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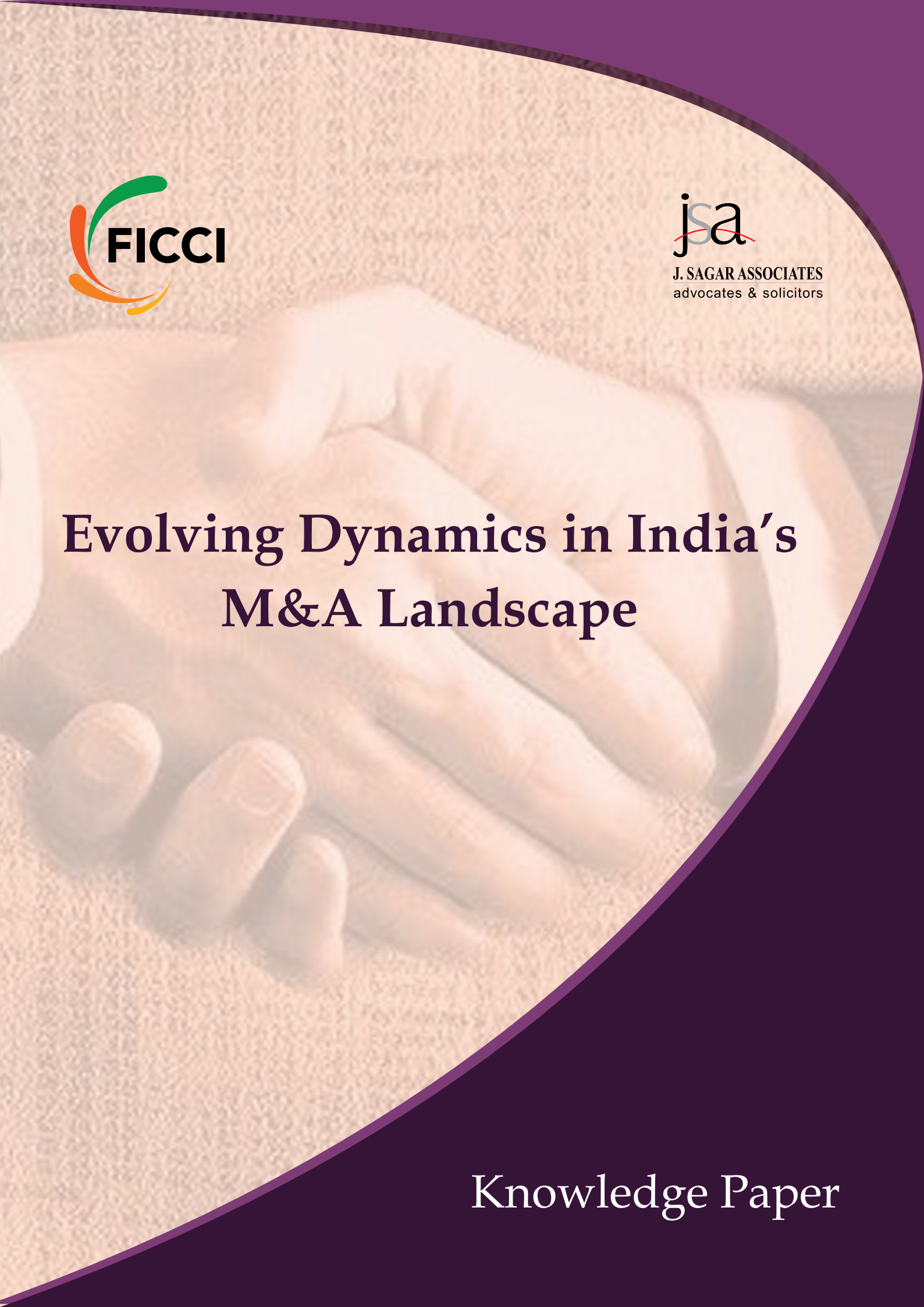

Evolving Dynamics in India's M&A Landscape

Knowledge Paper

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September 2012

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Foreword

Corporate laws in India are increasingly becoming more sophisticated and refined as India becomes a mainstay of the global corporate climate. Today, M&A in India is a vital part of inbound and outbound economic activity. As targets or acquirers, Indian business is increasingly involved in horizontal and vertical integration, and in maximizing the synergies that accompany M&A transactions. This knowledge paper provides a detailed roadmap of the history, process, rationale, future, and need for M&A, both to and from India. The layout of this knowledge paper is for the ease of chronological and schematic trends and the fundamentals of M&A along with the global economic parameters of this rigorous domain.

The Introduction (Section 2) traces the recent activity in M&A across the Asia Pacific, with a practical and theoretical explanation on the basis of critical sectors for inbound and outbound M&A accompanied with tabular data for the aforesaid trends. If reflects that China is the leader in Asia Pacific, India trailing behind at fourth place. It further discusses in brief the notable deals in the M&A space, and proceeds to outline the relationship that India has with Europe from an M&A perspective. This leads into the prevailing economic climate, and Section 3 details the rationale behind M&A, and the need for sustainable M&A activity in India. A discussion on the history of M&A activity in India is accompanied with the background for M&A through history around the world. The practical discussion on the history and current affairs leads into a detailed analysis of prevalent theory behind M&A, including but not limited to, a brief comparison on the types of mergers and acquisitions, the valuation process, and M&A-specific issues in cases of demergers and spin-offs to name a few.

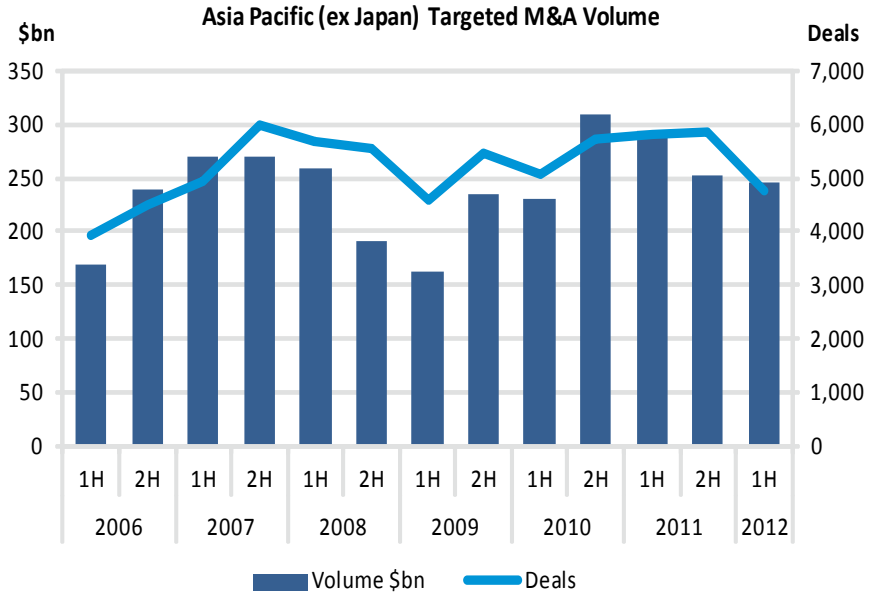
The theoretical discussion detailed in Section 3 leads into the law governing M&A activity in India, especially the policies and regulations governing M&A in India-the foreign exchange regulations, Companies Act, 1956, competition law, taxation law, etc. Salient aspects of this Section 4 includes a detailed summary of the current FDI Policy, pricing of shares, possible legal issues pertaining to M&A activity with respect to the Companies Act, 1956, and the most recent Competition Act regulations. This section then extends into a comparative analysis between prevailing laws and processes in India and the EU, concluding with the implications under taxation laws.

Section 5 provides a practical walkthrough for any M&A transaction, along with the most prevalent issues that arise in such transactions. Challenges and criticalities surrounding pre-emptive rights, put and call options and restructuring are highlighted and explained in this section. Section 6 deals with Bankruptcy Takeovers setting out various legislations in this regard including the SARFAESI Act. This leads into sections pertaining to growth estimates for M&A in and by Indian business, and sector-specific M&A issues and activity. This leads into Section 8 which walks the readers of this paper through the various stages of M&A transactions. Documentation, legalities, pertinent clauses, and stages of due diligence, drafting, negotiations, signing & closing of deals, and miscellaneous provisions are included in this section and explained in substantial detail. The section concludes with a comparison between India and the EU and a brief analysis.

The summary and conclusion of this paper provides a brief outlook for future M&A activity in India.

Introduction

The Asia Pacific (excluding Japan) region's target M&A reached approximately USD 250 billion in the first half of 2012. Although significant, this is 16 percent less than the comparable period in 2011 and marked the lowest half year period since the first half of 2009. China continued to be the primary target nation in Asia Pacific during the first half of 2012 almost reaching the USD 100 billion threshold (approximately USD 97.6 billion), seeing an increase from USD 91 billion during the same period in 2011. In all, China accounted for 32 percent of the total Asia Pacific M&A volume - the highest first half share since 2009, when it was 33 per cent. The leading target sector was finance (with USD 16.8 billion) followed by mining (USD 12.4 billion). The other sectors which followed finance and mining are real estate, technology, metal and steel, utility and energy, retail, oil and gas, telecom and construction



India is ranked fourth in the most targeted nations rankings of the Asia Pacific region in the first half of 2012 with USD 26.2 billion, down by 26 per cent when compared to the same period of 2011 (USD 35.2 billion). India's outbound M&A volume only reached USD 2.8 billion in the first half of 2012, the lowest figure for a half period since the second half of 2009 (USD 1.1 billion) and down by an extremely significant 87 per cent from the record amount achieved in the first half of 2010 (USD 21.1 billion). These statistics cover a vast array of M&A activities including but not limited to acquisitions of companies, acquisitions of assets (divestitures), stake purchases, mergers, joint ventures, spin-offs & split-offs, privatization, government awarded personal communications services / wireless licenses, real estate property transactions, and buy-back transactions structured as public tender offers, as divestments or as a defensive technique in response to an unsolicited takeover approach, among others.

Notable M&A deals for the first half of 2012 include the following:

a.) In the insurance sector, there were two notable deals (a) the buy-out by Japan's Mitsui Sumitomo of the entire 26 per cent stake that New York Life Insurance Company owned in Max New York Life Insurance Company; and (b) Nippon Life Insurance Company's acquisition of a 26 per cent stake in Reliance Capital Asset Management Ltd;

b.) Also of note was i-Gate's acquisition of the entire stake owned by Patni Computers (81 per cent).

Notable outbound deals included Piramal Healthcare's acquisition of the Decision Resources Group in the United States, and Binani Industries' acquisition of 3B The Fibreglass Co in Belgium. More recent one is Infosys's acquisition of Lodestone Holding AG, a Swiss technology consulting firm.

The sectors that dominated the inbound M&A in India during the first half of 2012 included technology, insurance, professional services, and finance. Utility & energy, oil & gas, and retail were left far behind.

Rank	Target Sector	Deal Value $ (m)	No.	% share
1	Technology	608	25	16
2	Insurance	522	1	14
3	Professional Services	363	24	9
4	Finance	360	10	9
5	Construction/Building	300	10	8
6	Healthcare	299	11	7.7
7	Telecommunications	281	4	7.3
8	Consumer Products	241	10	6.2
9	Food & Beverage	221	8	5.7
10	Utility & Energy	185	8	4.8
11	Oil & Gas	167	4	4.3
12	Transportation	106	9	2.7
13	Auto/Truck	80	7	2.1
14	Metal & Steel	45	8	1.2
15	Retail	42	5	1.1
16	Machinery	31	4	0.8
17	Leisure & Recreation	10	4	0.3
18	Chemicals	9	1	0.2
19	Publishing	5	1	0.1
20	Real Estate/Property	N/A	1	N/A
20	Agribusiness	N/A	1	N/A
20	Forestry & Paper	N/A	1	N/A
20	Dining & Lodging	N/A	3	N/A
	Total	**3,876**	**160**	**100**

Source: Dealogic

However, the trend in outbound M&A deals was quite different, with M&A in professional services and mining out distancing the sectors that led the inbound M&A trend - finance, retail, utility & energy, and oil & gas.

Rank	Target Sector	Deal Value $ (m)	No. of deals	% share
1	Professional Services	908	13	22.5
2	Mining	757	6	18.8
3	Dining & Lodging	633	2	15.7
4	Consumer Products	361	4	9.0
5	Food & Beverage	350	1	8.7
6	Technology	192	13	4.8
7	Forestry & Paper	153	2	3.8
8	Healthcare	151	8	3.7
9	Auto/Truck	148	5	3.7
10	Publishing	144	1	3.6
11	Oil & Gas	51	1	1.3
12	Transportation	44	6	1.1
13	Utility & Energy	35	1	0.9
14	Holding Companies	30	2	0.8
15	Agribusiness	22	2	0.6
16	Telecommunications	22	5	0.5
17	Machinery	15	5	0.4
18	Retail	7	3	0.2
19	Finance	5	2	0.1
20	Metal & Steel	3	4	0.1
	Total	**4028**	**93**	**100**

Source: Dealogic

The following tables highlight the Indian M&A deals (both inbound and outbound) with the European Union **("EU").**

Inbound

Rank	Target Sector	Deal Value $ (m)	No. of Deals	% share
1	Food & Beverage	206	3	26.7
2	Technology	205	6	26.7
3	Oil & Gas	130	1	16.9
4	Professional Services	55	12	7.2
5	Healthcare	53	2	6.9
6	Finance	40	5	5.2
7	Transportation	31	3	4.1
8	Auto/Truck	30	2	3.9
9	Leisure & Recreation	9	1	1.2
10	Construction/Building	6	4	0.7
11	Consumer Products	4	2	0.5
12	Dining & Lodging	N/A	2	N/A
12	Machinery	N/A	2	N/A
12	Metal & Steel	N/A	2	N/A
12	Agribusiness	N/A	1	N/A
12	Retail	N/A	1	N/A
12	Utility & Energy	N/A	2	N/A
	Total	**770**	**51**	**100.0**

Source: Dealogic

Outbound

Rank	Target Sector	Deal Value $ (m)	No. of Deals	% share
1	Consumer Products	361	2	32.9
2	Food & Beverage	350	1	31.9
3	Technology	190	5	17.3
4	Healthcare	101	4	9.2
5	Auto/Truck	56	3	5.1
6	Professional Services	30	5	2.8
7	Machinery	8	4	0.7
8	Metal & Steel	3	1	0.2
9	Mining	N/A	1	N/A
9	Retail	N/A	1	N/A
9	Telecommunications	N/A	1	N/A
9	Transportation	N/A	1	N/A
9	Chemicals	N/A	2	N/A
	Total	**1,098**	**31**	**100**

Source: Dealogic

The EU and India benefit from a long standing relationship going back to the early 1960s. The Joint Political Statement of 1993 and the 1994 Co-operation Agreement, which is the current legislative framework for cooperation, opened the door to a broad political dialogue, evolving through annual summits, along with regular ministerial and expert level meetings.

