CHAPTER 4

LEGAL FRAMEWORK

4.1 Regulation of M&As
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4.3 Legal Measures against Takeovers
4.4 Protection of Minority Shareholders Interests
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4.1 REGULATION OF M&As

A scheme of amalgamation or merger, involving two or more companies, requires approval of the Court. Chapter-V of the Companies Act, 1956 consisting of sections 390 to 396A deals with the provisions relating to merger/amalgamation. The procedure for obtaining the approval of the Court is laid down in the Companies (Court) Rules, 1959. The Court has very wide powers while sanctioning the scheme and can provide for all matters incidental to it. While the tax aspects are covered by the Income-Tax Act, 1961 and the Gift Tax Act, 1958; some of the schemes attract the provisions of the Capital Issue (Control) act, 1947 and/or the Foreign Exchange Regulation Act, 1973. In such cases, the approval of the authority (ies) prescribed in the Act(s) applicable to a specific scheme is also required. Further, to protect the interest of the shareholders in case of merger/takeover, provisions have been made in the Securities Contract (Regulations) Act, 1956 and Stock Exchange Listing Agreement.

However, recently based on the Raghavan Committee Report and in compliance with TRIMS agreement of the WTO, India has enacted a legislation called the Competition Act, 2002 to replace the erstwhile MRTP Act, 1969 as also the MRTP Commission in whose place Competition Commission of India becomes operative.

4.2 COMPETITION ACT, 2002

The Competition Act has four major objectives-

- To promote free and fair Competition
- To protect the Consumers
- To prevent abuse of monopoly and dominance
- To provide level plain field to all the players in terms of investment and Competition.

Unlike the MRTP Act, this legislation does not aim at restricting or preventing monopoly per-se but only the abuse of it. In other words, this legislation would not go against the practice of M&As but at the same time under the Act, the Competition
Commission of India would enjoy powers investigate suo-motu on receipt of complaints of any such merged entity in respect of its post merger assets exceeding Rs. 1,000.00 crores and/or turn over of Rs. 3,000.00 crores. Under the Act, several criteria and parameters have been identified so as to ensure free and fair Competitions like practices of price rigging, cartel formation, collusive bidding, predatory pricing, territory sharing, barriers to entry, and such other practices, which it is to monitor from time to time in ensuring free and fair Competition. In the course of framing this legislation, several observations like abolition of small-scale industries reservation, amendment of Industrial Development Regulation Act, etc were made in the course of reaching the fine print of the legislation.

4.3 LEGAL MEASURES AGAINST TAKEOVERS

The companies Act restricts an individual or a Company or a group of individuals from acquiring shares, together with the shares held earlier, in a Public Company to 25 percent of the total paid up capital. Also, the Central Government needs to be intimated whenever such holding exceeds 10 percent of the subscribed capital. The Companies Act also provides for the approval of shareholders and the Central Government when a company, by itself or in association of an individual or individuals purchases shares of another company in excess of its specified limit.

4.4 PROTECTION OF MINORITY SHAREHOLDERS INTERESTS

In a takeover bid, the interests of all shareholders should be without a prejudice to genuine takeovers. It would be unfair if the same high price is not offered to all the shareholders of respective acquired company. The large shareholders (including financial institutions, banks and individuals) may get most of benefits because of their accessibility to the brokers and the takeover dealmakers. Before the small shareholders know about the proposal, it may be too late for them. The Companies Act, 1956 provides that a purchaser can force the minority shareholders to sell their shares if:

- The offer has been made to the shareholders of the company.
• The offer has been approved by at least 90 per cent of the shareholders of the company whose transfer is involved, within 4 months of making the offer.

• The minority shareholders have been intimated within 2 months from the expiry of 4 months referred above.

If the purchase is already in possession of more than 90 per cent of the aggregate value of all the shares of the company, the transfer of the shares of the minority shareholders is possible if:

• The purchase offers the same terms to all the shareholders, and

• The tenders who approve the transfer, decides holding at least 90 per cent of the value of the shares, should also form at least 75 per cent of the total holders of shares.

4.5 ROLE OF SEBI

The Securities and Exchange Board of India is the Controlling Authority for all matters concerning Stock Markets, Mutual Funds, Foreign Institutional Investors and other persons connected to securities, shares, mutual funds etc. SEBI, being a stock market watchdog, has time-to-time issued guidelines for different activities. The guidelines of SEBI regarding takeovers are presented below-

4.5.1 The concept of Takeover

Although, the term 'Takeover' has not been defined under the said Regulations, the term basically envisages the concept of an acquirer taking over the control or management of the target company. When an acquirer, acquires substantial quantity of shares or voting rights of the target company, it results in the substantial acquisition of Shares.

