Laws Relating to Mergers and Acquisitions in India: A brief Study

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Introduction

The Companies Act, 1956 had almost reached its retirement age after having been in existence for more than five-and a half decades. It was essential that robust and young corporate laws were introduced in the system. This journey began in 2008, when the Companies Bill, 2008 was first introduced in the Lok Sabha. However, it hit a road-block on its introduction in August 2008 and had to be withdrawn due to dissolution of the Lok Sabha. The Bill was re- introduced in Parliament in 2009 and was subsequently sent to the Standing Finance Committee. After considerable deliberation with stakeholders, the Committee presented its report to the Lok Sabha in August 2010. Taking into consideration the recommendations of the report, a revised version of the Bill was again referred to the Committee in 2011 with the inclusion of certain new provisions. The Bill was passed by both the houses of Parliament between December 2012 and August 2013. The President signed on the dotted line on 29 August 2013, providing his much awaited consent to the 29 chapters, 470 clauses and 7 schedules comprising the Companies' Act, 2013. This marked a landmark event in the history of Indian corporate law. The much needed new Act will make acquisitions, certain mergers and restructuring easier for companies, empower private equity investors to enforce various restrictions in agreements and check the malpractices of promoters by increasing transparency in their operations. The Act also has the potential to trigger a spate of domestic and cross border mergers and acquisitions, and make Indian organizations more attractive to investors.

1. Theoretical Background

A. Mergers and Amalgamations

The term 'merger' is not defined under the Companies Act, 1956 (**"CA 1956"**), and under Income Tax Act, 1961 (**"ITA"**). However, the Companies Act, 2013 (**"CA 2013"**) without strictly defining the term explains the concept. A 'merger' is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of he distinct entities, but organization of such entity into one business. The possible objectives of mergers are manifold - economies of scale, acquisition of technologies, access to sectors / markets etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

- Horizontal Mergers

This kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process. A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market.

- Vertical Mergers

Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration.

- Congeneric Mergers

These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship. A company uses this type of merger in order to use the resulting ability to use the same sales and distribution channels to reach the customers of both businesses.

- Conglomerate Mergers

A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt apacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.

- Cash Merger

In a 'cash merger', also known as a 'cash out merger', the shareholders of one entity receives cash instead of shares in the merged entity. This is effectively an exit for the cashed out shareholders.

- Triangular Merger

A triangular merger is often resorted to, for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or

reverse (when the subsidiary merges into the target and the target survives).

B. Acquisitions

An 'acquisition' or 'takeover' is the purchase by one person, of controlling interest in the share capital, or all orsubstantially all of the assets and/or liabilities, of the target. Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target.

C. Joint Ventures

A joint venture is the coming together of two or more businesses for a specific purpose, which may or may not be for a limited duration. The purpose of the joint venture may be for the entry of the joint venture parties into a new business, or the entry into a new market, which requires the specific skills, expertise or the investment of each of the joint venture parties. The execution of a joint venture agreement setting out the rights and obligations of each of the parties is a norm for most joint ventures.

2. Mergers and Amalgamations: Key Corporate and Securities Law Considerations.

A. Company Law

Sections 390 to 394 of the CA 1956 (the **"Merger Provisions"**) and Section 230 to 234 of CA 2013 govern mergers and schemes of arrangements between a company, its shareholders and/or its creditors. However, considering that the rovisions of CA 2013 have not yet been notified, the implementation of the same remains to be tested. The currently applicable Merger Provisions are in fact worded so widely, that they would provide for and regulate all kinds of corporate restructuring that a company can possibly undertake, such as mergers, amalgamations, demergers, spin-off/hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

Applicability of Merger Provisions to foreign companies.

Sections 230 to 234 of CA 2013 recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. Although the Merger Provisions do not permit an Indian company to merge into a foreign company, the merger provisions under Section 234 of the CA 2013 do envisage this, subject to rules made by the Government of India. However, neither is Section 234 currently in force nor have any rules been formulated by the Government of India.

B. Securities Laws

Takeover Code

The Securities and Exchange Board of India (the **"SEBI"**) is the nodal authority regulating entities that are listed and to be listed on stock exchanges in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers)

Listing Regulations:

Prior to December 1, 2015, the listing agreement7 entered into by a company for the purpose of listing its shares with a stock exchange prescribed certain conditions for the listed companies which they have to follow in the case of a Court approved scheme of merger/amalgamation/reconstruction. However, on September 2, 2015, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**"Listing Regulations"**) were notified and has been effective from December 1, 2015.

