

(1983) 02 GUJ CK 0022

In the Gujarat High Court

Case No : Company Petition No's. 162 and 163 of 1982

**In Re: Bihari Mills Ltd.
 In Re: Maneklal Harilal Spg. and Mfg. Co. Ltd.**

Date of Decision : 23-02-1983

Acts Referred:

Companies Act, 1956 — Section 103, 21, 22, 23, 29

Citation : (1985) 58 CompCas 6

Hon'ble Judges : B.K. Mehta, J

Bench : Single Bench

Advocate : J.M. Thakore, for the Appellant; S.R. Shah, for the Regional Director, J.J. Yagnik and J.P. Bakriwala, Shareholders, for the Respondent

Judgement

Mehta, J.—By the group of these two petitions, this court has been moved to accord its sanction under s. 391(2) read with s. 394 of the Companies Act, 1956, to the scheme of amalgamation of Maneklal Harilal Spg. & Mfg. Co. Ltd. (hereinafter referred to as "the transferor company") with the Bihari Mills Ltd. (hereinafter referred to as "the transfer company"). At the outset, it should be noted that this is not the usual amalgamation of a sick unit which is non-viable with a healthy or prosperous unit. This is a case which is precisely the reverse of it which is an instance of "takeover by reverse bid". This is a scheme whereby the entire undertaking of the transferor company is to be merged and vested in the transfer company. I will consider at the appropriate places as to whether this peculiar feature of the scheme has any bearing on the larger question as to whether the court should or should not accord its sanction to the scheme in question. It would be profitable to briefly advert to certain particulars of the transferor company and the transferee company so as to appreciate the relevant and material aspects which have a bearing on the question of according sanction to the scheme in question.

2. The transferor company was incorporated on September 5, 1888, as a company limited by shares under s. 36 of the Indian Companies Act, 1882. The original name under which the transferor company was incorporated was "Tricomlal Harilal Spg. & Mfg. Co. Ltd." which subsequently changed to its

present name, that is, "Maneklal Harilal Spg. & Mfg. Co. Ltd." The registered office of the transferor company is situate in the area known as Saraspur within the City of Ahmedabad. The authorised share capital of the transferor company is Rs. 3,00,00,000 divided into 4,500 4 1/2% cumulative redeemable preference shares of Rs. 50 each and 1,48,875 equity shares of Rs. 200 each. The issued, subscribed and paid up capital is Rs. 98,25,000 divided into 48,000 equity shares of Rs. 200 each fully paid up and 4,500 4 1/2% cumulative redeemable preference shares of Rs. 50 each fully paid up redeemable at the option of the company at par by two months' notice. It should be noted at this stage that the above 4,500 preference shares been redeemed by the company by October 31, 1982, and the shareholders have been already paid the face value of the shares along with accrued dividend for the period up to October 31, 1982. The objects, as detailed in the memorandum of association of the transferor company, are, inter alia, the business of manufacturing and dealing in textiles and yarns.

3. The transferee company was incorporated on August 8, 1931, under the Indian Companies Act, 1913, having its registered office in the locality known as Mithipur in Khokhra-Mehmedabad within the City of Ahmedabad. The authorised share capital of the transferee company is Rs. 35,00,000 divided into 10,000 ordinary shares of Rs. 200 each; 10,000 6.43% cumulative redeemable preference shares of Rs. 100 each and 20,000 5.72% cumulative redeemable second preference shares of Rs. 25 each. The issued, subscribed and paid up share capital of the transferee company is Rs. 17,20,000 divided into 5,600 ordinary shares of Rs. 200 each fully paid up, 4,800 6.43% cumulative redeemable preference shares of Rs. 100 each fully paid up for cash and 4,800 5.72% cumulative redeemable second preference shares of Rs. 25 each issued as bonus shares by way of capitalisation of reserves without payment being received in cash and have been treated as fully paid up. It should be noted at this stage again that subsequent to the filing of this petition, by a special resolution passed at the extraordinary general meeting of the shareholders of the transferee company held on November 12, 1982, at the registered office of the company, it has been resolved to increase the authorised capital of the company from Rs. 35,00,000 to Rs. 3,00,00,000 which will be made up of ordinary capital of Rs. 2,85,00,000 divided into Rs. 1,42,500 equity shares of Rs. 200 each and the remaining component by way cumulative redeemable first and second preference shares remaining the same, and the consequent amendment of the relevant clauses in the memorandum and articles of association have been also resolved upon accordingly. The objects of the transferee-company, as detailed in its memorandum and articles of association, are, inter alia, business of manufacturing and dealing in textiles and years.

4. It appears that at the respective meetings of the board of directors of the transferor company and the transferee company held on August 17, and August 18, 1982, respectively, it was resolved to evolve and approve a scheme of amalgamation whereby the entire undertaking of the transferor company is to be transferred and be vested in the transferee company. The circumstances that

have necessitated the proposed scheme of amalgamation are, broadly stated, as under :

(1) The transferee company is subsidiary of the transferor company, inasmuch as the transferor company holds 4,303 shares out of 5,600 equity shares issued by the transferee company.

(2) The transferee company is a sick unit in the sense that it has been incurring losses since last about 7 to 8 years except the accounting year 1978, and the debit balance of the company as on December 31, 1982, is Rs. 1,48,60,252, and its current liability is to the tune of Rs. 2,22,50,560 and has also raised loans against security and otherwise to the extent of Rs. 2,22,19,802, as against its assets and properties of about Rs. 2,40,00,000.

(3) The transferor company is not only a healthy and a prosperous company but has a strong financial base and resources.

