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M&A LAB

Piramal – Abbott Deal Dissected

Dissected by – Team M&A

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August 05, 2010

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INDEX

1. Prologue.....	4
2. Executive Summary	4
3. Transaction details	5
4. Structure of the Acquisition.....	6
5. Commercial Considerations.....	8
• Why is Formulation Business a coveted acquisition for Abbott Lab?.....	8
• Future of Piramal Healthcare and how the deal is beneficial to them?.....	10
6. Legal, Regulatory and Tax Considerations.....	11
• Who should approve the Business Transfer?.....	11
• Can Promoters participate in a resolution approving Business Transfer?.....	11
• Is it mandatory to seek approval of creditors for a Business Transfer?.....	12
• Business Transfer v/s a Demerger?.....	12
• What is the direct tax implication of Piramal-Abbott deal?.....	13
• How will Piramal Healthcare transfer its intellectual property to AHPL?.....	14
• Does AHPL require any government approval to carry on the Formulation Business in India?.....	15
• Are non-compete provisions enforceable in India?.....	16
• Could demerger have been an alternative?.....	17
7. Chronology of Events.....	19
8. Epilogue.....	20

PROLOGUE

Affluent pharmaceutical giants from the West are in pursuit of their counterparts in the East to consolidate their presence and business in the emerging markets. The acquisition of domestic formulations business including mass market branded formulations business (the “**Formulation Business**”) by Abbott Healthcare Private Limited (“**AHPL**”), an Indian subsidiary of Abbott Laboratories, USA (“**Abbott Lab**”), from Piramal Healthcare Limited (“**Piramal Healthcare**” / “**Company**”) (“**Transaction**”) is the latest in a wave of consolidation within the global pharmaceutical industry over the past few years.

In this M&A Lab, we make a deeper probe into the Abbott – Piramal Healthcare deal which catapults Abbott Lab to *numero uno* position in the Indian pharmaceutical market, one of the most attractive and rapidly growing branded generics market. As always, we seek to analyze the legal, regulatory, tax and few commercial dimensions of this transaction.

EXECUTIVE SUMMARY

On May 21, 2010, Piramal Healthcare declared the execution of definitive agreements with Abbott Lab for sale of its Formulation Business to AHPL. It was not an easy catch for Abbott Lab that had to outbid a number of prospective acquirers to win this Formulation Business from the Piramal Healthcare.

The transaction, structured as a slump sale / business transfer, would result in Piramal Healthcare selling the Formulation Business to AHPL as a going concern excluding cash and cash equivalents (“**Business Transfer**”). Valued at about 9.4 times the sales, the acquisition of the Formulation Business is being done for a total consideration of USD 3.72 billion. The assets transferred include Piramal Healthcare’s manufacturing facilities at Baddi, Himachal Pradesh and rights to approximately 350 brands and trademarks and the employees of the Formulation Business.

The deal offers Abbott Lab a combined 7% market share in the Indian generic market and makes Abbott Lab the single largest player in the Indian pharmaceutical sector. Further, the deal provides Abbott Lab, the much required access to other emerging markets.

Piramal Healthcare’s retained business *inter alia* include custom manufacturing for third parties, critical care (including inhalation anesthetics), Over-the-Counter consumer products, manufacture and supply of active pharmaceutical ingredients, diagnostic medical devices and diagnostic services, including pathology laboratories and radiology centers and clinical research services.

As per the commercials, Piramal Healthcare shall pay Piramal Enterprises Ltd. (“**Piramal Enterprises**”) INR 3,500 million (approximately USD 75 million¹) for providing guarantee to Abbott Lab for the performance of all the obligations of Piramal Healthcare and its affiliates in connection with the Transaction. This payment also includes payment towards Non-compete provision prohibiting Piramal Enterprises Ltd., Piramal Healthcare and its affiliates from manufacturing generic drugs to be sold in India and other emerging markets for a period of eight years.

¹ Assuming 1 USD = 47 INR

Despite some concerns raised by a few sections of stakeholders over the deal, the decision of Piramal Healthcare to sell the Formulation Business at a high valuation is widely appreciated as a clever business strategy. It is said that the decision of Piramal Healthcare is expected to offer sufficient resources to add value to its remaining businesses which are also emerging with the time.

TRANSACTION DETAILS

BRIEF SNAPSHOT	
Acquirer	Abbott Healthcare Private Limited, India
Seller	Piramal Healthcare Limited, India
Assets acquired	Domestic Formulation Business (including mass market) which manufactures, markets and sells branded pharmaceutical products in finished form.
Mode of acquisition	Business Transfer of the Formulation Business into AHPL as a going concern.
Consideration	USD 3.72 billion (approx. INR 175 billion ²). Upfront payment: USD 2.12 billion Future payment: USD 400 million payable upon each of the subsequent four anniversaries of the closing commencing in 2011.
Mode of Funding	Cash on the balance sheet of AHPL.

