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Are Reverse Mergers Efficient?

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ABSTRACT

In recent years, there has been an increase in the number of reverse mergers involving Indian corporations. There have been numerous examples of cross-border reverse mergers between Indian and US corporations, in which Indian companies have bypassed existing domestic rules and accessed the US capital market through the back door. In light of this, the purpose of this study is to critically assess the performance of India's reverse merger regulatory framework and to identify major issues and flaws. The authors claim that the current regulatory framework does not effectively safeguard public shareholders and exposes the capital market to corporate governance failures.

This paper delves deeper into international trends in cross-border reverse mergers, with a focus on emerging countries, and examines the fundamental drivers and obstacles behind this phenomena. The report finishes with a warning to Indian companies considering cross-border reverse mergers, based on lessons learned from the failure of Chinese reverse mergers in the United States, and then lays out the regulatory reforms that will be required in the future

The author's goal in this endeavor is to Explore the international development in cross border reverse mergers, analyze the efficacy of the regulatory framework governing reverse mergers in India, highlight the critical issues and lacunae in the legal framework, critically examine how reverse mergers affects shareholders in long run, critically analyze the drawbacks for opting reverse mergers in long run, how reverse merger has opened doors for backdoor delisting, how reverse mergers serves as a pathway for cross border entrance for Indian Companies , explore the motives of reverse mergers apart from getting listed, and Critically analyze salient features of the regulations passed by SEBI in 2017.

Keywords *- Reverse Mergers, Companies Act, Acquisition, SEBI, Backdoor.*

I. INTRODUCTION

Mergers and acquisitions (M&A) have become a popular way for companies all over the world to achieve inorganic growth quickly. As a result of globalisation and other triggers, rising nations like India have seen significant M&A activity in a variety of industries, including medicines, autos, finance, and telecommunications. Various sorts of strategic corporate

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restructuring techniques are used to execute mergers and amalgamations in order to gain better synergies. Reverse mergers or reverse takeovers ("RTO") are one form of restructuring mechanism.

An RTO is a type of corporate reorganisation in which a smaller private firm takes control of a larger public corporation. Typically, the public business is just a shell, with the private company's stockholders gaining majority ownership and board power. The shareholders of the private firm swap their private company shares for public company shares, essentially turning the private company into a publicly traded company without having to go through the IPO process.

From a global point of view, this paper aims to evaluate the key drivers and challenges of RTO. It also assesses the efficacy of the regulatory framework that governs RTO in India, as well as the current legal concerns that surround this structure. This paper also seeks to highlight current trends and issues in cross-border RTOs, as well as examine the topic from a global viewpoint.

II. Why Reverse Merger

Traditional IPOs might take months to execute, whereas reverse mergers can be completed in a matter of weeks, saving time and resources for management. The risk of not going public is reduced with a reverse merger.

Reverse mergers may be one of the greatest ways to go public without having to make an initial public offering (IPO) or go through the time-consuming processes of a public offering, allowing unlisted firms (through a merger with a listed entity) to gain access to capital markets. Tax benefits may be obtained by a transferee entity, subject to certain circumstances, under section 72A of the Income Tax Act of 1961.

Simplified Process: Reverse mergers allow a private firm to go public without having to raise funds, making the process much easier. Reverse mergers require only a few weeks to complete, but traditional IPOs might take months. This saves management a lot of time and effort.

Reduces risk: Going through the traditional IPO procedure does not ensure that the company will eventually go public. Managers can put hundreds of hours into organizing a traditional IPO, but if stock market circumstances deteriorate, the IPO may have to be cancelled. The danger of pursuing a reverse merger is reduced.

Less Market Dependence — The reverse merger is only a mechanism for merging a private firm with a public company or vice versa, and the procedure is less market dependent.

One motivation is to carry forward the smaller firm's tax losses, allowing the combined corporation to pay lower taxes. In some circumstances, the smaller entity may have trademark or asset rights, making its survival critical. Or a company's licence agreements may be non-transferable, giving it a motivation to protect its identity.

Backdoor listing on exchanges is another popular inducement for going the reverse-path around the world. A major corporation may reverse merge with a smaller publicly traded corporation and become public without an initial public offering (IPO). Although the Indian Companies Act prohibits this, Chinese companies seeking to list in the United States continue to use this technique

III. DRAWBACKS FOR OPTING REVERSE MERGER IN LONG RUN

Due diligence requirements should be fulfilled by the unlisted company which is acquiring the listed company to identify any outstanding liabilities which would be accrued by the company after the merger. Due to incoherent and inefficient due diligence, it is often observed that when reverse merger takes between two companies, it rarely fructifies. Public companies' shareholders generally misrepresent their position, hide major liabilities, illegal practices, cases against the organisation and various other malpractices employed by them in corporate governance in order to get rid of the shares. This could further lead unwanted lawsuit between the parties.