(4) The amalgamation of the transferor company with the transferee company will have a twin advantage. In the first place, the transferee company will attain viability and regain its health so as to maintain and develop production and employment. Secondly, it will provide an opportunity to the transferor company for its future expansion and development since it will have an advantage of the excess available vacant land of the transferee company admeasuring about 56,427 sq. metres.

(5) Apart from the aforesaid twin advantage, the usual benefits of amalgamation, namely, reduction in the cost of production, stabilisation of business, economy resulting from expansion, and the tax benefits will also be available.

5. The accounting year of the transferor company as well as of transferee company is ending on December 31, and the audited balance-sheet and profit and loss accounts of both the companies for the accounting year 1981, together with the auditors' reports, have been annexed to the petitions.

6. Neither the transferor company nor the transferee company is within the purview of the MRTTP Act.

7. Briefly stated, the gist of the scheme is as under : The undertaking of the transferor company on the transfer date will be transferred to and vested in the transferee company subject to all encumbrances, if any, and the liabilities, contingent or crystallised, as the case may be. All transactions or proceedings already concluded by the transferor company on and after the transfer date will be binding on the transferee company and will be executed by it on behalf of the transferor company. Till the sanction of this court to the proposed scheme, the transferor company shall stand possessed of all their properties to be transferred, and shall carry on the business for and on behalf of the transferee company. All contracts, deeds, bonds and agreements and other instruments to which the transferor company is a party and subsisting, shall remain in force and effect against or in favour of the transferee company and may be in force as if

for all intents and purposes, the transferee company was a party thereto. On the scheme being sanctioned, the transferee company shall, without further application, allot to every member of the transferor company one equity share of Rs. 200 each fully paid up in the transferee company for one equity share of Rs. 200 each held by such member in the transferor company, and all the members of the transferor company shall accept the shares so allotted in the transferee company in lieu of their shareholding and for that purpose surrender to the transferee company for cancellation of their share certificates in respect of their holding in the transferor company, so as to enable the transferee company to issue necessary certificates for the shares so allotted in the transferee company, and all such shares to be issued and allotted as aforesaid by the transferee company shall rank *pari passu* in all respects with the existing shares in the transferee company. All the shares held by the transferor company in the transferee company shall stand cancelled. There will be no break in the services of the employees in the employment of the transferor company and their services would be taken over with all their rights and liabilities intact by the transferee company. The provision pertaining to the change of name of the new company after amalgamation has some bearing since some objections have been raised on behalf of the Regional Director of Western Region, Company Law Board. The relevant provision contained in clause 7, Part II of the proposed scheme, is as under :

"7. On sanctioning the scheme of amalgamation, the name of the Bihari Mills Ltd. will be changed to the Maneklal Harilal Mills Ltd., or such other name as may be approved by the board of directors of the Bihar Mills Ltd.

8. The transfer date has been defined to mean January 1, 1982. This is, in short, the gist of the scheme.

9. By the order of this court of August 27, 1982, in Company Applications Nos. 179 of 1982 and 178 of 1982, moved by the transferor company and the transferee company, respectively, it was directed to hold separate meetings of different interests concerned on September 30, 1982, and October 1, 1982, for purposes of considering, and, if thought fit, approving, with or without modification, the said scheme of amalgamation. The meetings were held accordingly under the chairmanship of Shri L. G. Baria, Assistant Registrar of this court. According to the separate reports of the chairman, it appears that the interests of the transferor company have unanimously approved the scheme without any modification. However, so far as the different interests of the transferee company were concerned, the scheme was approved and adopted without any modification unanimously in the meetings of both the classes of preference shareholders, while it was approved and adopted without any modification by the substantial majority of about 99.60% of the equity shareholders of the value of Rs. 9,53,200 and only two shareholders holding 15 shares had opposed the scheme and voted against it without submitting any written or oral objections in that behalf in the meeting. The transferor company

and the transferee company have, therefore, by Company Petitions Nos. 163 and 162 of 1982, respectively, moved this court for according sanction to the scheme of amalgamation.

10. Notices as required under s. 394 of the Companies Act, 1956, of these two petitions have gone to the Central Government through the Regional Director, Company Law Board, Western Region. The official liquidator attached to this court was also directed to make a report under the second proviso to s. 394 of the Companies Act, 1956, which has been accordingly submitted by him on December 13, 1982, in connection with the affairs of the transferor company.

11. At the time of hearing of these two petitions, Mr. J. J. Yagnik, learned advocate, has filed his appearance on behalf of Shri P. C. Shah, a shareholder, who had opposed the scheme in the meeting of the equity shareholders of the transferee company. Another shareholder of the transferee company, Shri J. P. Bakriwala, who had opposed the scheme, has appeared in person. The Regional Director has been represented by the learned advocate, Shri S. R. Shah. Since the present scheme of amalgamation with which I am concerned is slightly of an unusual type, inasmuch as the transferor company which is a prosperous and healthy unit has decided to merge itself in the transferee company which is a sick and non-viable unit, the entire matter was examined from the relevant angles.

12. What is the periphery jurisdiction of the company court in the matter of according sanction under s. 394(2) of the Companies Act, 1956, has been examined by this court as well as other courts, particularly in the context where a scheme of amalgamation has been adopted either unanimously or on the substantial unanimity of the interests concerned. In exercise of its discretion under s. 394 of the Companies Act, the company court has, besides its satisfaction to be arrived at on the report of the chairman of the meetings as to the compliance of the prescribed formalities in the section, particularly about the scheme being approved by the requisite statutory majority of the members present and voting, and also on investigation as to whether there was fair representation of the different interests in their respective meetings directed to be convened, has to be further satisfied whether the majority of these interests was acting bona fide and the proposed scheme is such as a man of business would reasonably approve : vide *Bank of Baroda Ltd. Vs. Mahindra Ugin Steel Co. Ltd.*, . Though the court has jurisdiction to examine the reasonableness and justification of the scheme, and not merely accept the prescribed majority opinion of the interests concerned in the approval of the scheme, the following rider is also to be borne in mind which has been digested in Buckley on the Companies Acts, Vol. 1, 14th edition, at page 474 :

"The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting; but at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in

the scheme."