3.Acquisitions: Key Corporate and Securities Laws Considerations.

A. Company Law

Transferability of shares

Broadly speaking, an Indian company is set up as a private company or as a public company. Membership of a private company is restricted to 200 members18 and a private company is required by the CA 2013 to restrict the transferability of its shares. A restriction on transferability of shares is consequently inherent to a private company, such restrictions being contained in its articles of association (the byelaws of the company), and usually in the form of a pre-emptive right in favor of he other shareholders. With the introduction of CA 2013, although shares of a public company are freely transferable, share transfer restrictions for even public companies have been granted statutory sanction. The articles of association may prescribe certain procedures relating to transfer of shares that must be adhered to in order to affect a transfer of shares. While acquiring shares of a private company, it is therefore advisable for the acquirer to ensure that the non-selling shareholders (if any) waive any rights they may have under the articles of association. Any transfer of shares, whether of a private company or a public company, must comply with the procedure for transfer under its articles of association.

B. Other Security Law

Pricing of the Issue

The Preferential Allotment Regulations set a floor price for an issuance. The floor price of shares is linked to the average of the weekly high and low closing price of the stock of the company over a 26 week period or a 2 week period preceding the relevant date.

Lock-in

Securities issued to the acquirer (who is not a promoter of the target) are lockedin for a period of 1 year from the date of trading approval. The date of trading approval is the latest date when trading approval is granted by all stock exchanges on which the securities of the company are listed. Further, if the acquirer holds ny equity shares of the target prior to such preferential allotment, then such prior holding will be locked in for a period of 6 months from the date of the trading approval. If securities are allotted on a preferential basis to promoters/ promoter group32, they are locked in for 3 years from the date of trading approval subject to a limit of 20% of the total capital of the company. The locked-in securities may be transferred amongst promoter/ promoter group or any person in control of the company, subject to the transferee being subject to the remaining period of the lock in.

Exemption to court approved merger

The Preferential Allotment Regulations do not apply in the case of a preferential allotment of shares pursuant to merger / amalgamation approved by the Court under the Merger Provisions discussed above.

Takeover Code

If an acquisition is contemplated by way of issue of new shares, or the acquisition of existing shares or voting rights, of a listed company, to or by an acquirer, the provisions of the TakeoverCode are applicable. The Takeover Code regulates both direct and indirect acquisitions of shares33 or voting rights in, and control34 over a target company.35 The key
objectives of the Takeover Code are to provide the shareholders of a listed ompany with adequate information about an impending change in control of the company or substantial acquisition by an acquirer, and provide them with an exit option (albeit a limited one) in case they do not wish to retain their shareholding in the company.

Mandatory offer

Under the Takeover Code, an acquirer is mandatorily required to make an offer to acquire shares from the other shareholders in order to provide an exit opportunity to them prior to
consummating the acquisition, if the acquisition fulfils the conditions as set out in Regulations 3, 4 and 5 of the Takeover Code. Under the Takeover Code, the obligation to make a mandatory open offer by the acquirer36 is triggered in the following events:

Voluntary Open Offer

An acquirer who holds between 25% and 75% of the shareholding/ voting rights in a company is permitted to voluntarily make a public announcement of an open offer for acquiring additional shares of the company subject to their aggregate shareholding after completion of the open offer not exceeding 75%.41 In the case of a voluntary offer, the offer must be for at least 10% of the shares of the target company, but the acquisition should not result in a breach of the maximum non-public shareholding limit of 75%. As per
SEBI's Takeover Code Frequently Asked Questions, any person.

Pricing of the offer.

Regulation 8 of the Takeover Code sets out the parameters to determine offer price to be paid to the public shareholders, which is the same for a mandatory open offer as well as a voluntary open offer. There are certain additional parameters prescribed for determining the offer price when the open offer is made pursuant to an indirect acquisition holding less than 25% shareholding/voting rights can also make a voluntary open offer for acquiring additional shares.

Competitive Bid/ Revision of offer/ bid.