Parties Involved in the Transaction

Abbott Laboratories, USA (“**Abbott Lab**”)

A corporation incorporated on March 6, 1900 under the laws of the State of Illinois, USA, with shares listed on New York Stock Exchange, Chicago Stock Exchange, London Stock Exchange and the Swiss Stock Exchange. Abbott Lab is currently into discovery, development, manufacture and sale of a broad line of health care products.

Abbott Healthcare Private Limited (“**AHPL**”)

A private limited company, incorporated under the Companies Act, 1956 (“**Companies Act**”) on January 1, 1997. AHPL is a wholly owned direct subsidiary of Abbott Lab and is into manufacture and sale of

² Assuming 1 USD = 47 INR

allopathic pharmaceutical preparations; sale of chemicals, scientific, medical & surgical instruments / equipment / devices, and nutritional products.

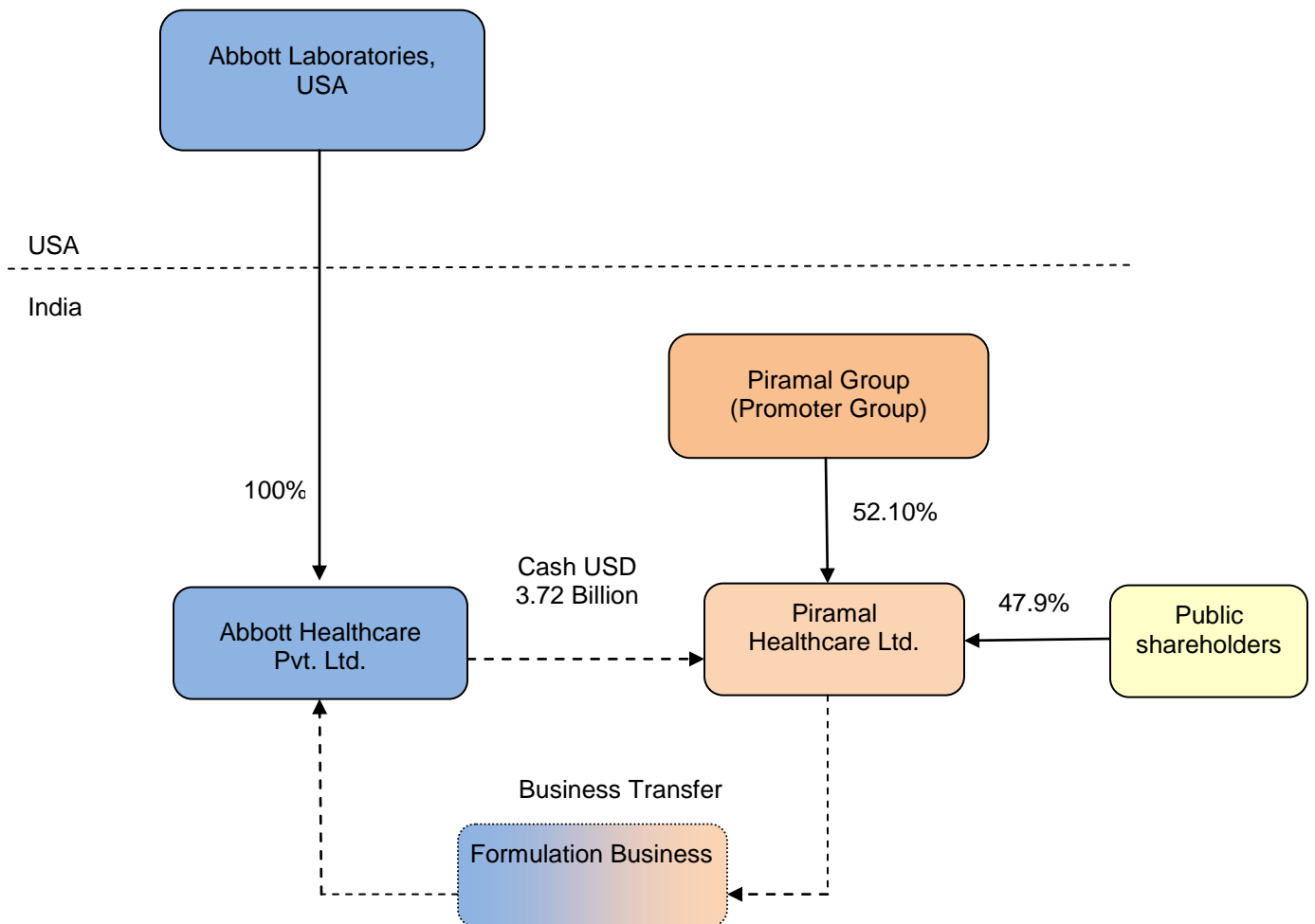
Piramal Healthcare Limited (“Piramal Healthcare”)

Piramal Healthcare a public company, incorporated under the Companies Act and is currently listed on Bombay Stock Exchange Limited (“BSE”) and National Stock Exchange of India Limited (“NSE”). The promoter holding in Piramal Healthcare is currently around 52.10%.

