IMPACT OF THE NEW COMPANIES ACT, 2013 ON MERGERS AND ACQUISITIONS

Prof. SASMITA SINGH

Abstract:

The Companies Act, 1956 ruled the Indian Corporate Scenario for over five decades. There was a need of introduction of the strong and progressive corporate laws. Hence, the new Companies Act containing 29 chapters, 470 clauses and 7 schedules was passed in August, 2013. There will be a phased transition from the Companies Act, 1956 to the new legislation. This article analyses the impact of this transition on the Mergers and Acquisitions front of the Indian corporate.

Key Words:

Companies Act, 2013; Companies Act, 1956; Mergers and Acquisitions

Introduction:

During this era of major economic overturns, Corporate law has undergone a radical change with the introduction of the Companies' Act, 2013 in India. Pursuant to receiving the final nod from the President in August 2013, the enactment of the Companies' Act, 2013 has been a significant step in the path of adapting with laws suitable for our times. The provisions enacted in the new legislation bring India at par with its global peers from a corporate law perspective on several fronts. A bright spot in the history of India's legislative initiatives, the new Act aims to improve transparency and accountability in India's corporate sector.

The new Companies Act, 2013 has sought to streamline and make M&A more smooth and transparent. It appears that the New Act can help to deal with the challenges and complexities that the current procedures face in relation to the ones contemplated under the old Act (Companies Act, 1956). The New Act has incorporated various provisions to tackle the problems actually faced during the process of mergers, by taking into consideration the practical aspects of the process. The newly added provisions have made it easier for companies to implement 'Schemes of Arrangement' (Mergers & Acquisitions, de-merger, corporate debt restructuring etc.) and at the same time impose checks & balances to prevent abuse of these provisions. It is an attempt to fine tune the process by making it more efficient and inturn effective.

The new law allows an Indian company to merge with a foreign company, making cross-border mergers and acquisitions easier. The new law also disallows reverse merger of a listed company with that of an unlisted one.

It retains the fundamental provisions of the earlier Act while incorporating stronger and progressive new provisions. In the recent past, India's economy has outperformed the West on its growth and attracted large inflows of foreign funds. Economists predict that the West will soon begin heading northwards. In this environment, Indian investors will get significant exposure to global economies. Furthermore, with opening up of international opportunities, companies can look at scenarios where strategic alliances take simpler routes, and global consolidation and fund-raising are required. Global integration and cross-border mergers are now permitted, which is an excellent change from the earlier environment in which only foreign companies were welcomed in India. The challenges faced by many corporate organizations in listing their businesses abroad if their entire business value is housed in India will now be reduced due to cross-border mergers, which will enable them to set up overseas listing vehicles. The introduction of Class Action Suits, the concept of arms' length pricing in related party transactions, the focus on Corporate Social Responsibility, recognition of inter-se shareholder rights, opening of doors to outbound mergers, fast-track mergers, an increased focus on governance and protection of minority shareholders are important initiatives for organizations to move toward global best practices. This paper elaborates on the key provisions of the corporate law affecting mergers and acquisitions. The new Act prescribes rules for implementation of its provisions. However, the Rules are at the draft stage at present. It is hoped, their implementation will help Indian corporate laws achieve parity with international ones and smoothen the transition from the Companies Act, 1956 to the Companies Act, 2013. It will also help organizations gauge whether Indian corporate laws are focusing northwards.

The much needed new Act will make acquisitions, certain mergers and restructuring easier for companies, empower private equity investors to enforce various restrictions in agreements and check the malpractices of promoters by increasing transparency in their operations. The Act also has the potential to trigger a spate of domestic and cross-border mergers and acquisitions, and make Indian organizations more attractive to investors. The New Act no doubt has some ambiguities attached to it, which would need to be sorted out in order to reduce any complexity in the process. It would need to reduce reliance on rules to be specified later and also ameliorate provisions that contrive other legislations.

Objectives of the study:

The main objective of this study is to assess the impact of the new Companies Act, 2013 on Mergers and Acquisitions. This objective can be further divided into following sub-objectives.

