INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 3 | Issue 4

2020

Current Key Legislation and Regulations Governing Mergers and Acquisitions in India with Special Emphasis on Cross- Border Mergers and Acquisitions

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ABSTRACT

The business sector around the world is transforming its operations through different forms of consolidation techniques, such as mergers and acquisitions, in order to address the challenges raised by the current trend of globalisation. Cross-border mergers and acquisitions (M&As) have increased sharply over the last two decades, partly as a result of financial liberalization policies, government policies and regional agreements. This paper aims to highlight the current key legislation and regulations governing Indian M&A activity with special emphasis on cross- border mergers and acquisitions.

Keywords:- *Mergers , Acquisitions, Cross-border, government policies*

I. INTRODUCTION

Merger- Economic analysts clarified the idea of a merger of two or more separate business companies into a single company, typically requiring the absorption of one or more firms by a dominant organization. Mergers can usually be categorized as Horizontal, Vertical or Conglomerate

Acquisition- Scholars elucidated this concept as an act of one company acquiring, directly or indirectly, of another company's shares, voting rights, properties or control over the management

II. LEGISLATION AND POLICY CHANGES

The main legislation and regulations regulating Indian M&A activities include:

- Companies Act,2013 : Adminstered by the Ministry of corporate Affairs (MCA),the companies Act is the primary legislation governing companies and mergers.
- Securities Regulations: The securities markets are regulated by the Securities and Exchange board of India (SEBI). The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Code) governs substantial Stake acquisitions

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in publicly listed companies. The SEBI (Delisting of Equity shares) Regulations, 2009 governs take- private transactions.

- Foreign Exchange Management Act, 1999(FEMA): Administered by the Reserve Bank of India (RBI) and the Government of India, FEMA , the rules issued by the Government of india thereunder as well as the associated RBI regulations regulate capital inflows and outflows.
- Competition Act, 2002: The Competition Commission of India (CCI), the regulator established under the Competition Act, accords anti- trust approvals.
- Income Tax Act,1961: Administered by the Income Tax Department , the Income Tax Act along with double tax avoidance treaties entered into by the Indian government govern the tax treatment of M&A transactions.
- Insolvency and Bankruptcy Code, 2016 (IBC): Administered by the National Company Law Tribunals, the IBC regulates auction sales under a corporate insolvency resolution process.

Recent legislative changes include a cut in tax rates on companies. The standard corporate tax rate in India is 30%, but tax laws now allow businesses to opt for a 22% lower corporate tax rate subject to certain codification. Separately, the concessional rate of 25% has been applied to companies with a revenue of up to INR 4 billion (compared to the previous cap of INR 2,5 billion). Furthermore, a preferential tax rate of 15% was introduced for new domestic manufacturing companies (established and registered on or after 1 October 2019 and starting production on or before 31 March 2023).

The Government abolished foreign investment caps for insurance intermediaries. The current limit of 49 per cent on foreign ownership of insurance intermediaries (such as insurance brokers) has been withdrawn.

CCI approval is required for Indian M&A transactions above certain thresholds. The 2019 amendment introduced a 'green channel' merger control route which allows for the approval of certain transactions that have a low competitive effect.

Further, there are a few other recent legislative and regulatory developments that may have an effect on M&A activities. One is the imposition of stamp duties on the transfer and issuance of dematerialised securities – these transactions and issuances were previously excluded from stamp duties. This reform will have an effect on the transaction costs of M&A (especially public M&A) deals. Another is the implementation of the Personal Data Protection Bill 2019

(PPD Bill). When passed, the PDP Bill will govern the collection, disclosure, sharing and processing of personal data in India and the processing of personal data outside India. India in respect of goods / services offered to individuals located in India. The PDP Bill is expected to have a significant impact on Fintech, e-commerce, financial services and the healthcare sector. Third, the inclusion of private unlisted InvITs under SEBI 's existing InvIT scheme. Private unlisted InvITs enjoy considerable market flexibility and are subject to considerably lower regulatory scrutiny compared to the listed InvITs. Private unlisted InvITs are expected to feature prominently in forward-looking Indian deals.

III. PUBLIC M&A

Mergers and amalgamations require sanction of the National Company Law Tribunal.