Disclosure requirements for an acquisition might lead to unwanted spill over of crucial information which could hamper the functioning of the management. Managing a listed company could become a real endeavour for the unlisted company and its inexperience could lead to many problems like inefficiency in operations etc. Listed companies' shareholders often seek for increase in the value of their shares after a reverse merger but due the inefficiency of acquiring company in managing the affairs of the listed company, the price of the stock remains at the same level even after Reverse Stock Split. Reverse Stock Split is process of reducing the number of shares of a company without reducing the value of total share capital which leads to the increase in the value of each share but if the reverse merger is not done in a right and efficient manner then it could be a disaster for shareholders.

In order to execute a successful reverse merger, there must be Shell Company which can be of two types namely Public Shell Company which is nothing but an inactive organisation which got out of business but is still listed at the stock exchange. The other one is a newly constituted Clean Company which is registered for the same reason with zero operational history. Greater risk lies when the company involved in the merger is a Public Shell Company because it may have numerous known and unknown liabilities, cases pending against it which increase both foreseeable and unforeseeable risks. Also, when a new entity is formed after the amalgamation of the companies, it faces new challenges of being a listed company on both domestic and international front. This new entity is fairly incompetent in managing the affairs of a new listed company which further leads to numerous problems.

IV. Long run effect on shareholders

Shareholders are the ones who are profoundly affected by the whole process of reverse merger. There always lies a great amount of risk for the shareholders till the newly incorporated entity starts its operation smoothly after the process of amalgamation is completed.

For Private shareholders, accruement of some pre and post-transaction costs is eminent in the process of taking the private company public. After every IPO or a Reverse merger, the shareholders' shares will consist a small proportion of the large pool of equity because of the dilutive nature of these processes even if the overall value of the equity does not grow. After a reverse merger, promoters generally keep 2%-8% of the to total equity and some part of the equity is also remains with the bystanders of the company. The larger portion of the equity kept with promoters and bystanders leaves lesser and lesser portion of the equity with pre-transaction private shareholders which shows the inverse relationship between the share of equity with promoters/bystanders and pre-transaction private shareholders. Unavailability of option with prior private shareholders to withhold their shareholding on pro-rata basis dilutes their share in the total equity after issuance of IPO or reverse merger. This is why this kind of shareholders should do their cost-benefit analysis before the company goes public so that their position in the overall equity isn't weakened. Both IPO and reverse merger leads to greater revelation of information, increased liquidity and dilution, but, reverse mergers are comparatively less expensive and are less time consuming. But the down side of reverse merger vis-à-vis IPO is that the reverse merger is a costly affair because in order to take over a company, a huge amount is incurred for its purchase, advisors and professionals are hired to facilitate the transaction and finally a portion of equity is kept separate for promoters and bystanders of the company. Shareholders must check out all the possible aspects before deciding that through which way they want to make their company public so that they can compare the relative value of pre-transaction equity to the post-transaction equity lying with pre-transaction shareholders.

For the shareholders of public shell entity, reverse merger is more lucrative because they are categorized as promoters and bystanders for whom a separate share of equity is set aside. A stable of shell companies are also reserved by them for reverse merger. Bystanders usually never closes their position in an operating public company that is wrapping up its affairs sending the company's common stock to a virtual zero prices. Promoters receive a cash fee at this stage for their financial advisory services related to the transaction along with a portion of the equity of the post-transaction combined entity and the bystander, both before and after the transaction, holds the same amount of common stock in the public shell company along with the economic benefit due to his/her equity position in the public company. They usually are not aware about the transaction because they don't accrue any cost related to the transaction. Reverse merger only enhances their position because it increases their value of equity in the post-transaction company.

V. HIDDEN MOTIVES BEHIND REVERSE MERGERS

Reverse merger is a quick way to make your company public within a small amount of time in comparison to IPO. Also, its demands way less formalities and paper work which makes the process even easier. But sometimes either of the parties opting for reverse merger enter into the transaction with maline interests.

As already stated above, sometimes the officials of the public company which is set to be acquired by the private company does not disclose all the necessary information which should be disclosed to the acquiring company so that they can lure out funds into their pockets. The motive behind hiding vital information like unrealised debt, pending litigations, etc is that if these kinds of information get into the hands of the acquirer, then it may significantly reduce the valuation at which the public company is being acquired and sometimes it can also lead to cancelation of the deal itself. That is why the officials of public company does not only hide the necessary information but also misrepresents the operations and financials so that the merger could take place on a higher valuation.