Piramal Enterprises Limited (“Piramal Enterprises”)

Piramal Enterprises Limited is an affiliate of Piramal Healthcare. It is a Mumbai based company, engaged in textiles, health care, glass containers, and engineering businesses.

STRUCTURE OF THE TRANSACTION



Overview of the deal

The transaction for sale of the Formulation Business has been structured as a slump sale / Business Transfer under Section 293(1)(a) of the Companies Act pursuant to a Business Transfer Agreement (“**BTA**”) dated May 21, 2010 entered into between Piramal Healthcare and AHPL.

Under the current deal, the Formulations Business, which is engaged in research, development, formulation, manufacture, sale, marketing, distribution, import and export of generic pharmaceutical products in finished form, shall be transferred to AHPL as a going concern. The said Business Transfer will involve the transfer of all the assets and liabilities of the Formulation Business excluding cash and cash equivalents and any liability relating to indebtedness of the Company, taxes, employee and other claims, environmental matters and any actual or potential litigation.

The Business Transfer is being undertaken for an all cash consideration of USD 3.72 billion (approx. INR 175 billion³). Out of the said amount USD 2.12 billion would be payable by AHPL to Piramal Healthcare on closing of the sale and a further USD 400 million is payable upon each of the subsequent four anniversaries of the closing commencing in 2011.

As per the Business Transfer Agreement, Piramal Enterprises, Piramal Healthcare and their respective affiliates are prohibited from engaging in business competing with the Formulation Business (“**Non-Compete**”) either in India or in emerging markets for a period of eight years from the date of closing of the Business Transfer. Further, Piramal Enterprises, Piramal Healthcare and their respective affiliates are prohibited from owning an interest in, managing, operating, joining, controlling, lending money or rendering financial or other assistance to or participating in, as a partner, stockholder, co-venturer, consultant or otherwise, with any person that is engaged in competing business either in India or in any Emerging Market. However this restriction does not extend to investment in shares of listed companies carrying on competing business, provided that such investment does not exceed 5% of the paid up capital and such an investment is not accompanied by acquisition of control or influence in the listed entity.

Additionally, guarantee has been provided by Piramal Enterprises to Abbott Lab for performance of all the obligations of Piramal Healthcare and its affiliates in connection with the Business Transfer.

In consideration of the Non-Compete and guarantee, mentioned above, Piramal Enterprises and its associates will receive from Piramal Healthcare an aggregate of INR 3500 million (approximately 75 million USD⁴), representing approximately 2% of the total consideration. This consideration is proposed to be paid out of the total consideration received by Piramal Healthcare and shall be paid in cash on closing of the Transaction.

³ Assuming 1 USD = 47 INR

⁴ *Ibid*

COMMERCIAL CONSIDERATIONS**❖ What makes the Formulation Business a coveted acquisition for Abbott lab even at a high valuation?****Abbott Lab – Expanding Geographies**

Abbott Lab, one of the leading pharmaceutical giants from the West, is on a look out for targets in the emerging markets and has outshone its rivals for the second time in less than a year with this acquisition. As part of its strategy to move beyond the proprietary or patented drugs business, Abbott Lab recently set up the Established Product Business globally. The business is spearheading Abbott Lab's penetration into emerging market regions. In September 2009, it struck a favorable deal to take over the drugs unit of Solvay, Belgium for USD 5.63 billion and within months it has struck another billion dollar deal with the Piramals for their Formulation Business.

Abbott Lab, over the years has been facing the pressure of its bigger rivals in the international markets. It ranks eighth in the global pharmaceutical rankings with revenues of USD 30.7 billion in 2009, which is about half of industry leader Johnson & Johnson's revenues of USD 61.8 billion for the same year. In terms of size, scale and scope, Abbott Lab is smaller as compared to other global pharmaceutical majors. Acquisition of Piramal's Formulation Business is expected to give Abbott Lab a better penetration into the emerging markets and likely to give it an edge over its mighty competitors.

Further, just 10 days before the acquisition of the Formulation Business, Abbott Lab announced a licensing and supply deal with Indian pharmaceutical company Zydus Cadila. The deal allows Abbott Lab to commercialize two dozen Zydus Cadila drugs in 15 emerging markets. The collaboration includes medicines for pain, cancer and cardiovascular, neurological and respiratory diseases, with product launches beginning in 2012.