13. In *Wood Polymer Ltd., In re* [1977] 47 Comp Cas 597 SC, this court has, in the background of the peculiar fact situation where through the instrumentality of the transferor company, a valuable asset was sought to be acquired by the transferee company with a view to defeat the tax liability arising as a sequel to ordinary transfer of such immovable properties, examined what is the concept of public interest in the second provision to s. 394(1), and held that the said expression takes its colour and content in the peculiar statutory context, and in order to determine in a given case whether the proposed scheme is in the public interest or not, the court may embark on an inquiry as to why the transferor company had come into existence, for what purpose it was set up, who were its promoters, who were controlling it and what was the precise object which was sought to be achieved through promotion of the transferor company, and why was it being dissolved by merging it with the transferee company. The court thus examined in *Wood Polymer's* case [1977] 47 Comp Cas 597 (Guj), the different factual aspects and having regard to the totality of the circumstances including the report of the official liquidator that the transferor company appeared to have been created solely to facilitate the transfer of the building to the transferee company without attracting the liability to pay capital gains tax, refused to accord sanction to the scheme. The approach of the court, therefore, is not conditional as it is in the proceedings where the courts or the tribunals proceed on an advisory basis, but it has inquisitorial and supervisory role to play requiring it to form an independent and informed judgment as indicated by this court in *Bank of Baroda Ltd. Vs. Mahindra UGINE Steel Co. Ltd.*, . Shortly stated, the approach of the court is to see for itself whether the scheme is reasonable, just and fair to all the interests concerned : vide *Carron Tea Co. Ltd., In re* [1966] 2 Comp Cas 278 (Cal) It is in view of this settled legal position that I have to examine whether the sanction should be accorded to the present scheme.

14. At the outset it should be noted that two shareholders, namely, S/Shri P. C. Shah and Dr. J. P. Bakariwala, who had voted against the scheme in the meeting of the equity shareholders of the transferee company, and who have appeared before me for opposing the grant of sanction, have, for reasons best known to them, thought fit to withdraw their objections and they have filed affidavits in this court stating accordingly, and that they have now thought fit to lend their support on the avowed ground of the larger interest of the shareholders. Apart from their objections, the court has to consider on its own as to whether the proposed scheme is just, fair and reasonable, besides the satisfaction of the statutory requirements before the sanction can be accorded.

15. Broadly stated, two questions arise. Firstly, whether the decision of the transferor company to merge itself in the transferee company, admittedly a sick unit, which apparently seems to be unusual, is warranted in the peculiar facts and circumstances of the transferor company. There is an incidental aspect of this larger question of according sanction, viz., whether the scheme offends any

statutory provision and, therefore, against the public policy. Secondly, whether the scheme is just and fair to all the interests concerned and, therefore, is one which a prudent businessman would evolve and implement.

16. The decision of the transferor company to merge itself with the transferee company, which is admittedly a sick unit, is, as stated above, one of the typical instances of take-over by reverse bid. Before I set out as to what is precisely the implications of such a take-over by reverse bid, it would be profitable to shortly point out the distinction between a take-over and a merger. A transaction or a series of transactions by which a person acquires control over the assets of a company is generally known as a "take-over" of the company. On the other hand, an arrangement whereby the assets of two companies vest in one is known as a "merger" (vide *Take-overs and Mergers*, fourth edition, by Weinberge and Blank, paras. s. 103 and 104 at pp. 3 and 4). The distinction between these two types of arrangement has been succinctly pointed out in the aforesaid classical book in para. 105 at p. 4 in the following terms :

"The distinction between a take-over and a merger is that in a take-over the direct or indirect control over the assets of the acquired company passes to the acquirer; in a merger the shareholding in the combined enterprise will be shaped between the shareholders of the two companies. Often the distinction is a question of degree; if the dominant company (M.Co.) makes a share-for-share exchange offer for a target company (S. Co.), a company of roughly the same size, the former shareholders of S. Co. will finish up holding roughly 50 per cent. of the share capital of H. Co. and the operation ought undoubtedly to be called a merger. If H. Co. is many times the size of S. Co., the operation ought generally to be regarded as a take over of S. Co. by H. Co., although even in such a case, the result might be if the shareholding in H. Co. was far more widely dispersed than in S. Co., that H. Co. comes under the joint effective control of the former controllers of H. Co. and the former controllers of S. Co., or even under the sole effective control of the former controllers of S. Co."

17. This last alternative is known as taking over by reverse bid. In paragraph 612, at page 80 of the aforesaid book, we find the discussion pertaining to take over by reverse bid;

"612 : Where H. Co. wishes to acquire complete control of a smaller company, S. Co. on a share-for-share basis, and the directors of S. Co. approve the proposal, it may be considered desirable to effect the take-over by way of "reverse bid" instead of a straight forward share-for-share bid by H. Co. for the capital of S. Co. In a reverse bid, S. Co. (at the instigation of the controllers of H. Co.) makes a share-for-share bid for the whole of the equity capital of H. Co., the procedure being the same as that described in paragraphs 603-606. If the bid is accepted by the holders of at least 90 per cent. in value of each class of equity capital of H. Co., and compulsory acquisition of any outstanding minority shares is carried out, the former shareholders of H. Co. will finish up as the majority shareholders in the enlarged capital of S. Co. and the pre-existing shareholders of S. Co. will

hold a minority interest in S. Co. : H. Co. will be wholly-owned subsidiary of S. Co. It will be observed that the position will be identical, in economic effect, with the position which would have been reached if H. Co. had made a share-for-share bid for the capital of S. Co. In either event, the original shareholders of the two companies will finish up holding the shares of the one company in roughly the proportion which the value of the net assets of the one company bears to the value of the net assets of the other company or which the earnings of one bear to the earnings of the other (or a mixture of the two) and the other company will be the wholly-owned subsidiary of the company in which the two groups of shareholders hold shares."

