The Institutional Mechanism for Corporate Reorganisations-Time to go back to the drawing board!

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Has the transfer of powers relating to Company Law matters from High Courts and Company Law Board to the new institution, National Company Law Tribunal (NCLT) effective 1 June 2016, met the objective of expediting matters ?

So was the expectation of Justice V Balakrishna Eradi Committee[1] when it recommended establishment of National Tribunal for expediting the process of dealing with insolvency and winding up of companies. The Committee recognised inability of High Courts to devote exclusive attention to winding up cases to conclude winding up of companies quickly and not so encouraging results of experiment with Board for Industrial and Financial Restructuring (BIFR), then prevailing mechanism for dealing with revival of sick or potentially sick companies.

That was also the expectation of Government in accepting the recommendations of the Committee and introducing provisions for establishment of National Company Law Tribunal in 2002[2]. It took much longer to be operationalized as a result of protracted litigation for over 10 years resting with judgements of Supreme Court[3] under Companies Act, 1956 as also under Companies Act, 2013[4] (which replaced the 1956 law) upholding its constitutional validity. NCLT and the Appellate Tribunal, the National Company Law Appellate Tribunal, were finally constituted in 2016[5].

Gradually, all matters under the Companies Act dealt with by High Court, Company Law Board and BIFR, whether dealing with insolvency or winding up or oppression and mismanagement or corporate restructuring and others are transferred to NCLT and NCLAT. Company Law Board and BIFR are since dissolved.

What is the experience of these 5 years since constitution of NCLT in 2016 ? Is it more encouraging than earlier mechanism ? Somewhat, one could say. But, on the whole, ground level experience is not so encouraging. Matters are getting delayed as days pass, litigation is increasing and recoveries are quite low. Significant investment is required in physical and soft infrastructure and skilling of members and registry of NCLT and NCLAT, in particular.

The reasons for not so good experience and suggestions to enhance its efficiency in relation to resolution and revival of companies, bankruptcies and winding of companies are well articulated in the Report of Parliament's Standing Committee on Finance tabled on 3 August. 2021 titled '*Implementation of IBC - pitfalls and solutions*'. The Report questions low recovery rates and long delays in the resolution process and seeks a review of design and implementation of the Insolvency and Bankruptcy Code (IBC).

What about Business Reorganisations ?

While insolvencies and bankruptcies is one major area assigned to NCLT, another major area assigned to NCLT relates to Compromises, Arrangements and Amalgamations referred to in Sections 230 to 240 of Companies Act, 2013 corresponding to Sections 391 to 394A of the erstwhile Companies Act, 1956.

How has the experience been, at ground level, in these matters?

That also does not appear to be encouraging and I believe, there also, we need to go back to the drawing board and examine the processes and jurisdictions afresh.

Adopting best practises to keep pace with the current fast pace of changing global business environment and India's growth trajectory are extremely critical. There can be no two views that need for business/corporate reorganisations has grown many folds in recent times with Indian economy poised for exponential growth amidst country's target of achieving 5 trillion dollar economy by 2025, just 4 years away !

Need for reorganisation is driven by several factors like growth, expansion, attracting fresh capital, bringing in new partners, consolidation, division, succession, regulatory requirements and so on. And, in this context, it is absolutely imperative to have institutional mechanism that ensures speed, involves minimal resources in terms of time and cost and is least litigation prone.

Expert Committee on Company Law chaired by Dr J J Irani, in its Report submitted on 31 May, 2005,[6] comprehensively examined several aspects of Companies Act, 1956 with a view to address changes taking place nationally and internationally, adoption of best international practises and so on. The Committee inter alia dealt with the ways and means of making the process of mergers and acquisitions more efficient. It noted that "*the process of mergers and acquisitions in India is court driven, long drawn and hence problematic*" and observed that "*Needless to say, in the context of*

increasing competitiveness in the market, speed is of the essence, especially in an expanding and vibrant economy like ours. A sign of corporate readiness, skill and stratagem is the ability to do such mergers and acquisitions with 'digital' speed".

This was in the year 2005, almost 15 years ago. Many of the suggestions of the Committee have been implemented in the Companies Act, 2013 and are now part of the law. But, we still have a long way to go.

Earlier High Courts and now NCLT are, burdened with large number of matters relating to business reorganisations and one must design and implement the processes that do not enhance that burden.

How to achieve that? Is change of jurisdiction an answer?

