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Law on Cross Border Demergers in India

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ABSTRACT

The law on cross border demergers is quite certain keeping in view the recent order of NCLT Ahmedabad in the matter of Sun Pharmaceuticals Ltd. wherein it rejected the application of the petitioner demerged company to demerge into two foreign subsidiaries. The legislature is silent in the law of cross border demergers. Although, demergers have been happening all the time, the courts have opted for two different approached while dealing with inbound and outbound cross border demergers. Law is ever progressive and must be construed in a sense so as to grow with development and growth of society. There has been consistencies in the order of courts not only while approaching different matter but also internal consistencies while dealing with the same matter.

There is an urgent and immediate need to have a uniform and objective approach while dealing with cross border demergers and as such a lack of legislative enactment works as an impediment to getting to the solution. A clear and confusion free enactment in this regard would be highly commendable and much appreciated, which in turn would help in dealing with the inconsistencies and leave little or no room for judicial discretion in allowing or disallowing a cross border arrangement in the nature of demerger.

The recent order[2] of NCLT Ahmedabad dated 19-12-2019 rejecting the application for cross border demerger of Sun Pharmaceuticals into two overseas subsidiaries has brought the law on cross border demergers into question. Cross border demergers are the demergers involving two or more jurisdictions, i.e. where either of the resulting company(s) or the de-merged company is an Indian company(s) while the other is a foreign company(s). A cross border demerger may be understood to be a cross border arrangement, whether inbound or outbound.

Sun Pharmaceuticals had approached NCLT Ahmedabad with a petition under Section 230 and 232 read with Section 234 of Companies Act, 2013 for approval of a scheme of arrangement in the nature of demerger into two overseas resulting companies, namely Sun Pharma (Netherlands) B.V. and Sun Pharmaceutical Holdings Inc., but vide order[3] dated 19 December, 2019 the bench rejected the application for certain reasons which have raised an issue as to

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[2] CP (CAA) No. 79 of 2019 in CA(CAA) No. 38/NCLT/AHM/2019
[3] Ibid.

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whether cross-border demergers are allowed under Section 234 of Companies Act, 2013 read with Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The two resulting companies are directly or indirectly the wholly owned subsidiaries of Sun Pharmaceutical Ltd.

The scheme of arrangement was proposed with the objective of consolidating the holding structure of the wholly owned subsidiaries of the petitioner company. All the requirements (as required under SEBI, Companies Act, FEMA guidelines, etc.) were complied with by the petitioner company. On the directions of the Tribunal, the petitioner company served notice of hearing upon statutory authorities. As a result, certain objections were raised by the Regional Director- North Western Region, Central Government. The main objection raised was that Section 234 refers only to mergers and amalgamation and the same does not refer to demergers.

NCLT while adjudicating the matter observed that Section 234 of the Companies Act, 2013 talks about 'merger' and/or 'amalgamation' of foreign company with Indian company and vice-versa, and does not refer to demergers or incorporate the terms 'arrangement' and/or 'compromises' as envisaged under Section 230 and 232 of the Companies Act, 2013. Thus, the court while applying literal rule of interpretation stated that Section 234 of the Companies Act, 2013 cannot be construed to permit 'compromise', 'arrangement' or 'demerger'. It was further observed that, Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 which was inserted to operationalise Section 234 of the Companies Act, 2013 sets out in detail the procedure and requirements in relation to cross-border mergers, is silent on demergers and refers only to mergers and amalgamations.

The NCLT also laid stress on the fact that the term 'demerger' was included in the definition of 'cross-border merger' in the draft version of Foreign Exchange Management (Cross Border Merger) Regulations, but the same was deleted in the final/ notified version of Foreign Exchange Management (Cross Border Merger) Regulations[4], 2017 and 2018. Thus, NCLT while applying literal rule of interpretation concluded that Section 234 does not permit Cross border demergers and rejected the application of the petitioner company. It is important to note that Section 9[5] of the Cross Border Merger Regulations states about prior deemed approval

[4] S. 2(iii) of Foreign Exchange Management (Cross Border Merger) Regulations - 'Cross border merger' means any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 notified under the Companies Act, 2013;

[5] S. 9(1) of Foreign Exchange Management (Cross Border Merger) Regulations - Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.