Emerging markets – the future growth drivers

As per reports, emerging markets offer an important source of future business for the pharmaceutical and healthcare industry and it is estimated that with the near saturation of western markets, a significant portion of the future growth in the global pharmaceutical industry will be attributed to these markets. Pharmaceutical industry in India has been witnessing significant growth over past few years and by 2015, India's pharmaceuticals market is expected to reach USD 20 billion and become one of the world's top 10 pharmaceutical markets, overtaking Brazil, Mexico, South Korea and Turkey⁵.

Currently, it is estimated that around 65% - 70% of the domestic drug needs in India are being met by the Indian pharmaceutical companies. This huge domestic market coupled with low cost research and manufacturing abilities has resulted in these local pharmaceutical companies becoming hot targets for global MNCs. An added attraction of emerging markets like India is that individuals, and not governments, pay for a big portion of healthcare costs. About 70% of the Indian market is self-pay,

⁵ Kumra, G., Mitra, P., Pasricha, C. (2008). *India Pharma 2015: Unlocking the Potential of the Indian Pharmaceutical Market*. McKinsey & Company

which means Formulation Business may not be as vulnerable to the Government budget belt-tightening as in the case of its European counterparts or competitors.

Top 5 M&A deals in Indian Pharmaceutical sector				
Date	Target	Acquirer	M&A Type	Deal Value USD mn
June 11, 2008	Ranbaxy Laboratories Ltd.	Daiichi-Sankyo	Inbound	4150
July 27, 2009	Shantha Biotechnics Ltd.	Sanofi Aventis SA	Inbound	625.18
August 28, 2006	Matrix laboratories Ltd.	Mylan Inc	Inbound	530
December 15, 2009	Orchid Chemicals and Pharmaceuticals Generic Injectable Pharmaceutical Business	Hospira Inc	Inbound	400
May 3, 2007	Negma Lerads SA	Wockhardt Ltd.	Outbound	265

That explains the rush of foreign companies including Abbott Lab to venture into India through mergers, acquisitions, licenses or strategic alliances. These deals have twin benefits; presence and business in India along with access to manufacturing capabilities and a portfolio of products that can be sold in other emerging markets.

Piramal's Formulation Business

During the year ended March 31, 2010, Domestic Formulations division of Piramal Healthcare reported a sales of around INR 20 billion (approx USD 425 million⁶) and had registered a growth of around 24%. Piramal Healthcare has been ranked 3rd in the Indian pharmaceutical market for the period January to March 2010 (Source: ORG IMS) and has been ranked 1st in the Indian pharmaceutical industry in terms of sales from new products.⁷ One of the largest custom manufacturing companies in India, Piramal Healthcare has registered a growth track record of over 29% CAGR since 1988.

Pursuant to the deal, Abbott Lab would benefit from Piramal's manufacturing facilities in Baddi in Himachal Pradesh, rights to approximately 350 brands & trademarks and about 5,000 employees, bringing Abbott's total workforce in India to more than 7,000 in India. This deal would enable Abbott to capitalize on Piramal Healthcare's strong commercial presence, including a large sales force in rural area and it is expected that the combined Abbott and Piramal Healthcare sales forces will be the industry's largest in India.

⁶ Assuming 1 USD = INR 47

⁷ Source: Press release dated May 7, 2010 made by Piramal Healthcare

Consequent to above, the deal grants Abbott Lab the *numero uno* position in the Indian pharmaceutical sector with a 7% domestic market-share.

❖ **Future of Piramal Healthcare and how the deal is beneficial to them?**

The Formulation Business has been valued by Abbott at about 9.4 times the sales of healthcare solutions for FY 2010 and a total consideration of around USD 3.72 billion (approx. INR 17,500) is proposed to be paid to Piramal Healthcare. The paid up and listed shares are currently around 209 million⁸. Accordingly, the per share earnings for the transaction is almost in excess of INR 830, which is at a premium of around INR 345 over the current market price of INR 488 per share⁹.

Though there have been some concerns raised by few sections of investors over the fact that no monies have been paid directly to the shareholders in the proposed deal, the high premium commanded by Piramal Healthcare in this deal has been applauded in the industry circles as a great business move. The cash pool generated by the Company out of this transaction is, *inter alia*, expected to be utilized by Piramal Healthcare for repayment of its debts, more investment into R&D, increase the value of the remaining business and to venture into new business activities in the years to come.