And, from that perspective, my suggestion is to, once again, change the jurisdiction in these matters from NCLT. We have come a long way from the time when such reorganisations needed vetting of High Courts and now, NCLT. We have more informed shareholders, more institutional investors, mechanism for protection of interests of minority shareholders, for ensuring high quality of information, different institutions for vetting of different aspects like SEBI, RBI. We have matured to a level where greater faith and trust is reposed in shareholders and creditors. Take for example, matters relating to managerial remuneration.

I believe, it is time now, to extend that for business reorganisations as well ! Let us, at a broad level, examine the current processes and evaluate the changes required in light of new environment ! Needless to say, a very detailed exercise like the one undertaken earlier, would be required to critically evaluate each challenge and solution.

A business reorganisation essentially involves arrangements:

- between company and its members or any class of them
  or
- between company and its creditors or any class of them.

Such arrangements could take form of:

- Amalgamations/mergers
- Demergers
- Capital restructuring which could be reduction of capital, conversion of one type of instrument into another and like
- Debt restructuring
- Combination of above.

Each of such arrangements requires approval of shareholders and creditors, the primary parties whose interests are affected. Simultaneously, other specialised agencies like income tax department, RBI for NBFCs, SEBI for listed entities, Competition Commission of India, Official Liquidator and others also have a say in such matters depending on the form of organisation and size of the entity, nature of business of the entity and like. Reports and objections are called for from them and they also get opportunity to present the same in person.

Companies, for this purpose, are classified in following groups:

Group 1 – based on public interest i.e. listed entities
Group 2 – based on size of the entity – small companies[7] i.e. companies with turnover of less than Rs 20 crores and paid up capital of less than Rs 2 crores other than a holding company, a subsidiary company, a Section 8 company or a company or body corporate governed by special act of Parliament.
Group 3 – holding company and its wholly owned subsidiary company
Group 4 - Others

Currently, schemes of arrangement between a holding company and its wholly owned subsidiary company (Group 3) and small companies (Group 2) are exempted from requirement to go through NCLT process subject to following specified procedure and no objection being raised by any party[8]. Both these categories are eligible for "fast track" amalgamations in view of these exemptions.

All others have to go through the process where approvals of NCLT are required.

Let me take example of amalgamation/merger of two or more companies which are not small companies and are also not holding company and its wholly owned subsidiary. In such cases, approvals of NCLT are required at three stages.

Stage 1

For admission of application for amalgamation and giving directions to convene meetings which inter alia involves:

- Determining class and value of creditors and / or members whose meetings are to be held
- date, time and place of meeting
- appointment of Chairperson and Scrutinizer for the meeting and fixing their terms and remuneration
- fixing quorum for the meeting(s).

NCLT after hearing parties, passes order giving directions. On receipt of the Order of the NCLT, companies have to take number of steps :

- Send individual notice and explanatory statement (along with a copy of the Scheme and the prescribed details) of meeting(s) to each of the members / creditors of the company
- Publish advertisement for the meetings in two newspapers:
  - one English newspaper and one vernacular language newspaper
- Send notice of meeting along with the scheme of arrangement, explanatory statements and disclosures to Central Government, RoC, Income-

Tax Authorities, Official Liquidator, Chartered Accountant to Official Liquidator and any other concerned regulator as directed by the Tribunal
- Filing of affidavit by Chairperson with NCLT stating that all the directions regarding issue of notices and the advertisements for convening meeting(s) are complied with
- Holding meeting of creditors / members of the company
- Submission of report of result of the meeting by Chairperson of the meeting(s) to the Tribunal
- Filing of Resolutions passed at the meeting to approve Scheme with MCA
- Filing of copy of the Scheme with RoC.

Stage 2
After this process is completed, a Petition is required to be filed with NCLT for confirmation of the Scheme. At hearing for this Petition, Tribunal admits the Scheme and fixes date and time of hearing.

Post this Order of Tribunal, the companies are required to:
- Issue advertisement in newspapers (English and vernacular language having wide circulation in that area)
- Send notice to creditors who had objected to the Scheme
- Send notice to Central Government and other regulators/statutory authorities whose representations are received

Regulatory/statutory authorities are required to submit their reports to the Tribunal, if they so desire and serve a copy of that to companies. If there is no representation, it is construed as deemed approval.

Stage 3
Tribunal then fixes final hearing when all the stakeholders have opportunity to represent and Tribunal passes final order sanctioning or rejecting the Scheme of Amalgamation.