For the purposes of understanding the implications arising from the aforementioned paragraph, it is necessary to know that what is the actual meaning of substantial quantity of shares or voting rights.
Meaning of substantial quantity of shares or voting rights

The said Regulations have discussed this aspect of 'substantial quantity of shares or voting rights' separately for two different purposes:

I. For the purpose of disclosures to be made by acquirer(s)

1. 5 per cent or more shares or voting rights: A person who, along with persons acting in concert, if any, acquires shares or voting rights (when taken together with his existing holding) would entitle him to more than 5 per cent or 10 per cent or 14 per cent shareholding or voting rights of target company, is required to disclose the aggregate of his shareholding or voting rights to the target company within two months and the target company is required to intimate to the Stock Exchanges where the shares of the target company are traded within 2 days of receipt of intimation of allotment of shares or acquisition of shares.

2. More than 15 per cent shares or voting rights: An acquirer who holds more than 15 per cent shares or voting rights of the company, shall within 21 days from the financial year ending March 31 make yearly disclosures to the company in respect of his holdings as on the mentioned date. Target company is, in turn, required to pass on such information to all stock exchanges where the shares of target company are listed, within 30 days from the financial year ending March 31 as well as the record date fixed for the purpose of dividend declaration.

II. For the purpose of making an open offer by the acquirer

1. 15 per cent shares or voting rights: An acquirer who intends to acquire shares, which along with his existing shareholding would entitle him to more than 15 per cent voting rights, can acquire such additional shares only after making a public announcement to acquire at least additional 20 per cent of the voting capital of the target company from the shareholders through an open offer.

2. Creeping limit of 5 per cent: An acquirer who is having 15 per cent or more but less than 75 per cent of shares or voting rights of a target company, can
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Consolidation of holding

An acquirer who is having 75 per cent shares or voting rights of target company, can acquire further shares or voting rights only after making a public announcement specifying the number of shares to be acquired through open offer from the shareholders of a target company. In order to appreciate the implications arising here from, it is pertinent to consider the meaning of the term 'public announcement'.

4.5.2 Public Announcement (PA)

A Public announcement is generally an announcement given in the newspapers by the acquirer, primarily to disclose the intention to acquire a minimum of 20 per cent of the voting capital of the target company from the existing shareholders by means of an open offer. However, an Acquirer may also make an offer for less than 20 per cent of shares of target company in case the acquirer is already holding 75 per cent or more of voting rights/ shareholding in the target company and has deposited in the escrow account in cash a sum of 50 per cent of the consideration payable under the public offer. The Acquirer is required to appoint a Merchant Banker registered with SEBI before making a PA and is also required to make the PA within four working days of the entering into an agreement to acquire shares, which has led to the triggering of the takeover, through such Merchant Banker. The other disclosures in this announcement
would inter-alia include the offer price, the number of shares to be acquired from the public, the identity of the acquirer, the purposes of acquisition, the future plans of the acquirer, if any, regarding the target company, the change in control over the target company, if any.

The procedure to be followed by acquirer in accepting the shares tendered by the shareholders and the period within which all the formalities pertaining to the offer would be completed. The basic objective behind the PA being made is to ensure that the shareholders of the target company are aware of the exit opportunity available to them in case of a takeover / substantial acquisition of shares of the target company. They may, on the basis of the disclosures contained therein and in the letter of offer, either continue with the target company or decide to exit from it.

4.5.3 Procedure to be followed after the Public Announcement

In pursuance of the provisions of Reg. 18 of the said Regulations, the Acquirer is required to file a draft Offer Document with SEBI within 14 days of the PA through its Merchant Banker, along with filing fees of Rs.50,000/- per offer Document (payable by Banker's Cheque / Demand Draft). Along with the draft offer document, the Merchant Banker also has to submit a due diligence certificate as well as certain registration details.

The filing of the draft offer document is a joint responsibility of both the Acquirer as well as the Merchant Banker. Thereafter, the acquirer through its Merchant Banker sends the offer document as well as the blank acceptance form within 45 days from the date of PA, to all the shareholders whose names appear in the register of the company on a particular date. The offer remains open for 30 days. The shareholders are required to send their Share certificate(s) / related documents to the Registrar or Merchant Banker as specified in the PA and offer document. The acquirer is obligated to offer a minimum offer price as is required to be paid by him to all those shareholders whose shares are accepted under the offer, within 30 days from the closure of offer.
4.5.4 Exemptions

The following transactions are however exempted from making an offer and not required to be reported to SEBI:

- Allotment to underwriter pursuant to any underwriting agreement,
- Acquisition of shares in ordinary course of business by
- Registered Stock brokers on behalf of clients,
- Registered Market makers,
- Public financial institutions on their own account;
- Banks & Financial Institutions as pledges;
- Acquisition of shares by way of transmission on succession or by inheritance;
- Acquisition of shares by Govt. companies;
- Acquisition pursuant to a scheme framed under section 18 of SICA 1985;
- Arrangement/ restructuring including amalgamation or merger or de-merger under any law or Regulation Indian or Foreign;
- Acquisition of shares in companies whose shares are not listed;
- However, if by virtue of acquisition of shares of unlisted company, the acquirer acquires shares or voting rights (over the limits specified) in the listed company, acquirer is required to make an open offer in accordance with the Regulations.

4.5.5 Minimum Offer Price and Payments Made

It is not the duty of SEBI to approve the offer price, however it ensures that all the relevant parameters are taken into consideration for fixing the offer price and that the justification for the same is disclosed in the offer document. The offer price shall be the highest of:

- Negotiated price under the agreement, which triggered the open offer.
- Price paid by the acquirer way of public rights/ preferential issue during the 26-week period prior to the date of the Public Announcement.
• Average of weekly high & low of the closing prices of shares as quoted on the Stock exchanges, where shares of Target company are most frequently traded during 26 weeks prior to the date of the Public Announcement.

• In case the shares of target company are not frequently traded, then the offer price shall be determined by reliance on the following parameters, viz.: the negotiated price under the agreement, highest price paid by the acquirer or person acting in concert with him for acquisition if any, including by way of public rights/ preferential issue during the 26-week period prior to the date of the PA and other parameters including return on net worth, book value of the shares of the target company, earning per share, price earning multiple vis a vis the industry average.

Acquirers are required to complete the payment of consideration to shareholders who have accepted the offer within 30 days from the date of closure of the offer. In case the delay in payment is on account of non-receipt of statutory approvals and if the same is not due to willful default or neglect on part of the acquirer, the acquirers would be liable to pay interest to the shareholders for the delayed period in accordance with Regulations. Acquirer(s) are however not to be made accountable for postal delays. If the delay in payment of consideration is not due to the above reasons, it would be treated as a violation of the Regulations.

4.5.6 Safeguards incorporated so as to ensure that the Shareholders get their payments

Before making the Public Announcement the acquirer has to create an escrow account having 25 per cent of total consideration payable under the offer of size Rs. 100 crores (Additional 10 per cent if offer size more than 100 crores). The Escrow could be in the form of cash deposited with a scheduled commercial bank, bank guarantee in favour of the Merchant Banker or deposit of acceptable securities with appropriate margin with the Merchant Banker. The Merchant Banker is also required to confirm that firm financial arrangements are in place for fulfilling the offer obligations. In case, the acquirer fails to make payment, Merchant Banker has a right to forfeit the escrow account and distribute the proceeds in the following way.
1/3 of amount to target company
1/3 to regional Stock Exchanges, for credit to investor protection fund etc.
1/3 to be distributed on pro rata basis among the shareholders who have accepted the offer.

The Merchant Banker advised by SEBI is required to ensure that the rejected documents which are kept in the custody of the Registrar / Merchant Banker are sent back to the shareholder through Registered Post.

Besides forfeiture of escrow account, SEBI can take separate action against the acquirer which may include prosecution / barring the acquirer from entering the capital market for a period etc.

4.5.7 Penalties

The Regulations have laid down the general obligations of the acquirer, target company and the Merchant Banker. For failure to carry out these obligations as well as for failure / non-compliance of other provisions of the Regulations, Reg. 45 provides for penalties. Any person violating any provisions of the Regulations shall be liable for action in terms of the Regulations and the SEBI Act.

If the acquirer or any person acting in concert with him, fails to carry out the obligations under the Regulations, the entire or part of the sum in the escrow amount shall be liable to be forfeited and the acquirer or such a person shall also be liable for action in terms of the Regulations and the Act. The board of directors of the target company failing to carry out the obligations under the Regulations shall be liable for action in terms of the Regulations and SEBI Act. The Board may, for failure to carry out the requirements of the Regulations by an intermediary, initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act. Provided that no such certificate of registration shall be suspended or cancelled unless the procedure specified in the Regulations applicable to such intermediary is complied with. For any mis-statement to the shareholders or for concealment of material information required to be disclosed to the shareholders, the acquirers or the directors where he acquirer is a body corporate, the directors of the target company...
company, the merchant banker to the public offer and the merchant banker engaged by the target company for independent advice would be liable for action in terms of the Regulations and the SEBI Act.