It is not always the case where the public company's officials are looking to earn money through unethical ways in a reverse merger transaction. The acquiring private company can also exploit its position during the transaction. Many a times it is observed that a well-known private company with a good market image enter into a reverse merger transaction to raise money for not the growth of the company but with the sole intention to defraud the investors. This is the result of the greed of the top tier officials of the private company who don't really care about the survival of the company but are only interested in accumulating large amounts of funds. Due to this, innocent investors which majorly comprises of ordinary public gets trapped in their scheme and loose a large amount of their investment which was derived from the representation. This is usually observed in a transaction involving foreign companies. An approximate of $500 billion were lost by American investors between the years of 2009 to 2012[3] to the Chinese entrants in the US equity market. Chinese companies occupy a major share among the total foreign reverse mergers in the 21st century. They do it to make quick money on the cost of numerous innocent small investors. They inflate their position to attract a large chunk of the crowd to invest in them by representing overstating profits, assets and number of employees contrary to the reality. They use unethical corporate governance practices to earn huge amounts of money in a very short period of time. Data shows that nearly 150 Chinese reverse merger companies have used fraudulent ways in the US equity markets.[4] Through this they raise a lot more through US equity market than they should have by representing the status of the business. Eventually people become aware of the company's reality which leads to the fall in the share price. An example of this is China Green Agriculture wherein a report accused the company of using fraudulent methods to hide the real value due to which its stock fell nearly 10% on the date of release of the report from $9.05 to $4.45.[5]

VI. CROSS BORDER M&A IN UNITED STATES

U.S. companies' acquisitions cover around 43% of the global M&A volume amounting to roughly $ 1.7 trillion in the year 2018. Latest guidelines concerning U.S. securities and corporate governance can be a matter of concern for non-U.S. acquirors who would be willing to raise capital from U.S markets. SEC rules, the Sarbanes-Oxley and Dodd-Frank Acts and stock exchange requirements should be evaluated to ensure compatibility with home jurisdiction rules and to be certain that a non-U.S. acquiror will be able to comply. Rules relating to director independence, internal control reports and loans to officers and directors, among others, can frequently raise issues for non-U.S. companies listing in the U.S. Non-U.S. acquirors should also be mindful that U.S. securities regulations may apply to acquisitions and other business combination activities involving non-U.S. target companies with U.S. security holders. Where the target is a U.S. public company, the customs and formalities surrounding board of director participation in the M&A process, including the participation of legal and financial advisors, the provision of customary fairness opinions and the inquiry and analysis surrounding the activities of the board and financial advisors, can be unfamiliar and potentially

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[3] https://bullandbearmcgill.com/the-reverse-merger-fraud-how-chinese-corporations-fooled-american-investors/.

[4] Lee, Charles M.C., Li, Kevin K. and Zhang, Ran. (2014) *Shell Games: Are Chinese Reverse Merger Firms Inherently Toxic?*. Stanford Graduate School of Business Working Paper No. 3063.

[5] Lang, Brittany; McGowan, John R. (December 2013). "Chinese Reverse Mergers: Accounting Fraud and Stock Price Collapse" (PDF). *Journal of Forensic & Investigative Accounting*. **5**: 175–192

confusing to non-U.S. transaction participants and can lead to misunderstandings that threaten to upset delicate transaction negotiations. Non-U.S. participants must be well advised on the role of U.S. public company boards and the legal, regulatory and litigation framework and risks that can constrain or prescribe board or management action. These factors can impact both tactics and timing of M&A processes and the nature of communications with the target company.

VII. Reverse merger regulation in China

China has made two key policy reforms in relation to RM. The Revised Regulations on Assets Restructuring and Related Financing of Listed Firms was published by the CSRC on May 13th, 2011. For the first time, this policy establishes the scope, circumstances, and methodology of the RM regulations. The eligibility requirements for an unlisted firm in an RM were not clearly established prior to the adoption of this policy. The rules set for IPOs can be utilised as a reference when evaluating the eligibility of an unlisted corporation in planned RM transactions, according to this regulation. However, this document does not state that an unlisted firm in an RM must meet IPO eligibility requirements.

Strictly Implementing IPO Standards in the Audit of Reverse Mergers was released by CSRC on November 30th, 2013. Unlisted companies that participate in RMs must now meet IPO listing standards, according to the new policy. Even with this new policy in place, the Restructuring and Merger Committee's assessment process is distinct from, and likely less severe than, that of the IPO Committee. Over and above the statutory listing rules, the IPO committee will frequently examine a candidate firm's earnings sustainability, the legality of its creation and development process, the type and scope of its related party transactions, and other risk indicators that may point to potential fraud. The RM review does not necessarily include these steps.

In China, the sequence of events that must occur as part of a reverse merger transaction-

The first essential event is a public notice that trade in the listed firm (i.e. the "shell") has been suspended. This is usually connected with or closely followed by news of a probable restructuring event, but no details are provided.

