investor - shareholder when an open offer is made to him for his holdings.

A recent study conducted by Business Line Research Bureau of 20 open offers made in the last one year, has given the following conclusions:

- It is evident that news of an impending open offer filters out to select market players much ahead of the public announcement. In the majority of the cases examined, importantly in the high profiles one, there was a remarkable appreciation in the stock price, in the run up to the public announcement.

- In some cases, stocks have actually lost value in the month before the public announcement date. This was because of either of the two factors. 1) The company was unattractive. From the markets point of view the company was down and out. 2) Once the open offer goes through, the stock would get delisted automatically.

- One of the major points that come through in the analysis was that only those stocks backed by a sound offer from either a foreign collaborator or principal, and which had a good chance of succeeding in the open
offer, witnessed activity in the period after the open offer announcement.

- The most crucial aspect of the offers, the pricing was also more than satisfactory. Thus, from the market's point of view these were serious offers with a specific strategy in mind—that of acquiring controlling interest—and given the attractive price offered, had a good chance of going through successfully. Not surprisingly, the stocks appreciated rapidly in the phase between the announcement and the close of the offer.

- On the other hand, the stocks largely sidelined by the market where the initial offer price was undervalued by the target companies.

- Another notable characteristics of the price movement in all the open till now is that barring a couple of exceptions, the market has not really tested the open offer price. In other words, the stock has not been valued in the market above the offer price on a sustained basis. Of course, there are cases where it has shot past the open offer price for a day or two, but this seems to be more of aberration, and the general rule has been that market quotations are substantially lower than the offer price. This can be traced to two factors. One, till now offer prices per se have been quite good in the sense that they have been fixed at a considerable premium to the prevailing market prices, thus neutralizing any contrary market movements.
What shareholders should do?

The shareholders should keep the following points in mind while deciding about the open offer:

- One of the first points a shareholder confronted with an open offer should note is whether the acquirer has a strategic plan in the proposed takeover.

- The second factor is the offer price. In a majority of open offers till now, the offer price has been at a considerable premium to the prevailing market price, which made the decision of those who wanted to sell out easy. But what happens where the offer price is at a discount to the current market price. Here the shareholder has to go only by what the market dictates. In the event of under valuation, the treatment of the stock in the market would give a clear idea by itself.

- Finally, the all important question is that should the shareholder tender their shares in case of an open offer or hold on to them in the market in the run up to the offer? One of the following strategies could be followed depending upon the circumstances of the case: -

When the offer is conditional or where the offer is only for the statutory minimum of 20%. In such cases the risk is that the shares tendered to the acquirer may be accepted only in part or even none at all if the condition is not fulfilled. In such a case it is better to sell in the market, assuming that the ruling price is close to the offer price, which it would be in any case, excluding exceptional circumstances. Otherwise it would not be worthwhile
to sell out in the market undergoing all the paperwork and paying a brokerage to boot.

In any other circumstances the shareholder has two choices: either tender the shares to the acquirer or hold on to them. It is difficult to make a generalization on which would be valid under all possible circumstances. One has to decide on the merit of each case and drawing a general conclusion would be difficult. In fact latter may be the good decision for a conservative investor playing for the long-term sweepstakes. One argument would be that you would be reduced to a status of minority shareholders once the acquirer succeeds in getting the controlling interest. But that is a risk one has to live with, and anyway if the company were to delist it would have to come out with another open offer at which time you could tender your shares if you choose to.27

LEGAL ASPECTS OF MERGERS

Procedure

The legal procedure to be followed for the merger of the companies is as follows:

1. Provision in the objects clause

The objective clause in the Memorandum of Association of both the Acquirer Company as well as the Acquirer Company should have adequate provision to amalgamate with any other company. The object clause of the Acquirer Company should have an adequate provision of authorized capital to be able to absorb the capital structure of the acquired company. Also, the
objects clause of the amalgamated company should contain provisions to carry on the business of the amalgamating company in horizontal, vertical or conglomerate nature or any other form as required. In the absence of these provisions in the objects clause, the Memorandum of Association has to be suitably amended, complying with the requirements of Sections 17 and 18 of the Companies Act, 1956. For alteration of the objects clause, approval from the Boards of Directors and shareholders followed by filing these resolutions with registrar of Companies and obtaining confirmation of Association should also be changed suitably.

