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Amalgamation and Reconstruction:

Reconstruction and Amalgamation

The company wished to avoid being wound up and negotiated a scheme in which the existing shareholdings in the company would be transferred to a new company which would take over the company's undertaking and assets as well as its debts. This was to be effected by a scheme for reconstruction which would result in the old company's shareholders holding four per cent of the shares in the new company.

Notwithstanding the heritage of schemes of arrangement which can be traced back to the United Kingdom in the 1860s, and the common origins of schemes in Australia and Singapore and an established body of legal principles, there is a notable degree of inconsistency in the line of judicial authorities on the nature of schemes of arrangements.

In particular, there is some controversy as to whether a scheme of arrangement derives its efficacy from an order of court or from the statute. Australian courts favour the former view. English courts, in contrast, take the position that a scheme of arrangement which has been approved by the requisite majority of the company's creditors derives its efficacy from statute and therefore operates as a statutory contract.

An arrangement embraces such diverse schemes as conversion of debt into equity, subordination of secured or unsecured debt, conversion of secured claims into unsecured claims and vice versa, increase or reduction of share capital and other forms of reconstruction and amalgamation.

According to Halsbury's Laws of England:
"Neither 'reconstruction nor amalgamation' has a precise legal meaning. Where an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is a reconstruction. It is none the less a reconstruction because all the assets do not pass to the new company, or all the shareholders of the transferor company are not shareholders in the transferee company, or the liabilities of the transferor company are not taken over by the transferee company. 'Amalgamation' is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to a new company or by the transfer of one or more undertakings to existing companies."

Mergers, Amalgamation and Demergers of Companies under the Companies Act 1956 are governed by sections 391 to 396 Companies Act 1956.

It requires companies to make application to the court under section 391, which empowers the court to sanction the compromise or arrangement proposed by the companies. Section 392 further empowers the High Court to enforce a compromise or arrangement ordered by the court under section 391 of the Companies Act. Section 393 provides supporting provisions for compliance with the provisions or directions given by the court. Sections 395, 396 and 396A are supplementary provisions relating to amalgamation. Section 395 deals with the power to amalgamate without going through the procedure of the court.

Amendment in the Companies Act, 1956 in year 2002 gave powers to National Company Law Tribunal to review and to allow any compromise or arrangement, which is proposed between a company and its creditors or any class of them or between a company and its members or any class of them. However, because of non formation of National Company Law Tribunal, these powers still lie with High Courts and the parties concerned can make applications to high courts.

Reconstruction and amalgamation by Voluntary Winding Up
A compromise involves a settlement of a dispute. An arrangement, in contrast, is broader and has been held to be of wide import. It can cover any lawful arrangement that touches or concerns the rights and obligations of the company and its shareholders or creditors, Section 494 of the Companies Act 1956, which similar to section 287 of the Companies Act 1948 givers power a company to reconstruct or amalgamate by means of voluntary liquidation wherein the liquidator transfers the assets of the company in exchange for shares or other shares of the transferee company.

- **Effect on Shareholders**

The effect on share holders is that the resolution is valid and the arrangement is binding upon them. Nevertheless, any shareholder may, in specific circumstances, dissent from the sale or arrangement.

The dissenting shareholder is required under sub section (3) of this section to give notice of his dissent to the liquidator in writing within seven days after passing of the special resolution. A legal representative of deceased shareholder is also entitled to dissent. However, it is open for the liquidator to waive such notice.

The share holder who neither agrees to the scheme nor challenges it but refuses to accept shares in transferee company (especially if they are not fully paid) to avoid further liability , on these shares , shall be deemed to have permitted the liquidator to sell the new shares and pay him the net proceeds. The liquidator shall recover the expenses incurred on such sale from the proceeds of that sale. If there is more than one such shareholder, net proceeds shall be distributed proportionately.

- **Effect on creditors.**

The scheme does not expressly state that any arrangement under this section is binding on the creditors yet it can be deducted from subsection (5) that the arrangement is binding on creditors as well unless they move the court / Tribunal within one year after passing of resolution of winding up and challenge the arrangement.