The second event is the reinstatement of trading, which usually happens three or four months later, along with the publication of a tentative RM proposal (event B). The agreement is detailed in this draught proposal, which is subject to final Board and Shareholder approval.

The preliminary proposal is submitted after the Board of Directors and the shareholders of the listed company have approved it is submitted to the CSRC for approval (event C).

This completes Stage 1 of the RM process, which takes 4 to 7 months on average. The CSRC is in charge of the next two steps of the procedure.

The RM proposal is reviewed by the CSRC's Restructuring Committee in Stage II.

The CSRC usually provides input and requests certain changes (event D). It may also ask for more supporting documentation to be submitted. The CSRC is likely to use the same disclosure and qualification rules as a full IPO in making its judgement. If everything goes well, the CSRC will give the RM its official approval (event E).

Stage II takes about 5 to 6 months to complete. The firm files for a formal transfer of ownership after gaining official authorisation. The RM is finished once the official transfer of ownership procedure is completed (event F). The entire process normally takes 10 to 16 months from the initial trade ban to the full transfer of ownership.

VIII. CROSS BORDER REVERSE MERGER TRANSACTION IN CHINA

In the years prior to 2011, the US capital market saw a massive flood of Chinese enterprises entering via the RTO route. These companies attempted to get quick and low-cost access to the US capital markets rather than going public, avoiding SEC scrutiny for share registration and other issues because the public company they merged with had already gone public[6].

The Chinese reverse merger fraud crisis shook the New York Stock Exchange in 2011. The disaster was caused by these Chinese companies' deceptive financial reporting, which overstated their financial health and deceived investors. As a direct result of the Chinese reverse merger fraud, there was an uptick in class action litigation in the United States from 2010 to 2012. In 2012, U.S. shareholders filed 31 class action lawsuits against Chinese reverse merger businesses, alleging fraud, misrepresentation, violation of federal securities laws, and GAPP. More than 50 Chinese companies listed in U.S. were delisted or suspended from trading as a result and billions of dollars in market capitalization were lost in the U.S. securities markets[7].

In order to avoid future corporate governance failures, NASDAQ has implemented various new regulations and strengthened existing laws and processes for listing and regulating reverse merger businesses since 2011[8].

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[6] David Cogman, Gordon Orr, How they fell: The collapse of Chinese cross-border listings¸ Mckinsey & Company Strategy & Corporate Finance http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/ourinsights/how-they-fell-the-collapse-of-chinese-cross-border-listing

[7] Brittany Lang, John R. McGowan, Chinese Reverse Mergers: Accounting Fraud and Stock Price Collapse, 5 JFIA (2013)

[8] Francine Mckenna, After China fraud boom, Nasdaq steps up scrutiny of shady listings, Marketwatch, Jun. 20,

The issue with cross-border RTOs is that there is a regulatory oversight vacuum. In most equities markets, investors take regulatory oversight and strong standards of due diligence for granted. Foreign investors are exposed to severe risks in a cross-border RTO of an Indian firm because to a lack of public disclosure and inadequate due diligence. Because it lacks robust control mechanisms, the international equities market is unprepared to regulate such transactions.

IX. RTO AS A PATHWAY FOR CROSS BORDER ENTRANCE FOR INDIAN COMPANY

The RTO can be utilised as a method of cross-border entrance. A private firm in one country takes on the identity of a public company in another. This is a common trend in quickly expanding economies like China, where Chinese companies list on US stock exchanges to obtain access to US stock exchanges and make other strategic investments. India has also witnessed a few significant cross border reverse mergers in recent years. Although reverse mergers are common in established markets such as the United States, China[9], and the United Kingdom, they are uncommon in India. In India, there have only been a few RTOs in recent decades, but the United States sees about 200 RTOs each year[10]. However, research suggests that the number of RTOs in India has increased in recent years.

ICICI Personal Financial Services Limited and ICICI Capital Services Limited amalgamated with ICICI Bank in a reverse merger on March 30, 2002, to form India's second largest bank. Changes in the global banking climate prompted the merger, as ICICI wanted to expand and become a universal bank, and the only way to do so was to merge with its banking affiliate[11].