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from RBI when compliance is made in accordance with Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

It is interesting to note that, there is some internal inconsistency in this order of NCLT Ahmedabad rejecting outbound demerger. The court earlier in the order stated that the term 'arrangement' is so wide that it includes 'demerger' as well and Section 234 does not include the term 'arrangement', but the court fails to understand this logic when it places reliance on the deletion of the term 'demerger' from the definition of 'cross-border merger' in the final Cross border merger regulations which includes 'arrangement'. The term "cross border merger" as envisaged under Cross border merger regulations include "arrangement", and the term "arrangement" is so wide that it includes "demerger".

It can also be pointed out that the same Tribunal has had two reasonings and an altogether different approach while dealing with inbound and outbound demerger. In an Inbound demerger order[6] passed by NCLT Ahmedabad on 31st October, 2018, the NCLT approved an application by Sun Pharmaceutical Ltd. for inbound demerger involving transfer of specified undertaking of Sun Pharma Global FZE (incorporated under the laws of UAE). Even in this matter, all the requirements were complied with and similar objections were raised by the Regional Director, Central Government that Section 234 does not refer to demerger and only refers to 'mergers' and 'amalgamations' of foreign company with Indian company and vice-versa. The Tribunal while adjudicating the matter, interpreted the Companies Act in such a way that Section 234 permits cross border demergers, thereby allowing inbound demerger.

It is pertinent to mention that the definition of "cross border merger" as envisaged under final draft of Cross Border Merger Regulations include the term "arrangement" which is so wide that demergers can be construed from the same. Moreover, the opening statement of Section 234 of Companies Act states that the provisions of the chapter shall apply *mutatis mutandis*, i.e. necessary changes having been made. Thus, it can be said that the provision envisaged under Section 234 shall include a demerger as well. Moreover, law is dynamic and ever changing, so it must be given a wide meaning and must be understood to incorporate the changes taking place in society and to promote the needs of the society. Law must never be construed to hamper growth and development.

As a result of globalisation, cross border transactions have increased exponentially and it only makes sense that if cross border mergers have been allowed and inbound cross border demerger has been allowed, an outbound cross border demerger must not be disallowed solely for the

[6] CP (CAA) 90/230-232/2018 in CA (CAA) No. 18/NCLT/AHM/2018

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want of clear language in the legislation. A major distinction between inbound and outbound demerger cannot be jotted down by the language of Companies Act and Rules and as such both must be allowed. The same judicial member of the Tribunal has relied on different approaches while dealing with Inbound and Outbound Demergers, which clearly establishes the confusion being faced on account of lack of clear enactment.

The same court has, while dealing with inbound and outbound demerger, has relied on two different approaches. It can be concluded that even though cross border demergers, both inbound and outbound, may be construed to be permitted by the provisions envisaged under Companies Act and Rules. A lack of clear intent of legislature by way of defective construction in legislative enactment, has led to a lot of confusion, and it would be highly commendable if necessary amendments are made so that uniform judicial mind and interpretation can be adhered to while dealing with the issue of cross border demergers.

Laws are intended to be progressive rather than regressive. As a provision for demergers was provided under the Companies Act, 1956, a deletion of express provision does not mean that demergers have been inhibited by the Act of 2013. Demergers happen all the time across the country and only outbound demergers have been regarded as being not provided under the act by the NCLT in the matter of Sun Pharmaceuticals Ltd. The golden rule of interpretation lays down that a statute must be read in a sense as provided, but if the same leads to absurdity it may be read harmoniously with the need of the time.

To iron out the latent and latent defects of the law of cross border demergers, it is advisable that legislature amends the Companies Act, 2013 in such a way as to include an express provision for demergers. This would help not only to satisfy the confusion, but would also help to give an objective approach while adjudicating a matter pertaining to demergers, and would leave little or no room for judicial discretion. Until and unless, an objective approach is laid down either through the judicial bodies or legislature, the courts would be at a discretion to allow or reject demergers.

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