6 Compromise, Arrangements and Reconstructions

6.0 Compromise and Arrangement

Though Companies Act defines “arrangement”, it does not define “compromise”. These terms have no definite legal connotation. ‘Compromise’ means an amicable agreement between parties to a controversy to settle their differences by making mutual concessions, as distinguished from adjudication on the basis of an exact ascertainment of the opposing rights. In a compromise, “the parties agree to try to settle it between themselves by a give-and-take arrangement”. For the purpose of a compromise, it has been held that it is but essential that each party thereto should be empowered to make the necessary concessions. [Dani Chand & Co. vs. Narain Das & Co. (1947) 7 Comp. Case 195 F.B.J]. Thus, compromise envisages the existence of a dispute, e.g. one relating to rights. But the word “arrangement” is of wide import and its meaning should not be limited to something analogous to a compromise.

Section 390(b) provides that the expression ‘arrangement’ includes a reorganisation of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods. An arrangement may also involve debenture holders being given an extension of time for payment, releasing their security in whole or in part or exchanging their debentures for the claims and the balance in shares or debentures of the company; preference shareholders giving up their rights to arrears of dividends, further agreeing to accept a reduced rate of dividend in the future, etc.

6.1 Reconstruction

Reorganisation or arrangement is said to have taken place only when one company is involved. Amalgamation, on the other hand, is of two or more companies. The term “reconstruction” includes reorganisation, arrangement, amalgamation, etc., and thus is a term of wide import.

A reconstruction is commonly said to have taken place when a company resolves to wind up its business and it is proposed to form a new company, with only the old shareholders as its members to take over its undertaking, the rights of shareholders in the old company being satisfied by their being allotted shares in the new company. In that case, the old company ceases to exist in point of law, and its assets are transferred to the new company. It would be, nonetheless, a reconstruction even if all the assets might not pass to the company, or all the shareholders of the transferor company might not be shareholders in the transferee company, or all the liabilities of the transferor company might not be taken over by the transferee company. A reconstruction, in such a case, would imply that substantially the same persons...
would carry on the same business substantially. [Re South African Supply and Cold Storage Co. (1904) 2 Ch. 286].

6.1.1 Why Reconstruction?

A reconstruction may be necessary for the following purposes:

1. **To extend the operations of the company:** If the shares are fully paid up and further capital is desired to be raised, the shareholders in the old company may be issued only partly paid shares in the new company so that by calling up the uncalled amount the company would have the funds it would require for carrying on its business.

2. **As a method for altering the Memorandum of Association:** When such an alteration cannot be undertaken under Section 17 i.e., in a case where the new company desires to have “objects”, in its memorandum, over and above those in the old company.

3. **For purpose of Reorganisation:** The term “reorganisation” is usually applied to an arrangement to alter or modify the rights of shareholders or creditors, or both.

4. **In order to amalgamate with one or more companies:** Amalgamation is the blending of two or more companies into a single undertaking, the shareholders of each such company becoming substantially the shareholders in the new company which is to carry on the blended undertaking. To achieve this objective, either a new company may be formed to take over the business of the existing companies or the business of one or more existing companies be taken over by one of the existing companies.

5. **Reconstruction or Arrangement undertaken for bringing the capital structure of companies into line with the requirements of the Act:** The Act requires that the capital of a company must consist only of equity and preference shares. Companies having deferred or other forms of capital, therefore, are obliged to conform to the legal requirement as to their capital structure by a scheme of reconstruction.

6.1.2 How Reconstruction is effected?

Reconstruction may be carried out:

(a) by sale of the company under the powers contained in its Memorandum of Association;
(b) by a scheme of arrangement under section 391;
(c) by acquiring all or a majority of the shares in another company under section 395;
(d) by a compulsory amalgamation of companies in the public interest by an order of the Central Government under section 396;
(e) by a sale under section 494 (members voluntarily winding up); or under section 507 (creditor’s voluntarily winding up); in the former case a special resolution and in the latter case the sanction either of the Court or of the Committee of Inspection is necessary.
(f) by a scheme of arrangement with creditors only; under section 517 (voluntary winding up both by members and creditors, a special resolution and consent of three-fourths in value of creditors are necessary.
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**Sale powers in the Memorandum:** Where a company has power in the objects clause of memorandum, it may dispose of the whole of its undertaking to another company. After the sale, the company will be wound up and the shares in the new company will be distributed among the members in proportion to their holdings in the old company. When a company is not in a position to raise further capital and it cannot otherwise carry on its business or when the carrying on of the company is considered not necessary, the company may resort to such a course.