The Takeover Code also permits a person other than the acquirer (the first bidder) to make a competitive bid, by a public announcement, for the shares of the target company. This bid must be made within 15 working days from the date of the detailed public announcement of the irst bidder. The competitive bid must be for at least the number of shares held or agreed to be acquired by the first bidder (along with PAC), plus the number of shares that the first bidder has bid for. Each bidder (whether a competitive bid is made or not) is permitted to revise his bid, provided such revised terms are more favourable to the shareholders of the target company.45 The revision can be made up to three working days prior to the commencement of the tendering period.

C. Listing Regulations.

On September 2, 2015, the Listing Regulations were notified and have been effective from December 1, 2015. The Listing Regulations provide for a comprehensive framework governing various types of listed securities. Regulation 30 of Listing Regulations deals with

disclosure of material events by the listed entity whose equity and convertibles securities are listed. Such entity is required to make disclosure of events specified under Part A of Schedule III of the Listing Regulations. The Listing Regulations divide the events that need to be disclosed broadly in two categories. The events that have to be necessarily disclosed without applying any test of materiality are indicated in Para A of Part A of Schedule III of the Listing Regulation. Para B of Part A of Schedule III indicates the events that should be disclosed by the listed entity, if considered material.

D. Insider Trading.

Under the SEBI Act, 1992, the penalty for insider trading is at least INR 10, 00,000 and may extend to INR 25, 00, 00, 000 or three times the amount of profits made out of insider trading, whichever is higher.49 Recently, SEBI replaced the two decade old SEBI (Prohibition of Insider Trading) Regulations, 1992 with the SEBI (Prohibition of Insider Trading) Regulation, 2015 (**“PIT Regulations”**) which are much more extensive in their outreach and scope. In respect of a listed company (or a company that is proposed to be listed), the PIT Regulations prohibit: i. An insider from communicating unpublished price sensitive information (**“UPSI”**), i. Any person from procuring UPSI from an insider, and iii. An insider from trading in securities50 when in possession of UPSI. Therefore the PIT prohibits the provision as well as the receipt of UPSI.

Who is an Insider?

Under the PIT Regulations, an ‘insider’51 is a person who is (i) a connected person; or (ii) in possession of or having access to UPSI. Connected Person**;** A connected person is one who is directly or indirectly associated with the company (i) by reason of frequent communication with its officers; or (ii) by being in a contractual, fiduciary or employment relationship; or (iii) by holding any position including a professional or business relationship with the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access. Therefore, any person who has any connection with the company that is expected to put him in possession of UPSI is connected. Persons who do not seemingly occupy any position in a company but are in regular touch with the company will also be covered. Certain categories of persons are all deemed to be connected, such as ‘immediate relatives’52, a holding, associate or subsidiary company, etc.

What is Unpublished Price
Sensitive Information?

UPSI means any information relating to a company or its securities, directly or indirectly, that is not generally available, and which upon becoming available is likely to materially affect the price of the securities. It includes: financial results; dividends; change in capital structure; mergers, demergers, acquisitions, delisting, disposals and expansion of business and such other transactions; changes in key managerial personnel; and material events in accordance with the Listing Agreement. The term ‘generally available’54 means information that is accessible to the public on a non-discriminatory basis.

Defenses/ Exceptions

The communication of UPSI by an Insider and the procurement of UPSI by a person from an insider is permitted if such communication, procurement is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

Disclosures

A significant aspect of the insider trading norms is disclosure requirements for different categories of persons involved in the affairs of the company. It is important to bear in mind that going forward, every promoter, key managerial personnel and director of a company would be required to disclose to the company his holding of securities of the company as on date of appointment/date of notification of the PIT Regulations i.e. May 15, 2015. More importantly, every promoter, employee or director would be required to make continual disclosures (within 2 trading days of such transaction) in case the traded value of securities over a calendar quarter exceeds the monetary threshold of INR 10,00,000 or such other value as may be specified.

4. Company Law

The Competition Act, 2002(**“Competition Act”**) replaced the Monopolies and Restrictive Trade Practices Act, 1969, and takes a new look at competition altogether. The Competition Act primarily covers (i) anti-competitive agreements (Section 3), (ii) abuse of dominance (Section 4), and (iii) combinations (Section 5, 6, 20, 29, 30 and 31).

Anti - Competitive
Agreements

The Competition Act essentially contemplates two kinds of anticompetitive agreements – horizontal agreements i.e. agreements between entities engaged in similar trade of goods
or provisions of services, and vertical agreements i.e. agreements between entities in different stages / levels of the chain of production, in respect of production, supply, distribution, storage, sale or price of goods or services.