1. To identify the changes proposed in the Companies Act, 2013 when compared to the Companies Act, 1956 with regards to Mergers and Acquisitions.
2. To assess the impact of the above changes on Mergers and Acquisitions in India.

Source, Scope & Limitations of the study:

This paper is an exploratory type research and based on the secondary data collected from the various sources like Research journals available online, Articles published in magazines & newspapers, various websites & blogs, media reports, etc.

While preparing the paper, major direction is taken from the 'Companies Act, 2013: Rules, Circulars & Notifications' published by Ministry of Corporate Affairs, India, which emphasize the aspect of company rules & regulations.

Apart from that, there are various agency publications like Deloitte's 'Company Act, 2013, Fresh thinking for a new start', Oct 2013, PWC, India's report on ' Company Act,2013, Key highlights and analysis', Nov 2013, Ernst & Young LLP's report on 'India Inc Company Act 2013 an overview', Sep 2013 and KPMG India's analysis on 'Company Act 2013, New Rules of the game', Oct 2013, which emphasize on the business friendly corporate regulation, improved CG norms, enhance accountability, raised levels of transparency and protection of interest of investors as per new Act, 2013.These articles were also studied in order to have a better understanding of the subject.

Scope of the study is limited to the impact of changes made in Companies Act, 2013 vis-à-vis Companies Act, 1956 on Mergers and Acquisitions in India. The new Companies Act, 2013 has become fully implemented from 01st Apr 2014, so that the actual output, difficulties & challenges faced by the Merger & acquisitions front of Indian corporate sector cannot be measured in this short time horizon.

Background:

The 1956 Act was in need of a substantial revamp for quite some time, to make it more contemporary and relevant to corporates, regulators and other stakeholders in India. While several unsuccessful attempts had been made in the past to revise the existing 1956 Act, there had been quite a few changes in the administrative portion of the 1956 Act. The most recent attempt to revise the 1956 Act was the Companies Bill, 2009 which was introduced in the Lok Sabha, one of the two Houses of Parliament of India, on 3rd August, 2009. This Companies Bill, 2009 was referred to the Parliamentary Standing Committee on Finance, which submitted its report on 31st August, 2010 and was withdrawn after the introduction of the Companies

Bill, 2011. The Companies Bill, 2011 was also considered by the Parliamentary Standing Committee on Finance which submitted its report on 26th June, 2012. Subsequently, the Bill was considered and approved by the Lok Sabha on 18th December, 2012 as the Companies Bill, 2012 (the Bill). The Bill was then considered and approved by the Rajya Sabha too on 8th August, 2013. It received the President's assent on 29th August 2013 and has now become the Companies Act, 2013. The changes in the 2013 Act have far-reaching implications that are set to significantly change the manner in which corporates operate in India.

This paper encapsulates the major changes as compared to the 1956 Act and the potential implications of these changes on Mergers and Acquisitions.

The paper is organized in three main sections. First, we briefly review some of the retained provisions from the Companies Act, 1956 related to M&As. Second, we describe the major changes brought in by the new Act, 2013 in the field of M&As. The third section comprises results of the study. We conclude with a broad discussion and pointing out implications, limitations and avenues for future amendments

Retained Provisions:

Although, substantial changes have been incorporated in the New Act, several key provisions remain unchanged.

For example, the acceptance of a scheme of merger or amalgamation by three fourths of the shareholders, like in section 391(2) of the Old Act, is still a pre-condition to a merger and acquisition. The power of the Central Government to order a merger or amalgamation in the interest of the nation is untouched and is placed in section 237.

Further, the obligation to maintain records of the mergers/amalgamations is retained in section239 as its importance cannot be ignored.

Other matters like convening meetings, obtaining the permission of the regulatory authorities and the central government in cases of mergers and amalgamations remain unaltered.

Also, the Old Act and the New Act both use the terms merger and amalgamation interchangeably and procedures for both are identical. Section 234 of the New Act states that the provisions of the New Act shall apply mutatis mutandis to both mergers and amalgamations, thus acknowledging that a merger and amalgamation may be conceptually different but are deemed to be the same for all purposes. As a result, no statute, except the Income Tax Act, exists to differentiate a merger from an amalgamation.