**Reconstruction under section 391:** In order to facilitate a reconstruction or amalgamation, it is frequently desirable or necessary for the company first to effect a compromise or arrangement with its creditors or any class of them or/and members or any class of them. Section 391 lays down the procedure by which the court’s assistance may be invoked in this respect.

According to section 391(1) of the Act, when a compromise or arrangement between parties aforesaid is proposed the following persons may apply to the Court:

(i) the company;
(ii) any creditor;
(iii) any member; or
(iv) in the case of company which is being wound up, the liquidator.

On such an application, the Court may order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court directs.

Further, as per sub-section (2), if at the meeting, a majority in number representing three-fourths in the value of the creditors or members (or any class of them), as the case may be, present and voting either in person or by proxy, where proxies are allowed (under the Rules made under section 643), agree to any compromise or arrangement, it is, if sanctioned by the Court, binding on all the creditors or class of creditors or on the members or class of members, as the case may be. The compromise or arrangement is also binding on the company or, if the company is being wound up, on the liquidator and on the contributories.

But, before according the aforesaid sanction, the Court must satisfy itself that the company or any other person which or who has made the application, has disclosed to the Court by an affidavit or otherwise all the material facts relating to the company, e.g., latest financial position of the company, the latest auditor’s report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under sections 235 to 251, etc. [Proviso to section 391(2)].

You have observed above that if the requisite three-fourths majority is obtained in favour of a scheme of reconstruction, the same shall bind the creditors, members, liquidators and contributories “if sanctioned by the Court”. This implies that the Court may not sanction, i.e. its power is discretionary and not obligatory. Moreover, under proviso to Section 391(2), the Court is under an obligation not to sanction any compromise or arrangement until a full disclosure of all material facts relating to the company have been made. This proviso is designed as a safeguard against any compromise placed by consideration of the shareholders or creditors. Therefore, the claim of minority, on proof that directors had failed to disclose materials facts regarding a company’s financial position, would succeed and the Court would not accept the contention if there be any, that the scheme has been duly approved by the majority if it is satisfied that full disclosure of all material facts had not been made at the meeting convened by the Court under sub-section (1) of section 391.

An order of the Court, made as aforesaid shall not be effective until a certified copy of the same has been filed with the Registrar. [section 391(3)]

A copy of the order is also required to be annexed to every copy of the memorandum or instrument which defines the constitution of the company issued after the certified copy of the order has been filed with Registrar; in default thereof the company and any of its officers at fault shall be punished with fine which may extend to one hundred rupees for each copy in respect of which default is made. [section 391(4) & (5)].

The Court may, at any time after an application has been made to it under this section, stay the commencement or continuation of any suit or proceeding against the company on such terms as the Court thinks fit, until the application is finally disposed of. [section 391(6)]
An appeal shall lie from any order made by a Court exercising original jurisdiction under this section to the Court empowered to hear appeals from the decisions of that Court, or if more than one Court is so empowered, to the Court of inferior jurisdiction. [section 391(7)].

Before giving its sanction, the Court must be satisfied that the statutory provisions have been complied with that the class of creditors or members have been fairly represented by those who attended, and that the statutory majority in approving the scheme is acting bonafide in the interest of the class if professes to represent.

The arrangement must also be such as a man of business would reasonably approve, as fair and reasonable as regards the different classes, if any [Re. Alabama, New Orleans, Texas and Pacific in Junction Rail Co. 1819 I. Ch. 213 CA; Re. Hindustan General Electric Corporation Ltd. AIR 1959 Cal 679; Nand Prasad vs. Arjun Prasad (1959) Pat (293)].