When an unlisted private firm in one nation wants to get listed on a foreign stock exchange by merging with a publicly traded company in that foreign country[12], this is known as a cross border reverse merger. This is a common trend in quickly expanding economies like China, where Chinese companies list on US stock exchanges to obtain access to US capital market and make other strategic investments[13]. India has also witnessed a few significant cross border

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2016 http://www.marketwatch.com/story/after-china-fraud-boom-nasdaq-steps-up-scrutiny-of-shady-listings-2016-06- 20 (

[9] Edmund L. Andrews Andrews, Charles Lee: How Well Do Chinese Reverse Mergers Perform?, Stanford Graduate School of Business, Nov. 14, 2013 https://www.gsb.stanford.edu/insights/charles-lee-how-well-do-chinese-reversemergers-perform

[10] Bill Meagher, Year in Review: Deal Flow, APOs Grow Significantly, The Reverse Merger Report, Jan. 13, 2011

[11] ICICI Board To Consider Reverse Merger On Oct 25, BS, Sept. 29, 2001 http://www.businessstandard.com/article/finance/icici-board-to-consider-reverse-merger-on-oct-25-101092901035_1.html

[12] Jordan Siegel Yanbo Wang, Cross-Border Reverse Mergers: Causes and Consequences, Harvard Business School Strategy Unit Working Paper No. 12-089 (2013).

[13] Jan Jindra, et. al., Reverse Mergers: The Chinese Experience, Menlo College Research Paper Series Working

reverse mergers in recent years

Yatra Online Inc. ("Yatra"), a well-known Indian online travel company, announced its merger with Terrapin Acquisition Corp ("Terrapin"), a special purpose acquisition company founded specifically for this purpose[14], on December 19th, 2016. All shares of the company are included in this scheme. Yatra's ordinary shares will be instantly swapped with Terrain (Class A Common Stock). All warrants to purchase shares of Class A Common Stock will be exchanged one for one. Warrants to buy Yatra's ordinary shares on the same conditions instantly become warrants to buy Yatra's ordinary shares on the same terms. The current transaction was organised as an RTO. An RTO is essentially a group of people who have come up with a way to make money. A merger in which a private firm buys out the stock of another. of a publicly traded corporation Yatra was formerly an unlisted private company; however, following the merger, it will be able to list its shares on the New York Stock Exchange because Terrapin was previously a publicly traded firm. The new entity will keep its status as a publicly-traded company. Yatra will, in essence, be allowed to list its shares on NASDAQ without having to go through the lengthy IPO procedure.[15]

Videocon d2H Ltd. became eligible to list its shares on the New York Stock Exchange[16] in 2015 after selling 33.5 percent of its equity shares to American blank check company Silver Eagle Acquisition Corp (a company listed on the New York Stock Exchange). In 2016, Strand Life Sciences Pvt. Ltd., a Bangalore-based healthcare company that specialises in clinical genomics and biotechnology, completed a reverse merger with Venaxis Inc. of the United States, allowing it to list on the NASDAQ.

Sify, Rediff, and Dr. Reddy's Laboratories Ltd[17]. are some of the other Indian corporations that have embarked on cross-border reverse merger strategies. The 2016 Ambuja Holcim merger is yet another example of a complex but yet successful cross border reverse merger by an Indian company.[18]

Paper No. 2012-18 (2012)

[14] Payal Ganguly, Yatra to merge with NASDAQ listed Terrapin 3 Acquisition Corp, valuing co at $218 million, E.T., Jul. 14, 2016 http://economictimes.indiatimes.com/small-biz/money/yatra-to-merge-with-nasdaq-listed-terrapin-3- acquisition-corp-valuing-co-at-218-million/articleshow/53202299.cms

[15] Biswarup Gooptu, Yatra completes reverse merger; to start trading on Nasdaq, E.T. Tech, Dec. 21, 2016 http://tech.economictimes.indiatimes.com/news/internet/yatra-completes-reverse-merger-to-start-trading-onnasdaq/56094792

[16] Bhavna Gupta, Videocon d2h inks $375M deal with US blank cheque co; on track for NASDAQ listing, VCC, Jan. 6, 2015 http://www.vccircle.com/news/media-entertainment/2015/01/06/videocon-d2h-inks-375m-deal-us-blankcheque-co-track-nasdaq

[17] Joseph Rai, Strand Life Sciences to list on NASDAQ via reverse merger, VCC, Jan. 29, 2016 http://www.vccircle.com/news/pharmaceuticals/2016/01/29/strand-life-sciences-get-listed-nasdaq-throughreverse-merge

[18] Ambuja proposal to buy 24% in Holcim gets nod, B.S., Jul. 21, 2016

X. ANALYSIS OF LEGAL FRAMEWORK OF REVERSE MERGER'S IN INDIA

The companies act 1956[19], did not have any provision or prohibition on reverse mergers also known as reverse takeovers and these transactions were also treated as normal mergers and acquisitions. With the evolution of time and changing business dynamics, a provision was added in Companies Act 2013[20], wherein section 232(h) of the Act explicitly states that when an amalgamation takes place between a listed company 111and an unlisted company, the entity formed out of the transaction will be treated as an unlisted company. This provision explicitly prohibits reverse mergers by not considering it as a listed company, thereby disallowing backdoor IPO (ultimately defeating the very purpose of reverse mergers). Companies act 2013 aims to prohibit private unlisted companies to gain the benefits of public listed companies by going public through indirect order manner or by going through a backdoor entry.