The penalties referred to in sub-regulation (1) to (5) may include –

- Criminal prosecution under section 24 of the SEBI Act;
- Monetary penalties under section 15 H of the SEBI Act;
- Directions under the provisions of Section 11B of the SEBI Act.

Regulations have laid down the penalties for non-compliance. These penalties may include forfeiture of the escrow account, directing the person concerned to sell the shares acquired in violation of the regulations, directing the person concerned not to further deal in securities, monetary penalties, prosecution etc., which may even extend to the barring of the acquirer from entering and participating in the Capital Market. Action can also be initiated for suspension, cancellation of registration against an intermediary such as the Merchant Banker to the offer.

Therefore, from the above discussion, we understand that the salient features of these guidelines are as follows:

- **Notification of takeover:** If an individual or a company acquires 5 per cent or more voting capital of a company, the target company and the Stock Exchange shall be notified immediately.

- **Limit to share acquisition:** An individual or a company can continue acquiring shares of another company without making any offer to other shareholders until the individual or the company acquires 10 per cent of the voting capital.

- **Public Offer:** If the holding of the acquiring company exceeds 10 per cent, a public offer to purchase a minimum of 20 per cent of the shares shall be made to the remaining shareholders through a public announcement.

- **Offer Price:** Once the offer is made to the remaining 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 6 months preceding the date of announcement.
• **Disclosure:** The offer should disclose the detailed terms of the offer, identity of the offeror, details of the offeror's existing holdings in the offeree company, etc. and the information should be made available to all the shareholders at the same time and in the same manner.

• **Offer Document:** The offer document should contain the offer's financial information, its intention to continue the offeree company's business and to make major change and long term commercial justification for the offer.

### 4.6 LEGAL PROCEDURES

The following is the summary of legal procedures for merger or acquisition laid down in the Companies Act, 1956:

• **Permission for merger:** Two or more companies can amalgamate only when amalgamation is permitted under their Memorandum of Association. Also, the acquiring company should have the permission in its Object Clause to carry on the business of the acquired company. In the absence of Memorandum of Association (M.O.A), it is necessary to seek the permission of the shareholders, the Board of Directors and the company Law Board before affecting merger.

• **Information to the Stock Exchange:** The acquiring and acquired companies should inform the Stock Exchanges about the merger when they are listed.

• **Approval of Board of Directors:** The Board of Directors of the individual companies should approve the draft proposal for amalgamation and authorize the management of companies to further pursue the proposal.

• **Application in the Court:** An application for approving the draft amalgamation proposal duly approved by the Board of Directors of the individual companies to the High Court. The High Court would convene a meeting of shareholders and creditors to approve the amalgamation proposal. The notice of meeting should be sent to them at least 21 days in advance.
4.7 DOCUMENTATION

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4.7.1 Documents for statutory requirement

(a) Scheme of Amalgamation

The Scheme of Amalgamation is basically a contract between two companies and the basis of the whole restructuring process. The scheme has to be submitted to all authorities with other documents required. A Scheme normally contains the following clauses:

- Definition clause
- Definitions of Transferor and Transferee Company, Appointed date, Effective date, Undertaking etc.
- Share Capital clause giving details of share capital of both the companies.
- Clause giving details of assets and liabilities getting transferred
- Consideration to be discharged & Exchange Ratio
- Clause giving details of obligations /liabilities under Contracts, Deeds, Bonds, Trade marks & other instruments getting transferred
- Pending Legal proceedings
- Treatment of reserves in the books of Transferee Company
- Restrictions on Transferor Company to do business until the Effective Date
• Clause giving:
  o operative date of the scheme
  o provisions for Transferor Company’s staff, workmen and employees and terms of their employment in Transferee Company

• Scheme should provide for continuity of service of employees of Transferor Company and terms should not be less favourable than their existing terms of employment.

• Clauses giving:
  o Expenses incurred to be borne by which Company
  o Any other details required to be disclosed with the scheme.
  o Some special information relating to the scheme

(b) Application

All the companies involved are required to make application to The High Court to obtain directions for holding various meetings of shareholders & creditors or dispensation thereof for approval of the scheme. The copy of the Application is given under Form 33. Generally, the contents of the Application are as under:

• Names of the transferor/transferee company
• Names of Directors
• Share capital- Authorized, Issued and Paid up
• Address of Registered Office
• Date of incorporation
• Date of commencement of business
• Latest Audited Balance Sheet
• Scheme of arrangement with creditors
• Copy of scheme of Amalgamation
• Prayer for holding meetings of shareholders and creditors
(c) Court Order on Application