The Court cannot sanction any scheme, which involves the doing of an act, which is ultra vires the company [Re. Oceanic Steam Navigation Co. Ltd. (1939), Ch. 4]. But the memorandum can be changed if members consent. It should be noted that a scheme, not certified by the Reserve Bank, cannot be sanctioned by the Court in respect of banking companies (See Section 45 of the Banking Regulation Act, 1949).

Powers of Courts: Apart from the power of sanctioning a compromise or arrangement the Court has inter alia the following powers:

(i) to stay, while application under section 391 is pending the commencement or continuation or any suit or proceeding against the company [section 391(6)];

(ii) to supervise the carrying out of the compromise or arrangement [section 392(1)(a)]. Only the High Court has this power when it makes an order under section 391; a District Court has no such power.

(iii) to modify the compromise or arrangement for the proper working thereof [Section 392(1)]; and

(iv) to order winding up of the company, if it is satisfied that the compromise or arrangement is unworkable [Section 392(2)].

It may be noted that only High Courts have powers (iii) and (iv).

(a) Circulation of information to creditors or members: Section 393 provides for the circulation of a statement, which must explain the objects of the proposed compromise or arrangement scheme. The statement should accompany the notice of the meeting to be called to consider the scheme. The statement should accompany the notice of the compromise or arrangement and explain its effect. In particular, the statement must state any material interest of the directors, managing director or manager of the company whether in their capacity as such or as members or creditors and the effect on those interests of the compromise or arrangement, if, and in so far as, the effect is different from the effect thereof on the like interests of other persons.

If the notice calling the meeting is given by an advertisement, a statement must be furnished to such creditor or member free of charge on an application being made in the manner indicated in the notice.
In the event of a default, the company and the officers responsible thereof would be punishable with fine which may extend to fifty thousand rupees.

It is the duty of every director, managing director, manager and trustee for debentureholders to serve notice on the company of such matters relating to himself as may be necessary for the purpose of the section; a default is punishable with a fine which may extend to five thousand rupees.

(b) **Facilitating reconstruction and amalgamation:** In order to facilitate schemes of reconstruction and amalgamation when application is made to the Court under section 391 for sanction of an arrangement which involves the transfer of the whole or part of the property of one company (called “transferor company”) to another company (called “the transferee company”), the Court may make an order under section 394 dealing with the following matters:

(i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;

(ii) the allotment or appropriation by the transferee company of any shares or debentures, policies, etc. to or for any person;

(iii) the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company;

(iv) the dissolution, without winding up, of any transferor company;

(v) the provision to be made for persons who dissent from the scheme, and

(vi) any other incidental matter.

The first proviso, to section 394(1) restraints the Court from accepting a compromise or arrangement in connection with the scheme of amalgamation, before receiving a report from the Company Law Board or the Registrar that the affairs of the transferor company have not been conducted in a manner prejudicial to the interest of its members or to public interest.

Further, under the second proviso, the order for the dissolution of the transferor company cannot be made until the official liquidator, on the scrutiny of the books and papers, has reported to the Court that the affairs of the company had not been conducted prejudicially to the interest of the members or to public interest.

**Note:** A transferor company includes any body corporate whether or not a company under the Companies Act, while a ‘transferee company’ comprises only a company within the meaning of this Act. This distinction is presumably designed to facilitate transfer of foreign companies to Indian companies by schemes of reconstruction or amalgamation.

Where, an order is made under section 394, every company in relation to which the order is made must file a certified copy thereof with the Register for registration with 30 days after the order is made.

In the event of the whole or any part of the undertaking of the company being transferred, the directors cannot receive from the transferor company any compensation for loss of
the office or by way of consideration for retirement. They may, however, receive such compensation from the transferee company or from any other person provided the particulars with respect to the payment proposed, have been disclosed to the members of the company and have been approved by them in general meeting. (section 319)

An order under Section 394 does not transfer automatically a contract of personal services, which are in their nature incapable of being transferred (previously existing between an individual and the transferor company) to the transferee company. [Noxes vs. Daneaster Amalgamated Collieries Ltd., (1940) 3 All. ER. 549 (HL)].