2. Obtaining government approval

Under Sections 391 and 394 of the Companies Act, 1956, the central government's approval of the merger proposal is necessary for filing petition before the high court for the approval of the merger.

RBI's approval is also necessary under Section 29 of the Foreign Exchange Regulation Act, 1973 for transfer of shares involving NRI's or foreign nationals.

3. Draft Amalgamation proposal

The amalgamation proposal should be prepared by the acquirer company on the basis of various reports, financial analyst's report, auditor's reports and audited accounts of both the merging companies prepared unto the effective date of merger. Generally the amalgamation proposal contains the information like, details of the transferor and transferee including the authorized, issued and subscribed capitals respectively, the
transfer of assets / liabilities and the effective date of merger, the changes in the capital, change of name, accounting year and the object. The proposal will also contain details on the management including the Board of Directors an participation of the directors of the transeree company on the new board, dividend position, the expenses involved in the merger and the conditions under which the proposal would be operative.

The Acquirer Company after preparing the draft proposal should get it betted with an authorized merchant banker. Also the respective Boards of Directors of the merging companies should approve the draft amalgamation proposal after which the Board should authorize the Directors to file a petition before the High Court under Section 391 of the Companies Act.

4. Intimate Stock Exchanges

The information on the proposal of the merger should b given to the stock exchanges in whose jurisdiction the listed companies proposing to merge are located. All notices and other resolutions in this connection are to be sent to the stock exchanges for their record.

5. High Court’s approval

Under Section 391 of the Companies Act, 1956 and Companies (Court) Rules, 1959, each company has to make separate applications in High Court seeking summons to convene the meeting of the members of the two companies for approving the scheme of merger. Based on the directions of the high court, separate meetings of equity and preference shareholders are convened.
6. Convening Meetings of Shareholders and Creditors

The creditors have to be informed about the merger proposal through a prescribed notice. This is mandatory under Section 393 of the Companies Act, 1956. The printed notices in the prescribed form along with the proxy forms have to reach the members and creditors at least 21 days in advance. Also, advertisements are required to be inserted in the newspapers.

Separate meetings of the shareholders of different classes and meetings of creditors should be held by each company for passing the merger scheme. Approval of 3/4 of the majority in value of the creditors or class of creditors or members or class of members should approve the scheme. Also, 51% in number should give their approval. The offer of the transferor company will be treated prima-facie a fair one in the event of the scheme being approved by 90% of the shareholders in value. The Chairman appointed for each meeting held will submit a report in the prescribed format including the minutes of the meeting to the High Court.

7. Petition to court of confirmation and order

Seeking confirmation of the scheme of amalgamation, the companies involved in the amalgamation shall present a petition to the court. Consequently the High Court directs the official liquidate to scrutinize the books of the transferor company and submit a report stating therein that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members. The inspection is carried out by a chartered accountant fixed by the official liquidator and until the official liquidator submits his report, the court shall not pass any order.
for dissolution of the transferor company under clause (iv) of Section 391 (1) of the Companies Act, 1956. The High Court will also fix a date of hearing. The notice has to be published in the newspapers and served to the Company Law Board. After hearing, the court may sanction the scheme including order for dissolution of the transferor company. The court may also modify the scheme for proper working. Within 30 days of the passing of orders by the court, a copy of the order must be filed with the Registrar of Companies. Also, copies of the orders are to be annexed to the Memorandum and Articles of Association of the transferor companies.

8. Issue of shares and debentures

The transferor company announces a date of book closure in order to know the number of shareholder entitled to the shares of the transferee company. The list of such eligible shareholders is their prepared and a necessary resolution for allotment of shares is passed. According to the ratio approved under the scheme, the transferee company issues shares and debentures of its company in exchange for the shares and debentures of the transferor company. Subsequently, the listing of the new shares and debentures on the stock exchange is done. Effective from the appointed date the transfer of movable and immovable assets and liabilities of the transferor take place.16

I must discuss the enactment's that regulate the mergers of the corporate entities. The most important of them all is the Companies Act, 1956.
Companies Act, 1956

Under Section 394 of the Companies Act, if an application is made to the court for purposes of amalgamations of any two or more companies and the transfer of Property or liabilities of the transferor company to the transferee company, under a compromise or arrangement between the company and others the court by an order shall make provision for all or any of the following matters:

a) The transfer of whole / part of the undertaking, property is liabilities of transferor company to the transferee company.
b) The allotment of nay shares, debentures, etc. by the transferee company under that arrangement.
c) The continuation of any shares, debentures etc. by the transferee company against (or by) any transferor company.
d) The dissolution of any transferor company and
e) Suitable provisions for a person dissenting from the compromise or arrangement.