18. What tests should be fulfilled before an arrangement can termed as a reverse take-over are specified in para. 618 at p. 83 of the said book in the following terms :

"618 transaction will be a reverse take-over if it fulfills any one of a number of tests; if the value of the assets of H. Co. exceeds the value of the S. Co.; if the net profits (after deducting all charges except taxation and excluding extraordinary items) attributable to the assets of H. Co. exceed those of S. Co.; if the aggregate value of the consideration being issued by S. Co. exceeds the value of the net assets of H. Co.; if the equity capital to be issued by S. Co. as consideration for the acquisition exceeds the amount of the equity share capital of S. Co. in issue prior to the acquisition; or if the issue of shares in S. Co. would result in a change in control of S. Co. through the introduction of a minority holder or group of holders."

19. The above is, therefore, a precise and brief discussion of what is known as take over by reverse bid. Judging the present arrangement by diverse tests, which have been indicated for purposes of finding out whether an arrangement is in the nature of reverse take-over, it is manifestly clear that the three tests, viz., (i) the assets of the transferor company being greater than the transferee company, (ii) equity capital to be issued by the transferee company pursuant to the acquisition exceeding its original issued capital, and (iii) the change of control in the transferee company, clearly indicate that the present arrangement is an arrangement which is a typical illustration of take-over by reverse bid.

20. The motives which may operate behind the decision of take-over or merger are broadly classified into four main classes by the learned authors of the above book on Take-overs and Mergers, and Chapter 3 indicates the classes of take-overs and mergers. One of the classes of such motives need be referred to since it is relevant for the purposes. In paragraph 303 at page 24, the learned authors have pointed out the advantage, or what is known in American business literature as "Synergy", as one of the inducing factors for such take-overs or mergers. The meaning of the terms, "Synergy" can be shortly stated as a favourable effect on the overall earnings of merger or take-over. In para. 303 at p. 24, one of the classes of motives for the point at discussion is stated in the following terms :

"(C) Because there is trade advantage or element of synergy in bringing the two companies under a single control, which is believed will result in the combined enterprise producing greater or more certain earnings than the sum of earnings of the two companies. The factors leading to this improvement in earnings could include :

- (a) economies of scale;
- (b) an accelerated learning process;
- (c) ensuring raw materials or sales;
- (d) financial advantages;
- (e) marketing advantages;
- (f) acquisition of a competitor;
- (g) diversification and reduction of earnings volatility; or
- (h) purchasing management.

This class of motive is more generally associated with a merger, although it would well give rise to a take-over."

21. Some of the factors likely to result in improving the earnings have been relied upon in the present petition which, inter alia, include economies of scale and marketing advantages to which I will refer to in detail presently.

22. There can be number of legitimate reasons for reverse take-over and which have been illustratively set out in paras. 613 and 614, at p. 80 of the aforesaid book, Take-overs and Mergers. The reasons which have been given in paras. 613 and 614 are obviously illustrative and not exhaustive. It will have to be examined in each case as to which reasons have promoted the decision for take-over by reverse bid, and whether they are legitimate otherwise. I shall presently refer to the reasons which prompted the present arrangement under consideration. Suffice it to say for the time being that the legitimate reasons underlying the decision of reverse take-over may be as illustrated in paras. 613 and 614, which include, inter alia, as to where the transferee company has large undistributed profits which it is desired to keep unfrozen or the advantage of the continuation of the listing which the transferee company enjoys at the stock exchange, or where the transferee company has the benefit of active management pursuing a dynamic policy of acquisition or where the directors of the transferee company and the transferor company take the decision having regard to the attitude of their respective shareholders.

23. So far as the first question is concerned, I am of the opinion that having regard to the following facts and circumstances, the decision of the transferor company to merge itself into the transferee company is justified.

24. The reasons need not be elaborately discussed since there is no worth-while

opposition to the proposed scheme. Notwithstanding the absence of such objections, I have myself examined the question about the justness of the decision of the transferor company to merge itself into the transferee company from different angles. It should be recalled that the transferee company is a subsidiary of the transferor company, since as many as 4,303 equity shares out of 5,600 equity shares issued by the transferee company are held by the transferor company. In other words, more than 75% of the equity shares issued by the transferee company are held by the transferor company. Apart from this fact of large holding and consequent stake in the financial working of the transferee company, there are other important additional motives justifying the decision of take-over by reverse bid. The economies of scale, trade advantage in the nature of favourable effect on the overall earnings resulting from the amalgamation which will reduce the cost of production and stabilise the business by ensuring the supply of raw materials and the advantage of a common sales organisation need not require to be emphasised. They are inherent in a properly conceived scheme of amalgamation. The tax benefits which will be available to the new unit amalgamation of the transferor company with the transferee company, which is a sick unit in the sense that it has accumulated losses to the tune of Rs. 1,48,60,252 and unabsorbed depreciation of about Rs. 1,46,00,000 will have a salutary effect of neutralising the deadening effect of such accumulated losses and unabsorbed depreciation on the financial results on the life of the new unit. Another important additional ground which should be emphasised is the stake of transferor company in the transferee company. It should be recalled that the transferor company has made a very large advance to the transferee company and as on November 13, 1982, the total amount due at the foot of the account of the transferee company in the trading books of the transferor company is to the tune of Rs. 67.72 lakhs excluding interest as might have accrued due from time to time on the said amount during the period of advance. In other words, the transferor company is a creditor of the transferee company and its outstandings would be in the vicinity of about 14% to 15% of the total value of the liabilities. This circumstance has been noted by the auditors appointed by the official liquidator for purposes of investigating the affairs of the transferor company in order to submit a report to this court as to whether the affairs of the transferor company were managed in the interest of the shareholders or not. If, therefore, the transferor company has decided for a scheme of amalgamation of the two companies, it cannot be said that it has been done with any ulterior purpose or with a view to secure some unfair advantages to its shareholders. Having regard, therefore, to the percentage of its shareholding in, and the extent of advances to, the transferor company was well advised to have scheme of amalgamation, since the total failure of the undertaking of the transferee company may have adverse consequences and far-reaching repercussions on the fortunes of the transferor company as well. It should be recalled that the transferor company and the transferee company are in the same line and they have the standing of about 94 years and 52 years, respectively. Both the companies are carrying on business in manufacturing

