

Modifications to Schemes of Arrangement

Once a scheme of arrangement has been approved by its shareholders or the relevant National Company Law Tribunal (“**NCLT**”), what, if any, modifications are permissible to the scheme of arrangement without seeking fresh shareholder approval?

This note considers the legal framework for modifications to approved schemes of arrangement. It also examines the proposed merger of Zee Entertainment with Sony Pictures India where this question potentially arises for consideration.

LEGAL FRAMEWORK

Section 231(1) of the Companies Act, 2013 (“**Companies Act**”) in relation to the power of the NCLT to enforce any compromise or arrangement provides that the NCLT may at the time of approving a scheme of arrangement or any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

The SEBI Master Circular on Scheme of Arrangement by Listed Entities, dated June 20, 2023, as amended (“**SEBI Circular**”), states that subsequent to filing the draft scheme with the Securities and Exchange Board of India (“**SEBI**”), no changes to the draft scheme are permitted to be made without specific written consent of SEBI unless mandated by regulators, authorities or tribunals.

In addition, typically a scheme of arrangement will provide that the parties to the scheme may, by mutual consent and acting through their respective board of directors, assent to any modifications/amendments to the scheme and/or to any conditions or limitations that the NCLT or any other governmental authority may deem fit to direct or impose or which may otherwise be considered necessary, desirable or appropriate by them.

MODIFICATION OF A SCHEME OF ARRANGEMENT: CASE LAW

Case law in India

1. In the case of S.K. Gupta and Ors. vs. K.P. Jain & Ors. ((1979) 3 SCC 54), the scheme of compromise/arrangement between Indian Hardware Industries Limited and its unsecured creditors was approved and after sanction of the scheme by the court, an application was filed for modification of the scheme and substitution of the proponent/sponsor. In this regard, the Supreme Court considered Section 392(1) of the Companies Act, 1956 (“**1956 Act**”) (which is similar to Section 23(1)(b) of the Companies Act) and the term "modification" in relation to such scheme and held that the definitions “modify” and “modification” would include the making of additions and omissions. In the context of Section 392, "modification" would mean addition to the scheme of compromise and/or arrangement or omission therefrom solely to make it workable.

Further, the Supreme Court while stating that Section 392 of the 1956 Act is required to be construed in a manner that will not permit the court to modify a scheme as to change its basic fabric held the following:

*“Strictly speaking, omission of the original sponsor and substituting another one would not change the '**basic fabric**' of the scheme. The scheme in this case is one by which a compromise is offered to the unsecured creditors of the company and whoever comes in as sponsor would be bound by it. Undoubtedly a sponsor of the scheme enjoys an important place in the scheme of compromise and/or arrangement but basically the scheme is between the company and its creditors or any class of them, or the company and its members or any class of them, and not between the sponsor of the scheme and the creditor or member.*

The scheme represents a contract sanctified by Court's approval between the company and the creditors and/or members of the company. The company may as well be in charge of directors and the implementation of the scheme may come through the agency of directors but that would not lead to the conclusion that during the working of the scheme the directors cannot be changed. If the scheme has to be ultimately implemented by the company as part of its contract and yet its, directors can be changed according to its Articles of Association, we see no difference in the situation where a sponsor is required to be changed in the facts and circumstances of a case. Therefore, it is not possible to accept the submission that as and by way of modification one sponsor of a scheme cannot be substituted for another sponsor.” (emphasis added)

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2. In the case of Meghal Homes Private Limited vs. Shree Niwas Girni K.K. Samiti and Ors. ((2007) 7 SCC 753), the Supreme Court held that the modifications proposed altered the position of the shareholders vis-à-vis the company and could not be considered a modification in the scheme necessary for the proper working of the compromise or arrangement and was a modification of the scheme itself and stated the following:

“As we read Section 392 of the Act, it only gives power to the court to make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement. This is only a power that enables the court to provide for proper working of compromise or arrangement, it cannot be understood as a power to make substantial modifications in the scheme approved by the members in a meeting called in terms of Section 391 of the Act. A modification in the arrangement that may be considered necessary for the proper working of the compromise or arrangement cannot be taken as the same as a modification in the compromise or arrangement itself and any such modification in the scheme or arrangement or an essential term thereof must go back to the General Meeting in terms of Section 391 of the Act and a fresh approval obtained therefor.” (emphasis added)

3. The Supreme Court in the case of Reliance Natural Resources Limited vs. Reliance Industries Limited ((2010) 7 SCC 1), relying on the earlier orders of the Supreme Court in the S.K. Gupta and Meghal cases stated that: “.....they both speak of the same thing, that the basic fabric of the scheme cannot be changed. **Which aspect of that basic fabric the courts may deal with could vary, but certainly the processes that protect the shareholders, their rights to know what is being transferred and the sanctity of the class of members who have voted together cannot be derogated from.**” (emphasis added)

Case law in the United Kingdom

4. In the case of In Re Aon plc [2020] EWHC 1003, the High Court of England and Wales (“**High Court**”) sanctioned a scheme of arrangement and confirmed a reduction of capital after examining two modifications to the scheme made after it had been approved by shareholders.