In a publicly listed company, an acquirer can choose two ways to secure control by either triggering a voluntary or mandatory tender offer. Under the Takeover Code, in the absence of such provisions, an arrangement to obtain 25% or more voting rights or ownership of a publicly listed company allows the bidder to make a public offer to further obtain at least 26% of the target stock. Furthermore, acquirers should ensure the minimum public float (prescribed at 25 percent) is retained at all times, unless the target is de-listed under the transaction.

Delisting has proved challenging in India, and is accomplished through a reverse book-building process to determine the price of the offer, resulting in a significant premium. If the price discovered is unreasonable, an acquirer may make a counter-offer that must not be lower than the book value (with its own set of challenges)

Customarily, hostile takeovers of publicly listed entities in India have been scarce. However, 2019 witnessed India’s first hostile take over in the IT space when Larsen & Toubro successfully launched a bid to take over Mindtree.

Public takeover may require mandatory regulatory approvals, including from sector specific regulators and anti- trust approvals. These regulatory approvals may be conditional or may prescribe additional compliance.

IV. PRIVATE M&A

The Completion Accounts system is widely used for price changes in private M&A transactions in India, although there has been an rise in the use of locked - box pricing mechanisms in recent years. Earn out and escrow structures are also gaining popularity-but, in the case of cross-broder transactions, the Exchange Control Regulations place some restrictions on these structures.

Warranty and indemnity insurance is not very common in India, and both compliance periods and insurance rates are substantially higher than in developed markets. However, due to an increase in cross-border transactions, difficulties in estimating litigation durations, and buyers seeking seller credit risk mitigation, the market for such insurance products is growing rapidly.

Private takeover offers are not performed in India because private companies are allowed to place limitations on the transfer of shares. Transactions involving the exercise of contractual rights, such as the selling majority investor's tag- along and drag-alone rights or the sale by lenders of pledged securities, are important exceptions. The MCA(Ministry of Corporate Affairs) recently (February 2020) informed the guidelines for the operationalization of private takeovers by the National Company Law Tribunal. The rules require shareholders with a 75 per cent or more interest in a company to buy a minority subject to certain conditions, including compliance with defined pricing standards.

Indian law usually governs private M&A transactions- however , cross- border transaction documents for dispute resolution generally provide for foreign – seated arbitration (in Singapore, New York or London)

V. CROSS BORDER MERGERS AND ACQUISITIONS

In contemporary market climate, cross-border mergers and acquisitions (M&As) are rapidly trendy. It is also claimed that cross-border reallocation of capital is partly the product of policies on financial liberalization, policy policies and regional agreements. Conventionally, the developing countries , in particular the developing countries of the European Union (EU15) and the United States, have been the main acquirers and target countries of M&As.

Cross border mergers and acquisitions or M&As are deals between international companies and domestic firms in the target region.

The trend of rising cross-border M&A has intensified with the globalization of the world economy. Nonetheless, the 1990s was a "golden decade" for cross-border M&A with a nearly 200 per cent rise in the Asia Pacific region's amount of these transactions. This region was preferred for cross-border M&A as most countries in this area were opening up their economies and liberalizing their policies, which gave these deals the much needed boost. Of note, it is another matter that more cross-border M&A is drawing Latin America and Africa in the last years. That is due to the combination of political gridlock in countries like India, which can not make up their minds as to whether the country needs more foreign investment, the dominance of China, and the rapid emergence of Africa as an investment destination. However, the fact that Latin America is preferred is partly due to the high growth rates of the economies of the

region.

Relationship Between FDI And Cross-Border M&A

Cross-border M&A is usually considered to be a sub-section of foreign direct investment ranging from around 50 to 90 per cent, depending on the source consulted. The remainder of the FDI is realized by investment in Greenfield. As a result, the bulk of FDI continues to occur by cross-border M&A. Although experts agree that cross-border M&A is a useful component of FDI, the relationship between cross-border M&A and FDI is complicated, as is evident from UNCTAD 's World Invest Report for 2000, which deals explicitly with cross-border mergers and acquisitions. In comparison to cross-border M&A, FDI signifies transactions between parents and affiliates.