textiles. The transferor company got hold of the transferee company when it purchased in about three parts, the entire block of shares aggregating to 4,303 in the month of August, 1982. The decision of the transferor company to purchase the equity shares of the transferee company appears also to be justified, since having regard to the book value of the block of the company of Rs. 1,99,30,850 and the depreciated value of Rs. 58,24,657, the deal was really in the interest of the transferor company. The resources position of the transferor company as disclosed from the valuation report of M/s. Talati and Talati, chartered accountants, who were retained for purposes of submitting their valuation of the transferor company as well as the transferee company indicated that the transferor company is in a position to provide necessary financial help and where-withal for rehabilitation of the sick unit of the transferee company. The financial working of the transferor company has been summed up in para. 6(b) and (c) of the valuation report as under :

"6(b) The company has as per its published accounts :-

Rs. General reserve 3,00,00,000 Statutory development rebate reserve 29,35,000 Investment allowance reserve 20,00,000 Investment allowance reserve utilised account 94,25,000 Balance of profit and loss a/c. 32,848

(c) We have seen the balance-sheet of the company for the last three years. The company has been working at excellent profit as can be seen below :

In	In	In	1981	1980	1979	-----	-----	-----	Rs.	Rs.	Rs.	Profit before tax
47,14,761	81,86,400	1,30,70,182	Profit after tax	40,64,761	56,36,400	70,17,136						

The company has declared a dividend for the year ending :

Rs. 1981 25 1980 25 1979 25 1978 30 Rs. The gross block of the company 11,44,50,160 The net block of the company 6,43,75,969 The investments 4,18,624 Current assets, loans and advances 13,90,16,590 Current liabilities and provisions 6,48,64,786 Loans fund 8,47,28,499."

25. There is an additional circumstance which must be also referred to while determining whether the decision of the transferor company to merge itself with the transferee company is justified. The transferor company has got a plot of land admeasuring about 61,600 sq. metres which according to the transferor company is not sufficient for its expansion programme. While on the other hand, the transferee company has got a plot of land admeasuring about 85,264 sq. metres out of which, I am told, the built up area is 28,837 sq. metres with the available vacant land of 56,427 sq. metres, and as per the municipal bye-laws, the land which will be available for further construction will be about 50% thereof, that is, 27,590 sq. metres. The transferor company, therefore, would have also an advantage of undertaking the development of the textile unit of the transferee company. In these circumstances, therefore, I do not think that the decision of the transferor company to merge itself into the transferee company

can be said to be unjustified.

26. In the course of discussion of this largest question, it was also examined as to whether the decision of the transferor company to merge itself with the transferee company offends or violates any statutory provision. Since the transferor company will have after the merger with the transferee company the benefit, inter alia, of claiming set off of all the accumulated losses and unabsorbed depreciation against future profits of the transferee company. This aspect was required to be examined, since the formalities prescribed under s. 72A of the I.T. Act, 1961, providing for the carrying forward or set off of accumulated losses and unabsorbed depreciation allowance in the present case of amalgamation would not be required to be gone through. It cannot be said by any stretch of imagination, and without violence to the language, that the amalgamation is only feasible when the sick unit is taken over and could exclude the cases where the prosperous units decide to merge into sick units as has been in the present case. The only short question which was examined was, whether the scheme of amalgamation and merger of the prosperous and healthy unit into the sick unit would offend s. 72A of the I.T. Act. Prima facie, the present scheme cannot be said to be offending or violating the spirit of the provisions of s. 72A since the object underlying insertion of this provision in the I.T. Act, 1961, is to facilitate the merger of sick industrial units with sound ones and unless some incentives are given to the prosperous units for taking over of the sick units, such mergers would not be feasible, and it is with that end in view that the benefit of set off the accumulated losses and unabsorbed depreciation against the future profits which would not have been available to the subsisting unit have been sought to be extended by this amended provisions, provided the conditions mentioned in the section are satisfied. It is no doubt true that whether the transferee company in which the transferor company will be merged will continue to enjoy the benefit of setting off of accumulated losses and unabsorbed depreciation since the unit continues is a question apart but there is no question of carrying out the exercise which is required to be carried out under s. 72A. It would not be tantamount to saying that the scheme, therefore, offends the provision contained in s. 72A of the I.T. Act, 1961, for the obvious reason that the question whether the new company after the merger will be entitled to claim the benefit of set off of accumulated losses and unabsorbed depreciation against the future profits will be determined in the assessment proceedings themselves. This question, therefore, need not detain me.