On the whole,
This process ordinarily, takes about 6 months or so if all the timelines are adhered to. However, often there are delays in the processes, objections, availability of hearing dates from Tribunal, adjournments and so on leading to significant overall delays.

What could be the new mechanism for expediting entire process?
So, the proposal, that I would like to suggest, for consideration is:

Do away with approvals of NCLT for all schemes of compromise and arrangements.

Some may question it as bizarre; how can the proposals not be examined by quasi-judicial authority? Would it not compromise the interest of stakeholders?

To answer these questions, let us examine the background to these provisions.

When 1956 Act was introduced, there were not many such cases of reorganisations, the number of companies were few, shareholders were not so enlightened, some regulatory agencies were not even in existence e.g. SEBI and so on. In that context, it was appropriate that a elaborate process was required and examination of that process and scheme of organisation was by judicial authority, the High Court. This was quite time consuming and problematic as observed by Dr J J Irani Committee (supra).

We have since come a long way from that time and have taken step to transfer that power from High Court to NCLT, a quasi-judicial authority. It is time now to move it away from NCLT as well and vest it with Regional Director and bring about other changes.

Take for example, the first stage approval of NCLT for determining class and value of creditors and shareholders for meeting, fixing date and time of meeting, etc.

There are provisions in law specifying the same. So, companies could be permitted to determine this on their own and take appropriate decisions. Why take time of NCLT to confirm what is in law and regulations? If there is ambiguity, let that be clarified. Digital meetings expedites the process.

Currently, often, meetings of creditors and shareholders are waived by the Tribunal in situations where amalgamating company and amalgamated company are solvent, there is no waiver of any liabilities to creditors and written no objection is available from shareholders. Such waivers can be provided in the law/rules.

Similarly, adherence to the procedure to be followed like publication of advertisement, sending of notices to shareholders/creditors/regulatory agencies/statutory agencies, monitoring conduct of meetings and reporting outcome of the same can be delegated to practising company secretary or statutory auditors of the companies.

This is currently the practise so far as the accounting treatment, if any, proposed in the Scheme is concerned. The Act provides that in such cases, a Certificate issued by the Statutory Auditor as to the conformity of the treatment with accounting standards is required before Scheme can be sanctioned[9].

So, these aspects could also be delegated to professionals who are themselves also regulated. A specific form of Report ought to be designed for the purpose capturing the key aspects. The report of completion of the procedure and filing of objections, if any, received together with the Report issued by the Practising Company Secretary or Statutory Auditor be then filed with Regional Director (RD).

RD, on receipt of this Report, should fix date and time for hearing which should be made public and posted on its website. Company be directed to also post on its website, etc. We have moved several processes to digital medium from physical and this could be too!

On the date of final hearing, RD should, after hearing all parties, their objections, if any, responses of companies ought to pass final, speaking order, sanctioning or rejecting the Scheme of Arrangement. Another aspect which also needs to be addressed, in this context, is appointed date vs effective date. That also has historical background and needs revisit.

Any party aggrieved by such order, who is sufficiently invested in the company (which is currently fixed at holding not less than 10% of the shareholding or having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement[10]) could challenge the same in High Court with prescription of stringent penalties, at the discretion of the Court, if the litigating party's claim or ground is found to be without substance, to discourage frivolous complaints.

This broad outline of changed process, to my mind, would achieve:

- Reduction in workload of registry and also members of NCLT freeing up their time to handle IBC related matters
- Expedite reorganisations of businesses which can be achieved in time frame of 2 to 3 months.

Win-win for all to achieve "digital" speed, reduce costs and enhance ease of moving to next stage of growth!

[1] http://reports.mca.gov.in/Reports/24-Eradi%20committee – Report of High Level Committee on Law relating to Insolvency and Winding up of Companies, 2000
[2] The Companies (Second Amendment) Act, 2002
[3] Union of India (UOI) Vs R. Gandhi and Ors; Civil Appeal Nos. 3067 of 2004 and 3717 of 2005
[4] Madras Bar Association Vs Union of India (UOI) and Ors; Writ Petition (C) No. 1072 of 2013 (Under Article 32 of the Constitution of India) decided on 14.05.2015
[5] Notification No SO 1932(E) dated 1 June 2016 issued by Ministry of Corporate Affairs
[6] https://www.mca.gov.in/Ministry/press/press/Press_032005.html
[7] Section 2(85) of the 2013 Act
[8] Section 233 of 2013 Act
[9] Section 230(7), First Proviso of the 2013 Act.
[10] Section 230(4) of 2013 Act