Section 394A makes it obligatory on the part of the Court to serve notice of every application made to it under section 391 or 394 upon the Central Government and to take into consideration the representations, if any, made to it by the Government before passing any order under any of these sections. The objective is to "enable the Government to study the proposal and to raise such objections thereto as it thinks fit in the light of the facts and information available with it and also to place the Court in possession of certain facts which might not have been disclosed by those who appear before it so that the interests of the investing public at large may be fully taken into account by the Court before passing its order."

The Ministry of Corporate Affairs vide General Circular No. 53/2011 dated 26th July, 2011 has issued guidelines for the Regional Director / Registrar of Companies in order to streamline the procedure in the matter of scheme of arrangement / amalgamation under section 391-394 of the Companies Act, 1956. These guidelines supersede all previous guidelines on the matter.

It may be noted that Section 394A, which provides for notice to the Central Government does not apply to proceedings under Section 392 [Mehtab Chand Golcha vs. Official Liquidator, Golcha Properties (P) Ltd. (1981) Comp. Cas. 103 at p. 104].

**Key Points**

| Who may apply to Court | (i) Company  
(ii) Creditor  
(iii) Member  
(iv) The liquidator, if company is being wound up |
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<td>After filing application</td>
<td>Meeting to be called, held and conducted by the order of the Court</td>
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| During the meeting     | (i) Majority in number representing 3/4 agree to any compromise or arrangement and if sanctioned by the Court shall be binding on others as the case may be  
(ii) Person making the application has disclosed to the Court by an Affidavit or otherwise all the material facts related to the company |
**Order by Court**

(i) Certified copy of it shall be filed with Registrar
(ii) Copy of order to be annexed to every copy of MOA or any other document as the case may be

**Acquisition or Amalgamation by Shares Purchase:** Of the various methods of amalgamation, this is the simplest method. A company may acquire business and control of another company not by amalgamation but by acquisition of a majority of shares in that company. The consideration for acquisition may be paid either in cash or shares or both. Section 395 provides a means for the compulsory acquisition of the shares of the dissenting minority to prevent such a minority from extracting unreasonably high price for its shares.

Under the section 395, a scheme of contract involving the transfer of shares or any class of shares in a company has first to be offered for approval of the holders of such shares by the company seeking to acquire the shares. The scheme or contract must then be approved by the holders of not less than 90% in value of the shares concerned within four months from the date of the offer (by the transferee company). Where, however, such shares which are to be transferred are already held by the offeror (i.e. transferee company) or its nominee or its subsidiary to value greater than 10% of the aggregate of values of all the shares of the transferor company, the terms of the offer must be the same for the holders of all other shares and the scheme or contract must not only be approved by 9/10th in value of such holders but they must also be not less than 3/4ths in number.

When these conditions have been satisfied, the transferee company may give notice in the prescribed manner to any dissenting shareholder, expressing its desire to acquire his shares. This notice, if decided to be given, must be served within 2 months after the expiry of the period of 4 months. If such notice is given, the transferee company is entitled and bound to acquire these shares on the terms approved by the majority, unless the dissenting shareholder applies to the Court within one month from the date of the notice, and the Court orders otherwise.

But, if the transferee company has served the aforesaid notice upon the dissenting shareholders and they made no application to the Court or, if the application has been made, but the Court has not ordered to the contrary, the transferee company must within the prescribed period, send a copy of the notice to the transferor together with an instrument of transfer executed by the transferee company and on behalf of the shareholders, by a person appointed by the transferee company. The transferee company must pay or transfer to the transferor company and on behalf of the shareholders, by a person appointed by the transferee company. The transferee company must pay or transfer to the transferor company the amount or other consideration representing the price payable for the shares, which the transferee company is entitled to acquire. The transferor company must thereupon register the transferee company as the holder of those shares, and within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the money or other consideration representing the price payable to them by the transferee company [section 395(3)].

All sums of money and any other consideration received by the transferor company from the
transferee company are to be held in trust for the several persons entitled to the shares in respect of which they have been received and until disbursed, these are to be kept in a separate bank account. These are to be paid to the shareholders against the deposit of relevant share certificates. [section 395(4)]

In relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company, the following provisions are applicable:

1. Every such offer of every circular containing such offer or every recommendation to the member of the transferor company by its directors to accept offer must be accompanied by such information as may be prescribed.