27. The second question which arises is whether the scheme is fair and just. The answer to this question depends mainly on what is the exchange ratio which has been prescribed in the scheme, and having regard to the totality of the circumstances, the exchange ratio is just and fair to the members of the transferor company. The relevant provision about the exchange ratio is to be found in clause 5 of the scheme. Clause 5 of the scheme provides as under :

"5. Upon the scheme being sanctioned by Honourable High Court at Ahmedabad

and transfers taking place as stipulated under clause 1 hereof;

(a) Bihari shall without further application allot to every member of M.H. one equity share of Rs. 200 each fully paid-up in Bihari for every one equity share of Rs. 200 each held by such member in M.H. All the members shall accept the aforesaid shares to be allotted as aforesaid in lieu of their shareholdings in M.H.

(b) Every member of M.H. shall surrender to Bihari for cancellation of his share certificate(s) in respect of shares held by him in M.H. and take all steps to obtain from Bihari a certificate for shares in Bihari to which he may be entitled under sub-clause (a) hereof, and all the shares to be issued and allotted shall rank *pari passu* in all respects to the existing shares in Bihari.

(c) All the shares in Bihari held by M.H. shall stand cancelled."

28. In order to decide about the reasonableness of the exchange ratio, it is necessary to refer to, in the first instance, as to the price of the shares quoted on the stock exchange of the respective scrips of the transferor company and the transferee company at the relevant time. It should be recalled that the effective date as prescribed under the scheme is January 1, 1982. The prices quoted at the stock exchange for the period of two months immediately preceding the effective date and for the entire calendar year 1982 have been annexed to the additional affidavits of S/Shri Radhakrishnan Kabra dated February 14, 1983, and S. R. Sanghvi of even date, who happen to the director and secretary, respectively, in the transferor company and the transferee company. The prices of the scrips of the transferee company in the relevant period commencing from the end of October, 1981, to the end of December, 1982, range between Rs. 430 to Rs. 445. On the other hand, the price of the shares of the transferor company for the same period range between Rs. 335 to Rs. 457. The exchange ratio which has been prescribed in the scheme is sought to be justified on the valuation of the respective scrips as estimated by M/s. Talati and Talati, a firm of leading chartered accountants, which has been annexed to the affidavit of Shri S. R. Sanghvi, secretary of the transferor company, filed in Company Petition No. 163 of 1982. The said auditors have, in their report, after setting out the various diverse relevant particulars showing the financial workings of the two companies from their respective balance-sheets, submitted their opinion about the respective values of the shares in paragraph 8 of their report. The said paragraph reads as under :

"..... For determining the assets for the value of the shares a breakup value of the shares on the basis of book figures of Maneklal Harilal Spg. & Mfg. Co. Ltd. is considered. The paid-up capital is Rs. 96,00,000, reserve surplus is Rs. 4,43,92,898, totaling to Rs. 5,39,92,898. As on 48,000 equity shares the break-up value would come to Rs. 1,125. In the case of Bihari Mills Ltd., there is a total debit balance in profit and loss account of Rs. 1,48,60,252. The general reserve is Rs. 29,29,771 leaving a debit balance in the profit and loss account of Rs. 1,19,30,477, as against the total paid-up capital of Rs. 96,00,000. As there is a

debit balance, the book value of share would come to nil. The profit for the year 1978 of Bihari Mills Ltd. was Rs. 19,77,848."

29. In other words, the value of the shares as estimated by the said auditors of the transferor company is Rs. 1,125 per share while that of the transferee company is nil. This opinion is corroborated by the auditors assisting the official liquidator for the purpose of reporting to this court as to whether the affairs of the transferor company have been managed in a manner prejudicial to the interest of the shareholders or public interest. The auditors appointed by the official liquidator to assist him, namely, M/s. Mehta Lodha and Co., have, in their report to the official liquidator, inter alia, stated to the effect that taking the paid-up capital and reserves together, the book value of the shares of the transferor company as per the balance-sheet as on December 31, 1981, would come to Rs. 1,125 while in the case of the transferee company, namely, Bihari Mills Ltd., it would be Rs. 1,921. It is no doubt true that both the auditors have opined as above about their estimate of the valuation of the shares of the respective companies on the application of break-up value method. In determining the break-up value of the shares, one has to ascertain the value of the company's physical assets and deduct therefrom the company's current liabilities and prior charge capital. Broadly speaking, the break-up value of shares means the difference between the assets and the liabilities of the company, vide *Commissioner of Wealth Tax Vs. Rajendra Singh Singhi*, . In *Diamond on Death Duties*, 14th edition, p. 578, it is observed that the break-up value is the amount which the shareholder would receive in the event of liquidation. It is no doubt correct that the break-up value of the shares is to be ascertained where the company is ripe for winding up, vide *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, . Notwithstanding, that the break-up value method is one of the well known and recognised methods of valuation of shares, the courts have often said that amongst the different methods of valuation of shares, the break-up method can be resorted to only in exceptional cases : vide *Commissioner of Income Tax Vs. Swadeshi Mining and Manufacturing Co. Ltd.*, . The mode or method of valuation, just like the content or meaning of the word "value", varies a good deal according to the purpose for which valuation is required (vide *Sampath Iyengar on the Three New Taxes*, 5th edition, p. 447) and the perspective of a given question and the context of the purpose of valuation would necessarily play a significant role in selecting the method of valuation. The principles which would be relevant for a fixation of the fair market value in the context of the Land Acquisition Act, would not conclusively operate in the field of evaluating the fair market value in the context of the acquisition proceedings under the Income Tax Act, vide *Commissioner of Income Tax, Gujarat II Vs. Vimlaben Bhagwandas Patel and Kamlaben Kanjibhai Patel*, . In *Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.*, , the Supreme Court examined the question of the valuation of shares in the context of s. 7 of the W.T. Act. The court, speaking through *Jaganmohan Reddy J.*, ruled that for the purposes of wealth-tax, the

valuation of the shares would ultimately depend on the facts and circumstances of the case, the nature of the business of the company and the prospects of profitability and such other considerations. The Supreme Court indicated broadly the principles which should govern the question of valuation of shares for the purpose of the W.T. Act. The first principle, which has been recognised by the court is in the following terms :

"Where the shares are of a public company and are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares."

