

Acquisition & Merger of Sick Companies through BIFR

Takeover of sick industrial units is often seen as a promising alternative to building a business from scratch. A 'sick industrial company' means an industrial company that has been registered with the Register of Companies for minimum of five years and at the end of any financial year its accumulated losses is equal to or exceeding its entire net worth (i.e., the sum of the company's paid share capital and free reserves). An 'industrial company' is defined as a company that is engaged in any scheduled industry specified in the First Schedule to Industries (Development and Regulation) Act, 1951 (for ex. Metallurgical industries, telecommunications, transportation, chemicals, textiles but not include financial services, software services etc). The above definitions also exclude small scale or ancillary undertakings.

The revival and rehabilitation of sick industrial units is governed by Sick Industrial Companies (Special Provisions) Act, 1985 ("**SICA**") and it constituted Board for Industrial and Financial Reconstruction ("**BIFR**") for this purpose. One of the significant powers of BIFR is to sanction a scheme of amalgamation/re-organization/takeover of management between a sick unit and a "healthy" company.

SICA establishes an elaborate regime to deal with sick industrial units. If a company at any point qualifies under the definition of "sick company" a reference to BIFR is made by its board of directors. BIFR may even on the basis of its own knowledge or any information received about the financial position of any company, can require an Operating Agency ("**OA**") to inquire into its working and submit a report. The OA is usually a lead financial institution or bank (such as IDBI, ICICI, IFCI, and SFC) that had financed the unit. After inquiry, if the unit is considered "sick" by BIFR, it may direct OA to recommend measures or prepare a scheme of rehabilitation for the company. A scheme of merger may also be prepared, and such schemes are framed by the OAs in consultation with the companies being merged and the lead bank which takes initiative to decide the terms and conditions of the restructuring.

First, OA submits a draft scheme to BIFR and then, BIFR sends the same to the abovementioned stakeholders and publishes it in a local daily newspaper to invite any suggestions or objections from shareholders, creditors or employees. The merger scheme must be approved by shareholders of the healthy company in a general meeting through a special resolution. Finally, after BIFR has made necessary modifications as per opinions received and shareholders have granted approval, it has to sanction and monitor the implementation of the scheme. In past, the Bombay High Court has held that notwithstanding a reference pending with BIFR, Courts have jurisdiction to grant sanction to a scheme under Section 391 and 394 of the Companies Act. Thus, acquisition of a sick company can also take place outside SICA while its reference is pending.

In the initial period of the SICA regime it was left to OA to find healthy companies. Now, BIFR also resorts to the method of public advertisements to move towards potential arrangements. If more than one acquirer is interested, BIFR obtains detailed offers from the parties and assesses them on factors such as financial health, management track record, synergy and the degree of their dominance in the industry. Another alternative method used is to first frame a scheme of rehabilitation and then invite offers publicly. In October 2010, BIFR framed guidelines for change of management ("**COM**") of sick companies detailing procedure of acquisition through BIFR. It states that following a BIFR order for COM, company should submit full details of its assets and liabilities on the basis of which OA shall prepare a profile of the company. The OA is then required to advertise the same in newspapers and its website within 15 days of receipt of information from company, seeking offers for change of management of the company by way of amalgamation. Copies are also to be supplied to leading Chambers of Commerce and Industry. 2% of the outstanding principal secured debt of banks/FIs of the company is required to be

deposited within 15 days of the advertisement, by the interested acquirers as earnest money deposit at the time of submitting expression of interest. OA should thereafter facilitate the interested parties to visit factory premises, machineries, land, buildings etc. of the company. Within 60 days of the advertisement they have to submit their bid outlining draft revival proposal for the company. OA shortlists the potential acquirers for approval of the board within 2 months from close the offer who shall deposit an additional amount of 10% of outstanding principal debt.

Tax Benefits under Income Tax Act, 1961

An acquisition under a BIFR approved scheme is eligible for various relaxations in law. A major incentive for acquiring companies is the tax benefits given consequent to amalgamation. Sometimes, the approach is to analyze the concessions first and then get an order of rehabilitation from BIFR.

Section 72A of the Income Tax Act, 1961 provides that the accumulated losses and unabsorbed depreciation of amalgamating company shall be deemed to be the losses or allowance for unabsorbed depreciation of amalgamated company for the previous year in which the amalgamation was effected. To avail the benefits of this provision it is required that the amalgamating company has been engaged in the loss causing business for at least three years and, has held continuously as on amalgamation date at least three-fourths of the fixed assets which it has already held for two years. The amalgamated company is required to continue the business and continuously hold from the amalgamation date at least three-fourths of the fixed assets of the amalgamating company for five years. SICA also incorporates that 72A of the Income Tax Act, 1961 shall apply relation to amalgamations under BIFR schemes. Supreme Court has gone further in *Indian Shaving Products Ltd v. BIFR* by holding that sanction of a scheme of amalgamation under Section 18 of SICA necessarily implies that the requirements of Section 72A have been met with, and BIFR must exercise its power conferred by Section 32 of SICA as the benefit is a co-occurrence. In some circumstances, it may be prudent that the amalgamating company is the healthy company and the amalgamated company is the sick company. This form of restructuring is known as a 'reverse merger' and it has been made possible after an amendment to SICA in 1994.

Other Relaxations for Acquirer

Special treatment has also been given to BIFR acquisitions in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (takeover code) and the listing agreement. Continuing exemptions in the older regulations, the new takeover code provides that acquisitions pursuant to the SICA act are exempt from the obligation to make a public announcement of open offer under Regulation 3 for take over of shares or voting rights; and for the acquisition of control under Regulation 4.

Clause 40A of the listing agreement requires a company to maintain on a continuous basis, public shareholding of at least 25% of the total number of issued shares of a class or kind, for every such class or kind of its shares which are listed. Securities and Exchange Board of India ("SEBI") amended Clause 40A of the listing agreement in 2006 to make an exemption for companies in respect of which reference had been made to the BIFR, or any such company in respect of which any rehabilitation scheme was sanctioned, and such reference or implementation or an appeal against the scheme was pending. Thus, in these situations the non-promoters' shareholding can be below 25%.

Conclusion

The BIFR route avoids the need to apply for letters of intent and industrial licenses, eliminates gestation periods and makes available production facilities at historical cost. Moreover, BIFR itself is competent to approve mergers/acquisitions and sanction tax reliefs which it does much faster than the Courts. Nevertheless it is important to note that Companies (Second Amendment) Act, 2002 brings the process of dealing with sick industries under the purview of the Companies Act. The Companies (Second Amendment) Act, 2002 establishes National Company Law Tribunal (“NCLT”) with regional benches that are empowered with the powers earlier vested with BIFR. The bill to repeal SICA has been passed, however SICA shall remain in force until the NCLT is constituted. Last year in May, 2010 Supreme Court had approved setting up of NCLT in *R. Gandhi v. Union of India* and soon we may witness tremendous change in the current law as the new provisions focus on early detection of sick units and introduce the ‘inability to pay debts’ clause as a yardstick to measure ‘sickness’.