The High Court to which application is made for seeking permission to file the petition passes an order either allowing or rejecting the application. The contents of the order are as follows:

- Object clause to contain amalgamation as one of the objectives
- Scheme approved by the Board of Directors & advertisement of the same to be given
- Prayer has to be made for the transfer of asset (specific asset)
- Inform court of the consideration of transfer
- Confirmations required to be taken considering the interests of both the shareholders & the members
- Prayer for dispensation of meeting if confirmation for secured/unsecured creditors has already been taken (This is compulsory in case of Transferor Company. The Transferee Company may do it only to keep its creditors informed about the merger).
- Conveying the meeting of different class of shareholders
- Decide upon the time, place, chairperson of the meeting
- Notice to be given regarding publication of notices in two languages. One in English & the other in a vernacular language & also in the Govt. Gazette.

(d) Petition

After complying with various directions issued by the Honorable High Court companies are required to make petition to the court, and after the scheme is approved by all of the above parties, the company is required to file petition to the Court. This petition is in form no 40. The contents of the petition are as follows:

- Appointed Date
- Registered Office
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- Date of incorporation
- Share Capital - Authorized, Issued and Paid up
- Objects of the Petitioner company
- Details of shareholders and creditors meetings held
- Prayer for sanctioning the scheme
- Copy of Memorandum and Articles of Association of Transferor and Transferee companies
- Copy of Audited Accounts of Transferor and Transferee companies
- Scheme of amalgamation
- Copy of Chairman's Report

(e) Valuation Report

General Content of Valuation Report
- Purpose of the report
- Sources of information
- Scope and limitations
- Assumptions
- Company Profile - i. Background
  
  ii. Business Profile
  
  iii. Registered Office
  
  iv. Authorized, issued ad subscribed capital
  
  v. Management Strengths and weakness
  
  vi. Shareholding pattern
- Approach and methodology for valuation
- Computation under different methods
- Final Value
4.7.2 Document required by various parties

(a) For the High Court

I. With Application

II. With Petition

I. With Application

- Application (Summons for directions in Form No. 33)
- Director's Affidavit (Form No. 34)
- Vakalatnama
- Memorandum of registered office address
- Copy of M.O.A & A.O.A (both companies)
- Balance sheet & Profit & Loss Account of Both Companies
- Scheme of Amalgamation
- Confirmations of creditors (Secured & Unsecured) in the case of Transferor Company may also be enclosed if possible to avoid their meetings
- Summons for direction to convene the meeting of the members of the transferor & transferee companies to approve of the scheme (form no 35)
- Minutes of order

II. With Petition

- Copy of Petition (Form 40)
- Vakalatnama
- Copy of Balance Sheet & Profit & Loss A/c
- Memorandum of registered office address
- Copy of M.O.A & A.O.A (both companies)
- Scheme of Amalgamation with explanatory statement u/s 393
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- Valuation Report for exchange ratio
- Chairman's Report (Form 39)
- Directors Affidavit
- Copy of Court order on Application (Form 35)

(b) For Shareholders

- Notice convening the meeting of the Equity Shareholders mentioning the following (to be signed by the chairman appointed by The Court) by giving 21 days clear notice & under certificate of posting under the authority of the Chairman appointed by the Court specifying therein date, time and place of meeting and name of person appointed as chairman or alternate chairman by the Court.
- To Attach form of Proxy
- Copy of Scheme of Amalgamation
- Explanatory statements pursuant to Sec 393 of the Companies Act, 1956 including details of shareholding of directors of both the companies in both the companies

(c) For Regional Director - Company Law Board (official Liquidator)

- Notice of petition with all enclosures to be served on official Liquidator by Transferor Company and on ROC by both companies
- All details required to be furnished are as required by the questionnaire issued upon the company. Some of them are as under:
  - whether the company has complied with all the formalities as required to be done under the law.
  - whether all details in regards to documentation have been filed with the Registrar of Companies (R.O.C).
(d) For Registrar of Companies

I. Before Merger is Approved.

- Copy of application and petition should be filed with R.O.C.

- Whether all details in regards to documentation have been filed with the R.O.C.

- R.O.C. looks into whether all requirements are complied and if not satisfied it can file affidavit in the court stating its objectives

II. After Merger is approved

- Copy of Order sanctioned by the Hon'ble High Court.

- Scheme of Amalgamation.

- Changed M.O.A & A.O.A (Amend through Scheme)

- Any other document which has to be filed as per the requirements of the Companies Act, 1956.i.e. if, say, change of name or change in object clause is also being done at the same time then procedure for the same etc.