The High Court noted that the scheme was drafted in wide terms to allow modifications where the company and the other party gave consent and the court approved. The High Court was also satisfied that what was contemplated “**would not have caused any reasonable shareholder to take a different view in relation to the scheme had it been put before them.**” The High Court was also satisfied, having considered the test described in the case of In Re Equitable Life Assurance Society [2002] BCC 319, that there had been a material change of circumstance and the present situation was

far removed from anything that might properly be described as "foisting" on creditors something substantially different to what had been approved at the relevant meeting. Accordingly, the High Court approved the modifications and sanctioned the scheme, including confirming the reduction of capital.

5. In relation to the modification of the scheme, the court in the case of *In Re Equitable Life Assurance Society* [2002] BCC 319 held the following:

*“Paragraph 13.3 of the scheme allows for modifications of or additions to the scheme, and for conditions which the court may approve or impose. One such condition is the giving of an undertaking which I will mention below. Some objectors picked up the idea of a modification and suggested that in this way the scheme could be transformed into something materially different. That is not a permissible approach. **The provision is salutary, because there may be some immaterial error or oversight, or change of circumstances, that needs to be corrected or covered. But it would be quite wrong to use the provision so as to foist on a class of creditors something substantially different to what has been approved at the relevant meetings. It is not possible, as one person suggested, for example, to sanction the scheme on terms that the uplifts be treated as being in escrow pending further litigation to clarify the effect of the House of Lords ruling, being released if that litigation showed that the Society's present understanding is correct, but otherwise remaining in escrow pending new arrangements for a 'fairer' distribution.**”*
(emphasis added)

KEY TESTS

The tests set out by the Indian courts (and courts in the United Kingdom) in respect of modifications to approved schemes, whether by the court or by the board of directors of the relevant companies, set out the following tests, among others, to determine whether a modification to an approved scheme is one to make it workable or one that is a material change that requires a fresh shareholder vote:

1. Whether the proposed change is one which alters the basic fabric of, or makes a substantial modification to, the scheme of arrangement?
2. Whether the proposed change could have caused a reasonable shareholder to take a different view in relation to a scheme of arrangement had the change been put before them?

THE SONY-ZEE ENTERTAINMENT MERGER

The NCLT, Mumbai bench (“**NCLT Mumbai**”), pursuant to its orders dated August 10, 2023 and August 11, 2023 sanctioned the Composite Scheme of Arrangement among

Zee Entertainment Enterprises Limited (“**Zee Entertainment**”), Bangla Entertainment Private Limited and Culver Max Entertainment Private Limited (formerly, Sony Pictures Networks India Private Limited) (“**Transferee Company**” or “**Merged Entity**”) and their respective shareholders and creditors (“**Sony/Zee Merger Scheme**”) under sections 230 to 232 and other applicable provisions of the Companies Act.

The NCLT Mumbai’s approval of the Sony/Zee Merger Scheme has been challenged in appeals filed by various parties, including IDBI Bank Limited and Axis Finance Limited, before the National Company Law Appellate Tribunal (“**NCLAT**”).

As is the case with other schemes of arrangement, paragraph 7 of Part V of the Sony/Zee Merger Scheme permits any modification/amendments to such scheme and states that subject to the provisions of the SEBI Circular, the parties to the Sony/Zee Merger Scheme may, by mutual consent and acting through their respective board of directors (which will include any committee constituted by the respective boards), assent to any modifications/amendments to the Scheme and/or to any conditions or limitations that the NCLT or any other governmental authority may deem fit to direct or impose or which may otherwise be considered necessary, desirable or appropriate by them.

The Sony/Zee Merger Scheme *inter-alia* provides for the appointment of Mr. Punit Goenka as the managing director and the chief executive officer of the Transferee Company (“**MD/CEO**”), on terms set out in the Sony/Zee Merger Scheme and as agreed between Mr. Punit Goenka and the Transferee Company.