Under this section it is also required that a copy of the order from the court is filed with the Registrar of companies within thirty days of passing such as order or in default be liable for punishment.

Section 391 of the Companies Act empowers the court to sanction the compromise or arrangement as proposed by the companies. When a compromise or an arrangement is proposed between the company and its creditors or an arrangement is proposed between the company and its creditors or members the court, on receiving an application, may order a meeting of the
creditors or members. If the creditors or members representing 3/4th in value and majority in numbers present and vote either in person or by proxy, to agree to any compromise or arrangement, it shall be binding on all creditors or members and the company, subject to the sanctioning of such an arrangement by the court.

Where a High Court makes an order under Section 391 sanctioning a compromise or an arrangement in respect of a company, it shall have power to supervise the carrying out of the compromise or arrangement and effect such modifications in the arrangement as it may consider necessary, under the provision of Section 392 of the Companies Act, 1956.

Section 393 makes it mandatory on the part of the company to make available, information in respect of the terms of the compromise or arrangement and its effect, to the creditors or members while arranging their meeting under Section 391.

Under Section 395, if the transferee company's scheme involving transfer of shares in the transferor company to shares in its company, which has been accepted by shareholders of not less than nine-tenths in value of the shares within 4 months of such an offer, has been dissented by any shareholder, then the transferee company shall be entitled and bound to acquire those shares on the term so the scheme by giving a notice provided the dissenting shareholder does not apply to the court within a month of receiving such a notice and get an order to the contrary.

Section 396 gives power to the Central government to provide for amalgamation of two or more companies if it is satisfied that it is essential in public interest. Then not withstanding anything contained in Sections 394 and 395, the
central government by an order notified in the Official gazette may provide for such an amalgamation with such property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

Every member or creditor of each of the companies shall have the same interest in or rights against the company resulting from the amalgamation as he had in the company of which he was originally a member or creditor. Under Section 396, a member or creditor shall be entitled to compensation to the extent to which his interests in or rights against the company resulting from the amalgamation are less than his interest in or rights against the original company.

Section 396 A specifies that without the prior permission of the central government, the books and papers of an amalgamated company shall not be disposed of. Under this section, the government is empowered to appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of committing offense in connection with the promotion or formation, or the management of affairs of the amalgamated company, before granting such permission.

Sick Industrial Companies (Special Provisions) Act, 1985

The Board of Industrial and Financial Reconstruction's (BIFR) prescription for revival of a sick unit is the takeover of management of the sick industries company by another company or amalgamation of the sick unit with any other healthy industrial company, in pursuance of Sections 18 (b) 18 (c) of the Sick Industrial Companies (Special Provisions) Act. 1985.
The scheme suggesting takeover or merger of the sick company with any other healthy company and manner of transfer of undertakings, properties, assets and liabilities have to be specified by the BIFR. The scheme finalized by BIFR needs the approval of the shareholders of the transferee company by a special resolution.

LEGAL PROCEDURE

Some of the legal procedures to be followed in a merger are as follows:

- **Formulation of the scheme**: Once the prospecting phase is over, the companies seek the help of the legal and financial advisors to finalize the details of the proposed scheme of the merger.

- **Memorandum of Association**: The object clause of amalgamated company should be examined to see if it permits continuation of business of the amalgamating companies by it. If it does not, then suitable changes have to be made in the manner prescribed by the companies act.

- **Intimation to Stock Exchange and Notification**: As soon as the merger offer is made the stock exchange where these companies are listed should be notified and the fact of the offer should be notified through the newspapers. To ensure proper disclosure the announcement should be made in the manner prescribed by the regional stock exchange.