In 2004 India became one of the EU's Strategic Partners. Since 2005, the Joint Action Plan which was further revised in 2008, is helping to realise the true potential of this partnership in key areas of interest for India and the EU. Current efforts are centered on the following:

(a) in light of the *EU-India Declaration on International Terrorism,* there is a focused effort to develop cooperation in the field of security;

(b) ongoing negotiations for a free trade agreement; and

(c) implementation of the joint work program on climate change adopted in 2008.

The Country Strategy Paper for India 2007-2013 which estimates a yearly average of € 67 million for a total of € 470 million concentrates EU funds on health, education and the implementation of the Joint Action Plan (refer also to its mid-term review). A memorandum of understanding for the Multi-Annual Indicative Programme **("MIP")** 2011-2013 was signed between the EU and India in February 2011. A review confirmed the need to further support social sectors like health and education, with a special focus on secondary education and vocational training. For the MIP, the EU intends to fund fellowships for Indian students and professors through the Erasmus Mundus initiative under the European Commission **("EC"),** as well as projects in the fields of energy, environment and trade related technical assistance.

European companies have shown and continue to show a significant level of confidence in the medium and long term prospects of the Indian economy by contributing and partnering in the growth and success story of India. EU-India trade relations remain healthy and the commitment of the numerous EU companies with a presence in India is a testimony to this.

Despite a challenging global macro-economic situation, the latest figures in trade and investment present a continuing positive trend. 2011 saw trade in goods grow to the highest annual figure ever, reaching € 80 billion, representing a 17 per cent annual growth in what is overall a balanced trade relationship between EU and India. The latest figures for first quarter of 2012 continue to show healthy levels of growth with nearly 7 per cent growth for that quarter as compared to the first quarter of 2011.

Trade in services, has been equally robust at over € 20 billion with Indian trade services growing by over 12 per cent in 2011. This brings total annual trade between the EU and India to over € 100 billion which is a significant milestone, especially in the current economic climate.

At the same time, 2011 saw a two and a half times increase in foreign direct investment **("FDI")** from the EU into India, surpassing previous estimates by reaching € 12 billion, when the average annual level of FDI over the last 5 years (2007-11) had been € 5.6 billion. Indian companies in turn invested € 1.9 billion in the EU in 2011.

[Source: Website of European External Action Service]

The aforementioned statistics support the view that India and EU enjoy healthy trade relations with sizeable investment flowing back and forth in numerous sectors of both economies.

Nevertheless, the European debt crisis and the danger associated with it cannot be ignored. Five countries in the EU - Greece, Portugal, Ireland, Italy, and Spain have failed to honour commitments to pay back the debt raised on account of the failure to generate sufficient economic growth. The EU crisis may spread gloom in the financial markets globally, with the US economy already reeling due to its exposure to the EU. Recently, Moody's Investors Service cut EU's outlook to negative reflecting the risks to countires like Germany, France, the UK and the Netherlands which account for around 45% of the group's revenue budget. Moody's Investors Service has further said although there is a moderate direct impact of an expected European recession for most corporate issuers of debt in Asia (excluding Japan), indirect risks are rising on account of weak exports to the EU region. As far as India is concerned, the extent of the effect on the Indian economy is still open to debate. The jury is out on whether the present environment will provide opportunities to Indian investors for making acquisitions in the EU easier, or whether reaching out and supplying exports to countries which had earlier relied heavily on the EU. These are pressing issues with contrasting viewpoints. What is clear however, is that India will not remain insulated from the Eurozone crisis – the nature of how and what happens will become clearer in the future. Although there does not appear to be any imminent danger of the kind which has hit some European countries, nevertheless there do appear to be numerous signs of an economic slowdown in India. Some of the global credit rating agencies have not been kind to the Indian economy, downgrading it in their forecasts and more recently Pew Global Attitudes Project India Report making India the most pessimistic among some major global economies. While this has sparked angry rebuttals from the powers that be in India, the fact remains that these forecasts cannot be dismissed offhand. Indonesia has recently outpaced India giving room for debate whether it should be the new"I" in the BRICS group replacing India. The optimism which was India's pride some years ago seemed to have completely evaporated due to ever increasing prices, unemployment, unstoppable spate of scandals that have rocked the current coalition government. Though some action has been there including allowing both inbound and outbound foreign investment under government approval route from and to Pakistan but that was primarily done to strengthen commercial cultural ties between the two countries. However, uncertainty looms large over some of the most important legislations in India including the new company law which for long is waiting to see the light of the day and then not to forget the decision by the elected body of the world's largest democracy to overrule the apex court's decision to bring a retrospective amendment to India's taxation laws. Understandably, this has sent extremely negative signals around the globe. However, with the changing of the guards at the ministry of finance, one hopes for a similar change in India's economic fortunes. At the very least, the silver lining is that the process has commenced to restore confidence in the Indian legal and economic system. The very recent move by the Union Cabinet to allow foreign direct investment in multi brand retail, relaxing some conditions for single brand retail and allowing foreign airlines to invest in Indian carrier are steps in the right direction. However, there is still a huge backlog of reforms which as said above extends to certain very important legislation being held up for long, with public opinion placing the blame for this squarely on the shoulders of the coalition government. At times fractious and dichotomous nature of a bi-cameral legislature can make revolutionary economic initiatives difficult to implement.

Rationale and need for M&A and important concepts in M&A

Rationale behind M&A

Mergers and Acquisitions, or its universal moniker - M&A, has become a part and parcel of the global corporate domain. It is crucial, essential and relevant. It sets the stage for growing, expanding, enhancing, synergizing, and consolidating the entire fabric of corporate evolution. With wholesale innovation becoming scarcer, both horizontal and vertical integration models have become the mainstay for corporate sophistication. Simply, the importance of M&A cannot be ignored in today's fast evolving corporate world when restructuring and expansion of business organization is needed to grow businesses. In the Indian story, the last two decades have seen the gradual spurt in M&A activity, the catalyst for this being the liberalization of the Indian economy in 1991. The steep increase in activity in recent times can be attributed to the growing sophistication and value propositions of Indian corporations, as India has become the target destination for global corporations, and now that the Indian economy has attained maturity, there is a flow of both outbound and inbound M&A. This will only increase in the near future.

Broadly, businesses can grow in two ways - organically and inorganically. Organic growth often entails the incremental growth of tangible resources over time, including but not limited to the customers, employees, infrastructure, resources, revenues and profits of a company. Inorganic growth results in instantaneous growth that enables the company to skip a few steps on the growth ladder. By leapfrogging the normal course of events, businesses maximize the favorable environment and dynamics that help build global conglomerates. M&A are considered an inorganic growth strategy.

The rationale behind M&A is multi-pronged, and the case for M&A in India has many facets. M&A is commonly used in developed economies as a growth strategy and is now increasingly finding acceptance by Indian businesses as a critical tool of business strategy which could help achieving economies of scale, enhancing market share (including venturing into newer geographies), developing synergies and efficiency, reducing tax impact, consolidation of businesses, acquiring licenses and permits required to undertake business. Many attribute the spurt in economic growth in the corporate world to the advent of M&A and the growth in M&A activity usually act as a bellwether for a country and its economy to be considered 'developed'. India is now knocking on the door of being granted 'developed' status, so it stands to reason that M&A is vital for India's growth. It is increasingly becoming the order of the day in businesses - especially in rapidly evolving businesses like information technology, telecommunications, business process outsourcing as well as traditional businesses. Indian businesses are also engaging in increased M&A activity to expedite their international footprints. India Inc with a vision to grow globally now acquires businesses to gain strengths, expand customer base, cut competition or enter into a new market or product segment. Positive pecuniary externalities and a positive cost benefit analysis yields increased reliance on M&A as both a short and long term sustainable strategy.

The maximizing of value addition and value creation is embodied in M&A. By allowing a two pronged growth strategy whereby a corporate focuses on its core competencies, and synergies by merging with or acquiring additional competencies for efficiencies, and returns to

scale and scope. It is equally important to plan for selling a business as it is to acquire a business. Hence, a key reason for divesting a business could be to focus on core activities. The other reasons could be declining profitability or as an exit opportunity for promoters. Alternately, a key factor for growth and integration could be through acquiring a business with competencies in areas that complement or enhance the company's existing strengths and vision.

From the seller's perspective, an M&A activity could have various reasons including selling a business which is not its core business so that the focus can be concentrated on the core business(es). For example, Max India's decision to sell its speciality films business to Treofan of Germany to focus on its core businesses of healthcare and insurance. Sometimes during financial crunch, the seller may sell some part of its business to generate funds to sustain the other businesses. Additionally, it is common to see sellers parting with underperforming or loss making units. Sale and divestments are also made to comply with certain regulatory reasons or as directed by statutory authorities.

Valuation for M&A

Investors in a company that are aiming to take over another company must determine whether the purchase will be beneficial to them. In order to do so, they must identify how much the company being acquired is really worth. Naturally, both sides of an M&A deal will have different ideas about the worth of a target company. Its seller will tend to value the company at as high a price as possible, while the buyer will try to get the lowest possible valuation.

There are, however, many legitimate ways to value companies. The most common method is to look at comparable companies or comparable transactions in an industry, overall assets valuation, past earnings, future earnings or discounted cash flow valuation. The deal makers do not restrict only to one of these methods, they employ a variety of methods in combination (assigning weights wherever required) and tools when assessing a target company. Broadly, these methods can be classified into:-

(a) **Earnings based valuation:** Earnings based valuation (discounted free cash flow being the most common technique) takes into consideration the future earnings of the business and hence the appropriate value depends on projected revenues and costs in future, expected capital outflows, number of years of projection, discounting rate and terminal value of business. In a cost to create approach, the cost for building up the business from scratch is taken into consideration and the purchase price is typically the cost plus a margin. This is suitable in cases like build-operate-transfer deals. The value of a business is estimated in the capitalized earnings method by capitalizing the net profits of the business of the current year or average of three years or a projected year at required rate of return.

(b) **Market based valuation:** Market based valuation for unlisted companies implies that comparable listed companies have to be identified and their market multiples (such as market capitalizations to sales or stock price to earnings per share) are used as surrogates to arrive at a value.

(c) **Asset based valuation:** Asset based value considers either the book value or the net adjusted value. Intangible assets of the

company like the brand, intellectual property etc., are valued independently and added to the net asset value to arrive at the business value. Sometimes, if the businesses are not to be acquired on a going concern basis, the liquidation value (or the realization from sale of assets) is considered for the purpose of valuation.

Accurately valuing a target is perhaps one of the most important aspects of any M&A deal for it is extremely important to know the price at which the business will be bought and sold.

Mergers

Simply put, a merger is a combination of two or more distinct entities to form one entity. The objective behind such a combination is not merely the accumulation of assets and liabilities of the distinct entities but also to achieve several other benefits such as economies of scale, acquisition of cutting edge technology, obtaining access into sectors/ markets with established players etc. A merger generally results in the creation of a completely new entity, while the former entities cease to survive.

Sections 390 to 394 of the Companies Act, 1956, without specifically mentioning or defining "merger", set out the key provisions that apply to a scheme of arrangement between a company and its shareholders/creditors. Ordinarily "a merger will have two different schemes - one for the company getting merged (transferor) and the other company (transferee)."

Depending on the requirements of the merging entities, mergers may be of several types:-

(a) **Horizontal Mergers:** Also referred to as a 'horizontal integration', this kind of merger takes place between entities engaged in same sector (generally competing businesses) which are at the same stage of industrial process. For example, a BPO company buying another BPO company to enhance its market share, increase its balance sheet size, tapping new clients of the target company, etc.

(b) **Vertical Mergers:** Vertical mergers refer to the combination of two entities at different stages of industrial or production process. For example, the merger of a company engaged in BPO Services with a company engaged in training of employees of BPO companies would lead to vertical integration with an intent to reduce overall cost of production.

(c) **Cogeneric Mergers:** These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship.

(d) **Conglomerate Mergers:** A conglomerate merger is a merger between two entities in unrelated industries. The principal reason or a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.

(e) **Cash Mergers:** In a typical merger, the merged entity combines the assets of the two companies and grants the shareholders of each original company shares in the new company based on the relative valuations of the two original companies.

(f) **Triangular Mergers:** 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).

Acquisitions

When a company purchases the controlling interest in the share capital, or, all or substantially all of the assets and/ or liabilities of another company, such a process is called a takeover or an acquisition. Acquisitions can be divided as 'private' acquisition and 'public' acquisition; wherein 'private' acquisition refers to acquisition of an unlisted company whereas a 'public' acquisition is where the target is a listed company whose shares are listed / traded on stock exchanges. Acquisitions may be effected through agreements between the acquirer/ offeror and the majority shareholders, the purchase of shares from the open market, or by making an offer for the acquisition of the offeree's shares to the entire body of shareholders. Depending upon the acquirer's approach, a takeover may be friendly or hostile. The following are the kind of takeovers:-

(a) **Friendly takeover:** Friendly takeovers are also known as negotiated takeovers. Such a process involves an acquisition of the target company through negotiations between the existing promoters and prospective investors wherein the parties involved cooperate in the negotiations to achieve the desired objectives. Generally, recourse is taken to such a takeover to further some common objectives of both the parties.