New provisions:

1. **National Company Law Tribunal**
   NCLT (National Company Law Tribunal) to assume jurisdiction of High courts in context of the company restructuring process i.e. the power to sanction the scheme of merger/amalgamation would now be invested with NCLT. This change should help in shortening the time taken in obtaining sanctions in cases of mergers and acquisitions **[section 408]**.

2. **Takeover Offer**
   Under the New Act, a scheme of compromise or arrangement involving a merger/amalgamation may include a takeover offer, which the Old Act didn't allow **[section 230(11)]**.

3. **Approval through postal ballot**
   The new act has extended the concept of E-voting (postal ballot) to unlisted companies, which is expected to increase the participation of shareholders and creditors in arrangements, and thereby protect the rights of all shareholders **[section 230(6)]**.

4. **Objection to the scheme**

The objection to the scheme can be raised only by shareholders holding 10% or more equity and creditors whose debt represent 5% or more of the total debt as per the last audited financial **[section 230(4)]**.

The impact of the New Act is two fold: genuine claims of shareholders may go unrepresented, while mala fide and frivolous claims will no longer act as dampeners.

5. **Accounting treatment**

While SEBI has introduced a process of regularizing the accounting treatment of listed companies, now Companies Act, 2013 also brings the accounting treatment of the unlisted companies under scanner, as NCLT can no longer sanction a scheme unless a certificate from the auditor is received about the correctness of the accounting treatment by the company **[section 232(3)]**.

6. **Valuation Report**

To further protect the rights of the shareholders, the new act makes attachment of the copy of the valuation report to the notice sent to shareholders and creditors for meeting compulsory **[section 232(2)]**.

7. **Related Party Transactions**

New Act has specifically defined the terms 'related parties' and 'related party transactions'. Such transactions now need to be undertaken at arm's length by companies **[section 188]**.

8. **Regulatory / Third Party Approval**

The law also provides that notice of every scheme should be sent to various interested regulatory authorities such as the RBI, the CCI, SEBI and the Income Tax department, requesting their representation. This would have an impact on timelines and could increase attention paid and scrutiny by the authorities.

In fact, under the 1956 Act the courts have made mergers subject to approval of the regulators. The 2013 Act prescribes a 30 day time frame for the regulators to make representations, failing which the right would cease to exist. This is a positive step because in the 1956 Act no such time frame was provided leading to considerable delays in the court proceedings. **[Section 230(5)]**.

9. **Intervention by the Statutory Authorities**

An important feature that may delay the process is the provision allowing all statutory authorities to intervene in the NCLT process and use this tactic effectively to seek payment of all pending demands, even the disputed amounts **[section 230(5)]**.

10. **Merger of a listed company into an unlisted one**

The merger of a listed company with an unlisted company will allow the latter to remain unlisted as long as the shareholders of the merging listed companies are offered an exit option. Payment of the value of shares and other benefits, needs to be in accordance with the pre-determined price formulae or according to their prescribed valuation **[section 232(3) (h)]**.

11. **Fast Track Mergers**

Under the Old Act, mergers/amalgamations between group companies and subsidiaries are placed on the same pedestal on which mergers/amalgamations between entirely unrelated companies are placed. This means that, mergers between group companies, and subsidiaries have to also conform to the normal procedure.

However, the New Act allows merger between two small companies and holding companies and their wholly owned subsidiaries may not have to go through the normal procedure.

Mergers/Amalgamations may be completed, if the official liquidator and the members approve, and if sanctioned by the Central Government, without having to wait for the order of the NCLT confirming the merger/amalgamation. This leeway helps cut costs involved in complying with the procedures, saves time and simplifies the procedure of mergers between two small companies or wholly owned subsidiaries and their parent companies **[section 233]**

However, if the Regional Director is of the opinion that the Scheme is not in the interest of the stakeholders, he may approach the Tribunal who could follow the merger procedure prescribed under the 2013 Act. This ability to transfer to the Tribunal has the potential to change fast-track to a normal merger and make such mergers less appealing.