2. Every offer must contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that the necessary cash will be available.

3. Every circular containing or recommending acceptance of such an offer should be first presented to the Registrar for registration and it should not be circularised until it has been registered.

4. The Registrar may refuse to register any such circular which does not contain the information required to be given under paragraph (1) above or which sets out such information in a manner likely to give a false impression.

5. Against an order of the Registrar refusing to register any such circular, an appeal lies to the Court.

6. Whosoever issues a circular mentioned in paragraph (3) above, which has not been registered, shall be punishable with fine extending to ₹ 5000 [section 395(4A)].

Further, to safeguard the interest of dissenting shareholders, sub-section (3) of section 395 imposes an obligation on the transferor company to advise the shareholders, whose shares have been taken over, as to the price payable to them within one month of the date of registration of the shares in favour of the transferee company and of the receipt of the amount or other consideration representing the price.

When all the shares of the company have been agreed to be transferred, the directors, qualification shares will not be transferred till new directors, properly qualified to act as directors, have been appointed [Briess vs. Wolley (1954) 2 W.L.K. 832; (1954) I. A.I.R. 909].

The directors of the transferor company cannot receive compensation for the loss of office or as consideration for retirement from office or in connection with retirement from the transferor company. But they may receive it from the transferee company or any other person if the particulars of the payments, proposed to be made, are stated in the notice of the offer sent to the shareholders of the transferor company and the proposal is approved by the company in general meeting. (section 320)

It may be noted that payments received by directors in contravention of sections 319 and 320 are to be held in trust for the company.
6.10 Corporate and Allied Laws

Key Points

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Power of the Central Government to provide for amalgamation of companies in the public interest: Section 396(1) provides that where in the "Public" interest it appears to the Central Government that amalgamation of two companies is essential, it may, through notification in the Official Gazette, provide for the amalgamation of the two companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the notification.

Under section 396(2), the order aforesaid may provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and may also contain such incidental, consequential and supplemental provisions necessary to give effect to the amalgamation.

Every member or creditor (including a debentureholder) of each of the companies before the amalgamation shall have, as nearly as may be, the same interests in or rights against the amalgamated company as he has in the company of which he was originally a member or creditor. If his interests in or rights against the amalgamated company are less than his original interests etc., in the original company, he shall be entitled to receive compensation from the amalgamated company to the extent these have been reduced. [section 396(3)]
The prescribed authority would assess the amount of compensation receivable. Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Company Law Board and thereupon the assessment of the compensation shall be made by the Company Law Board. [Section 396(3A)].

Further, as per sub-section (4), the Central Government would not make such an order for amalgamation unless:

(a) the draft copy of the proposed order has been sent to each of the companies concerned.
(b) the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and
(c) the Central Government has considered the suggestion, objection or modification to the same made by the said companies or any class of shareholders thereof or any creditor or class of creditors thereof, within a period fixed by the Central Government.

The expression “public interest” has not been defined either by this Act, or by the General Clauses Act. It is a very wide expression and comprehends inter alia, (i) economic welfare of the community [Shri Kishan vs. State of Rajasthan 1955 2 SCR 53]; (ii) welfare of labour [Basti Sagar Mills vs. Ram Ujagar AIR (1964) S.C. 355]. The concept of public interest has been discussed in detail at the end of this Study paper.

Without prejudice to the generality of Section 396, the Ministry of Corporate Affairs vide General Circular No. 16/2011 dated 20th April, 2011 has decided that, in appropriate cases, simpler procedures shall be adopted for the amalgamation of Government Companies under section 396 of the Companies Act, 1956 as given below:--

(1) (a) Every Central Government Company which is applying to the Central Government for amalgamation with any other Government Company or Companies under the simplified procedure prescribed in this circular, shall obtain approval of the Cabinet i.e. Union Council of Ministers to the effect that the proposed amalgamation is essential in the ‘public interest’.
(b) In the case of State government companies, the approval of the State Council of Ministers would be required.
(c) Where both central and state government companies are involved, approval of both State Cabinet(s) and Central Cabinet shall be necessary.