(b) **Hostile Takeover:** Hostile takeovers usually occur when the board of directors rejects the offer and the bidder continues to pursue it. They also take place when the bidder makes the offer without informing the board of directors beforehand and the board is caught unaware of the acquisition moves of the acquirer. Sometimes a hostile takeover attempted could change into a friendly takeover where the acquirer understands the terms of acquisition expected by the target and improves / revises the terms of the offer accordingly to make it more attractive.

(c) **Leveraged Buyouts:** When an acquisition is funded by borrowed money the process is known as a leveraged buyout. In such a case, the assets of the target company are often used as collateral for the loan. This is a common structure when acquirers wish to make large acquisitions without having to commit too much capital. They usually expect the business to garner revenues sufficient enough to service the debt so raised.

(d) **Bailout Takeovers:** When a profit making company acquires a sick company, such an acquisition is called a bailout takeover. Such a takeover is usually pursuant to a scheme of reconstruction/ rehabilitation for the sick company with the approval of lender banks/ financial institutions. One of the primary motives for a profit making company to acquire a sick/ loss making company would be to set off of the losses of the sick company against the profits of the acquirer, thereby reducing the tax payable by the acquirer.

Once a decision of any M&A is made, it is equally crucial to decide the financing or funding of that M&A. Popularly, cash or shares (stock) are offered by the acquirer to the target or the shareholders of the target depending upon the structure adopted for the acquisition.

Joint Ventures

The entity created when two or more entities collaborate for a specific purpose which may or may not be for a limited duration, is known as a joint venture. The rationale behind such collaboration is usually a foray by the two parties into a new business or strengthening an existing business by combining their strength

and resources or their entry into a new market. Such a move may require specific skills, expertise or investments by each of the joint venture parties. The general norm for most joint ventures is the execution of a joint venture agreement setting out the rights and obligations of each of the parties. The joint venture parties may also incorporate a new company which will engage in the proposed business. The by-laws of the joint venture company should ideally incorporate the agreement between the concerned parties to ensure enforceability of the provisions of the joint venture agreement against the joint venture company.

Demergers / Spin-Off / Spin-Out

The splitting up of an entity into two or more entities is called a demerger. In such a case the shareholders of the original company usually receive shares in the new company. This is especially effective in cases where one of the businesses of the company is financially sick and needs to be disposed of. Such a business may be demerged and only the financially sound ones may be retained. This ensures that the assets of the healthy business of the company remain unaffected while those of the sick business get disposed of. However, spinning-off the sick unit may not be only reason, even profitable businesses are demerged so that the transferor entity can concentrate on its core business(es) or achieve certain other objectives.

Assets and Business Transfer

In assets/business acquisition, the acquirer does not acquire the shares of the target entity but the assets or business of the target entity, as the case may be. In assets acquisition, the purchaser acquires all or part of the assets of the other company as identified. This is popular when the acquirer is interested only in certain identified immovable or movable assets of the other company such as land, building, factory premises, machinery and equipment or even intangible properties such as copyrights, patents and trademarks, without acquiring any equity stake in the target entity (as the objective is only to acquire assets and not shares). In this scenario, the acquirer typically acquires (or intends to acquire) the assets free of all encumbrances.

Acquisitions of intangible property such as copyrights, patents and trademarks can also be made which are governed by the specific statutes dealing with these intellectual property rights. Acquisition of the same has to take place pursuant to a written document, and in respect of registered trademarks and patents, the transfer is effective only upon registration with the concerned registration authority.

In a business transfer on a going concern basis which is popularly called as a 'slump sale' as defined in the Income Tax Act, 1961, the acquirer acquires the 'business undertaking' of the target i.e. acquiring all the assets and liabilities of such business and it is not an itemized sale of assets as in the case of an asset acquisition. Usually this arises in the sale of a division of target to the acquirer. The assets may include movables (tangible and intangible, including intellectual property) and immovable properties. Since, in this case the acquirer also acquires the liabilities (although contractually some liabilities may be excluded), the assets may be encumbered to that extent. Further, the consideration for the acquisition of the business division is a lump sum price and separate consideration for each of the assets constituting the business division is not required to be assigned.

Policies and Regulations governing M&A

M&A is a regulated activity with various legal provisions applicable to any M&A deal. The legal provisions applicable depends on various factors such as whether the M&A is in a private space or is a public M&A, whether any non-resident investor is involved in the M&A or not. Plethora of regulations including foreign exchange regulations, securities regulations, anti-trust laws, taxation, general corporate commercial laws apply to any M&A activity. Some of such laws are discussed herein.

A. Foreign Direct Investment Policy

FDI in Indian entities is governed by the foreign direct investment policy **("FDI Policy")** of the Government of India and the relevant provisions of Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Transfer or Issue of Security by a person Resident Outside India) Regulations, 2000. The latest FDI Policy was notified by the Government of India vide FDI Circular 1 of 2012 dated April 10, 2012 **("Latest FDI Policy")**. Further, the Reserve Bank of India **("RBI")** releases every year master circulars which contain the regulatory framework and instructions issued by RBI on a particular subject. In this regard for the purpose of foreign direct investment, the RBI has released the Master Circular on Foreign Investment in India No. 15/2012-13 dated July 2, 2012 which provides for the regulatory framework and instructions regarding foreign direct investment.

Under the Latest FDI Policy, FDI is prohibited in the following areas or activities: gambling and betting, including casinos, lottery business including government, private and online lotteries[1], business of chit funds, real estate business or construction of farm houses (except for the development of townships, housing, built-up infrastructure and construction development projects, trading in transferable development rights, multi-brand retail trading, manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes and certain agricultural and plantation activities and activities/sectors not opened to private sector including atomic energy and railway transport (other than mass rapid transport system) and nidhi company[2].

The Latest FDI Policy clearly provides the method of calculating total foreign investment in Indian company i.e. both direct and indirect foreign investment. Further, the Latest FDI Policy also provides for provisions applicable to downstream in an Indian company i.e. investment by an Indian company (which is owned and / or controlled by non-resident entity(ies) into another Indian company.

(a) Automatic Route

The Government of India **("GoI")** has placed most of the areas or activities for the purposes of FDI, under the automatic route for investment. Under the automatic route, both the GoI and the federal bank of India, i.e. RBI permits Indian companies to accept FDI without obtaining any prior approvals (subject, however, to the

[1] Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for lottery business and gambling and betting activities.

[2] Nidhi Company is a non-banking finance company in the business of lending and borrowing with its members or shareholders.

compliance of certain conditions) with simply notifying the RBI in advance reporting form of the receipt of inward remittances not later than 30 days from the date of receipt of such investment by the investee Indian company. Further, the equity or equity linked instruments should be issued within 180 days from the date of receipt of the inward remittance and such an Indian company has to file the Form FC-GPR (i.e. the prescribed form) (including certain documents) with the RBI (through authorized banker) not later than 30 days from the date the shares are allotted to the concerned foreign investor. In the case of transfer of shares from a resident to a non-resident or vice versa, such transfer of shares needs to be notified to the RBI within 60 days from the date of such transfer.

International financial institutions may also invest in domestic companies through the automatic route however the same is subject to the Securities and Exchange Board of India **("SEBI")** and RBI regulations applicable in their context, apart from the generic sector specific caps (if applicable) as discussed below.

For most sub-heads finding mention under the automatic route, including inter alia, investment in power, construction development projects and non-banking finance companies (subject to certain conditions such as minimum capitalization norms that are prescribed for financial services sector), manufacturing activities, venture capital funds, the GoI has permitted FDI up to 100 per cent or all of the capital requirements.

For the remaining sub-heads listed under the automatic route, FDI is permitted up to prescribed percentages or sectoral caps qua the specific sector. FDI in excess of the sectoral caps require the prior approval of the GoI. For instance, FDI in the case of "Airports" (existing projects as opposed to greenfield projects) is permitted up to 74 per cent of the capital requirements under the automatic route, however FDI in excess of the 74 per cent prescribed percentage would require prior approval from the GoI.

(b) Approval Route

FDI in the areas or activities, which do not fall within the automatic route or where the proposed FDI exceeds the specific sectoral caps requires prior approval of the GoI through its Foreign Investment Promotion Board **("FIPB").**

Additionally, FDI in any industrial undertaking which is not a micro or small scale enterprise, where foreign investment is more than 24 per cent in the capital and manufactures items reserved for the micro or small enterprise requires prior FIPB approval.

Further, investments in certain specific sectors including broadcasting, aviation, publishing, defence production etc. are subject to guidelines issued by relevant ministerial departments and also requires the prior approval of the FIPB.

In terms of the FDI Policy, in cases of investment by way of swap of shares (i.e. exchange of shares of Indian company in return of shares of the foreign investing company), irrespective of the amount, valuation of the shares needs to be done by a Category I merchant banker registered with SEBI or an investment banker outside India registered with the appropriate regulatory authority in the host country. Approval of the FIPB is also a prerequisite for investment by swap of shares.

An Indian company can issue warrants and partly paid shares to person(s) resident outside India only after obtaining approval under the Government route.

When upon an application made to FIPB (now online applications are filed) a FDI proposal is accorded approval by the FIPB, permission is granted for such FDI proposal in the form of an approval letter issued by the FIPB. The terms and conditions of the said permission are binding both, on the investing company as well as on the Indian investee company. Upon securing the FIPB approval, the Indian company may then arrange to receive the investment from and issue shares to, the foreign investor. The Indian company is however required to undertake filings pertaining to the issuance of shares in the prescribed forms with the concerned regional office of the RBI within the stipulated time frame.

(c) Issue, Purchase and Transfer of Shares

Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/ valuation norms prescribed by the GoI. The price/conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. Other kinds of preference shares / debentures i.e. non-convertible, optionally or partially convertible are considered as debts and consequently the applicable norms applicable to external commercial borrowings apply.

Purchase of shares and convertible debentures of an Indian company are permitted to foreign investors under the FDI Policy subject to the terms and conditions of the same.

In addition to the above, there are certain instances of transfer of shares between a resident and a non- resident which require prior approval of RBI.

A company issuing equity shares or fully and compulsorily convertible debentures / preference shares to a person resident outside of India is required to receive the amount of consideration for such shares by inward remittance through normal banking channels or in the case of non-

resident Indian **("NRI")** investor by non resident external/foreign currency non-resident account of the person concerned maintained with an authorized dealer/authorized bank.

Non-resident shareholders are permitted to purchase rights shares/bonus shares of Indian companies subject to sectoral cap if any.

(d) Nature of the investor

The nature of the investor will also determine the provisions that will be applicable to it, for example, different provisions are applicable to investments made by foreign institutional investors **("FIIs")**, foreign venture capital investor **("FVCI")**, NRI (depending whether the investment is on repatriation basis or non-repatriation basis), qualified foreign investor **("QFIs")** etc. Further, for example, FVCI which was earlier permitted to invest only through intial public offer or private placement is now permitted to invest by acquiring through private arrangement/purchases from a third party also. Therefore, the nature of the investor is important to determine the laws that will be applicable.

(e) Nature of the Indian entity

It is also important to know that foreign investment is only permitted in entities listed in the Latest FDI Policy. While investment is permitted in Indian companies, partnership firms (subject to certain conditions), venture capital fund **("VCF")**, limited liability partnership **("LLP")** but it is not permitted in trusts other than VCF.

(f) Price of shares

Price of shares issued to persons resident outside India under the FDI Policy shall not be less than -

i) the price worked out in accordance with the SEBI guidelines[3], as applicable where the shares of the company is listed on any recognized stock exchange in India; and

ii) the fair valuation of shares done by a SEBI registered Category-1 merchant banker or a chartered accountant as per the discounted free cash flow method where the shares of the company are not listed on any recognized stock exchanges in India.

(g) Transfer price

The price of shares for transfer of shares by resident to non-resident:

i) Where shares of an Indian company are listed on a recognized stock exchange in India, the price of shares transferred by way of sale shall not be less than the price at which a preferential allotment of shares can be made under the SEBI guidelines[4], as applicable, provided that the same is determined for such duration as specified therein, preceding the relevant date (the date of purchase or sale of shares).

ii) Where the shares of an Indian company are not listed on a recognized stock exchange in India, the transfer of shares shall be at a price not less than the fair value to be determined by a SEBI registered Category-I merchant banker or a chartered accountant as per the discounted free cash flow method.

iii) The price per share arrived at should be certified by a SEBI registered Category - I merchant banker/chartered accountant.

The price of shares offered on rights basis by the Indian company to non-resident shareholders shall be, in the case of a listed company will be as determined by the company and in the case of an unlisted company at a price which is not less than the price at which the offer on right basis is made to the resident shareholders.

(h) Issue of Shares for consideration other than cash

An Indian company subject to the satisfaction of the applicable conditions can issue equity shares and compulsorily convertible preference shares against conversion of (a) external commercial borrowings, (b) lump sum technical know-how fee and (c) royalty without GoI's prior permission.

Also an Indian company can issue equity shares with prior permission from GoI, against import of capital goods/machinery/equipment (excluding second hand machinery) or in relation to operative/pre-incorporation expenses (including payments of rent etc.) subject to satisfaction of the specified conditions.

(i) Mergers and Amalgamations

Pursuant to a court approved scheme of merger or amalgamation, the transferee company or new company is allowed to issue shares to the shareholders of the transferor company who are resident outside India. This is subject to conditions such as, the percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap and that the transferor company or the transferee or the new company is not engaged in agriculture, plantation or real estate business or trading in transferable development rights.

(j) Repatriation

Sale proceeds of shares is allowed to be remitted to the seller of shares resident outside

[3] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

[4] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

India, provided the shares have been held on repatriation basis, the sale of shares have been made in accordance with the prescribed guidelines and NOC/tax clearance certificate from the Income Tax Department/chartered accountant has been produced.