Post the Business Transfer of the core Formulation Business, the business which will continue to be carried out by Piramal Healthcare would include custom manufacturing (both API & Formulations) for third parties, critical care (including inhalation anesthetics), over-the-counter consumer products, manufacture and supply of active pharmaceutical ingredients, vitamin and fine chemicals, diagnostic medical devices / equipment and diagnostic services¹⁰, including pathology laboratories and radiology centers and clinical research services. In addition, Piramal Healthcare will continue to pursue novel drug discovery and research through its affiliate company, Piramal Life Sciences Limited. It is expected that the critical care business, in which Piramal Healthcare is already at No. 3 in global anesthetics market, and contract manufacturing business would be the next big growth drivers for the Company in the times to come.

⁸ As on June 30 2010 – Source – www.bseindia.com

⁹ Closing price of shares on BSE as on July 26, 2010

¹⁰ Piramal Healthcare has *vide* press release dated July 14, 2010 informed BSE that it is proposed to sell its stake in Piramal Diagnostic Services Private Limited to Super Religare Laboratories Limited.

LEGAL, REGULATORY AND TAX IMPLICATIONS**❖ Who should approve the Business Transfer?**

Section 293(1)(a) of the Companies Act requires every company to obtain prior approval of its shareholders to undertake a sale of whole or substantial part of its undertaking. Such an approval has to be obtained by way of an ordinary resolution (simple majority). The Companies (Passing of the Resolution by Postal Ballot) Rules, 2001, makes it mandatory for all listed companies to obtain such approval of shareholders by way of a postal ballot and not in any ordinary meeting of shareholders.

Unlike a demerger under section 391 – 394 of the Companies Act, such a Business Transfer of business undertaking need not be approved by the High Courts.

Accordingly, pursuant to the approval of the board of directors of the Company on May 21, 2010, necessary steps were taken to seek the approval of equity shareholders of Piramal Healthcare vide postal ballot for the following:

- (i) Business Transfer of Formulations Business and terms thereof; and
- (ii) Payment of INR 3,500 million (approximately USD 75 million¹¹) to Piramal Enterprises and its associates as a consideration for corporate guarantee and Non-Compete obligations imposed on them under the Business Transfer Agreement.

The results of the said postal ballot were announced on June 25, 2010 and both the resolutions mentioned above were approved by the shareholders of Piramal Healthcare by an overwhelming majority.¹²

❖ Can Promoters participate in a resolution approving Business Transfer?

Though from a corporate governance perspective it could be desirable that such key corporate decisions be taken only by factoring the votes of non promoter shareholders, currently there are no restrictions under the Companies Act prohibiting promoters of a company from participating and voting in shareholders' resolution in which they may be directly or indirectly interested. Section 300 of the Companies Act prohibits an interested director from participating in board discussions and voting thereat, however, the same restriction does not currently extend to a shareholders' meeting.

Accordingly, legally it is possible for the promoters of Piramal Healthcare, who are currently holding around 52.10% in the entity, to participate and vote on the resolution for Business Transfer and payment of guarantee and Non-Compete fees. However, in the current case, the said resolutions were approved by overwhelming majority and, more importantly, out of the total non promoter (public)

¹¹ Assuming 1 USD = 47 INR

¹² Source: Letter dated June 25, 2010 by Piramal Healthcare addressed to the stock exchanges

valid votes that were exercised 99.85% votes were in favour of the Business Transfer and 99.62% of the votes were in favour of payment of Non Compete and guarantee fee.¹³

❖ Is it mandatory to seek approval of creditors for a Business Transfer?

Unlike a scheme of demerger under Section 391 – 394 of the Companies Act, under the Companies Act, it is not mandatory for the company to seek the approval of the secured and unsecured creditors before approving a Business Transfer. However, the approval of the creditors could be contractually required depending on the terms and conditions of the respective loan agreement.

❖ Business Transfer v/s a Demerger?

Demerger

Demerger is a process by which one or more business units of a company are hived off into separate entities or transferred to other companies. Though there are references to such an arrangement under Section 391 – 394 of the Companies Act, the terms ‘merger’ / ‘amalgamation’ or ‘demerger’ have not been expressly defined therein.

The Income Tax Act, 1961 (“IT Act”) defines ‘demerger’ to mean transfer by a demerged company¹⁴ of one or more undertakings into any resulting company¹⁵. Demerger is effected by a scheme of arrangement and has to be approved by the shareholders, creditors and by the High Court.

Demerger will result in the following tax benefits, subject to satisfaction of certain conditions¹⁶:

¹³ http://www.bseindia.com/xml-data/corpfiling/AttachHis/Piramal_Healthcare_Ltd_250610.pdf

¹⁴ Demerged company means the company whose undertaking is transferred pursuant to a demerger, to a resulting company - Section 2(19AAA) of the Income Tax Act.

¹⁵ Resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger – Section 2(41A) of the Income Tax Act.