It was not that only companies act had imposed such restrictions but with time Securities Exchange Board Of India(SEBI) had made changes in its regulations concerning reverse mergers. Now by adhering to the provisions of the companies act 2013, listed companies that were undergoing mergers before the SEBI's 2013 circular dated 4/2/2013[21], just had to seek court approval and in-principle approval from stock exchanges. However, vide SEBI's 2013 circular dated 4/2/2013, listed companies that were undergoing mergers need to obtain mandatory approval from SEBI (another roadblock). Further another circular was issued o the same year dated 21/5/2013[22], wherein SEBI has been vested with the power to regulate the schemes which are to the detriment of public/minority shareholders with regards to inadequate disclosures and inflated values.

The above-mentioned circulars by SEBI[23] imposing stringent requirements for listed companies going under mergers. This in return confers that any scheme of merger or amalgamation (reverse merger) between a private unlisted company and a public listed company will tend to be open to SEBI's scrutiny.

Following this, SEBI has barred other businesses from seeking backdoor IPOs through reverse mergers, including Emami Realty and Zandu Realty[24]. SEBI has also expressed concerns about

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http://www.businessstandard.com/article/economy-policy/ccea-clears-ambuja-cements-proposal-to-acquire-24-in-holcim116072100025_1.html

[19] Companies Act, 1956, No. 1, Act of Parliament, 1956 (India), § 391

[20] Companies Act, 2013, No. 18, Act of Parliament, 2013 (India), § 232 (h)

[21] SEBI Scheme of Arrangement under the Companies Act, 1956 – Revised

[22] 4 SEBI Scheme of Arrangement under the Companies Act, 1956 – Revised requirements for the Stock Exchanges and Listed Companies - Clarification, 2013 http://www.sebi.gov.in/cms/sebi_data/attachdocs/1369139160079.pdf

[23] Ibid

[24] Emami calls off merger between two group firms, The Hindu B.L., Nov. 13, 2014

any such schemes in which shares of a publicly-traded business are issued in a way that favours the promoters of an unlisted private firm. Reverse Mergers (Reverse Takeovers) are currently controlled under the new Companies Act as well as SEBI circulars, even though they are not forbidden.

RTO from the perspective of Taxation-

Here lies the ambiguity between the laws, as we can see that companies act and SEBI are a major hurdle for reverse mergers whereas the Income Tax Act, motivates companies to go for reverse mergers by granting them incentives[25]. Before the addition of Section 72A[26] in 1977, a company formed as a consequence of a merger with a sick company could not take advantage of the sick company's tax benefits. However, with the enactment of Section 72A of the Finance Act of 1977, a corporation formed as a result of the merging of a sick company[27] might benefit from the sick company's accumulated loss and allowance for depreciation. The Sick Industrial Companies (Special Provisions) Act of 1985 (SICA) is supplemented by Section 72A, which encourages the rehabilitation of financially unviable businesses.

This in return motivates companies to undergo reverse mergers with sick companies to mitigate their tax liabilities. Section 72A of the IT act uses the term “amalgamation” which is clearly defined under section 2(1) of the IT act. Now, to fall within the ambit of section 2(1B), the scheme proposed shall comply with the following perquisites:

- As a result of the strategy, all of the assets and liabilities of the amalgamating firm before the merger are passed to the amalgated company. As a result of the arrangement,

- shareholders who own at least 90% of the value of shares in the amalgamating firm becomes shareholders of the merged company[28]

Although it is quite evident that the primary objective of Section 72A is to facilitate and assist in the revival and rehabilitation of sick companies, it is at the discretion of the central government as the government has to be satisfied that the amalgamating company is financially

http://www.thehindubusinessline.com/news/emami-calls-off-merger-between-two-group-firms/article6595707.ece

[25] Mohd Aadil Khan, Assim Hasan, A study on Reverse Merger in India: Tax Implications, 2 IOSR-JEF, 24-26 (2014)

[26] Income Tax Act, 1961, No. 43, Act of Parliament, 1961 (India), § 72A.

[27] Vinod George Joseph, Tax Implications of Reverse Mergers, 10 NLS Student Bar Review,38-41 (1998).

[28] 0 Income Tax Act, 1961, No. 43, Act of Parliament, 1961 (India), § 2 (1B)

nonviable[29] and that the amalgamation is done in the public interest[30] and to facilitate and assist in the revival of the sick company[31].