Cross-border M&A also includes investments which are funded by domestic and foreign capital markets. It is not always possible to track the country from which the funds come. In addition, FDI refers to net investments, whereas M&A refers to gross transactions (acquisitions and divestments). Due to these differences, cross-border M&A may therefore exceed the documented value of the FDI.

VI. CROSS-BORDER MERGER AND ACQUISITION OF THE INDIAN LAW

Previous law only permitted inbound mergers, which means that only foreign firms were permitted to merge with Indian companies and not vice versa. The Companies Act 2013 proposed providing for all types of merger pursuant to section 234 of the Act but was not published.

The Act allows for the merger of an Indian company with a foreign corporation. It notes that provisions relating to mergers and amalgamation shall extend mutatis mutandis to mergers and amalgamation between companies listed under the Companies Act and those incorporated within the jurisdiction of the countries approved by the central government in consultation with the RBI[2]

The definition of the term foreign company has been expanded by having the company or corporate body incorporated outside India, whether or not it has a place of business in India.[3]

As specified in the definition section, the foreign company is defined as the corporation registered in any jurisdiction outside India which has a place of business in India, whether on its own, through an agent, physically or electronically, and conducts its business in India in

[2] Section 234, Companies Act 2013
[3] Explanation, Section 234, Companies Act 2013

some other way.[4] The payment of consideration can be rendered to the shareholders of the merged companies either in the event of a merger corporation.

The Ministry of Corporate Affairs, in consultation with the RBI, notified section 234 of the Act with the corresponding rules via notification dated 13 April 2017. The rules are referred to as the Companies (Compromise, Arrangement and Amalgamation) Amending Rules 2017, inserting Rule 25A and Annex B in the Companies (Compromise, Arrangement and Amalgamation) Rules 2016 in relation to the operation of Section 234. It provides that both categories of mergers, i.e. inbound and outbound, are subject to prior approval of RBI and the provisions of the Companies Act 2013. For an outbound cross-border merger the foreign entity concerned should be in consultation with the RBI from a jurisdiction approved by the central government.

Jurisdictions for which outbound merger is permitted

(i) a State whose stock market regulator is a signatory of a bilateral Memorandum of Understanding with SEBI or the Multilateral Memorandum of Understanding with the International Securities Commission, or

(ii) the central bank of which is a member of the International Settlement Bank (BIS) and

(iii) In the case of a jurisdiction not listed in the Financial Action Task Force's public statement (FATF) as the following:

(A) jurisdiction with a specific anti-money laundering or anti-terrorism funding weakness usually protected by counter-measures;

(B) Jurisdiction which has not made significant progress in addressing the deficiencies or which has not committed itself to any action plan established with the Financial Action Task Force to address the deficiencies.[5]

Factors to be considered for cross-border mergers and acquisitions

Having said that, it must be noted that cross-border M&A only actualizes when incentives are available to do so. In other terms, both the international corporation and the domestic partner would take advantage of the deal as otherwise; ultimately, the deal will turn sour. Considering that many domestic firms in many emerging markets overstate their capabilities to attract M&A, international firms must practice due diligence when negotiating an M&A transaction with a domestic firm. Which is why many multinational companies take the assistance of

[4] Section 2(42), Companies Act 2013

[5] Annexure B, MINISTRY OF CORPORATE AFFAIRS NOTIFICATION , New Delhi, the 13th April, 2017

management consultants and investment banks before they enter into an M&A contract. In addition, international companies often find the risk factors associated with cross-border M&A, which are a mixture of political risk, economic risk , social risk and general risk associated with black swan incidents. International firms determine potential M&A partners and countries by creating a risk matrix consisting of all of these elements and, based on whether or not the score is sufficient, decide on the M&A agreement. Third, cross-border M&A also needs regulatory approvals as well as political support because, in the absence of such facilitating factors, the agreements can not be concluded.