Abuse of Dominant Position

An entity is considered to be in a dominant position if it is able to operate independently of competitive forces in India, or is able to affect its competitors or consumers or the relevant market in India in its favor. The Competition Act prohibits an entity from abusing its dominant position. Abuse of dominance would include imposing unfair or discriminatory conditions or prices in purchase/sale of goods or services and predatory pricing, limiting or restricting production / provision of goods/services, technical or scientific development, indulging in practices resulting in denial of market access etc.

Regulation of Combinations

The Combination Regulations are the key regulations through which the CCI regulates combinations such as mergers and acquisitions. Under Section 32 of the Competition Act, the CCI has been conferred with extra-territorial jurisdiction. This means that any acquisition where assets / turnover are in India (and exceed specified limits) wouldbe subject to the scrutiny of the CCI, even if the acquirer and target are located outside India.

5.Exchange control

The FI Regulations segregate foreign investments into various types: foreign direct investments (FDI), foreign portfolio investments (FPI), investments by non-resident Indians (NRI) on portfolio basis, or on non-repatriation basis, foreign venture capital nvestments.

A.Foreign Direct Investment (FDI)

Schedule 1 of the FI Regulations contains the Foreign Direct Investment Scheme (**"FDI Scheme"**), and sets out the conditions for foreign direct investments in India. Annex A of the FDI Scheme sets out the sectors in which FDI is prohibited. This list includes sectors such as lottery, gambling, defence etc. A foreign investor can acquire shares or convertible debentures60 in an Indian company upto the investment (or sectoral) caps for each sector provided in Annexure B to the FDI Scheme. Investment in certain sectors requires the priorapproval of the Foreign Investment Promotion Board (**"FIPB"**) of the Government of India, which is granted on a case to case basis. As per Press Note 6 of 2015, any foreign equity inflow that requires prior FIPB approval and is above INR 3,000 crores requires a prior approval of the Cabinet Committee on Economic Affairs.

Portfolio Investment Scheme

Foreign portfolio investors registered with the SEBI as per the SEBI (Foreign Portfolio Investment) Regulations, 2014 and non-resident Indians (**"NRI"**), are permitted to invest in shares / convertible debentures under the portfolio investment scheme. This scheme remits Investment in listed securities through the stock exchange.

Foreign venture capital investors ("FVCI")

An FVCI registered with the SEBI can invest in Indian venture capital undertakings, venture capital funds or in schemes floated by venture capital funds under the terms of Schedule 6 of the FI Regulations. One of the important benefits of investing as an FVCI is that an FVCI is not required to adhere to the pricing requirements that are otherwise required to be met by a foreign investor under the automatic route61 when purchasing or subscribing to shares or
When selling such shares.

B. Indirect Foreign Investment

Foreign investment may be direct or indirect. Generally speaking (and subject to certain exceptions) if an Indian investing company is "owned"62or "controlled"63by "non-resident entities"64, then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment.

Conclusion

As Dale Carnegie91 said "Flaming enthusiasm, backed by horse sense and persistence, is the quality that most frequently makes for success". A quote that holds good for M&A in India, and a credo to which Indian companies seem to subscribe given their successes to date in completing acquisitions. There is little to stop Indian companies that desire to be global names for playing the merger and amalgamation game globally. With a plethora of financing options, this aspiration has become a reality for many corporate houses, who can now boast of having the best in the industry under their wings. Indian companies have often surpassed their foreign counterparts in corporate restructuring both within and beyond the national frontiers. Mergers and acquisitions are powerful indicators of a robust and growing economy. The legal framework for such corporate restructuring must be easy and facilitative and not restrictive and mired in bureaucratic and regulatory hurdles. The biggest obstacle in the way of completing a merger or an amalgamation remains the often long drawn out court procedure required for the sanction of a scheme of arrangement. 91. November 24, 1888 – November 1, 1955. The recommendations of the JJ Irani Report are of particular significance in this regard. The Report has recommended that legal recognition to 'contractual merger' (i.e., mergers without the intervention of the court) can go a long way in eliminating the obstructions to mergers in India. The report also recommended that the right to object to a scheme of merger/ acquisition should only be available to persons holding a substantial stake in the company. As George Bernard Shaw92 is reputed to have said "we are made wise not by the recollection of our past, but by the responsibility for our future", and the future of India is bright indeed.

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