(2) (i) A Government Company may, by a resolution passed at its general meeting decide to amalgamate with any other Government Company, which agrees to such transfer by a resolution passed at its general meeting;
(ii) Any two or more Government Companies may, by a resolution passed at any general meetings of its Members, decide to amalgamate and with a new Government Company.

(3) Every resolution of a Government Company under this section shall be passed at its general meeting by members holding 100% of the voting power and such
resolution shall contain all particulars of the assets and liabilities of amalgamating government companies.

(4) Before passing a resolution under this section, the Government Company shall give notice thereof of not less than 30 days in writing together with a copy of the proposed resolution to all the Members and creditors.

(5) A resolution passed by a Government Company under this section shall not take effect until (i) the assent of all creditors has been obtained, or (ii) the assent of 90% of the creditors by value has been received and the company certifies that there is no objection from any other creditor.

(6) The resolutions passed by the transferor and transferee companies along with written confirmation of the Cabinet decision referred to in para (i) shall then be submitted to the Central Government which shall, if it is satisfied that all the requirements of section 396 and of this circular, have been fulfilled, order by notification in the Gazette that the said amalgamation shall take effect.

(7) The order of the Central Government shall provide:-
   a) for the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company.
   b) that the amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.
   c) for such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

(8) The Cabinet decision referred to in para (1) above may precede or follow the passing of the resolution referred to in para (2).

(9) When an order has been passed by the Central Government under this section, it shall be a sufficient conveyance to vest the assets and liabilities in the transferee.

(10) Where one government company is amalgamated with another government company, under these provisions, the registration of the first-mentioned Company i.e. transferor company, shall stand cancelled and that Company shall be deemed to have been dissolved and shall cease to exist forthwith as a corporate body.

(11) Where two or more Government Companies are amalgamated into a new Government Company in accordance with these provisions and the Government Company so formed is duly registered by the Registrar, the registration of each of the amalgamating companies shall stand cancelled forthwith on such registration and each of the Companies shall thereupon cease to exist as a corporate body.
(12) The amalgamation of companies under the foregoing sub-sections shall not in any manner whatsoever affect the pre-existing rights or obligations, and any legal proceedings that might have been continued or commenced by or against any erstwhile company before the amalgamation, may be continued or commenced by, or against, the concerned resulting company, or transferee company, as the case may be.

(13) The Registrar shall strike off the names of every Government Company deemed to have been dissolved under sub-sections (10) to (11).

Key Points

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<tr>
<td>Person aggrieved by assessment of compensation</td>
<td>(i) Prefer an appeal to CLB within 30 days from the date of publication of such assessment in the Official Gazette</td>
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<td>(ii) Thereupon, the compensation shall be assessed by CLB.</td>
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Reconstruction under section 494: The section gives complete power of a special type for sale of business in winding up. A company which is proposed to be, or in the course of being wound up, voluntarily, may sell its business to another company and the compensation received, whether in the form of shares, policies or other like interest in the transferee company, may be distributed among the shareholders of the company that is being wound up, or the members of the transferor company may receive any other benefit from transferee company. To give effect to it the following condition must exist:

(i) the transferor company should be in process of being wound up as a members’ voluntary winding up.

(ii) there should be a proposal to transfer or sell the whole or part of its business or property to another company (i.e. the transferee company); and

(iii) the transferor company should approve, by a special resolution, the proposal to confer authority, whether general or particular on the liquidator to put the above scheme or arrangement into effect.

The liquidator usually gives notice to the shareholders of the transferor company as regards
the number of shares to which they are entitled, the amount payable by them thereon and the time within which they must apply for the shares. The sale or arrangement under this provision is binding on all the members whether they agree to it or not. If any member does not vote in favour of the special resolution, he may address to the liquidator his dissent in writing even 7 days subsequent to the passing of the special resolution and require him:

(a) to abstain from carrying the resolution into effect; or

(b) to purchase his interest at a price to be determined by agreement or arbitration in the manner provided by section 494.

The liquidator has the right to exercise either of the above options. Should he elect to purchase, he must raise the money in such a manner as determined by the company. It must be paid prior to the company being dissolved.