(k) Miscellaneous Provisions

Subject to satisfaction of certain conditions:

i) the shares of an Indian company held by the non-resident investor can be pledged in favour of an Indian bank in India to secure the credit facilities being extended to the resident investee company for bonafide business purposes;

ii) the shares of the Indian company held by the non-resident investor can be pledged in favour of an overseas bank to secure the credit facilities being extended to the non-resident investor / non-resident promoter of the Indian company or its overseas group company;

iii) AD Category-I banks have been given general permission to open escrow account and special account of non-resident corporate for open offers/exit offers and delisting of shares. The relevant SEBI Regulations and other relevant provisions of the Companies Act are applicable.

In addition to the above, AD Category-I banks have also been permitted to open and maintain, without prior approval of RBI, non-interest bearing escrow accounts in Indian Rupees in India on behalf of residents and/or non-residents, towards payment of share purchase consideration and/or provide escrow facilities for keeping securities to facilitate FDI transactions subject to the terms and conditions specified by RBI. SEBI authorised depository participants have also been permitted to open and maintain, without prior approval of RBI, escrow accounts for securities subject to the terms and conditions as specified by RBI. In both cases, the Escrow agent shall necessarily be an AD Category-I bank or SEBI authorised depository participant (in case of securities accounts). These facilities will be applicable for both issue of fresh shares to the non-residents as well as transfer of shares from / to the non- residents.

B. Implications under the Companies Act, 1956

The provisions regarding the merger and demerger are governed by the provisions of the Companies Act, 1956 wherein broadly respective approvals of the shareholders and creditors is required (being majority in number and ¾ in value), followed by the approval of the court to permit the merger or demerger. Additional compliances of securities laws and listing agreement are required in cases of listed companies. For example, a prior approval of the stock exchanges is required before the application is filed with the court with the scheme of merger or demerger. Presently, under the Companies Act, 1956 a foreign company can merge into an Indian company but the reverse is not possible i.e. an Indian company cannot merge into a foreign company.

If however, the sale or acquisition is of a set of assets or a unit which constitutes an undertaking in itself, then prior approval of shareholders will be required by a majority vote in case the concerned company is a public limited company. In case of a listed company, the shareholders approval will have to be obtained by way of a postal ballot. However, no approval from shareholders is required in case of a private limited company.

The acquisition of shares of the target company have separate provisions in Companies Act, 1956 where the investment limits of the investing company are based on the paid-up capital and free reserves of the investing company, such that if the prescribed limits are exceeded a prior approval of the shareholders will be required before the investing company acquires shares of the target company.

C. Implications of Competition Law on M&A in India & the EU

Introduction

While in India the Competition Act, 2002 **("Act")** and certain regulations drafted under it cover mergers, acquisitions and amalgamations, in the European Union **("EU")**, the relevant regulations are contained in the EC Merger Regulations, 2004 **("ECMR")**.

The Act provides that any transaction that qualifies as a 'combination' requires mandatory prior approval of the Competition Commission of India **("CCI")**. Similarly in the EU, any transaction that qualifies as 'Concentration' requires mandatory prior approval from the European Commission.

Combinations and Concentration

India

Under the Act, an acquisition, merger or amalgamation that exceeds the prescribed thresholds of assets or turnover contained in Section 5 of the Act is a combination.

However, if the value of target enterprise's assets in India is not more than Rs. 250 crores or if its turnover in India is not more than Rs.750 crores, the transaction is exempted from filing requirement.

Exceptions —The Act provides that no pre-approval is required in connection with a share subscription or a financing facility or any acquisition by a public financial institution, a foreign institutional investor, a bank or venture capital fund, pursuant to any loan or investment agreement. The concerned institution is, however, required to make an 'information only' filing within 7 days from the date of the acquisition, along with a copy of the loan or investment agreement.

Additionally, the regulations under the Act provide a list of transactions that would 'normally' not require pre-approval from the CCI. These inter alia include:

(a) Acquisition of shares or voting rights leading to holding of less than 25 per cent of the total shares or voting rights of the target;

(b) Acquisition of shares or voting rights, where the acquirer, prior to acquisition, has 50 per cent or more shares or voting rights in the target, unless the transaction results in transfer from joint control to sole control;

(c) Acquisition of shares or voting rights pursuant to a bonus issue or stock splits or consolidation of face value of shares or buy back of shares or subscription to rights issue, not leading to acquisition of control;

(d) Intra-group acquisitions;

(e) Intra-group mergers or amalgamations involving enterprises wholly owned within the same group;

(f) A combination that takes place entirely outside India with insignificant local nexus and effect on markets in India.

European Union

In the EU, Concentrations are based on the concept of 'control'. Under the ECMR, a concentration arises only where a change of control on lasting basis results from acquisition, merger or a full function joint venture.

Pre-Notification Consultation

India

Informal and verbal consultation is permitted. Such consultation will be treated as confidential. However any opinion or view expressed in the course of such consultation shall not be binding on the CCI.

European Union

Informal and confidential consultations between the parties to a proposed concentration and DG COMP are recommended by the EC, and have been endorsed by the General Court. Pre-notification consultation process is used

regularly by the parties and is considered a means to ensure faster approval.

Procedure

India

(a) Obligation to file –

(i) In case of an acquisition - the acquirer;

(ii) In case of a merger and amalgamation - the parties jointly.

(b) Form to file –

(i) All pre-approval notifications to be 'ordinarily' filed in Form I (short form). However, the parties to the combination are free to choose to file in Form II.

(ii) An 'information only' filing to be made in Form III, post completion, in case of share subscription or financing facility or any acquisition by a public financial institution, a foreign institutional investor, a bank or venture capital fund pursuant to any loan or investment agreement.

(c) Trigger events and timelines for filing –

(i) Form I and Form II –

Notice of intent to enter into a combination shall be given to the CCI in the prescribed forms within 30 days of:

(1) The approval of the proposal relating to merger and amalgamation by the boards of directors of the enterprises concerned; or

(2) The execution of any binding agreement or document conveying the acquirer's decision to acquire;

(ii) Form III –

The concerned institution shall file the requisite form within 7 days of the acquisition.

(d) Filing fees –

(i) Form I – Rs. 10,00,000/-;

(ii) Form II – Rs.40,00,000/-;

(iii) Form III – Nil.

The filing fees are to be paid by the party making the filing.

(e) Failure to notify –

(i) A failure to notify when required attracts penalties of up to 1 per cent of the turnover or assets of the combination, whichever is higher.

(ii) The CCI shall direct the parties to the combination to file a notice in Form II.

(f) Investigation —

(i) On receipt of notification of a combination, the CCI is expected to form a prima facie opinion within 30 calendar days on whether the combination so notified causes or is likely to cause an appreciable adverse effect on competition.

(ii) Where the CCI is of the opinion that the combination does not cause or is not likely to cause appreciable adverse effect on competition in the relevant market, it shall approve the combination.

(iii) Where the CCI deems a further investigation desirable, it shall issue a show cause notice to the parties, in which case a decision must be taken within 210 days.

(iv) It must be noted that the CCI has envisaged various scenarios in which the above time-lines (30 calendar days for a prima facie opinion or 210 calendar days for the final approval) shall be suspended including where (a) the notifying party submits an incomplete form; or (b) the notifying party is requested to file any additional information by the CCI.

European Union

Phase I

The first stage of the procedure commences with Notification – i.e., submission of Form CO – and "starts the clock" on the 25-day period for the EC to issue its Phase I decision approving the transaction.

Phase II

During the Second-stage proceedings, competition assessment must be concluded within 90 days. This timetable is subject to extension by the parties or the EC "stopping the clock" or the parties offering remedial commitments after the 54th day of the proceedings.

Failure to Notify

ECMR provides for imposition of fine of up to 10 percent of the aggregate turnover of the undertaking(s) concerned in case of failure to notify a concentration prior to its implementation.

Factors for Analysis

India

CCI considers inter alia the following factors while analyzing a combination:

(a) Actual and potential level of competition through imports in the market;

(b) Extent of barriers to entry into the market;

(c) Extent of effective competition likely to sustain in a market;

(d) Extent to which substitutes are available or are likely to be available in the market;

(e) Market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

(f) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition.

European Union

EC would consider the following factors while analyzing a concentration:

(a) The need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or outside the Community;

(b) The market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition.

Factors for defining the Relevant Market

Both in India and the EU, the relevant market is defined on the basis of various economic factors like demand substitutability, supply substitutability, price, consumer preference, etc. In India, the Act has given detailed factors for purposes of defining the relevant market.

Remedy

In India CCI can propose modifications in Combinations having competition concerns. Parties can only suggest amendments to the modification and it is CCI's discretion to accept or reject such amendments. In case CCI rejects the suggested amendments, parties would be bound by the modifications proposed by CCI.

EC can accept undertakings from the parties that modify their proposed concentration to make it compatible with the common market. EC prefers structural remedies over conduct remedies.

Judicial Review

CCI's orders are subject to judicial review by the Competition Appellate Tribunal and Supreme Court of India. Similarly EC's decisions are subject to judicial review by the General Court and the European Court of Justice.

Confidentiality

In India as well as in the EU, confidentiality of data and information is maintained upon request.

D. Implication under the taxation laws

Taxation laws play a very important role in structuring of any M&A deal including provisions relating to capital gains tax, the benefit of any double taxation avoidance treaty, carry forward of losses from the amalgamating company to the amalgamated company, etc. Therefore, it is very important that any M&A deal should be examined from the perspective of taxation laws.

In case of foreign investment in India, the foreign investing entity before investing generally makes a comparison between certain tax havens like Mauritius, Singapore, Cyprus to see which country will be better to route the investment into India such that maximum tax benefits can be obtained. Generally, it is seen that most investments in India are routed through Mauritius and it is still the most preferred route. The choice of the jurisdiction also depends on the nature of the instrument to be issued to the foreign investor. For example, in the case of an interest bearing compulsorily convertible debenture, Cyprus is preferred over Singapore and Mauritius. The reason being that witholding tax on interest paid on compulsorily convertible debenture is 10% in Cyprus as compared to 15% in Singapore and around 40% in Mauritius. Therefore, although Mauritius may be a preferred route for equity investment but in case of an interest bearing compulsorily convertible debenture Cyprus scores over Mauritius.

E. Implication under the stamp duty laws

The implication of stamp duty applicable on any M & A deal cannot be overlooked. For example, while transfer of shares of a company held in 'physical form' attracts a stamp duty at the rate of 0.25% of the consideration paid, there is no stamp duty if the shares transferred are held in 'dematerialised form' (i.e. shares held in electronic form). So this is an important aspect to be considered in case of secondary sale of shares i.e. sale between two parties. However, in case of primary issuance of shares by the company i.e. fresh issue / allotment of shares by the company, the shares to be issued will attract stamp duty on the certificates issued by the company to the shareholders depending upon the place from where the certificates have been issued. This is because different states prescribe for different rate of stamp duty on share certificates. Since transfer in electronic form does not attract any stamp duty, it is common to see the physical shares being converted into electronic shares (if the amount of stamp duty is high) before the transfer of shares between parties is effected.

In cases of assets or business transfer, the stamp duty chargeable will depend upon the stamp duty applicable in the state where the assets are situated and the stamp duty can vary from state to state. Further, the implication of the stamp duty is cases of scheme of amalgamation / demerger, etc. will also depend upon the situation of the assets to be transferred.

Therefore, it is important to factor the cost that would be incurred in paying the stamp duty as may be applicable in a certain M&A deal.

Challenges and Critical Issues faced in any M&A deal

M&A deals are complex in nature and have to pass certain hurdles before they are successfully closed. There could be legal or regulatory challenges, challenges arising out of uncertainty in provisions of laws. Some of the legal issues and challenges faced are provided hereunder.

(A) Enforceability of Pre-Emptive Rights in a Shareholders Agreement

While the law is settled with respect to the enforceability of pre-emptive rights in a shareholders agreement in the case of a private company, ambiguity continues to exist with respect to the enforceability of pre-emptive rights in the case of a public company.

The recent judgment of the Bombay High Court in Messer Holdings Limited vs. Shyam Madamohan Ruia confirmed the right of shareholders of public listed companies to enter into consensual pre-emptive agreements. The judgment examined the scope and applicability of Section 111A of the Companies Act, 1956 on the pre-emptive provisions contained in a Shareholders' Agreement.

In the said judgment, the division bench of the Bombay High Court examined Section 111A and the legislative intent and the circumstances that led to its inclusion in the Companies Act, 1956. The Court held that the ambit of Section 111A is only to restrict the board of directors from refusing to register share transfers, unless sufficient cause exists for such refusal. The expression 'freely transferable' is thus a mandate against the board from exercising arbitrary powers.

Thus, Section 111A cannot be construed so as to curtail the rights of shareholders from entering into pre-emptive agreements.

The division bench held as under:

".....thus, the expression "freely transferable" in Section 111A does not mean that the shareholder cannot enter into consensual arrangement/agreement with the third party (proposed transferee) in relation to his specific shares. If the company wants to even prohibit that right of the shareholders, may have to provide for an express condition in the Articles of Association or in the Act and Rules, as the case may be, in that behalf. The legal provision as obtained in the form of Section 111A of the Companies Act does not expressly restrict or take away the right of shareholders to enter into consensual arrangement / agreement in respect of shares held by him."

In view of this judgment, any provision in a shareholders' agreement restricting transferability of shares would not be invalid and void inter se the shareholders.

With the appeal in the case of Messer Holdings Limited pending before the Supreme Court, the law with respect to enforceability of pre-emptive rights in a Shareholders Agreement remains open uncertain.

(B) Put and Call Option on Shares of a Public Company

Another major obstacle which is often encountered is the enforceability of "put" and "call" options on shares of a public company.