12. Cross border mergers

The 1956 Act permits cross-border mergers only where the transferor is a foreign company. In contrast, the 2013 Act permits in-principle mergers between an Indian and a foreign company located in a jurisdiction notified by the central government in periodic consultation with RBI. Such a merger would be subject to RBI approval and Scheme may provide payment in cash or depository receipts or both. The payment in cash or depository receipts would facilitate exit to the shareholders of the merging entity who do not want to be a part of the merged entity. These changes reflect the legislature's intent to facilitate cross-border business. The Income Tax Act presently grants tax exemptions on mergers if the transferee is an Indian company and does not recognize a situation where the transferee will be a foreign company, as contemplated under the 2013 Act. The introduction of cross-border mergers under the 2013 Act may, therefore, require corresponding changes in other laws, including foreign exchange and tax **[section 234].**

13. Penalties

The penalties for contravention of the provisions under the 1956 Act were a maximum of INR 50,000 (approximately US$ 80617) which apply to the company as well as officer-in default. However under the 2013 Act, separate penalties have been levied on the company and its defaulting officer. To bring in more accountability, quantum for companies has been increased from the aforesaid sum to a minimum of INR 100,000 and maximum of INR 2,500,000. Defaulting officer(s) will also be punishable with imprisonment up to one year or with a minimum fine of INR 100,000 and maximum INR 300,000 or both. Such stringent penal provisions will not apply to mergers of small companies and that of a holding company with its wholly-owned subsidiaries unless their merger is transferred to the Tribunal and approved by it **[section 232(8)].**

14. Buybacks

Under the Old Act, 365 day time gap was required between board-approved buybacks (i.e. buy-backs up to 10%). Under the New Act, buyback possible after 3 years from which specified defaults (repayment of deposits / interest etc.) ceased to subsist. Minimum 1 year gap required between two buybacks (whether shareholder approved or board approved), even if buyback is within 25% limit **[section 68].**

15. Differential Voting Rights

The New Act permits issue of shares with differential voting and dividend rights subject to restrictions / rules – section 43. There is no exemption / relaxation to private limited companies, which was available earlier. There are onerous conditions laid in Rules for issue of DVR shares, which inter-alia includes authorization in AOA and special resolution, track record of at least 10% dividend pay-out during past 3 financial years, no default in repayment of investor or creditors dues and that the company has not been convicted of offence under RBI Act, SEBI Act, SCRA or other special acts **[section 43].**

16 **Restrictions on Investments**

Under New Act, investment not permitted through more than two layers of 'Investment Companies'. This restriction shall not apply to:

- Company acquiring another company incorporated overseas having more than two layers, as per laws of that country
- Subsidiary having investment subsidiaries for meeting any statutory requirements **[Section 186].**

17. **Treasury Stock**

Earlier companies were not prohibited from holding treasury stock. Companies were utilizing such stock to control their voting rights and manage their cash flows due to this relaxation. On account of a merger or compromise under the new legislation, no company can hold shares in the names of trusts, either on its own behalf or of its subsidiaries **[section 232].**

18. **Class Action Suits**

The Companies Act, 2013 introduced the concept of class action suits in India. While there is a threshold on the minimum number of shareholders or depositors required to initiate such class action suits, this initiative will enable stakeholders to seek compensation, not only from a company but also its directors, auditors and expert advisors for any unlawful or wrong conduct **[section 245].**

Comparative Analysis & Conclusion:

The 2013 Act provides that until the Government notifies a date for transfer of all matters, proceedings or cases sent to the NCLT, the provisions of the Act in regard to the jurisdiction, powers, authority and function of the current Company Law Board and the Company Court will continue to apply.