Numerous factors that inspire cross-border M&A firms include

- Globalization of the Financial Market
- Market pressure and declining demand due to foreign competition
- Seek new business opportunities as technology is rapidly evolving
- Improve productivity of companies in the manufacture of goods and services
- Completing the goal to grow profitably
- Increase the production scale
- Technology sharing and innovation that reduces costs

Some Recent Examples of Cross Border M&A

If we take some recent examples of cross-border M&A deals, the Jet-Etihad deal and the Air Asia deal in India's aviation sector are good examples of how cross-border M&A deals need to be judged against the points previously listed. For example, there is support and opposition both to the Jet-Etihad deal and to Air Asia deal. This has made many international companies afraid of joining India. On the other hand, if we consider the cross-border M&A deals in the opposite direction , i.e. from the developing markets to the developed world, the Chinese oil major Sinopec had to face strong resistance from the US Senate due to security concerns and possible ownership issues. Of course, the recent takeover of Unilever 's subsidiaries around the world is an example of a good transaction. Acquisition of Flipkart's 77% interest in Walmart Inc. is an example of an Inbound Merger. The acquisition of Jaguar and Land Rover by Tata Motors in 2011 and the acquisition of Hamleys by Reliance Group are examples of Outbound M&A. The strong consequences of these successes, as well as the shortcomings, are that there must be a mechanism that is organized and standardized in each country and by each company on how to handle the M&A deal. Otherwise, there are incentives for animosity to the mechanism and to energize the economic climate for all stakeholders. Even than that, due

diligence must be carried out before any such arrangement is considered.

The Effect of culture on fusion and acquisition across borders

With the advent of globalisation, it has become popular for Western multinationals to participate in mergers and acquisitions with companies in emerging markets. The method of reaching these markets is usually carried out through the Greenfield route, which requires huge investments and takes time for the plants and factories to start up from scratch. The other path is through mergers with a local partner by joint ventures and other approaches. Apart from that, the acquisition of local companies is the third option that multinationals have.

In this context , it is important to note that, because of the variations in culture between the countries to which western companies belong and the cultures of the countries to which they join, the cultural aspects must be treated with care and caution. For example , it is common in many emerging markets to have labor and other policies that are unique to those countries that prohibit the hiring and firing of employees at will. This means that western multinationals must ensure that their global policies are tailored to local conditions and adapted to local cultures through "Glocalizing" or a process of merging global perspectives with local implementation.

Effect of Cultural Differences

The next dimension of the cultural aspects of cross-border mergers and acquisitions is that, because of the various working cultures, each of the partners in the company must consider the culture of the other and adapt accordingly. For example, differences in attitudes towards gender, minorities and diversity are problems that may lead to possible disputes between partners. Apart from this, the cultural aspects of the democratic style of governance in the West vary from the patriarchal and authoritarian aspects of governance in the East, which means that all parties must adapt their working culture to the circumstances on the ground.

In comparison, Western businesses work in a standardized and systematic manner where there is very little ambiguity and everything is laid out and written out clearly. On the other hand, in many emerging markets, the working environment is defined by uncertainty about infrastructure, culture and local conditions, which contribute to a kind of hazy working climate. Yes, this is a cultural shock faced by many Western companies in South Asian and South-East Asian countries where the working climate operates in a laissez faire way , which means that we can somehow get the job done, is the prevailing mindset compared to the West where every achievement of the project is carefully designed.

VII. Cross Border Merger and Acquisitions – Problems and Concerns

Political concerns: The political situation has a major role to play in cross-border mergers and acquisitions, particularly for politically sensitive industries such as defence, security etc. It is also necessary to resolve stakeholder concerns such as government agencies (federal, state , and local), employees, suppliers, and all other stakeholders after the merger plan is publicly identified. In addition, there might be a need for prior notification and negotiation with the trade unions and other interested parties in some situations. To avoid the possibility of political risk emerging, it is necessary to recognize and assess current or likely political consequences.

Legal considerations: Companies involved in combining can not neglect the difficulty of various legal and regulatory issues. Several laws relating to security, corporate law, and competition law are bound to diverge. It is therefore necessary, before considering the agreement, to review the employment, antitrust and other contractual conditions to be addressed. Such laws are part of both when the deal is undergoing operation and even after the deal is closed. When undertaking the process of reviewing these issues, it could mean that the proposed merger or acquisition will be entirely incompatible and thus it is recommended that the deal not proceed.