¹⁶ A transaction would qualify as a demerger if it is a transfer by a demerged company of one or more undertakings, pursuant to a scheme of arrangement under Section 391-394 of the Companies Act, whereby:

- All the property of and liability relating to the undertaking immediately before the demerger, being transferred by the demerged company, should become the property and liabilities of the resulting company
- The property and liabilities of the undertaking being transferred should be at book value
- As consideration for the demerger, the resulting company should issue shares to shareholders of the demerged company on a proportionate basis
- The shareholders holding not less than three-fourths in value of shares in the demerged company should become the shareholders of the resulting company
- The transfer of the undertaking should be on an ongoing basis.

- *Capital Gains:* As per Section 47(vib) of the IT Act, any transfer, in a demerger, of a capital asset by the demerged company to the resulting company is not regarded as a transfer for the purpose of attracting capital gains tax so long as the resulting company is an Indian company. Further, the issue of shares of the resulting company to the shareholders of the demerged company should not be regarded as a transfer attracting capital gains tax if the issue of shares is made in consideration of the demerger. Further, such issuance of shares would also not be regarded as deemed dividend for the purpose of the IT Act.
- *Carry forward and set off of losses:* Section 72A(4) of IT Act provides for allowance of carry forward and set off of the accumulated losses of the demerged company in the hands of the resulting company in case where the loss or unabsorbed depreciation is directly relatable to the undertaking transferred. Where the same is not directly relatable to the undertaking transferred, the loss or unabsorbed depreciation can be apportioned between the demerged company and the resulting company in the same proportion as the assets.

Business Transfer / Slump Sale

Slump sale means the transfer of one or more undertakings as a result of the sale, for a lump sum consideration, without values being assigned to the individual assets and liabilities.

In comparison to demerger, slump sale is not generally tax efficient as the transfer of assets could be subject to capital gains tax in the hands of the transferor. Where the undertaking being transferred was held for more than 36 months prior to the date of the slump sale, the gains from such a sale would qualify as long-term capital gains, and the effective rate of tax would be 20%¹⁷. If the undertaking had been held for 36 months or any period lesser than that, prior to the date of slump sale, then the income would be taxable as short-term capital gains, the effective rate of which is currently 30%¹⁸. Also, any distribution by the company to its shareholders could attract dividend distribution tax.

Further, unlike in a demerger, the consideration for the slump sale is paid to the transferor company and not to its shareholders directly. Business Transfer / slump sale will also be subject to stamp duty.

❖ **What is the direct tax implication of Piramal-Abbott deal?**

The transfer of the Formulation Business is structured as a Business Transfer / slump sale wherein 55% of the existing business of Piramal Healthcare, constituting the Formulation Business is transferred to AHPL on a going concern basis without assigning values to the individual assets and liabilities transferred. The remaining 45% of the existing business is retained by Piramal Healthcare. *In lieu* of the transfer of the Formulation Business, AHPL will pay a total consideration of USD 3.72 billion, out of which USD 2.12 billion shall be paid upfront and USD 400 million shall be paid annually for the next 4 years from 2011.

¹⁷ Excluding surcharge of 7.5% and an education cess of 3% on the tax and surcharge

¹⁸ Excluding surcharge of 7.5% and an education cess of 3% on the tax and surcharge

Section 50B of the IT Act provides for taxation of slump sale. Such capital gains are deemed to be long term where the undertaking has been owned and held by the transferor for more than 36 months, irrespective of the period for which each individual asset of the undertaking has been held. Therefore, the current transaction will result in a long term capital gains tax @ 20%¹⁹ in the hands of Piramal Healthcare.

According to section 45 of the IT Act, capital gains tax has to be paid in that financial year in which the transfer of capital asset takes place i.e. transfer of Formulations Business in the instant case irrespective of whether the actual payment of consideration was received in that financial year or not. Accordingly, it was estimated that a net tax amount in the range of USD 0.80 billion (approx. INR 3,800 crores) would be payable by Piramal Healthcare in this financial year on this transaction. The tax on the entire transaction may be paid from the initial tranche of USD 2.12 billion (approx. INR 10,000 crores) receivable in this financial year or any other resource available with Piramal Healthcare.

❖ **How will Piramal Healthcare transfer its intellectual property to AHPL?**

The Agreement provides for the transfer of all the assets and liabilities of Piramal Healthcare relating to the Formulation Business including the intellectual property (“IP”). In today’s competitive world, IP is one of the most treasured assets for any business and it is all the more precious in the pharmaceutical sector where brand value is critical. It is believed that the high valuation of the Formulation Business by Abbott Lab can be partly attributed to the hoard of IP with the Formulation Business.