The 2013 Act does not provide for any transitional provisions to govern the restructuring in progress at the time of notification of such a date. Furthermore, if the restructuring currently ongoing under the 1956 Act is to be continued under the 2013 Act, any nonconformity of the portion of the process completed under the 1956 Act with the provisions of the 2013 Act is a question that remains unaddressed. For example, an ongoing scheme of a merger envisages the creation of treasury stock, would this need to be deleted, and the swap ratio to be reworked if the relevant section governing treasury stock becomes effective prior to the final sanction of the scheme by the court.

The implementation of the 2013 Act will also require updates in other laws to link these with the new provisions. Laws including Stamp Duty (the conveyance rate provided for orders under section 391–394 of the 1956 Act), Exchange Control regulations (for holding of real estate, sectoral limits, etc.) and tax laws (definition of mergers, demergers and other conditions for tax neutrality) will need amendments prior to notification of sections relating to merger provisions, to provide the effect of benefits envisaged by the 2013 Act.

While the 2013 Act is a step in the right direction for India Inc. and investors, it may be worthwhile for the regulators to pay heed to concerns being voiced by lawyers and corporate organizations and incorporate the required amendments while notifying rules and issuing clarifications.

Furthermore, the 2013 Act seeks to align other laws such as Income Tax and Exchange Control provisions to facilitate its efficient implementation. Only time will tell whether the 2013 Act will be successful in making M&A easier and more efficient or be a legislation, which is open to interpretation, leading to further disputes and litigation.

To conclude, the overall impact of the 2013 Act on mergers, compromises and arrangements is to introduce certain simplistic and forward-looking concepts, and also codify in law certain concepts (such as dispensation, statutory auditor certificates and demerger accounting), which were followed in practice, but not contained in law. As of now, the full impact of the law is not very clear, since many matters will be governed by rules, which will be formalized once feedback from stakeholders is received by the MCA and incorporated in the final rules to be issued. On the whole, the 2013 Act is a step toward bringing greater transparency and accountability in the age-old procedures of M&A, thereby visibly making the Indian Corporate Law relatively friendlier and more acceptable in the global arena.

References:

Bare Acts

- Companies Act, 1956.
- Companies Act, 2013

Websites

- http://www.icsi.edu/portals/0/CORPORATE%20RESTRUCTURING.pdf
- http://www.caclubindia.com
- http://www.caclubindia.com/articles/comparison-between-old-versus-new-provisions-of-companies-act-18151.asp#.U1oBw1WSxv4
- http://www.club4ca.com/formats/corporate-law/companies-act-2013-vs-companies-act-1956/
- http://www.sngpartners.in
  http://www.sngpartners.in/files/Company%20Law,%20a%20Comparision.pdf
- https://www.pwc.in
- https://www.pwc.in/en_IN/in/assets/pdfs/publications/2013/companies-act-2013-Key-highlights-and-analysis.pdf
- http://www.kpmg.com
- http://www.kpmg.com/IN/en/Documents/KPMG_Companies_Act_2013.pdf
- http://www.mca.gov.in
- http://www.mca.gov.in/Ministry/pdf/ProvisionsTable_CompAct.pdf
- http://www.citehr.com
- http://www.citehr.com/472546-difference-between-companies-act-1956-2013-a.html
- http://lawsofindiaforcommanman.blogspot.in
- http://lawsofindiaforcommanman.blogspot.in/2013/09/change-in-authorized-capital-comparison.html
- http://www.companiesact.in
- https://www.icsi.edu
- https://www.icsi.edu/WebModules/LinksOfWeeks/OCT2013.pdf
- http://www.ey.com/Publication/vwLUAssets/Assocham_White_paper_Companies_Act/$File/Assocham_White_paper_Companies_Act.pdf
- https://www.pwc.in/en_IN/in/assets/pdfs/publications/2013/companies-act-2013-Key-highlights-and-analysis.pdf
- http://isindexing.com/isi/papers/1424766969.pdf

Articles

- Sharma N. & Dang R. (2014). Analyzing Companies Act: A move towards better Governance
- Jain P. (2014). Mergers Acquisitions: A new beginning under Companies Act, 2013
- Karavadi A. (2014). Changing contours of mergers and acquisitions under Companies Act, 2013