Nevertheless, an arrangement sanctioned by the special resolution does not relieve the liquidator of the old company is dissolved. To leave every thing to the new company is a “gross dereliction” of duty by the liquidator.[11]

Consent of the shareholders
The Companies Act, 1956, prescribes varying requirements for decisions to attain binding force on the company and with sound and profound reasons. As is evident from a reading of sections 189 and190 of the Act, some decisions are efficacious on receiving the assent of a simple majority whilst others require that there must be not less than three times the number of votes cast in favour of a Resolution than those opposed to it. Section 391 of the Act, which deals with compromises and arrangements, contemplates the consent of three-fourths in value of the affected persons for the decision to be binding on the remainder. Chapter VI, comprising sections 397 to 409of the Act, protects the rights of persons constituting a minority, holding not less than ten per cent of the members. Section 395 of the Act is logically at the end of this spectrum, and envisages and permits, within a defined arena, the drastic dilution of the rights of a class consisting of members constituting less than ten per cent. Although this dilution has been seen and termed even as an ‘expropriation’, jural interference was nonetheless found to be unnecessary only on this ground. The question that arises is whether there is any rationale in the prescribed percentages, dependent upon the gravity of theme assures to be effected. In my opinion, it is not legally odious to expect a minuscule group to fall in line with the dictates of an overwhelming majority comprising ninety per cent of the group. Usually, there is wisdom in the strength of members. There is every possibility that where nine persons are willing to accept a particular offer, the remaining single person may be standing a part

from the others for motives which are not mercantile or commercial. While considering provisions analogous to section 395 of the Act, Maugham, J. had expressed the following opinion which has stood the test of time, thus

"I think, however, the view of the Legislature is that where not less than nine-tenths of the shareholders in the transfer or company approve the scheme or accept the offer prima facie, at any rate, the offer must be taken to be a proper one, and in default of an application by the dissenting shareholders, which includes those who do not assent, the shares of the dissentients may be acquired on the original terms by the transferee company. Accordingly, Ithink it is manifest that the reasons for inducing the court to 'order otherwise' are reasons which must be supplied by the dissentients who take the step of making an application to the court, and that the onus is on them of giving a reason why their shares should not be acquired by the transferee company.

One conclusion which I draw from that fact is that the mere circumstance that the sale or exchange is compulsory is one which ought not to influence the court. It has been called an expropriation, but I do not regard that phrase as being very apt in the circumstances of thecase. The other conclusion I draw is this, that again prima facie the court ought to regard the scheme as a fair one in as much as it seems to me impossible to suppose that the court, in the absence of very strong grounds, is to be entitled to set up its own view of the fairness of the scheme in opposition to so very large a majority of the shareholders who are concerned. Accordingly, without expressing a final opinion on the matter, because there maybe special circumstances in special cases, I am unable to see that I have any right to order otherwise insuch a case as I have before me, it is affirmatively established that, notwithstanding the viewsof a very large majority of shareholders the scheme is unfair."

Tek Chand, J. has in Benarsi Das Sara/ v. Dalmia Dadri Cement Ltd. opined that the" principle underlying section 395 is that where a company obtains 90 per cent of the shares or class of shares under a scheme of arrangement, it can compel the dissentient minority to partwith its shares. Conversely the dissenting shareholders are also entitled to compel the company to acquire their shares as well as and on the same terms. Section 395 of the Companies Act, 1956, corresponds to section 209 of the English Companies Act,1948, which reproduces with amendments section 155 of the English Act of 1929."final on account of pending appeals.

Conclusion

Though no protection is available to any dissenting minority shareholders on this issue, the Courts, while approving the scheme, follow a judicious approach of publishing a notice in the newspapers, inviting objections, if any, against the scheme from the stakeholders. Any interested person, including a minority shareholder may appear before the Court.

MCQs:

1. When two or more companies carrying on similar business decide to combine, a new company is formed, it is known as ....

(A) Amalgamation

(B) Absorption

(C) Internal reconstruction

(D) External reconstruction

2. When one of the existing companies take over business of another company or companies, it is known as ....

(A) Amalgamation

(B) Absorption

(C) Internal reconstruction

(D) External reconstruction

3. While calculating purchase price, the following values of assets are considered

(A) Book value

(B) Revised Value

(C) Average values

(D) Market values

4. Shares received from the new company are recorded at –

(A) Face value

(B) Average price

(C) Market value

(D) None of the above

5. Which of the following statement is correct?

(A) The amount of Goodwill or Capital Reserve is recorded in the books of purchasing company only

(B) The amount of Goodwill or Capital Reserve is recorded in the books of vendor company only.

(C) Goodwill = Net Assets – Purchase price

(D) The face value of shares of purchasing company will be taken in to account while calculating purchase consideration.