DCS/IPO/TL/ESOP-IP/2456/2022-23 **"E-Letter"** **August 23, 2022**

The Company Secretary,
HINDUSTAN ZINC LTD.
Yashad Bhawan, Udaipur,
Rajasthan, 313004

Dear Sir,

Sub: Observation Letter regarding the Scheme of Arrangement between Hindustan Zinc Ltd and its Shareholders

We are in receipt of the draft Scheme of Arrangement filed by **Hindustan Zinc Ltd** as required under SEBI Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017; SEBI vide its letter dated August 22, 2022, **has inter alia given concerns on the draft scheme which are placed as Annexure I and it's comment(s) on the draft scheme of Arrangement wherein Company shall ensure that the comments shall be part of the explanatory statement sent to shareholders and before NCLT for the purpose of seeking their approval as Annexure II:**

Annexure I

I.FACTS OF THE CASE IN BRIEF:

1) **Draft Scheme of Arrangement filed by Hindustan Zinc Limited provides for transfer of an amount of Rs.103,83,15,26,729 standing to the credit of the General Reserve to Retained Earnings of the Company.**

2) **Hindustan Zinc Limited is listed on Bombay Stock Exchange Limited and National Stock Exchange of India Limited.**

3) **As per the draft scheme document, the rationale provided by the company for the scheme is as follows:**

   i. **Over the years, the Company has built up significant reserves through transfer of profits to the reserves in accordance with provisions of the erstwhile Companies Act, 1956 and erstwhile Rules notified thereunder, namely, the Companies (Transfer of Profits to Reserves) Rules, 1975.**
   ii. **Steady growth in sales volume, balanced capital expenditure for continuing operations has helped the Company achieve a strong track record of generating cash flows. With healthy business practices in place, the Company expects that it will continue its growth trajectory and its business operations will keep generating incremental cash flow over the coming years.**
   iii. **The company is of the view that the funds represented by the general reserves are in excess of the Company's anticipated operational and business needs in the foreseeable future, thus, these excess funds can be utilized to create further shareholder's value, in such manner and to such extent, as the Board of the Company in its sole discretion, may decide, from time to time and in accordance with the provisions of the Act and other applicable law.**
   iv. **The scheme is in interest of all stakeholders of the Company**

II.COMMENTS OF SEBI ON THE DRAFT SCHEME OF ARRANGEMENT:

1) **In terms of section 205(2A) of the erstwhile Companies Act, 1956, it was mandatory for companies to transfer a certain percentage of profits, not exceeding ten percent, to the reserves, which would be beneficial to both, company and shareholders, because such reserves would be available to the company for ploughing them back for expansion of the activities of the companies and would also be available for declaration of dividends in a lean year.**

2) **The erstwhile Companies (Declaration of Dividend out of Reserves) Rules, 1975 provided that in event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of accumulated profits earned by it in previous years and transferred by it to reserves, subject to conditions that-**

   i. **Rate of dividend declared shall not exceed dividend declared for previous five years or 10% of paid up capital, whichever is less.**
   ii. **Total amount to be transferred from general reserve shall not exceed 10% of paid-up capital and free reserves and amount be first utilized to set off the losses before declaring dividend.**
   iii. **Balance of reserves after such transfer shall not fall below 15% of the paid up capital.**

3) **However, section 123 of the Companies Act, 2013, which corresponds to section 205(2A) of the erstwhile Companies Act, 1956, made effective from September 12, 2013, provides that a company may, before declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Thus, in terms of the above first proviso, to section 123(1) of the Companies Act, 2013, such transfer of profits to reserves has not been made compulsory.**

4) **Incidentally, the second proviso to section 123 of Companies Act, 2013 still provides that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.**

5) **In this regard, the Companies (Declaration and Payment of Dividend) Rules, 2014, states as under –**

   In the event of inadequacy of absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfilment of the following conditions, namely:-

   i. **The rate of dividend declared shall not exceed the average of rate at which dividend was declared by it in the three years immediately preceding that year. Provided that this sub-rule shall not apply to a company which has declared any dividend in each of the three preceding financial years.**
   ii. **The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid up share capital and free reserves as appearing in the latest audited financial statement.**

iii. The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

iv. The balance of reserves after such withdrawal shall not below fifteen percent of its paid up share capital as appearing in the latest audited financial statement.

6) As a result of this scheme, the funds which were meant for restrictive use, as part of general reserve, would now be available for any purpose, including distribution as dividend, after transfer to P&L Account, which does not have any apparent restrictions on its use.

7) By transferring funds from general reserves to P&L Account, the companies are practically re-transferring funds which had been transferred to the general reserve as per the compulsory provisions existing then under the erstwhile Companies Act, 1956. However, no such explicit provision is provided in the extant law and it is silent on enabling/restraining such retransfer. Nevertheless, the purposes for which general reserve could be utilized does not envisage transfer of the general reserve (compulsory) to P&L Account for an unfettered and unrestricted use.

8) The freedom to transfer profits to reserves on a voluntary basis, as outlined in para 3 above, would be prospective in nature, after notification of the 2013 Act. In effect, the company is attempting to apply the provision for voluntary transfer to reserves, on a retrospective basis by transferring back the entire general reserve to P&L account.