All the IP of the Formulation Business including patents and around 350 trademarks are proposed to be transferred to AHPL pursuant to the Transaction. The most common mode of IP transfer is an assignment of such rights between the parties.

Law prescribes certain prerequisites for an assignment of IP to be valid and enforceable. Section 68²⁰ of the Patents Act, 1970 (“**Patents Act**”) requires an assignment of a patent or the creation of any interest in a patent in any form to be in writing and such assignment should be reduced into a document embodying all the terms and conditions governing their rights and obligations.

Further, section 69(1)²¹ of the Patents Act provides that the assignee has to file an application for registration of such the assignment agreement in the prescribed manner with the Controller-General

¹⁹ Excluding surcharge of 7.5% and an education cess of 3% on the tax and surcharge

²⁰ An assignment of a patent or of a share in a patent, a mortgage, licence or the creation of any other interest in a patent shall not be valid unless the same were in writing and the agreement between the parties concerned is reduced to the form of a document embodying all the terms and conditions governing their rights and obligations and duly executed.

²¹ Where any person becomes entitled by assignment, transmission or operation of law to a patent or to a share in a patent or becomes entitled as a mortgagee, licensee or otherwise to any other interest in a patent, he shall apply

of Patents, Designs and Trade Marks within six months from the execution of the document or within such further period not exceeding six months as may be permitted by the Controller. Once the Controller is convinced about the title of the patent assigned, the validity of the assignment and the assignee's name the notification of the assignment will be registered in register of patents kept at the patent office.

Section 2(1)(b) of the Trademarks Act, 1999 ("**Trademarks Act**") defines "assignment" as *an assignment in writing by act of the parties concerned*. Section 37²² of the Trademarks Act empowers the proprietor of a registered trademark to assign the trademark by way of a written agreement. The assignment shall not take effect unless the assignee, within a period of six months from the date on which the assignment is made or within such extended period, as permitted by the Registrar of Trade Marks advertises the assignment in such form and manner.²³ Further, the notification of the assignment has to be duly filed in the Register of Trade Marks kept at the head office of the Trade Marks Registry.²⁴

❖ **Does AHPL require any government approval to carry on the Formulation Business in India?**

The Drugs & Cosmetic Rules, 1945 ("**Rules**") mandate that every drug manufacturer need to mandatorily obtain a license in the prescribed format from the authority concerned to manufacture drugs in India and the Rules further prescribe certain prerequisites to be fulfilled by the manufacturer to receive the license. Rule 71 prescribes that all manufacturing units must comply with the Good Manufacturing Practices as provided in Schedule M of the Rules to be eligible for obtaining the license to commence its operations.

Depending upon the nature of the drugs to be manufactured and the classification of the drugs under the Drugs & Cosmetic Act, 1940 ("**Act**") and the Rules, the licensing authority can be the state

in writing in the prescribed manner to the Controller for the registration of his title or, as the case may be of notice of his interest in the register.

²² Section 37: The person for the time being entered in the register as proprietor of a trade mark shall, subject to the provisions of this Act and to any rights appearing from the register to be vested in any other person, have power to assign the trade mark, and to give effectual receipts for any consideration for such assignment.

²³ Where an assignment of a trade mark, whether registered or unregistered is made otherwise than in connection with the goodwill of the business in which the mark has been or is used, the assignment shall not take effect unless the assignee, not later than the expiration of six months from the date on which the assignment is made or within such extended period, if any, not exceeding three months in the aggregate, as the Registrar may allow, applies to the Registrar for directions with respect to the advertisement of the assignment, and advertises it in such form and manner and within such period as the Registrar may direct.

²⁴ Section 6(1): For the purposes of this Act, a record called the Register of Trade Marks shall be kept at the head office of the Trade Marks Registry, wherein shall be entered all registered trademarks with the names, addresses and description of the proprietors, notifications of assignment and transmissions, the names, addresses and descriptions of registered users, conditions, limitations and such other matter relating to registered trademarks as may be prescribed.

specific Food and Drug Administration in every state or the central authority, the Drugs Controller General of India.

Pursuant to the Transaction, Piramal Healthcare has transferred the Formulation Business to AHPL including its manufacturing facilities at Baddi, Himachal Pradesh on a going concern basis enabling AHPL to carry on the Formulation Business in future. The question is whether AHPL is permitted to take the benefit of the manufacturing licenses procured by Piramal Healthcare to conduct the Formulation Business or will they have to apply for fresh licenses. The Act and the Rules do not provide for the assignment or transfer of licenses nor do they expressly prohibit it.

One school of thought is that any transfer of a business undertaking on a going concern basis implies transfer of all such manufacturing licenses and approvals relating to the undertaking. However, the other is that the licenses obtained by one drug manufacturer may not automatically get transferred under a business transfer agreement to another nor can the licenses be expressly assigned by way of an agreement. Hence, there are views that a specific approval from the relevant authorities may have to be taken for continuation of the manufacturing activities as mentioned above.