PROVISIONS UNDER THE SONY/ZEE MERGER SCHEME REGARDING APPOINTMENT OF MR. PUNIT GOENKA

The Sony/Zee Merger Scheme states the following in relation to the appointment of Mr. Punit Goenka as the MD/CEO of the Merged Entity:

1. Mr. Punit Goenka will be appointed for a period of five years from the effective date of the merger. This provision is stated to be “*an integral part of the Scheme.*”
2. The approval of the Sony/Zee Merger Scheme by the board of directors and the shareholders of the relevant companies will be deemed to be the approval of board of directors and the shareholders of the respective companies for the appointment of Mr. Punit Goenka under the relevant provisions of the Companies Act and/ or rules and the SEBI (Listing Obligations and Disclosure Requirements), 2015 and the articles of association of the Transferee Company.
3. No further resolution or actions, including compliance with any procedural requirements, will be required to be undertaken by the Transferee Company in this regard. Upon the Sony/Zee Merger Scheme coming into effect, the Transferee

Company will, if required, file all necessary documents/ notifications with the relevant governmental authorities to record the appointment of Mr. Punit Goenka.

4. The Sony/Zee Merger Scheme will become effective upon fulfilment of certain conditions, including approval from the Ministry of Information and Broadcasting, Government of India for *inter-alia* the appointment of Mr. Punit Goenka as MD/CEO.

THE NCLT MUMBAI ORDER

1. While the Sony/Zee Merger Scheme has been sanctioned by the NCLT Mumbai, in the intervention applications filed by various objectors against the petition filed by Zee Entertainment, one of the objections raised was in relation to the appointment of Mr. Punit Goenka as MD/CEO of the Merged Entity.
2. It was contended that (a) SEBI passed an interim order dated June 12, 2023 (“**SEBI Interim Order**”) against Mr. Punit Goenka and Mr. Subhash Chandra restraining them from holding any key managerial positions in any listed company or its subsidiary, and therefore, the Sony/Zee Merger Scheme to the extent of appointing Mr. Punit Goenka as the MD/CEO of the Merged Entity cannot be implemented; and (b) while Mr. Subhash Chandra and Mr. Punit Goenka had filed an appeal against the SEBI Interim Order, since the appeal was rejected by the Securities Appellate Tribunal (“**SAT**”), Mr. Subhash Chandra and Mr. Punit Goenka were disentitled to hold any post in the Merged Entity, until the ban was lifted by SEBI.
3. The NCLT Mumbai pursuant to its order dated August 10, 2023 dismissed the intervention applications. It held that the SEBI Interim Order was a very recent one, that was passed after filing the Sony/Zee Merger Scheme with NCLT Mumbai, which could not have been anticipated at the time of approving such scheme by the board and filing with NCLT Mumbai. Further, NCLT Mumbai also stated the following: “.....Culver Max Entertainment Private Limited (the transferee Company) *has every right to take up this issue at their board level after approval of the scheme depending upon the final outcome of the order of the SEBI for which the present scheme need not be halted on that ground. At the same time the above observations of this bench does not in any way amount to approving the appointment of Mr. Goenka under the scheme as it is subjudice and subject to further approval of the transferee company or of any other authority required as per regulations.*” (emphasis added)
4. The SEBI orders, including the SEBI confirmatory order dated August 14, 2023, have been challenged by Mr. Punit Goenka before the SAT on the basis that the order was unfair and against public interest keeping in view the merger. After hearing the arguments of the parties, the SAT has reserved orders on September 27, 2023.

CONCLUSION

The NCLT Mumbai order approving the Sony/Zee Merger Scheme stated that the appointment should be decided by the board of directors of the Merged Entity depending on the final outcome of the SEBI orders and such scheme “*need not be halted on this ground*”.

The question not addressed by the NCLT Mumbai is whether, in the facts of the present case, any change to the provision in respect of the appointment of Mr. Goenka as the MD/CEO for a period of five years from the effective date (described in the Sony/Zee Merger Scheme as an integral part of such scheme) will be considered as a modification that is necessary for the proper working of such scheme or as a substantial modification to such scheme or change in ‘basic fabric’ of such scheme which would require fresh shareholders’ approval.

As a practical matter, the Sony/Zee Merger Scheme in its current form cannot be implemented today in view of the SEBI’s orders in relation to Mr. Goenka without a modification to such scheme or a reversal of the SEBI order barring Mr. Goenka from being the MD/CEO of the Merged Entity.

The outcome of the appeals before the NCLAT against the NCLT Mumbai’s order could well provide further guidance on this issue.

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