9) Further, though the extent provisions of the Companies Act, 2013 do not make it mandatory for transfer to general reserves, Companies (Declaration and Payment of Dividend) Rules, 2014 exist which in effect are having similar provisions as that of Companies (Declaration of Dividend out of Reserves) Rules 1975. Thus, the right of payment of dividend out of reserves is not an unfettered right and is subject to conditionalities. The only provision done away with is the compulsory transfer from profits to reserves which gives freedom to the companies in this respect.

10) Consequently, the limited freedom given to companies through the Companies Act, 2013, is with respect to whether or not profits may be transferred to reserves, and not an untrammelled right to utilize the already existing compulsorily transferred reserves in total disregard to the restrictions on usage as contained in the Companies (Declaration and Payment of Dividend) Rules, 2014.

11) In a nutshell, the prospective nature of the Section 123 of the Companies Act, 2013 as well as the retention of restrictions on payment of dividend out of accumulated reserves as enshrined in the Companies (Declaration and Payment of Dividend) Rules, 2014, suggests that the lawmakers had neither intended unrestricted use of accumulated profits to pay dividend, nor transfer of reserves to P&L account to possibly pay dividend in this circumlocutory manner. Thus, the conduct of the company may be at variance with the spirit of the law.

12) Once the scheme is permitted, Hindustan Zinc Limited, is free to use the money liberally disregarding the conservative policies as are contained in Companies (Declaration and Payment of Dividend) Rules, 2014.

13) **Also, in the instant case, it has not been specified how shareholder value is intended to be created. Such vagueness of purpose, and conduct of the management with respect to the possible usage outlined in the paras above, may not be in the interest of shareholders.**

14) **In view of the above, the proposed scheme may not be justified, both from the legal and the corporate governance point of view.**

15) **It may also be mentioned that in respect of some Schemes providing for similar transactions, in past, the Ministry of Corporate Affairs, had contended before Hon'ble National Company Law Tribunal that Scheme is not in the public interest as it is framed to circumvent the provisions of Section 123 of Companies Act, 2013 and the Companies (Declaration and Payment of Dividend) Rules, 2014.**

16) **Incidentally, it may also be mentioned that Hon'ble Supreme Court in the case of National Confederation of Officers Association of Central Public Sector Enterprises and Ors. Vs. Union of India & Ors. vide order dated November 18, 2021 had inter-alia observed that –**

"There is sufficient material for registration of a regular case in relation to the 26 percent disinvestment of Hindustan Zinc Limited by the Union Government in 2002. The CBI is directed to register a regular case and proceed in accordance with law."

III.

"Company is advised to make Stock Exchanges a party in the matter and they should suitably articulate the said concerns before the NCLT during the proceedings regarding this scheme."

Accordingly, based on aforesaid comment offered by SEBI, the company is hereby advised:

i. To provide additional information, if any, (as stated above) along with various documents to the Exchange for further dissemination on Exchange website.
ii. To ensure that additional information, if any, (as stated aforesaid) along with various documents are disseminated on their (company) website.
iii. To duly comply with various provisions of the circulars.

In light of the above, we hereby advise that we have no adverse observations with limited reference to those matters having a bearing on listing/de-listing/continuous listing requirements within the provisions of Listing Agreement, so as to enable the company to file the scheme with Hon'ble NCLT.

Further, where applicable in the explanatory statement of the notice to be sent by the company to the shareholders, while seeking approval of the scheme, it shall disclose information about unlisted company involved in the format prescribed for abridged prospectus as specified in the circular dated March 10, 2017.

Kindly note that as required under Regulation 37(3) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the validity of this Observation Letter shall be six months from the date of this Letter, within which the scheme shall be submitted to the NCLT.

The Exchange reserves its right to withdraw its 'No adverse observation' at any stage if the information submitted to the Exchange is found to be incomplete / incorrect / misleading / false or for any contravention of Rules, Bye-laws and Regulations of the Exchange, Listing Agreement, Guidelines/Regulations issued by statutory authorities. Please note that the aforesaid observations does not preclude the Company from complying with any other requirements.

Further, it may be noted that with reference to Section 230 (5) of the Companies Act, 2013 (Act), read with Rule 8 of Companies (Compromises, Arrangements and Amalgamations) Rules 2016 (Company Rules) and Section 66 of the Act read with Rule 3 of the Company Rules wherein pursuant to an Order passed by the Hon'ble National Company Law Tribunal, a Notice of the proposed scheme of compromise or arrangement filed under sections 230-232 or Section 66 of the Companies Act 2013 as the case may be **is required to be served upon the Exchange seeking representations or objections if any.**

In this regard, with a view to have a better transparency in processing the aforesaid notices served upon the Exchange, the Exchange has **already introduced an online system of serving such Notice along with the relevant documents of the proposed schemes through the BSE Listing Centre.**

Any service of notice under Section 230 (5) or Section 66 of the Companies Act 2013 seeking Exchange's representations or objections if any, **would be accepted and processed through the Listing Centre only and no physical filings would be accepted.** You may please refer to circular dated February 26, 2019 issued to the company.

Yours faithfully,

Sd/-

Prasad Bhide
Senior Manager

Sd/-

Tanmayi Lele
Assistant Manager