It is common practice to make a provision in the scheme, enabling the liquidator to sell the shares of those who neither agree nor apply within the prescribed time and to distribute the sale proceeds among them.

The transferor company may pass such a special resolution either before or concurrently with the resolution for voluntary winding up or for the appointment of a liquidator. After an order for winding up of the company by or subject to the supervision of the court has been passed within a year, the special resolution would not be valid unless sanctioned by the Court.

The Arbitration Act, 1940, will govern arbitration, under this Section for determining the purchase price of shares of the dissentient member.

Section 494 makes no provision as regards the rights of creditors who felt that they have been affected by the scheme of transfer. As such the only remedy available to them is to present a petition either for compulsory winding up or for winding up under the supervision of the Court within a year of the making of the order.

The impact of section 494 on the sale of the whole or part of the business or property is that a sale under such scheme can be made even to a foreign company.

Under section 507, it is provided that the procedure under section 494 would apply to a creditors, voluntary winding up as well as to a members' voluntary winding up. The liquidator in the former case will have to exercise the power only with the sanction of the Court or that of the Committee of inspection.

At times an existing company may require further capital to make up the deficiency caused by losses or otherwise but the usual methods of raising capital may not be available to it. In such a case, it may resort to reconstruction under section 494 by constituting a new company to take over the undertaking. The members of the existing company will be allotted partly paid shares in the new company in lieu of assets transferred. Fresh capital afterwards will be raised by calling the unpaid amount of the shares. The shareholders of the existing company however will not be bound to take the partly paid shares and they may not assent to the scheme; they may call for the purchase of their interest or for giving up the scheme. The shareholders concurring in the scheme, however, shall have to pay whenever the call is made for raising further capital.
### Key Points

<table>
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<tr>
<th>Selling of a business</th>
<th>By a Company (Co.) which is being wound up voluntarily</th>
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| Compensation in lieu of it | (i) In the form of shares, policies or other like Interest in Transferee Co.  
(ii) May be distributed among the shareholders of the Transferor Co. |
| Conditions | (i) Co. being wound up Voluntarily  
(ii) Proposal to transfer or sell the whole or part of its business  
(iii) Approval of proposal by Special Resolution (SR) by Transferor Co. to put the above scheme or arrangement into effect |
| Sale or Arrangement | Shall be binding on all the members of the Transferor co. |
| If member does not vote in favour of SR | May express his dissent in writing to the Liquidator within 7 days after passing SR and may require:  
(i) to abstain from carrying the resolution into effect  
(ii) To purchase his interest |
| If Liquidator elects to purchase the member’s interest | Purchase money shall be paid before the co. is dissolved and be raised by the Liquidator in manner prescribed in SR |
| If order is made within a year for winding up the Co. by the Court | SR shall not be valid unless it is sanctioned by the Court. |

**Reconstruction under section 517:** It is another form of reconstruction pursuant to an arrangement with the creditors when the company is being voluntarily wound up. Under this Section, any arrangement entered into between a company about to be wound up or in the course of winding-up and its creditors is binding on the company and its creditors provided it has been:

(a) approved by a special resolution of the company; and  
(b) agreed to by three fourths in number and value of the creditors.

Any creditor or contributory may, however, within three weeks from the completion of arrangement, appeal to the Court and the court may amend, vary, confirm or set aside the arrangement.

**Note:** Students may note that reconstruction under section 517 is not commonly resorted to in as much as it might be difficult to secure the 3/4th the majority referred to in paragraph (b) above.
6.16 Corporate and Allied Laws

- **Compensation for loss of office on amalgamation or reconstruction**: Section 318(3) of the Act prohibits the payment of compensation to a managing director, or other director for the loss of office when he resign his office in consequence of the reconstruction of the company or its amalgamation and he is appointed as a managing director, manager or other officer of the reconstructed or amalgamated company.