Companies availing of the tax benefits under section 72A also need to furnish a certificate from the specified authority stating that all the required steps have been taken by the company to revive and rehabilitate the ongoing business of the sick company[32]. As it is evident that section 72A encourages reverse mergers, but it primarily seeks to aid in the revival of sick companies in the public interest. The scheme which is prepared by the companies is subject to extensive scrutiny by the Central Government, which in return lowers the risk for abuse of this provision. Even though after such strict procedure, there still exists a scenario wherein a competent company acquires a sick company with the only motive of tax evasion[33] and after ripping out all the tax benefits, the company again demergers itself from the sick company, defeating the very objective of section 72A.

This is a major problem which the country has been facing lately even after such an elongated and strict procedure. The problem is that there is no regulation to monitor the progress or conduct of companies post-merger, which gives the company's total freedom to abuse section 72A of the IT act. The central government must introduce some regulations or keep a watchdog on the conducts of the companies post-merger[34] and impose penalties or take actions against those companies whose conducts shows that their real motive behind the merger was not for the revival of the sick company but tax evasion.

XI. Backdoor Delisting in the Name of Reverse Merger

Listed companies sometimes voluntarily opt to delist their securities for commercial reasons to eliminate ongoing listing expenses and avoid cumbersome compliances under listing agreements. Other drivers behind voluntary delisting include lack of trading on stock exchanges and promoter's seeking to acquire full control over the company. Delisting of securities in India is regulated by SEBI (Delisting of Equity Shares) Regulations 2013; read with SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2015 (collectively referred to as "SEBI Delisting Regulations")[35]

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[29] Id. at § 72A (1 a).
[30] Id at § 72A (1 b); Duncan Agro Industries Ltd. v. Secretary, Department of Industrial Development [1983] 144 ITR 94 (Cal.) (India)
[31] CIT v. Mahindra and Mahindra Ltd [1983] 15 Taxman 1 (SC) (India)
[32] Income Tax Act, 1961, No. 43, Act of Parliament, 1961 (India), § 72A (2 ii)
[33] Mc Dowell and Co. Ltd. v. Commercial Tax Officer, (1985) 3 SCC 230 (India)
[34] Rosabeth Moss Kanter, Mergers That Stick, Harvard Business Review, Oct. 2009 https://hbr.org/2009/10/mergers-that-stick
[35] SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2015

The process of delisting in India is time taking and tedious process and the companies need to comply with the guidelines mentioned by SEBI, and upon failure to do so or delay in the whole process, SEBI also charges interest upon the company for the delay, which makes the process expensive, as by going through the formal delisting process the companies need to seek approval from the board of directors, appoint a merchant broker registered with SEBI, fixation of floor price by book building method and many more steps which takes a lot of time and also they need to send a letter of offer to its public shareholders after which the final price is set which is given by the majority shareholders. After all this process an offer is deemed to be successful if the shareholding of the promoters combined with the shares accepted through bid reaches 90% higher of the shares issued of that class and Aggregate percentage of pre-offer promoter shareholding plus 50% offer size.

If the delisting attempt fails, the acquirer will still be bound to complete the mandatory open offer process under the Takeover Regulations and also pay interest at the rate of 10% p.a. for the delayed open offer.

To be sure, the 2015 Amendment to the 2009 Regulations has made the delisting procedure a little easier. It is, however, still incredibly difficult, time-consuming, and costly.

CA 2013 limits RTO by banning backdoor IPOs, but it also presents another severe concern i.e. backdoor delisting. Unlisted companies are prohibited from gaining the status of a listed company through RTO under Section 232 (h). However, it makes no provisions for the opposite scenario, in which a publicly-traded business wishes to delist from the stock exchange through an RTO with an unlisted firm, thereby gaining unlisted status. Companies that seek refuge in this ostensibly grey space can have a significant impact.

When they choose voluntary delisting of shares, they avoid SEBI Delisting Regulations. Surprisingly, the Companies Amendment Bill, 2016[36], which altered several parts of CA 2013, ignored this flaw, which might lead to backdoor delisting, and failed to close the ostensible legal loophole.

XII. SEBI 2017 REGS – IS IT IN THE RIGHT DIRECTION?

SEBI recently tightened merger and amalgamation norms for listed and unlisted companies via resolutions passed at a board meeting held on January 14, 2017[37], in response to an increase in

http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427261684807.pdf

[36] The Companies (Amendment) Bill, 2016, No. 23, Lok Sabha, 2016 (India) http://www.prsindia.org/uploads/media/Companies,%202016/Companies%20bill,%202016.pdf (

[37] SEBI Board Meeting 2017 http://www.sebi.gov.in/cms/sebi_data/pdffiles/35602_t.pdf

the number of mergers and amalgamations involving Indian companies that seek to circumvent existing laws and to protect public shareholders. These resolutions were passed in order to update and streamline the requirements for listed and unlisted entity mergers and amalgamations[38].