30. The court further pointed out that in cases of public companies whose shares are not quoted on the stock exchange, the value may be determined by reference to the dividends, or on the application of yield method. It is in this background that I have to determine whether the auditors were justified in arriving at the valuation of the shares of both the transferor company and the transferee company on application of the break-up value method.

31. It is no doubt true that so far as the question of valuation of shares in mergers and take-overs is concerned, the transferor company is not to be wound up but none the less it is to be dissolved without formal winding up. If, therefore, in such a context an attempt is made to evaluate the break-up value of the transferor company, it cannot be said that the approach is unjustified. If once, therefore, in relation to the transferor company the break-up value has been arrived at, it would be reasonable to find out the break-up value of the transferee company. I do not mean to say that if the stock exchange prices are higher than the break-up value or on the basis of yield method or dividend method, the higher valuation is not justified, and the company seeking to evolve the arrangement of merger or take-over should adopt the best valuation by applying the break-up method, or any other method which is convenient for purposes of obtaining lesser valuation unless there are valid and compelling reasons which may justify lower valuation. I have, therefore, called for the valuation of the shares of the transferor company on application of that alternative recognised method of yield value. It should be noted again that in the present facts and circumstances, the transferee company was making losses during the last five years, except in the year 1978, and, therefore, also the evaluation of its shares on the break-up method was justified. If, therefore, the break-up method has been adopted in case of one company, namely, the transferee company in the present case for purposes of finding out whether the exchange ratio is proper or not, the same method should generally be applied for the valuation of the shares of the transferor company also. If the break-up valuation of the transferor company and the transferee company is taken into consideration, the exchange ratio which has been prescribed is unexceptionable. I have also called for the purpose of finding out whether the prescribed exchange ratio is justified or not, the valuation of the new shares which the transferee company would be required to issue after merger. The statement of computation for determining the

estimated value of one equity share of Rs. 200 which shall have to be issued on the amalgamation of the transferor company and the transferee company is annexed to the affidavit of February 9, 1983, of Shri Radhakrishnan Kabra, who happens to be the director of the transferee company. In the said statement of computation, the loss of the transferee company which shall have to be adjusted against the reserves of the transferor company as well as value of the open land which would be available after the amalgamation with the transferee company is taken into consideration and the figure of the revised reserves as a result of the amalgamation has been arrived at. The break-up value of the new shares which shall have to be issued after the amalgamation comes to about Rs. 1,173. In that view of the matter also, no exception can be taken to the exchange ratio particularly because the break-up value of the transferor company as on December 31, 1981, is Rs. 1,125. In order to find out as to what is the value of the shares of the transferor company on yield basis, further particulars and estimation were called for. The statement of computation has been furnished along with the affidavit of Shri S. R. Sanghvi, secretary of the transferor company. The average profits for the years 1977 to 1981 have been taken into consideration so as to have a long time view. The valuation is also made on the alternative basis of four years and three years average of the profits, and according to the estimation, the value per share on five years, four years and three years average profit basis comes to Rs. 868, Rs. 985 and Rs. 972, respectively. The intrinsic value of the shares which will be issued on amalgamation is much higher than the value estimated on the yield basis as above. The relevant factors which are to be taken into account in determining the final share exchange ratio have been enumerated in the Weinberg and Blank's classical Treatise, paras. 2052 to 2060 at pp. 519 to 522. Shortly stated, these factors are as under :

1. The stock exchange prices of the shares of the two companies before the commencement of the negotiations or the announcement of the bid.
2. The dividends presently paid on the shares of the two companies.
3. The relative growth prospects of the two companies.
4. The cover for the present dividends of the two companies.
5. The relative gearing of the shares of the two companies.
6. The values of the net assets of the two companies.
7. The voting strength in the merged enterprise of the shareholders of the two companies.
8. The past history of the prices of the shares of the two companies.

32. It should be noted that almost all these factors, except the relative gearing of the shares, have been considered by me in examining whether the exchange ratio is just and reasonable. It is no doubt true that the break-up value of the

new shares which will be issued is only slightly higher than the original break-up value of the shares of the transferor company. But it is well recognised that the premium element in the arrangement of take over or merger is slight. In para. 2052 in Weinberg and Blank's Treatise, this principle is recognised as under :

"While the essence of a bid for cash is that it must in normal circumstances represent a premium over the pre-bid market price so as to attract acceptances from shareholders who are not willing to sell in the market at current prices, in a merger (and in theory in a share-for-share takeover as well) the "premium" element in the arrangement or bid ought to be small, since the offered shareholders are to become shareholders in the combined enterprise and the combined enterprise is generally expected to produce better results than the two enterprises separately."

33. The proposed arrangement of takeover by reverse bid in the present case would not affect the right of control with the existing controllers of the transferor company. In para. 641, at p. 93, in the aforesaid book of Take-overs and Mergers, the following observation is instructive :

"641. Where H. Co. acquires the undertaking of S. Co. for shares and the shares in H. Co. issued as consideration are retained by S. Co., the concentration of a block of shares in the hands of S. Co. may give it effective control of H. Co. To avoid this consequence (or possibly for other reasons discussed earlier), it may be decided that S. Co. should acquire the undertaking of H. Co. in exchange for an issue to H. Co. of shares in S. Co. In this way, control of H. Co. remains firmly with its existing controllers, H. Co. acquires a controlling block of shares in S. Co. and the original shareholders of S. Co. remain as minority shareholders in S. Co....."