**Conditions prohibiting reconstruction or amalgamation of company**: According to section 376 of the Act, where any provision in the memorandum or articles of a company, or in any resolution passed in general meeting by, or by the Board of Directors of, the company, or in an agreement between the company and any other person, whether made before or after the commencement of this Act, prohibits the reconstruction of the company or its amalgamation with any body corporate or bodies corporate, either absolutely or except on the condition that the managing director or manager of the company is appointed or reappointed as managing director or manager of the reconstructed company or of the body resulting from amalgamation, as the case may be, shall become void with effect from the commencement of this Act, or be void, as the case may be.

- **Preservation of books and papers of amalgamated company** (Section 396A): The books and papers of a company which has been amalgamated with or whose shares have been acquired by another company under Chapter V of Part VI cannot be disposed of without the prior permission of the Central Government which may appoint a person to examine the books and papers in order to ascertain whether they contain any evidence of commission of an offence in connection with promotion or formation or the management of the affairs of the first-mentioned company or its amalgamation or the acquisition of its shares.

It is a measure introduced to prevent accounts and records of a company being disposed of following amalgamation with a view to destroying incriminating evidence.

### 6.2 Amalgamation of Two Companies-Steps to be taken by both

**Procedures for amalgamation of the Companies**: Proceedings for an amalgamation by the transferor and transferee companies should be carried out simultaneously. These are as follows:

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<th>In The Transferee Company</th>
<th>In The Transferor Company</th>
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<td>1. To check up whether the memorandum contains the power of amalgamation; if not, then to carry out the proceedings for its alteration and to obtain Company Law Board’s Confirmation.</td>
<td>The same as in the case of transferee Company.</td>
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<td>2. To Prepare the draft scheme including exchange ratio and get it approved by the Board’s meeting.</td>
<td>–do–</td>
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<td>3. To apply to the Court for directions to convene the general meeting by way of Judge’s Summons [Rule 67 of the Companies (Court) Rules, 1959]; such directions would be in respect of matters set out in Rule 69.</td>
<td>–do–</td>
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4. To send notice for general meeting to every member along with a statement setting forth the terms of the compromise or arrangement and explaining its effect and particularly stating any material interests of the directors, managing director or manager, whether in their capacity as such or as members or creditor, or otherwise and the effect on those interests on the amalgamation and insofar as it is different from the effect on the like interests, of other persons [Section 393(1)(a)]. In case of the said notice being given through advertisement, to either include the aforesaid statement or to notify the place for obtaining the copies of such statement [section (1)(b)]; these can be obtained free of charge on making an application therefore in the manner indicated in the notice [section 393(3)].

In case of debenture holders’ rights being affected by amalgamation, the said statement to give like information and explanation regarding the trustees under the deed [section 393(2)].

[Rules 69 to 76 of the Companies (Court) Rules to be noted in this connection.]

5. To hold the general meeting and pass the resolution approving the draft scheme of amalgamation subject to the confirmation of the High Court, resolution to be passed by a majority in number representing 3/4ths in value of the members as required by section 391.

The same as in the case of transferee company.

6. To move the High Court for approval of the scheme, and for the purpose to supply it with material facts as required by the proviso to section 391(2).

To move the High Court jointly with the transferee company, and also to supply the court with all material facts. Further the court would need a satisfactory report from the Company Law Board or the Registrar that the affairs of the Company have not been conducted in a manner prejudicial to the interests of its members or to public interest, because it is a scheme for the amalgamation of it, with the
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<td>7.</td>
<td>On receipt of the Court’s order, to file the certified copy thereof with the registrar within 30 days after the making of the order [section 394(3)]; otherwise it would not be effective.</td>
<td>The same as in the case of transferee company.</td>
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<td>8.</td>
<td>A copy of the Court’s order also to be annexed to every copy of the memorandum or instrument, which defines the constitution of the company, issued after the certified copy of the order has been filed with the Registrar. [section 391(4)].</td>
<td>The same as in the case of transferee company.</td>
</tr>
<tr>
<td>9.</td>
<td>To proceed to effect the scheme of amalgamation as per the scheme approved and the directions given by the High Court by issuing suitable notices to shareholders and persons concerned and to allot shares and take over the business as per the scheme.</td>
<td>To do the same in the case of the transferee company, except of allotment of shares and taking over business, because no question of these arises in this case.</td>
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