The salient features of the resolutions have been analyzed below:

- The unlisted company must submit an abbreviated prospectus that contains all material information and meets the required disclosure criteria. This increased disclosure requirement is intended to better protect public shareholders from unscrupulous tactics.
- Only if an unlisted firm is listed on a stock exchange with countrywide trading terminals can it be merged with a listed company. Only schemes of mergers and amalgamations between Indian firms were covered by Section 232 (h) of the Companies Act. Because there is no rule banning an unlisted Indian firm from combining with a listed foreign entity, the Yatra merger reveals this apparent flaw. An unlisted Indian company can now only merge with a company listed in India; it cannot merge with a company listed on a foreign stock exchange.
- The pricing formula provided in the ICDR Regulations must be followed in such schemes to avoid preferential treatment of particular classes of shareholders/promoters and to bring parity in shareholder rights. This aims to address the issues with unbalanced swap ratios by introducing the concept of fair valuation.
- In the post-merger shareholding pattern, the pre-merger holdings of public shareholders in the listed business and Qualified Institutional Buyers (QIBs) in the unlisted firm must not fall below 25%. The purpose of this threshold restriction is to protect the interests of pre-merger shareholders and investors and guarantee that they are not harmed unfairly as a result of the arrangement.
- E-voting rights have been extended to specific types of schemes in order to increase public shareholder participation. This permits more public shareholders to participate and offers them more freedom to express their opposition to any proposed scheme.
- Companies would also have to produce a compliance report from a Company Secretary, CFO, and Managing Director attesting to their compliance with the circular and

[38] Mehul Shah, Aayush Misra, India: New SEBI Proposals On Merger Of Unlisted & Listed Companies, Mondaq, Jan. 18, 2017 http://www.mondaq.com/india/x/560882/Securities/New+SEBI+Proposals+On+Merger+Of+Unlisted+Listed+Companies

Accounting Standards. This is an additional compliance requirement aimed at increasing transparency and accountability.

XIII. Way forward

Over the last decade, emerging capital markets have sensed the need for a comprehensive regulatory framework for domestic and cross-border reverse mergers. The Competition Commission of India recently accepted a proposed multi-layered cross-border reverse triangle merger between Johnson Controls Inc. and Tyco International Plc.[39], demonstrating that reverse merger structures are fast changing in India.

SEBI's 2017 circular, which has the authority to regulate schemes of mergers and amalgamations between listed and unlisted firms, is a step in the right direction toward regulating reverse mergers. It can use its authority to prevent RTOs whose primary goal is to avoid disclosure requirements and other listing requirements at the expense of public stakeholders. However, numerous crucial grey areas, such as delisting and cross-border reverse mergers, must be resolved as soon as possible. To properly govern RTOs in India, a more explicit and less ambiguous legal framework that harmonises CA 2013 with the SEBI Regulations is essential.

The new surge of cross-border RTOs between Indian and US corporations, which bypass existing rules, is symptomatic of the Chinese model and must be strictly monitored to avoid yet another global corporate governance disaster. At the international level, regulatory oversight inadequacies must be filled, and capital markets around the world should embrace common worldwide disclosure and transparency norms.

XIV. Conclusion

“Flaming enthusiasm, backed by horse sense and persistence, is the quality that most frequently makes for success,” Dale Carnegie remarked. A phrase that holds true for M&A in India, and a credo to which Indian corporations appear to subscribe based on their recent acquisition success. There is little that can prohibit Indian enterprises that want to be global names from engaging in worldwide mergers and acquisitions. This desire has become a reality for many corporate organisations, who can now brag of having the best in the field under their wings thanks to a myriad of funding choices. In terms of corporate restructuring, Indian corporations have frequently outperformed their foreign counterparts, both within and outside of

[39] Competition Commission approves Johnson-Tyco deal, B.S., Jul 1, 2016 http://www.business-standard.com/article/ptistories/competition-commission-approves-johnson-tyco-deal-116070100871_1.htm

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India.Mergers and acquisitions are strong markers of a healthy, expanding economy. The legal foundation for such business restructuring should be simple and straightforward, not burdensome and riddled with bureaucratic and regulatory stumbling blocks. The most significant impediment to executing a merger or amalgamation remains the frequently lengthy judicial process required for the approval of a plan of arrangement.

In this context, the JJ Irani Report's recommendations are very important. According to the report, legal recognition of a "contractual merger" (i.e., a merger that occurs without the participation of a court) can go a long way toward removing barriers to mergers in India. The report also suggested that the power to object to a merger/acquisition strategy should be limited to those with a significant investment in the company.

As George Bernard Shaw is reputed to have said “we are made wise not by the recollection of our past, but by the responsibility for our future”, and the future of India is bright indeed.

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