- **Director's approval of the prescribed scheme**: The proposed scheme of the merger should be submitted to the
board of directors to approve. This should be done for both the companies involved in the merger.

- **Shareholders' approval:** The scheme proposed should be placed before the shareholders at a general meeting for their approval. It is not a necessity in the legal sense but this is done by the companies to get approval from their shareholders for the actions of the companies. This is done prior to the filing of the application for sanction of the court.

- **Application to the court:** At this stage the companies in question file an application with the High Court of the state in which registered office of the company is located. The court on receipt of the application convenes a meeting of the creditors and members of the company.

- **Meeting ordered by the court:** The chairman of such a meeting or any such person directed by the court sends individual notices to the creditors and members. The notices accompanied by a copy of the proposed scheme of the merger is sent by post under the certificate of posting at least 21 clear days before the date fixed for the meeting.

  Simultaneously, a notice of the meeting is advertised in which newspaper as the judge or the person directed by the court issue the advertisement and send notices of the meeting files an affidavit, at least seven days before the scheduled meeting, that the court's directives in this regard have been complied with. The proposed merger scheme is taken as approved if it is passed by the majority in number, representing 3/4 the value of the numbers, present and voting in person or proxy. The chairman of the meeting shall report to the court the results of the meeting.
within 7 days of the meeting or such time as directed by the court.

- **Petition for the confirmation of the amalgamation:** If the merger proposed is passed by the creditors and members of the company within 7 days of filing of the report by the chairman, presents a petition for confirmation of the scheme and appropriate orders and directions under the section 394 of the companies act. The court, then fixes a date for the hearing of the petition. The notice of such a hearing is advertised in such newspapers at least 10 days before the date fixed for such a hearing. This notice is served on the Central government, the Registrar, the Company Law Board and the Official Liquidator as well.

- **Order of the court:** The court after receiving a report from the Registrar of companies and the Official Liquidator that the affairs of the company have not been conducted in a manner prejudicial to the interests of it's members or of the parties shall satisfy itself that the proposed amalgamation is fair and reasonable. The court, if satisfied, shall pass the order to be effective; every company in relation to which the order is passed should file a certificate copy of the order with the Registrar, within 10 days of the order.

- **Transfer of the assets & liabilities, issue of shares etc.**

Finally the companies can implement the scheme by transferring the assets and liabilities, by issuing shares and giving any other consideration to the members of the amalgamating company as per the scheme of the merger.
The chronological orders in which legal procedures as entailed by the new takeover code occur are as follows:

<table>
<thead>
<tr>
<th>Day</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Day 1</td>
<td>- Date of first public announcement</td>
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<tr>
<td></td>
<td>- Creation of escrow account</td>
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<tr>
<td>Days 1-14</td>
<td>- Offer documents filed with SEBI</td>
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<tr>
<td></td>
<td>- Offer conveyed to target company</td>
</tr>
<tr>
<td>Days 1-21</td>
<td>- Period within which competitive bids can be announced</td>
</tr>
<tr>
<td>Day 30</td>
<td>- Last day that can be specified as the record date for an open offer</td>
</tr>
<tr>
<td>Days 21-35</td>
<td>- Period within which original bid can be withdrawn</td>
</tr>
<tr>
<td>Days 35-45</td>
<td>- Mailing of letter of offer to shareholders</td>
</tr>
<tr>
<td>Day 37</td>
<td>- Last day for the target company to furnish a list of it’s shareholders</td>
</tr>
<tr>
<td>Day 60</td>
<td>- Last day for the bidder to open its offer to the shareholders</td>
</tr>
</tbody>
</table>
Day 102  □ Last day for the revision of bids by competing shareholders

Day 105  □ Last day for the closure of all offers, including competitive bids

Day 135  □ Last day for the completion of all official procedures

Conclusion:

This chapter has described the statutory and non-statutory legal framework for the regulation of takeovers. Alternative takeovers and merger procedures have been examined.

The current attempts at developing a common takeover regime for the Indian economy have been highlighted through legal aspects of open offer and merges.

The trend among multinational companies towards the takeover code has been noted. The researcher has also discussed the statutory approvals through legal procedure.

In the next chapter a detailed discussion has been made about 'valuation for mergers and acquisitions'.

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