The Securities Contracts (Regulation) Act, 1956 **("SCRA")** gives power to the Government, SEBI or the RBI to ban certain contracts in securities. Pursuant to such powers, the Government, in order to curb speculation banned all forwards and options contracts in securities by a circular of 1969. Therefore, if securities and cash were

exchanged on the date of the agreement in an arrangement which was not a spot delivery contract, would be illegal. Further the provisions of SCRA are applicable only to listed and unlisted public companies but not to private companies.

The aforementioned 1969 circular in 2000 was subsequently replaced by a circular issued by SEBI which continued the ban. Therefore, in view of the SCRA and the notifications issued thereunder, the validity of put and call options on securities of public limited companies entered into outside the stock exchange have ever since been in doubt.

While the Bombay High Court in the case of MCX Stock Exchange Limited vs. The Securities and Exchange Board of India dated March 14, 2012, held that "buy-back arrangements" cannot be held to be illegal. The rationale for the same being that a buy back confers an option on the promisee and no contract for the purchase and sale of shares is made until the option is exercised. Once a contract is arrived at upon the option being exercised, the contract will be fulfilled by spot delivery and would therefore, not be unlawful. However, the provision continues to be unclear as the Bombay High Court has clarified only aspect of it i.e. such "buy-back arrangements" cannot be held illegal but it has not opined on the illegality of options on shares under Section 18A of the Securities Contract Regulation Act, 1956. Therefore, to that extent there is still uncertainty around this issue.

Further, the RBI continues to hold that any kind of option in favour of a non-resident is invalid inspite of GoI deleting the clause from the FDI Policy which held such options are invalid. This is one of the examples of diverging views that the government and regulators take.

(C) Affirmative Voting Rights vis-a-vis Control

The Securities Appellate Tribunal **("SAT")** on January 15, 2010 in the case of Subhkam Ventures (I) Pvt Ltd vs. The Securities and Exchange Board

of India held that the power of the acquirer to nominate its directors on the board and having affirmative voting rights did not result in conferring control over the day to day affairs of a company and such rights were granted for the investor to protect its investment and basic structure of the company and is not altered without the approval of such investor.

SEBI filed an appeal against the said order of SAT in the Supreme Court of India and through its order dated November 16, 2011 the Supreme Court while disposing of the case due to the mutual consent of the parties clarified that the order passed by the SAT will not be treated as a precedent.

In view of the above, there is lack of clarity on whether grant of affirmative voting rights would result in acquisition of control under the takeover regulations and therefore resulting in the requirement of an open offer.

(D) Service Tax on Non-Compete Fee and Right of First Refusal

The cost of M&A deals will increase since the new service tax regime now includes certain "declared" services being subject to payment of service tax. Specifically, one of the declared services being included is agreeing to the obligation to refrain from an act which means

that non-compete payments will also be caught in the service tax net.

A non-compete fee, typically paid at the time of the acquisition to promoters to prevent them from competing with sold business for a stipulated period of time, will now be subject to service tax. Typically, M&A deals have non-compete agreements and an accompanying non-complete fee.

Therefore, if a non-compete agreement is accompanied with a consideration, then it will be taxable under the new list of service tax.

If a Right of First Refusal obligation is accompanied with a consideration, it could be taxable under the new list of service tax.

(E) Service Tax on Escrow Services

Escrow services will also attract service tax. Representations and warranties are a part and parcel of a transaction document for an M&A transaction and often escrow accounts are set up wherein the indemnification amounts are deposited in order to insulate the acquirer from risk and financial loss in the event the representations and warranties prove to be false.

Such "escrow" accounts are now liable to service tax as escrow is a service provided by the bank.

(F) Service Tax on IPR

Since 'temporary transfer or permitting the use or enjoyment of any intellectual property right' has been included within the definition of declared services, service tax will be payable thereon and on providing license to use software.

(G) Service Tax on Manpower Recruitment Services

In a case of slump sale or asset sale in a merger or amalgamation, where the object of asset sale or slump sale is to acquire the business of the seller there may be covenant in the asset purchase agreement that the seller will procure that its employees accept offers of employment with the acquirer. A part of the consideration to such asset purchase agreement will be contingent on the number of employees who will join the acquirer. It is possible that such covenant could amount to the provision of manpower recruitment services by the seller on which service tax is applicable.

(H) Stamp Duty on Court Sanctioned Schemes of Amalgamation

The issue of calculation and payment of stamp is always an issue in the case of scheme of arrangement sanctioned by the high court.

This is because some states have specific entries in their respective state stamp laws which clearly provide that stamp duty is leviable on the court order sanctioning the scheme as "conveyance". However, some states do not have such a specific entry in their state stamp laws. However, it has been held in numerous cases (including in the case of Hindustan Lever vs. State of Maharashtra) that court order is an instrument to be stamped as "conveyance".

Bankruptcy Takeovers

Indian laws provide for a number of corporate restructuring mechanisms to facilitate the acquisition of a company on the verge of bankruptcy. Some of these are a result of legislations enacted by the Parliament and some by way of delegated legislations created by SEBI and RBI. These mechanisms are as follows:-

(A) Schemes of Compromise or Arrangement Under The Companies Act, 1956

Sections 390-394 of the Companies Act, 1956 also regulate schemes relating to compromise or arrangement of companies on the verge of bankruptcy. These sections permit the entering into of compromises/ settlement with creditors and amalgamations/ mergers with other companies, subject to the necessary court approvals. In a settlement with creditors, the affected creditors are divided into appropriate classes and a meeting of each class is conducted to obtain their consent to the scheme. The scheme must be approved by majority in number and 75 per cent in value of creditors in each class present and voting at the meeting. The court must approve the scheme after its approval by each class of creditors. The approved scheme will also bind the dissenting creditors.

A scheme approved by the majority creditors will ordinarily be sanctioned by the court unless it believes that such a scheme is unfair or detrimental to the interests of the company. While sanctioning the scheme, the court may modify it or stipulate additional conditions. However, it may not examine the commercial merits of the scheme. Although it can be a time consuming process since the court would have to hear all objecting creditors, it is effective in binding dissenting creditors once the majority has agreed and court has approved.

(B) Bail Out Takeovers Under The Sebi (Substantial Acquisition Of Shares And Takeover) Regulations, 2011 (Takeover Code)

The Takeover Code has special provisions for the substantial acquisition of shares in a financially weak company, not being a sick industrial

company. A company which has at the end of the previous financial year accumulated losses, resulting in the erosion of more than 50 per cent but less than 100 per cent of its net worth as at the beginning of the previous financial year, is a financially weak company. A scheme of rehabilitation needs to be approved by a public financial institution or a scheduled bank (known as the "lead institution") for such financially weak companies. The acquirer is selected by this lead institution on the basis of bids received, and such acquirer acquires the shares in the company. The provisions of the Takeover Code however, do not apply in cases of:-

(a) Acquisition of shares pursuant to a scheme framed under the Sick Industrial Companies (Special Provisions) Act, 1985.

(b) Acquisition of shares pursuant to a scheme of arrangement/ reconstruction under any law, Indian or foreign.

(C) Restructuring Under The Sick Industrial Companies (Special Provisions) Act, 1985 ("SICA")

The restructuring process under the SICA is facilitated by the Board for Industrial & Financial Reconstruction **("BIFR")**. According to the provisions of the SICA, if a company with one or more industrial undertakings becomes sick, i.e. its accumulated losses become equal to or exceed its net worth, the company's directors are obliged to refer the company to the BIFR. If the BIFR is satisfied that restructuring is appropriate, it will appoint an operating agency (usually the lead lender) to prepare a restructuring scheme. The powers conferred on the BIFR by the SICA for restructuring a sick company are very wide and once it sanctions a scheme, it is binding on all members and creditors of the company.

The SICA provides for the revival/ rehabilitation of "sick industrial companies". To fall under the purview of a "sick industrial company":-

(a) A company (being a company registered for not less than 5 years) should be engaged in any scheduled industry, i.e. any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951. Scheduled industries include metallurgical,telecom munication, transportation, chemical and textile industries but not financial services and software technology.

(b) The company should have accumulated losses equal to or exceeding its entire net worth at the end of any financial year.

The BIFR may direct any "operating agency" (a primarily public institution) to prepare a scheme of rehabilitation for the company. The scheme may provide for:-

(a) The financial reconstruction of the company.

(b) The proper management of the company.

(c) The amalgamation of the company with another company.

(D) Corporate Debt Restructuring Governed By The Reserve Bank Of India

Another mechanism for corporate restructuring is the Corporate Debt Restructuring Scheme **("CDR")**. This scheme applies to companies which have obtained financing from several banks and have outstanding debts of more than Rs. 100 million (US$ 2 million). The restructuring can be carried out by creditors within 90 days

(extendable to 180 days) of submitting the matter to the restructuring process. Once 75 per cent of the lenders by value and 60 per cent by numbers agree to the scheme, it becomes binding on all creditors. However, the CDR guidelines also offer exit options to any creditor who does not agree to the restructuring package. A dissenting creditor can sell his/ her stake to any majority creditor at a price to be agreed, or to any other lender who agrees to be bound by the terms of the restructuring. This system is purely contractual and operates on the basis of a creditor-debtor agreement and inter-creditor agreements.

This system is outside the scope of the BIFR and other legal proceedings. Accordingly, it is restricted to those creditors who have acceded to the relevant contractual arrangements (as is generally the case with most Indian banks and financial institutions). However, non-CDR signatories are allowed to join the CDR mechanism on a case-by-case basis. It is imperative that the CDR signatories agree to not initiate legal proceedings for debt recovery and enforcement of security while the process is pending.

(E) Asset Reconstruction Under The Securitisation And Reconstruction Of Financial Assets And Enforcement Of Security Interest Act, 2002 ("SARFAESI Act")

The SARFAESI Act provides for the establishment of asset reconstruction companies **("ARCs")**, which manage non-performing loans acquired from creditors. The SARFAESI Act grants certain special rights on ARCs, including the right to take over the management of a company and appoint any number of people to the board of directors.

An advantage of this legislation is that it allows secured creditors (if 75 per cent by value exercise any of the self-help remedies available) to decrease the number of matters pending before the BIFR. Also, no reference may be made to the BIFR where secured creditors have taken recourse to enforcement measures under the SARFAESI Act.

Specific sector study – Retail, Financial Services and Natural Resources

(A) Retail Sector

FDI in Single Brand Retail

There is no legal restriction on a person resident in India undertaking trading activities – whether on a wholesale basis or retail basis. However, there are restrictions and conditions in case of FDI in trading. The same are dealt herein.

100 per cent FDI in single brand retail under the government approval route was permitted in January 2012 subject to the satisfaction of the stipulated conditions.

The said conditions are as follows:

(a) Products to be sold should be of a 'Single Brand' only.

(b) Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India.

(c) 'Single Brand' product-retail trading would cover only products which are branded during manufacturing.

(d) The foreign investor should be the owner of the brand[5].

In respect of proposals involving FDI beyond 51 per cent, at least 30 per cent of the value of products sold would have to be mandatorily sourced from Indian 'small industries/ village and cottage industries, artisans and craftsmen'. For the purpose of this clause, 'Small industries' has been defined as industries which have a total investment in plant and machinery not exceeding USD 1,000,000. The aforementioned valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, the said valuation is exceeded, the industry will cease to qualify as a 'small industry' for the purpose of this clause. The compliance of this condition will be ensured through self-certification by the company, to be subsequently checked, by statutory auditors, from the duly certified accounts, which the company will be required to maintain[6].

An application seeking permission of the Government for FDI in retail trade of 'Single Brand' products would be made to the Secretariat for Industrial Assistance **("SIA")** in Department of Industrial Policy & Promotion **("DIPP").** The application would need to specifically indicate the product/ product categories which are proposed to be sold under a 'Single Brand'. Any addition to the product/ product categories to be sold under 'Single Brand' would require a fresh approval of the Government.

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[5] The Union Cabinet on September 14, 2012 has approved modification to the above condition to provide that only one non-resident entity whether owner of the brand of otherwise shall be permitted to undertake single brand product retail trading in the country, for the specific brand, through a legally tenable agreement, with the brand owner for undertaking single brand product retail trading in respect of the specific brand for which approval is being sought. The onus for ensuring compliance with this condition shall rest with the Indian entity carrying out single-brand product retail trading in India. The investing entity shall provide evidence to this effect at the time of seeking approval, including a copy of the licensing / franchise/sub-licence agreement, specifically indicating compliance with the above condition.

[6] The Union Cabinet on September 14, 2012 has approved modification to the above condition to provide that in respect of proposals involving FDI beyond 51% sourcing of 30% of the value of goods purchased will be done from India, preferable from medium, small and micro enterprises, village and cottage industries, artisans and craftsmen, in all sectors where it is feasible. The quantum of domestic sourcing will be self-certified by the company to be subsequently checked by the statutory auditors, from the duly certified accounts which the company will be required to maintain. For the purpose of ascertaining the sourcing requirement, the relevant entity would be the company incorporated in Indian which is the recipient of FDI for the purpose of carrying out single-brand product retain trading. The fact that 30% domestic sourcing is being mandated would imply that the single brand retailers would have to build production capacities in the country, either in existing units, or set up new ones, catering specifically to their sourcing requirements. Hence, even the 30% domestic sourcing is expected to develop production capacities in the country, with the attendant global best practices, relating to design, production and quality. Since single brand retailers are global players, Indian suppliers and vendors to these retailers would have an opportunity of becoming a part of their global supply chains. Thus, Indian products could find their way in the stores of these single brand retailers located in other countries, thereby augmenting exports from India as well.

It appears that the important test whether or not to procure locally from India is whether or not it is "feasible" to procure. In other words, it will become subjective to decide whether procuring locally is feasible or not. A foreign brand could very well argue that such sourcing is not 'feasible' for it and may seek waiver or escape this condition.

Applications would be processed by DIPP, to determine whether the products proposed to be sold satisfy the notified guidelines, before being considered by the Foreign Investment Promotion Board for Government approval.