34. For the aforesaid reasons, I am of the opinion that examining the question of exchange ratio from any angle and particularly in the context of take-over by reverse bid in the present arrangement cannot be opposed on the ground that it is not just and fair, and that a prudent and reasonable businessman will never accept. All the relevant aspects necessary to be borne in mind while considering the question of grant of sanction to a scheme of arrangement are, in my opinion, satisfied and, therefore, the consent should be accorded to the proposed scheme under s. 394 of the Companies Act.

35. A short question remains to be dealt with. An objection has been raised on behalf of the Regional Director of Company Law Board, Western Region. The objection which has been sought to be raised on behalf of the regional Director is that since clause 7 of the proposed scheme postulates a change in the name of the company after amalgamation, the court should not make any observation in that behalf since the power of granting sanction to a change in the name of the company is with the Central Govt. No doubts s. 21 of the Companies Act enables a company to change its name by making appropriate special resolution in that behalf with the approval of the Central Govt. However, this power under s. 29 to

grant approval of the Central Govt. has been delegated to the Regional Directors of Company Law Board, Bombay, Calcutta, Madras and Kanpur : vide GSR No. 71 set out in A. Ramaiya's Guide to Companies Act, 9th edn., pp. 1098-1099. The apprehension of the Regional Director that the name of the transferee company is to be changed to that of transferor company is factually not correct. What is proposed in clause 7 of the scheme is that on sanctioning the scheme of amalgamation, the name of Bihari Mills Limited will be changed to Maneklal Harilal Mills Limited. It should be recalled that the name of the transferor-company is Maneklal Harilal Spg. & Mfg. Co. Ltd. The approval envisaged in s. 21 can be ex post facto, since the legislative intent does not appear to be (the) obtaining (of a) prior approval before the change can be made effective. It is a formality which is to be carried out and the change is to be sanctioned in the light of the guidelines prescribed by the Central Government in that behalf. The transferee company is, therefore, directed to obtain necessary approval of the Regional Director, Bombay, under s. 21 of the Companies Act.

36. For the reasons aforesaid, therefore, the scheme of amalgamation of the transferor company and the transferee-company, as approved and adopted by the interests concerned of both the companies which annex. "A" to both the petitions, is sanctioned subject to the transferee company making an application for approval to the change of the name under s. 21 of the Companies Act latest by 30th April, 1983, and all the reliefs as prayed for in the petitions should be granted.

37. Rule in each petition is made absolute accordingly.

38. The costs of the learned advocate for the Regional Director, Bombay, which are quantified at Rs. 2,500 in each of the petitions shall be borne by the transferee-company.

Mehta, J.

39. This note has been for speaking to minutes on behalf of the applicant-company for purposes of clarification as to whether the transferee company can use the new name prescribed under the scheme of amalgamation of the two companies, viz., the Bihari Mills Ltd. and Maneklal Harilal Spg. & Mfg. Co. Ltd., (described as "transferee company" and "transferor company", respectively, in the order sanction to the scheme). The clarification is required since while granting sanction to the amalgamation of the aforesaid company by the order of this court of February 8, 23, 1983, the following direction has been given :

"For the reasons aforesaid, therefore, the scheme of amalgamation of the transferor company and the transferee company, as approved and adopted by the interests concerned of both the company is which is annexure "A" to both the petitions, is sanctioned subject to the transferee company making an application for approval to the change of the name under s. 21 of the Companies Act latest by April 30, 1983, and all the reliefs as prayed for in the petitions should be granted."

40. This conditional accord of sanction has caused some apprehensions in the matter of use of the new name by the transferee company since the use of the name of the transferee company may create some difficulties in the matter of licences, quota, etc., held by the transferor company and the sale of the products of the transferor company in the market, etc. It should be noted that this court has, in its order, held that the approval envisaged in s. 21 can ex post facto since the legislative intent does not appear to be of obtaining previous approval before the change can be made effective. This position is clear having regard to the requirement of the previous approval of the central Govt. under s. 22 which provides for a rectification of the name of the company, if through inadvertence or otherwise, a company on its first registration or on its registration by a new name, is registered in a name which, in the opinion of the Central Govt., is identical with, or too nearly resembles, the name by which a company in existence has been previously registered, whether under the Companies Act, 1956, or under the previous companies law. In the same group of sections providing for the change of name necessitated by the decision of the shareholders as expressed in special resolution (vide s. 21) or by the direction of the Central Govt. under the circumstances as specified in s. 22, the Legislature has prescribed previous approval so far as the rectification of name is concerned under s. 22 while under s. 21 it has prescribed only the approval and, therefore, the legislative intent appears to be clear enough that so far as the change of the name under s. 21 is concerned, no previous approval is required. However, for obtaining the approval which can be ex facto effecting the change of name under s. 21, the requisite condition about the special resolution is to be satisfied and, thereafter, necessary application can be made. It is in this circumstances that while according the sanction to the scheme of amalgamation this court directed that the sanction is accorded subject to the transferee company making an application latest by April 30, 1983. Till this application is made, the new scheme will not be effective and, therefore, the continuance of the transferor company for purposes of day-to-day business and the operation of the licences, quota, sale of products, etc., shall not be affected. On the special resolution being passed and a proper application being made by the said date, or the extended date, if necessary, the scheme will come into operation. The Central Govt. and, for that matter, the Regional Director, Company Law Board (Western Region), Bombay, will have to consider it and grant the formal sanction within the terms of the guidelines prescribed by the Central Govt. in this behalf and on such sanction being granted, the transferee company has to obtain appropriate certificate from the Registrar of Companies under s.23.

41. Subject to the clarification made in this order, the note for speaking to minutes is disposed of.