Tax and accounting considerations: tax concerns are important, especially when it comes to the structuring of transactions. The proportion of the debt and equity involved in the deal will have an effect on the tax burden; hence, a clear understanding of the same is necessary. The issue of transfer taxes is another consideration to determine whether to arrange an asset or buy a stock. It is very important to reduce the tax risks involved. Countries also follow various accounting practices, but the adoption of IFRS has limited this to a large degree and several countries have yet to enforce it. If the parties to the transaction are well aware of the financial and accounting provisions of the agreement, it would help to mitigate misperception.

Due diligence: due diligence is an integral aspect of the M&A process. In addition to legal, political and regulatory concerns, there are also infrastructure, currency and other local threats that need to be thoroughly assessed. Due diligence could influence the terms and conditions under which an M&A transaction will take place, the structure of the agreement and the price of the agreement. It encourages the disclosure of the dangerous region and offers a detailed view of the planned transactions. It has been recognized that cross-border mergers and acquisitions have many benefits, but there is also a high risk of failure.

Difference in intellectual property Regime: **According to the TRIPs Agreement, member states must comply with the general principles set out in it, but as stated in Part II of the**

Agreement, member states are free to implement measures that may be higher in quality than specified in the Agreement and at the same time comply with the TRIPs Agreement. It in turn leads to disparity in the system for intellectual property.[9]

Currency fluctuation : The fluctuation of the currency affects the value of the properties and liabilities of the participating firms. It in turn leads to unsafe situations.

Recommendation to promote cross-border mergers and acquisition in india

- Amendments are required to be made to existing legislation which contains relevant provisions such as the Income Tax Act, the Exchange Control Regulations, etc. For example. The Indian Income Tax Act exempts a merger transaction where the transferee is an Indian corporation. When an Indian company merges with a foreign corporation, this will be a taxable transaction. This is also important to amend these requirements in order to make the procedure consistent.
- In order to ensure continuity, the RBI should lay down a comprehensive regulatory structure setting out the eligibility requirements and other considerations to be considered by the RBI when considering cross-border M&A.
- Section 394 of the earlier Act referred to both merger and demerger, but section 234 only applies to merger and amalgamation without stating any demerger. However, if we take the clause literally, it would mean that demergers are not permitted to do so. This illustrates the lack of clarification on the question of whether or not demerger is allowed. [11] It is therefore necessary for the Government of India to make more clarifications and amendments, keeping in mind the practical implications of a cross-border merger.
- Outbound mergers will also be expected to comply with the provisions of the Indian Companies Act on agreements, arrangements and mergers, and these provisions will need to be amended in order to comply with the newly notified provisions on outbound mergers, in particular on the applicability of foreign companies. For example , in the case of outbound fusions, there is a lack of clarity in addressing the eventuality of any conflict between the Indian merger framework and the resulting foreign company laws.
- The need for the hour is to coordinate all cross-border merger transactions with the criteria set out in Indian foreign exchange legislation.
- Pursuant to Rule 25A, which provides for compliance with Sections 230 to 232 of the Act, it is only by doing so that the transferee company is required to seek permission

from NCLT. The provision specifically exempts the applicability of section 233 from cross-border mergers. As a result, a wholly owned foreign subsidiary can not merge into its Indian holding company, or vice versa, by taking advantage of a fast-track merger.

- In the case of cross-border M&A, the competition act should be adequately applied to ensure that the transaction is not being conducted to reduce competition.

VIII. Conclusion

Despite global headwinds and poor macroeconomic indicators, M&A operation in India is expected to show resilience this year due to recent business-friendly reforms such as favorable tax policies, the elimination of some sectoral foreign investment limits and other proposed regulatory reforms. Continued divestment of state-owned properties, increasing trust in the insolvency process, the appetite for buyouts and domestic consolidation are likely to drive M&A operation, while new investment instruments, such as InvITs and REITs, are likely to be more prevalent in 2020. Under the new cross-border system, the road to community restructuring exercises and to making Indian companies more internationally important and successful is clearer than ever. The implementation of a roadmap and framework for governing bound mergers is indeed a welcome move which provides regulatory inviolability for these transactions. The goal should be to boost the foreign market accessibility of the companies. The need is to mitigate the difficulties associated with cross-border merger and acquisition in particular with cultural and regulatory discrepancies between various jurisdictions. India's government needs to come up with numerous amendments and clarifications taking into account the practical nature of these transactions

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