While there are numerous foreign retailers who propose to set up shop in India including Sweden's Ikea however, the condition relating to sourcing of products locally was acting as a deterrent for such foreign retailers. With the recent approval of Cabinet Committee on Economic Affairs relaxing this condition it would undoubtedly bring cheers to big foreign brands and consequently foreign investment in India.

FDI in Multi Brand Retail

The Union Cabinet on September 14, 2012 has approved 51% FDI in multi brand retail subject to certain conditions as under.

i) Retail sales outlets may be set up in those states which have agreed or agree in future to allow FDI in multi-brand retail trade. The establishment of the retail sales outlets will be in compliance of applicable State laws/ regulations, such as the Shops and Establishments Act etc.

(ii) Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census and may also cover an area of 10 kms around the municipal/ urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking; In States/ Union Territories not having cities with population of more than 10 lakh as per 2011 Census, retail sales outlets may be set up in the cities of their choice, preferably the largest city and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities. The locations of such outlets will be restricted to conforming areas, as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking.

(iii) The minimum capitalisation will have to be USD 100 million, at least 50% of total FDI brought in shall be invested in 'backend infrastructure' within three years of the induction of FDI, where 'back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units; for instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, ware-house, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of backend infrastructure.

(iv) A high-level group under the Minister of Consumer Affairs may be constituted to examine various issues concerning internal trade and make recommendations for internal trade reforms.

(B) Financial Services

(a) Banking

The Indian financial sector has undergone a process of rapid transformation. These reforms are continuing as part of the overall structural reforms aimed at improving the productivity and efficiency of the economy and to stimulate and sustain economic growth.

Increase in incomes with potentially high penetration of both banking and insurance products to increase the market size, are expected to be the powerful drivers of growth in the financial sector. Continued de-regulation and increased competition is expected to result in Indian financial services reaching previously unattained revenue targets.

RBI formulates the banking policy in India from time to time in the interest of the banking system, monetary stability and sound economic growth. Such policy is formulated with due regard to inter alia, the interests of the depositors, the volume of deposits and other resources of the banks and the need for equitable allocation and efficient use of these deposits and resources.

Foreign banks may operate in India through one of three channels viz. (i) branches; (ii) wholly owned subsidiary; or (iii) a subsidiary with aggregate FDI of up to 74 percent in a private sector bank, which may be established through acquisition of shares of an existing private sector bank provided at least 26 percent of the paid up capital is held by resident Indians at all times.

FDI up to 49 per cent is permitted in Indian private sector banks under the automatic route and beyond that up to 74 per cent through the approval route. The automatic route is not applicable to a transfer of existing shares in a banking company from residents to non-residents. Also, the foreign investor's total voting rights in private sector banks is presently capped at 10 per cent of the total voting rights of all the shareholders irrespective of their actual shareholding.

FDI and portfolio investments in nationalized banks are subject to overall statutory limits of 20 per cent as provided under the Banking Companies (Acquisition and Transfer of Undertakings) Acts 1970 and 1980.

Banking companies in India are regulated under the Banking Regulation Act, 1949 (**"BR Act"**). The BR Act regulates the business of banking companies, prohibitions on trading, disposal of non-banking assets, rules pertaining to Boards of Directors, management; powers of the RBI, minimum paid-up capital and reserves requirements, reserve fund, cash reserves and restrictions on loans and advances, among others.

(b) Non-Banking Financial Companies

In recent times, non-banking financial companies **("NBFCs")** have become one of the preferred vehicles for entering and operating in the financial services sector. An NBFC is an Indian company engaged in the business of loans and advances, acquisition of shares / stock / bonds /debentures / securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

Considering that obtaining a banking license is a complex and long drawn procedure NBFCs are being recognised as complementary to the banking sector due to their customer-oriented services, simplified procedures, attractive rates of return on deposits, flexibility and timeliness in meeting the credit needs of specified sectors.

The RBI has classified NBFCs into the following types:

(i) Asset Finance Company **("AFC")**;
(ii) Investment Company;
(iii) Loan Company;
(iv) Infrastructure Finance Companies;
(v) Core Investment Companies **("CIC")**;
(vi) Microfinance Institutions; and
(vii) Factoring Company.

The above type of companies may be further classified into those accepting deposits or those not accepting deposits.

(c) Capital Markets

Capital markets and securities transactions

are regulated by the SEBI. The markets have witnessed a transformation over the last decade placing India amongst the mature markets of the world. SEBI has been functioning effectively as an independent regulator with statutory powers. Key progressive initiatives include:

- Depository and share dematerialization systems that have enhanced the efficiency of the transaction cycle;
- Replacing the flexible, but often exploited, forward trading mechanism with rolling settlement, to bring about transparency;
- The technology of the National Stock Exchange **("NSE")** has been complemented with a national presence and other initiatives to enhance the quality of financial disclosures;
- Corporatization of stock exchanges;
- Indian capital markets have rewarded FII(s) with attractive valuations and increasing returns; and
- Many new instruments have been introduced in the markets, including inter alia, index futures, index options, derivatives and options and futures in select stocks.

SEBI has taken and continues to take several measures for widening and deepening different segments of the capital markets and promotion of investor protection and market development. In case of the primary market, the core focus is to safeguard and stimulate investors' interest in capital issues by strengthening norms for and raising standards of disclosure in public issues. Measures for the secondary market are aimed at making the market more transparent, modern and efficient. The safety and integrity of the markets have been strengthened through the institution of risk management measures which included a comprehensive system of margins, intra-day trading and exposure limits.

The SEBI (Disclosure and Investor Protection) Guidelines, 2000 which dealt with issues relating to the capital market in India were replaced by the ICDR Regulations in 2009.

(d) Venture Capital And Private Equity

Domestic Funds

The SEBI regulates private pools of capital in India under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations 2012 **("AIF Regulations").** In May 2012, the AIF Regulations replaced an earlier set of regulations called the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 as the latter was outdated in light of the developments in the Indian market since 1996.

As a result, all privately pooled investment vehicles established in India in any form are required to register with the SEBI and comply with the AIF Regulations. Certain funds and pools of capital[7] are excluded from the scope of the AIF Regulations. The AIF Regulations permit all funds registered under the repealed regulations and existing as of the date of issue of the AIF Regulations to continue to be governed by the repealed regulations until the relevant fund life is completed and subject to certain restrictions.

The AIF Regulations categorise funds into 3 *(Three) categories, Category I Alternative Investment Funds, Category II Alternative Investment Funds and Category III Alternative Investment Funds,* based on the nature of the funds and their investment focus. The 3 (Three) categories of funds have dis-

[7] Family trusts, ESOP trusts, employee welfare trusts, funds managed by securitisation companies, pools of funds directly regulated by any other regulator in India and certain other kinds of entities specified under the AIF Regulations as well as those funds and pools of capital that are governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 and any other regulations issued by the SEBI to regulate fund management activities are excluded from the purview of the AIF Regulations.

tinct investment conditions and restrictions to comply with during their life.

- A fund can be registered as a Category I Alternative Investment Fund if it falls within one of the 4 identified sub-categories[8].
- A fund can be registered as a Category II Alternative Investment Fund if it is not a Category I Alternative Investment Fund or a Category III Alternative Investment Fund and does not leverage other than to meet day to day operational requirements and subject to prescribed limits.
- A fund can be registered as a Category III Alternative Investment Fund if it employs diverse or complex trading strategies and proposes to leverage, including through investment in listed and unlisted derivatives[9].

Foreign Funds

Foreign funds may invest in India either under the FDI route as outlined in 1.1 above or under the Portfolio Investment Scheme **("PIS")** route as Foreign Institutional Investors **("FIIs")** or as Foreign Venture Capital Investors **("FVCIs")**. While entities making FDI investments are not required to be registered with any Indian regulator, FIIs and FVCIs are required to be registered with the SEBI.

FIIs are regulated by the SEBI under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 and FVCIs are regulated by the SEBI under the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000. Both FII as well as FVCI investments are required to meet the investment norms of SEBI set out in the respective regulations that govern them as well as the investment norms of the Government of India and the RBI with respect to foreign investments in India.

FIIs could be funds investing their own corpus or fund managers making investments on behalf of other registered foreign entities referred to as *sub-accounts*[10].

FVCIs could either be funds or special purpose vehicles of funds making investments in India. FVCIs are permitted to make investments in securities of unlisted companies in India other than in certain identified sectors and in SEBI registered domestic funds without prior approval.

(e) Insurance

A well-developed and evolved insurance sector is critical for economic development as it provides long term funds for infrastructure development and strengthens risk taking abilities.

Insurance is a federal subject in India. There are two legislations that govern this sector: the Insurance Act, 1938 **("Insurance Act")** and the Insurance Regulatory and Development Authority Act, 1999 **("IRDA")**.

The GoI liberalized the insurance sector in 2000 lifting entry restrictions for private players and allowing foreign players to enter the market under the automatic route with limits on direct foreign investment (i.e. 26 per cent). The GoI has

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[8] The 4 sub-categories under a Category I Alternative Investment Fund are (1) Venture Capital Fund - which invests primarily in unlisted securities of start-ups or early-stage unlisted Indian companies in specified sectors, (2) SME Fund - which invests primarily in unlisted securities of investee companies which are small or medium enterprises or securities of such enterprises which are listed or proposed to be listed on an exchange, (3) Social Venture Fund - which invests primarily in securities of social ventures, sets certain social performance obligations for itself and whose investors accept restricted or muted returns, and (4) Infrastructure Fund - which invests primarily in entities formed for the purpose of operating, developing or holding infrastructure projects

[9] SEBI has said that funds in the nature of hedge funds or funds which trade with a view to making short terms returns or such other funds which are open ended and which receive no specific incentives or concessions from the Government or any other regulator would fall within this category.

[10] Sub-accounts are typically funds managed / advised by the FIIs and are also required to be registered with the SEBI and are regulated under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995.

very recently announced that it will increase the FDI limit in the insurance sector to 49 per cent. This is subject to the necessary license from the Insurance Regulatory & Development Authority for undertaking insurance activities.

The IRDA provides for the protection of the interests of holders of insurance policies and regulates, promotes and ensures orderly growth of the insurance sector.

With the opening of the Indian market, foreign and private Indian players are keen to convert untapped market potential into opportunities by providing tailor-made products. The presence of a host of new players in the sector has resulted in a shift in approach and the launch of innovative products, services and value-added benefits. Foreign majors have entered the country and have announced joint ventures in both life and non-life areas.

(C) Natural Resources

(a) The oil & gas activity in India is broadly divided into Upstream (exploration, development and production); Midstream (refining and transportation); and Downstream (marketing, distribution and retail). The Ministry of Petroleum and Natural Gas, GoI **("MoPNG")** is the principal regulator of exploration, development and production in the petroleum industry. The Directorate General of Hydrocarbons **("DGH")** was set up by MoPNG in 1993 with an objective of ensuring correct reservoir management practices, reviewing and monitoring exploratory programs and production, development plans for national oil companies and private companies.

(b) It is pertinent to note that the oil and natural gas exploration activities are governed by the Oilfields (Regulation and Development) Act, 1948 **("ORD Act")** which provides for regulation of oilfields and for the development of mineral fuel oil resources. Under the ORD Act, the GoI is empowered to frame rules with respect to the conservation and development of mineral oils, production of oil and regulation of oilfields, granting petroleum exploration or prospecting licenses, and granting or prohibiting the grant of mining leases. The GoI has framed the Petroleum and Natural Gas Rules, 1959 **("P&NG Rules")** pursuant to the powers under the ORD Act. The P&NG Rules provide the framework for the granting of petroleum exploration licenses **("PEL")** and petroleum mining leases **("PML")** and provide that no person shall prospect and/or mine petroleum unless it has been granted a petroleum exploration license and/or a petroleum mining lease. The P&NG Rules further provide that the petroleum mining leases shall be granted by (a) the GoI for land or mineral vested in the GoI or (b) the relevant State Government, with the previous approval of the GoI, for any land vested in a State Government.

(c) Prior to the national exploration licensing policy, 1999 **("NELP")**, the ORD Act and the P&NG Rules regulated the issue of licenses and the production sharing contracts **("PSCs")**. Under the Industrial Policy prevailing at that time, exploration blocks were offered for exploration and production only to national oil companies. However, in 1999 the GoI announced the

NELP to provide a level playing field where prospective contractors, including the public as well as the private sector, compete on equal terms for award of exploration and mining acreage. The NELP notification of 1999 specifies that there would be no mandatory state participation through the national oil companies and that national oil companies would have to compete for obtaining PELs on a competitive basis instead of the previous system of obtaining PELs on a nomination basis. In accordance with the terms of the NELP, the GoI notified the model production sharing contract **("Model PSC")** to be executed between the GoI and a licensee or lessee in respect to grant of a PEL or PML. Under the Model PSC the contractor or the licensee bears the exploration risks and development and production costs in return for a stipulated share of production resulting from this effort. The costs incurred in reality in exploration and production activity by the licensee/contractor are to be recovered from commercial production.

(d) Further, the midstream and the downstream activities essentially involve refining, storage, transportation and distribution of oil and petroleum products. The refining activity, involves receiving the crude through pipelines/ coastal tankers from the indigenous/ import destination, for refining the crude into different products. Pursuant to the Petroleum and Natural Gas Regulatory Board Act, 2006 **("PNGRB Act")** the GoI has constituted the Petroleum and Natural Gas Regulatory Board **("PNGRB")** which is be the regulator of the midstream and downstream oil & gas activities, including, inter alia, the refining, processing, storage, transportation (including laying of pipelines), distribution, marketing, import, export and sale of petroleum and petroleum products (excluding the production of crude oil and natural gas). In this regard, it is also pertinent to note that the governmental instrumentalities exercising control over and the legal and regulatory framework governing upstream and downstream oil & gas activities are separate.

(e) It may be noted that pursuant to PNGRB Act, all entities currently engaged in, or proposing or contemplating any downstream petroleum activities, are governed by the PNGRB Act and have to follow intimation and authorization procedures, as well as the downstream pricing mechanism prescribed hereunder. For entities already engaged in downstream petroleum activities in India, the intimation and authorization process will have to be completed within six months from the Appointed Date, i.e., by March 31, 2008. Further, the provisions of the PNGRB Act, inter alia, mandates that every entity marketing or desirous of marketing any notified petroleum and petroleum product must fulfil the eligibility conditions as may be prescribed by the PNGRB and must be registered with the PNGRB.

(f) Further, the Petroleum Act, 1934 **("Petroleum Act")** governs the import, transport, storage, production, refining and blending of petroleum and the display of warnings and dangerous petroleum. It further provides powers of inspection and sampling of petroleum products to the GoI. The Petroleum Act prescribes broad guidelines and empowers the GoI to frame rules for licensing the import, transport or storage of petroleum and prescribes the regime relating to inspection and sampling of petroleum and the standards for testing apparatus. In this regard, it may be noted that the Petroleum Rules, 2002 have been framed by the GoI under the provisions of the Petroleum Act which, inter alia, seeks to regulate the delivery

and dispatch of petroleum by introducing mandatory licensing requirement for storage, transportation and importation of petroleum and petroleum products.

(g) In addition, it may be noted that the laws applicable to the oil and gas sector are fairly complex and there are various macro level consents, licenses, permits, approvals and compliances from the various State and GoI's authorities as are required to be obtained and maintained under the applicable laws of India depending upon the nature of activity or business being carried out or proposed to be carried out by the entity engaged in or purporting to be engaged in the oil and gas sector.

FDI on Oil and Gas Sector

The present FDI, for petroleum & natural gas sector allows 100 per cent automatic route for exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas pipelines, LNG regasification infrastructure, market study and formulation and petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework in the oil marketing sector. Under refining projects, FDI up to 49 per cent in case of public sector undertaking can be approved through FIPB without involving any divestment of dilution of domestic equity in the existing public sector undertakings, subject to sectoral policy and in case of private companies FDI up to 100 per cent can be automatically approved subject to sectoral policy.

Issues and Challenges in Natural Resources (Oil and Gas)

(a) In the nine rounds of NELP for award of oil and gas blocks have seen participation by the state owned companies, however, the participation by private players especially the foreign majors has been limited. The participation of private players not only ensures the inflow of the investment required for development of capital intensive and high risk upstream projects it also brings in the technological expertise and diverse project experience especially in context of offshore operations. There are some members of the industry who believe that inconsistency and ambiguity in the policy and fiscal framework is one of the major factors due to which foreign companies either stay away or withdraw participation.

(b) The main reason for shortfall in crude oil production against the projections is due to (i) land acquisition problems for facility and infrastructure creation, (ii) delay in obtaining approvals especially the environment and forest clearances required to be obtained from Ministry of Environment, State Pollution Control Boards and Ministry of Forests respectively; (ii) less than planned production from a few wells; (iii) factors like strikes, law & order, miscreant activities disrupting oil field operations; and (v) crude oil production loss arising out of crude oil upliftment problem on account of prolonged shutdown of the refinery. In addition, there is a shortage of labor with specialized skills such as reservoir engineering or with experience of developing unconventional gas assets.

(c) Ambiguity on policies relating to pricing and marketing of domestic gas as well as the gas end-user segment policies creating hurdles to gas market development: For instance, in the downstream sector, the GoI has introduced certain reforms including deregulation of petrol prices. However, with the marketing companies, under the control of GoI, still set the prices at levels which are more reflective of the consumer concerns and not markets, the sector represents a risky environment to operate in for private fuel retailers which do not qualify for subsidy dissuading them from using or expanding their retail portfolio.

(d) The growth in gas sector in India is constrained on account of ambiguity about pricing and marketing policies of the GoI with respect to the domestically produced gas. Further, the sudden dip in the domestic gas supplies has added a new dimension to the ambiguity surrounding the gas sector in India. Further, growth in gas infrastructural facilities has not kept pace with demand-supply dynamics owing to the way the new regulatory regime has unfolded. In addition, because of the gas allocation policy of the GoI, the LNG market development has also not realized its potential largely since the allocation policy focuses or gives priority of allocation to power and fertilizer sector.

(e) Ministry of Coal, GoI **("MoC")** has awarded coal blocks to the operators, which have overlapping areas with CBM blocks. The overlapped area between coal and CBM operators is the cause of disputes since the oil & gas and CBM operations are under the administrative domain of MoPNG and MoC respectively and the grant of the licenses and activities of exploration, development and production of oil & gas and CBMs are governed by different set of regulations. While the oil & gas operations are under the domain of MoPNG and are governed by the relevant laws, namely, Oil Fields (Regulation & Development) Act., 1948 and Petroleum & Natural Gas Rules, 1959 framed there under, which are also being administered by MoPNG, the coal operations are under the administrative control of the MoC and are governed by relevant laws like Mines Act 1952. Further, CBM and oil & gas operations are carried out under deferent contractual regimes within the existing CBM and NELP policies. CBM operations are carried out under the contractual regime, which envisages production linked payment to the GoI in addition to royalty and taxes. Whereas oil & gas operations are governed by production sharing contracts that provides for cost recovery, profit petroleum share to GoI in addition to royalty and taxes. At present it is therefore, not possible to conduct both the operations under a common contractual regime.

Stages of M&A activity

Comparison Of Share Acquisitions And Asset Acquisitions

Businesses can be bought in two ways. Either:-

(a) the company that owns the business can be purchased (i.e. a share acquisition) or amalgamated (i.e. a merger/ amalgamation); or

(b) the parts of the business, i.e. assets and liabilities, can be purchased (i.e. an asset acquisition or through business transfer).

At the same time, there may also be a hybrid between a share deal and an assets deal. The seller can either:-

(a) hive-down the parts of the business it wants to sell into a company and sell that company; or

(b) to extract from the company the parts that it wants to keep and hive them up into another vehicle, and then sell the existing corporate box.

Irrespective of the mode of acquisition, generally any M&A activity involves various stages right from identifying the target, conducting preliminary due diligence, executing memorandum of understanding/term sheet, conducting detailed legal due diligence, executing transaction agreements and closing the deal.

Share acquisitions and asset acquisitions can be compared under the following headings:-

(a) Assets: On a share acquisition, the buyer will get all the assets if he/ she buys the shares as they are all within the corporate box. If the transaction is effected through an asset acquisition, the buyer is able to pick and choose which assets it wants to acquire.

(b) Liabilities: Again, with liabilities, if the buyer acquires shares, it gets all the liabilities as again they are inside the corporate box. It is possible to negotiate warranties and indemnities effectively to remove the impact of some of them, but this will not stop the buyer from actually acquiring them and having primary liability for them. With an assets deal, a buyer can pick and choose the liabilities that it wants.

(c) Business: It is worth considering how each type of transaction will disrupt the business. A share acquisition should be relatively less disruptive as all the people, assets, liabilities, contracts, etc, stay inside the corporate box, so the business can carry on the same the very same day of acquisition. The only difference would be that it would have a new owner. However, under an assets deal, consents could be required which can take some time to obtain. There may be employees not employed within the business (e.g. by the holding company or a management company), so the buyer will have to negotiate with them individually. Additionally, there may be contracts that do not readily pass across the business, so this could cause further disruption. For a seller, selling the shares through a share acquisition achieves a clean break. This is to a certain extent an oversimplification, as the seller will have to warrant and possibly indemnify in respect of known liabilities. However, ultimately it has parted itself from the company and from the primary responsibility for liabilities for a consideration paid by the buyer.

(d) **Title:** Another aspect to consider from the buyer's perspective is how to get title to the assets being acquired. If the buyer is buying the company (i.e. a share acquisition), all that is required is a share transfer and then the buyer will own the entire company. If the buyer is buying the assets of the company, then all the assets will have to be transferred. Some assets will get transferred by delivery but for others there will need to be specific documentation e.g. for intellectual property, goodwill and real property. Thus the actual documentation that must be executed to achieve the transfer will be more complicated.

(e) **Tax:** It is important to bear in mind that if a company has tax losses, these losses are in a way assets of the company in a share acquisition. Provided the company carries on a similar trade in the future, those tax losses may be offset against future profits. In the case of an asset acquisition, depending on the methods of transfer that are used, those tax losses will not be transferred for use in the future if the buyer simply buys the business. Nevertheless, there are ways of ensuring that the tax losses can be transferred. If a seller is selling a business that has tax losses in it, the seller could negotiate payment for those losses. However, if those tax losses are not there to be used by the buyer, there is the risk that as part of a commercial deal the buyer will be able to demand the return of some of the consideration. Tax losses are often (and arguably better) used as a bargaining chip rather than attributing a specific value to them.

(f) **Change Of Control:** 'Change of control' basically refers to provisions in contracts that either allow a party to walk away or allow a variation if the 'control' of the other party (either by way of equity or voting rights) changes hands. This sometimes applies only to the immediate holding company, but may also apply to the entire group. If present, these contracts need to be dealt with first. These issues commonly arise in commercial and financing contracts. An example is a customer or a supplier contract where there is a provision for the customer or supplier to terminate the contract if they do not like the buyer. It is crucial to concentrate on these provisions in due diligence.

(g) **Warranties:** The warranties for a share acquisition are usually far more extensive than on an asset acquisition. There is obviously a greater risk of a claim on a share acquisition. Thus the clean break that the seller gets upon the sale of shares may not be as clear cut as it seems at first glance.

Due Diligence

When a buyer buys a business, whether they buy assets and liabilities or shares, they need to know what they are buying. This is often achieved through a due diligence process. For an assets deal, it is only necessary to study what the buyer is actually buying. This usually includes the assets, liabilities and component parts that the buyer is going to buy.

Conversely, with shares, the aim is to research as much as possible about everything to do with the company. However, what is being attempted is to prove a negative, because unless there is

evidence that there is something wrong with the company, it will not be known until the buyer has bought the company.

Special caution needs to be exercised while doing a diligence of a listed company since any information gathered during the diligence of a listed company (or any element of it) may constitute 'unpublished price sensitive' information in relation to such company. In the event that such information is 'unpublished price sensitive' information in relation to such company, a person who is connected to such a company (as defined in the relevant securities law) or has access to such information will be prohibited from dealing, whether on his own behalf or on behalf of any other person, in securities of the said listed company or from disclosing the information. This prohibition will continue until such time as the relevant information is made public. Accordingly, it is advised to keep all such information gathered during the due diligence as confidential and not to buy, sell or otherwise deal in any manner whatsoever in any securities of the company until such time the information is publicly announced.

In the event if for any reason the transaction or the purpose for which the due diligence is conducted is abandoned, even in such a situation, the person in possession of any unpublished price sensitive information should neither buy, sell or otherwise deal in any manner whatsoever in any securities of the company nor communicate or counsel or procure, directly or indirectly, any unpublished price sensitive information to any person until such time the information is publicly announced.

It is now increasingly seen that the acquirers insist on a specific diligence being conducted to assess if there are any anti corruption **("FCPA")** risks associated with the target company. The coverage of such diligence is generally with an objective to determine whether the target has well defined codes of conduct and related policies and procedures with respect to bribery, ethical standards, gifts, entertainment, etc. and how are those codes and policies implemented including imparting of training to the employees regarding the implementation and importance of such codes and policies. Further, the diligence exercise needs to check if there is any history of any corruption related investigation / cases against the target, to see if any facilitation payments, bribes, gifts, hospitality, etc have been extended by the target in the course of its business operations. The result of such diligence could play a very important role in the decision of the acquirer whether or not to proceed with the acqusition.

Preliminary Agreements

"Preliminary agreements" refer to documents which are entered into at the beginning or during the course of negotiations in the context of a wide variety of transactions. Preliminary agreements include the following:

(a) Heads Of Terms: The heads of terms is a document that outlines the main terms that the parties have in principle agreed to whilst negotiating a proposed transaction. These terms can be quite useful as they set out a "road map" showing the steps to be taken on the way to signing the formal sale and purchase agreement. The heads of terms should cover important deal points and not routine, drafting ones though, inevitably, at some point the distinctions will blur. These terms show serious intent and have moral force but they do not legally compel the parties to conclude the deal on

those terms, or even at all (although this is of course subject to a contrary intention i.e. in case where the heads of term is made binding on the parties). Heads of terms is usually entered into at the beginning of the transaction, once the preliminary terms have been agreed upon.

(b) **Exclusivity Agreements:** An exclusivity agreement is designed to prevent the seller from negotiating with other parties for an agreed period of time since a prospective buyer who is about to commit time and expense to due diligence and lengthy negotiations will be very keen to obtain the necessary protections. These agreements are becoming increasingly common in the context of acquisitions and disposals. They usually involve substantial due diligence and elaborate negotiations since they reduce the risk of wasted fees and management time. A typical exclusivity agreement include the following terms:

i. The duration of the exclusivity period, since it is vital that this period be a fixed and reasonable one. A reasonable period may be anything from a few weeks to a few months, depending on the particular transaction.

ii. An obligation on the seller to immediately cease any ongoing discussions with a third party regarding a possible transaction during the exclusivity period.

iii. An obligation on the seller not to solicit, initiate or enter into any new discussions with third parties in connection with a possible transaction. In this case, the definition "transaction" should include a full range of possible transactions and not just the specific transaction that the buyer has in contemplation.

iv. An obligation to not provide any confidential information about the business/company to any other prospective buyer.

(c) **Break Fees:** Break fees refer to "failure" costs agreements, termination and/ or inducement fees. In essence, a break fee is a sum payable by one party to the other for failure to consummate the transaction usually for specific reasons such as failure to obtain shareholders consent. In the context of most private acquisitions and disposals, each party generally accepts responsibility for its own costs in the event that the transaction does not proceed. However, it is of course open to a party to seek an undertaking from the other party to contribute towards its legal, accounting and other costs incurred during the course of the negotiations if the deal fails to proceed to exchange of contracts or completion. Moreover, in order not to be an unlawful penalty, a break fee must be a genuine pre-estimate of losses incurred from the events giving raise to its payment.

(d) **Confidentiality Agreements:** There are a number of reasons why a formal written confidentiality agreement is desirable in the context of an acquisition and a disposal:

i. It ensures that the seller focuses on what needs to be disclosed; and

ii. It ensures that the mind of the buyer is focused on the fact that the information being disclosed is proprietary, confidential and valuable. It may also act as a deterrent to the buyer disclosing the information to a third party or making unauthorised use of it.

iii. The seller requires the buyer to keep confidential certain information disclosed during the course of the transaction and to use that information only for the particular purpose for which it is disclosed. In practice, it is worth noting that a confidentiality agreement is very difficult to enforce and police. They sound great in principle and may be drafted extremely well but one

needs to think about whether they are really worth the paper they are written on. Once the information is out in the market place it loses its essential nature and it may be very difficult to prove any loss. In reality, the strategy in timing the release of highly sensitive contracts is far more important (i.e. ensure that contracts containing confidential information are not disclosed until the last possible moment prior to signing the deal) rather than relying upon a confidentiality agreement.

Transaction Documents

The purchase of shares in an acquisition agreement generally takes place through the execution of a "Share Purchase Agreement" **("SPA")**, whereas the transfer of assets in such an agreement is done through the execution of a "Business Transfer Agreement" **("BTA")**. For, schemes of amalgamation and merger generally there would be a merger agreement followed up with a detailed scheme of arrangement (i.e. scheme of amalgamation, merger or demerger, as the case may be). While the terms and conditions of every agreement differ on a case to case basis, some salient features that are common to all acquisition agreements can be identified. These are described in the following paragraphs.

Representations And Warranties

The drafting of representations and warranties is one of the most significant features of any M&A agreement. The seller's representations and warranties typically comprise the larger part of the agreement. In general, representations and warranties serve three important purposes: firstly, they are informational. The seller's representations and warranties and the carve outs to the representations and warranties by way of a disclosure schedule coupled with the buyer's due diligence, enable the buyer to learn as much as possible about the seller's business prior to signing the definitive acquisition agreement.

Secondly, they are protective. The representations and warranties provided by the seller institute a mechanism for the buyer to walk away from or possibly, to renegotiate the terms of the acquisition, provided the buyer discovers facts that are contrary to the representations and warranties between the signing and the closing of the transaction or even subsequent to that. Thirdly, they are supportive. The seller's representations and warranties provide the framework for the seller's indemnification obligations to the buyer after conclusion of the agreement.

Common representations and warranties in an acquisition agreement include those relating to:

(a) corporate organization, authority, capitalization;

(b) ownership and good title to assets/ shares;

(c) nature of intangibles;

(d) conducting business in accordance with the memorandum of association and articles of association;

(e) existing financial indebtedness and security;

(f) financial statements and other records;

(g) payment of taxes;

(h) contracts, leases, and other commitments;

(i) share holding pattern;

(j) employment matters;

(k) compliance with laws and litigation;

(l) no defaults under existing borrowings;

(m) audited accounts;

(n) solvency/ winding up;

(o) environmental compliance, if any; and

(p) others, as may be required.

Typical Qualifications to Representations and Warranties

Certain representations made by the seller are invariably proclaimed as being "to the best of the seller's knowledge". Typically, the seller would warrant that to the best of its knowledge that:

(a) there are no covenants, restrictions, easements, burdens, stipulations or non-statutory outgoings affecting any freehold property;

(b) the financial statements and accounts reflect the true state of affairs and the profits and losses of the seller adequately disclose all assets and liabilities of the business and policies of accounting which have been consistently applied in the accounts;

(c) there are no facts which are likely to give rise to any litigation or arbitration or prosecution or other legal proceedings which would be material in the context of the financial or trading position of the business.

Survival of the Representation and Warranties

Representations and warranties generally survive the termination of the acquisition agreement. In such cases, therefore, the acquirer would be entitled to claim indemnification on the basis of misrepresentation after the closing of the deal. No limitation is imposed by the law on seeking indemnification if the claim is raised within the prescribed period from the time the cause of action arose. However, on the insistence of the seller, the parties may contractually agree to limit the benefit of the representation both in respect of time and value of indemnification.

General Covenants

General covenants as used in acquisition agreements, can be classified into negative and affirmative covenants. Negative covenants restrict the seller from taking certain actions prior to the closing without the buyer's prior consent. It protects the buyer as the seller is restricted from taking any actions prior to the closing that changes the business the buyer wishes to buy. The following would include typically negative comments:-

(a) Not changing accounting methods or practices;

(b) Not entering into transactions or incurring liabilities outside the ordinary course of business or in excess of certain amounts;

(c) Not paying dividends or making other distributions to stockholders without prior consent of the acquirer;

(d) Not amending or terminating 'material' contracts;

(e) Not making capital expenditures beyond those budgeted, disclosed, etc.;

(f) Not transferring assets other than those contracted for and disclosed, etc.

(g) Not creating any encumbrances on the assets/shares;

(h) Not releasing claims or waiving rights;

(i) Not doing anything that would make the seller's representations and warranties untrue;

(j) Not divulging confidential and sensitive information to third parties (except wherever necessary by law).

Affirmative covenants place an obligation on the seller or the buyer to take certain actions prior to the closing. Typically, an affirmative covenant would include: (a) allowing the buyer full/restricted access to the seller's books and records; (b) obtaining the necessary approvals from the board and the shareholders; (c) obtaining the

necessary third party consents; and (d) obtaining the necessary statutory approvals.

Conditions Precedent

An essential component of the agreement from the buyer's perspective is the conditions precedent. They play a vital role in protecting the interests of the buyer by imposing certain conditions on the seller. They provide the buyer with an exit option in case of non-fulfillment of the said conditions or at the very least, leverage for renegotiation of the terms of the acquisition. The following are the most common conditions precedent incorporated in any acquisition agreement:-

(a) **Foreign investment permissions:** As far as foreign investments are concerned, the permission of the RBI and/ or the FIPB may be required for investment in India in several sectors including banking, telecommunication, aviation, etc. given that India has not yet permitted full capital account convertibility and still maintains sectoral restrictions on foreign investment. Further, in the case of a company in the financial services sector, transfer from a resident to a non-resident also requires prior permission from the concerned authorities/regulators.

(b) **Regulatory approvals:** This is an important condition precedent since, in addition to permissions obtained from the RBI and/ or the FIPB, clearances from various other ministries, government departments and local authorities are also necessary for a M&A deal.

(c) **Corporate authorization:** The Companies Act, 1956 permits the board of directors of a company to take decisions for and on behalf of the company except for those aspects which specifically require prior authorization by the shareholders of the company. Certain shareholder approvals may be required.

(d) **No Objection Certificates:** Lenders and

secured creditors often stipulate conditions in the loan agreements which require the prior consent of such lenders in case of any change in control and/ or transfer of substantial assets of the debtor company, or change in the capital structure or board of directors of the company. No objection certificates are important since they ensure that nothing detrimental to the interests and security of the buyer occurs without their knowledge and consent.

(e) **Due Diligence Results:** A three-pronged due diligence (financial, accounting and legal) is normally carried out by the buyer prior to any merger or acquisition. Adverse findings found in the course of such due diligence process is promptly sought to be removed/ rectified prior to the closing of the transaction.

Indemnification

Provisions relating to indemnification generally deal with misrepresentations, omissions and/ or breaches of covenants or representations and warranties that are discovered subsequent to the execution of the agreement. The indemnification is generally mutual, i.e. the buyer and seller indemnify each other. Such indemnification is valid for all losses (except for indirect losses), claims, damages, costs and expenses incurred due to the acts or misrepresentation or any breach, inaccuracy or inadequacy in any representation or

warranty of the buyer and/ or the seller. In order to protect the parties from any wrongs that may have been committed before the termination/ completion of the agreement, these indemnification provisions survive even after such termination/ completion has taken place.

Dispute Resolution

Dispute resolution in M&A cases usually involves an agreement between both parties on a neutral location for the conduction of arbitration proceedings. This lays to rest any reservations or inhibitions of the parties about the existence of a home advantage. The substantive law governing the contract is predominantly Indian or English and occasionally American, particularly that of New York.

It is advisable that the arbitration agreement be unambiguous. The agreement must clearly specify the place of arbitration, the substantive law governing the contract, the proper law of the arbitration agreement, the procedural law governing the arbitration, the courts having exclusive jurisdiction (subject to arbitration), etc.

The Supreme Court, in a judgment passed on September 6, 2012, has clarified the law in relation to international commercial arbitrations and the Arbitration and Conciliation Act, 1996 ("Arbitration Act"). The Constitutional Bench, in Bharat Aluminium v. Kaiser Aluminium, overruling the judgments passed in Bhatia International v. Bulk Trading SA and Venture Global Engineering

v. Satyam Computer, has set out the following main principles:

(a) Principle of territoriality is the governing principle of the Arbitration Act. Seat of arbitration will determine jurisdiction of the court;

(b) Part I of the Arbitration Act (providing provisions relating to domestic awards) will apply only to arbitrations having seat in India. As rightly provided in Section 2(2) of the Arbitration Act, Part I applies only to arbitrations held within India;

(c) The intention of the legislature was to completely segregate Part I and Part II of the Arbitration Act. Therefore, Part I will not apply to any arbitration where award is made outside India;

(d) Awards passed outside India can only be submitted to Indian Courts for recognition and enforcement under Part II of the Arbitration Act. Challenge to such award can be preferred to the country in which the Award has been made. No challenge to such award will lie in India under Section 34 of the Arbitration Act;

(e) Section 9 of the Arbitration Act cannot be used to seek interim reliefs in arbitrations where seat is outside India. Once the party choose to go out of India, they have to apply to the Courts of that country for any interim reliefs;

(f) A suit simplicitor for seeking interim measures in aid of the arbitration will not lie, as Code of Civil Procedure does not envisage it; and

(g) The law laid down by this judgment is prospective. It will only apply to those agreements which are entered after the date of the judgment.

Differences between Indian Deals And EU Deals

Preliminary Agreements

One must be aware of adverse tax and competition consequences when drafting preliminary agreements - for example, it would be uncommon for an Indian court to award injunctive relief if one party believes its time has been wasted in pursuing this transaction – this is a real concern in Europe. It is also pertinent to note that confidentiality is a bigger concern in the UK and Europe – Indian dealmakers are not fully tuned to the fact that most deals in Europe, if disclosed to the public, will mean that the other side will walk away, irrespective of the consequences. Another point to note in relation to employees is that non-solicitation and non-compete will differ from jurisdiction to jurisdiction. Note that non-compete provisions are unenforceable in India except in cases where the seller sells the business alongwith goodwill of the business and agrees with the buyer for non-compete on similar business.

Warranties and Disclosure Letters

If acting for a buyer one does not have to accept any particular disclosure. One can agree with the seller that it be withdrawn thus preserving ones right to sue on the warranty. Alternatively, if the matter disclosed is an issue of real concern, rather than ask for the disclosure to be withdrawn it may be better to ask for an indemnity as there is authority, albeit on a preliminary point of law, which indicates that a court may not uphold a breach of warranty claim where the buyer knew there was a breach and still entered into the transaction. However, one should be aware that rejecting a disclosure or asking for an indemnity on the matter it relates to can be a sensitive matter and should only be sought where the matter is sufficiently: (a) important; (b) specific and stand alone; and/or (c) not the buyer's responsibility.

Transaction Agreements

It is interesting to note that in the UK, guarantors must provide written guarantees, whereas the use of a guarantor (or a guarantee, for that matter) by holding companies when concluding deals in India is not yet prevalent, except for sophisticated transactions involving financing by banks.

Completion

If the buyer buys the company, i.e., acquires shares, then theoretically, there is no change in the employer. On the other hand, if the buyer acquires assets, then regulations concerning transfer of undertakings apply. These provide that people employed in the business will automatically transfer with the business whether the buyer wishes them to or not.

Takeovers in the UK, France and Germany

Compulsory Acquisition in the UK is a relatively simple process: all one needs to do is to get to 90 per cent of votes and shares first. Also, if a scheme of arrangement is used, it is again a fairly regular matter. Things change in France: the key there is to get to 66.67 per cent or go to the market and purchase at least 95 per cent of share capital and voting rights. Also, in Germany, one will need to reach 75 per cent of voting shares for control or acquire at least 95 per cent of voting and non-voting share capital for compulsory acquisition.

Future Outlook

As India Inc becomes increasingly coveted as an M&A destination, it also becomes more susceptible to the vagaries and uncertainty of the global economic climate. While the liberalization of the Indian economy has led to exponential growth in the size of the Indian M&A revenue pie, there needs to be an injection of vibrancy in the interpretation and implementation of global best practices. Today, Indian business continues to grow, but given the global economic slowdown, and the increased focus on corporate accountability and return to investment, India no longer remains the Emerald city of Oz. India now must focus on improving processes, removing obstacles, increasing the ease of doing business internationally, and coming up to speed with regard to commercial and legal best practices. M&A activity is dependent on the perception of the Indian economy by the rest of the world, and on the ability to ensure that transactions are reliable, the synergies sustainable, and the processes flexible and vibrant so as to not face a significant slowdown in overall economic growth. India is merely a toddler in M&A years and maturity levels, but it is a large enough economy and domain that it will need to immediately incentivize foreign investments, and provide opportunities to Indian business for investment opportunities abroad. The time now is crucial, and the future is critical. M&A is the lifeblood of Indian business now, and it must be provided the support and stability to ensure that the sector and economy remain progressive and positive.

Disclaimer

This knowledge paper is intended to provide broad legal perspective on M&A in India. The knowledge paper is written in general terms and its application to specific situations will depend on the particular circumstances involved. Readers should obtain their own professional advice and this knowledge should not be seen as replacing the need to seek such specific legal advice.

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