❖ **Are non-compete provisions enforceable in India?**

A non-compete arrangement between the seller of a business and the buyer is a commercial understanding whereby the seller agrees for a consideration to refrain from indulging in like business for a fixed period of time, enabling the buyer to commercially exploit the business to the maximum without any competition from the seller. The rationale is that the seller who has been in the business for relevant period of time would have created a brand value which should not be used by the seller to compete with buyer to the disadvantage of the buyer.

Non-Compete under the Business Transfer Agreement prohibits Piramal Enterprises, Piramal Healthcare and their respective associates from engaging in any business that competes with the Formulation Business either in India or in the emerging markets for a period of eight years from the date of closing of the Business Transfer. It is a common practice to include similar non-compete provisions in most of the Mergers & Acquisitions in India. However, the enforceability of such non-compete provisions has been a subject matter of numerous litigations in the past.

Non-compete provisions may not always be enforceable under Indian law owing to the reason that non-compete provisions can have the effect of restraining trade or profession. Section 27²⁵ of the Indian Contract Act, 1872 ("**Contract Act**") invalidates all agreements that are in restraint of trade. The prohibition on such agreements is absolute irrespective of whether the restraint is general, absolute or partial unless the agreement falls within the exception provided under section 27 of the Contract Act. Therefore, courts may declare non-compete provisions in commercial contracts or agreements as void for restricting trade if they do not qualify under the exception to section 27 of the Contract Act.

²⁵ Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

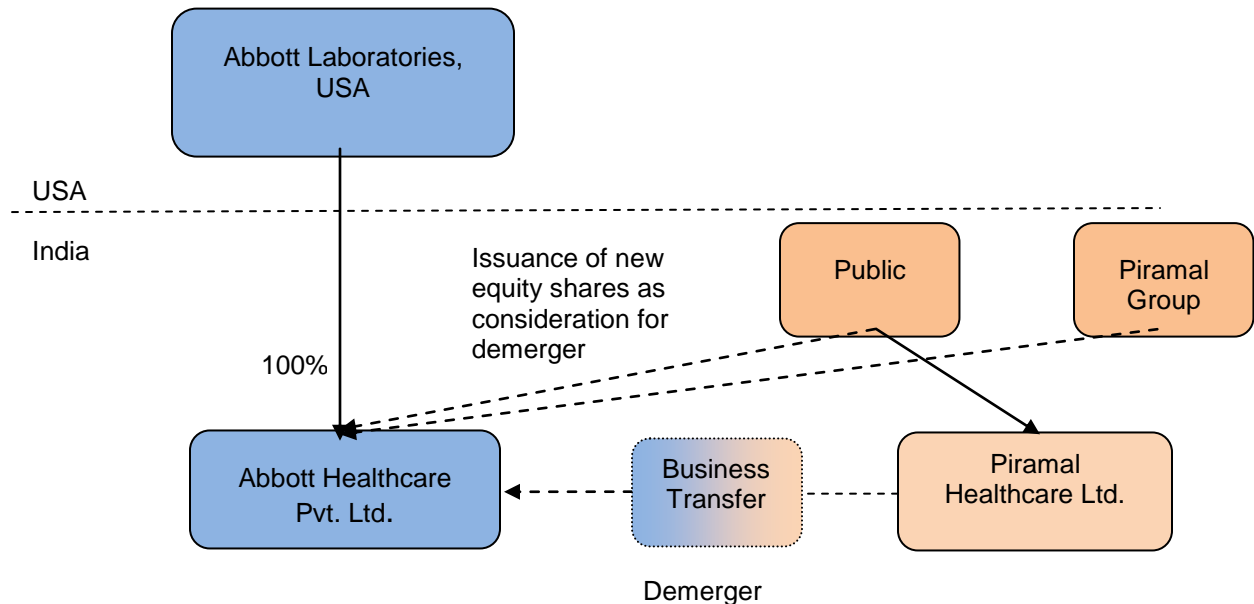
The exception to section 27 allows non-compete provisions in those agreements that provide for sale of goodwill if:

- i. the scope and application of such non-compete provisions is limited to reasonable and specified geographic boundaries; and
- ii. the non-compete provision is operational for such period of time during which the buyer, or any person deriving title to the goodwill carries on a like business within such specified local limits; and
- iii. the competent court believes that the geographic limits to which the non-compete applies is reasonable in light of the nature of the business.

Enforceability of non-compete provisions remains a highly debated issue even today without a straight jacket answer. Applying the basic tenets of law, the courts will review non-compete provisions on a case to case basis and accordingly determine their enforceability.

❖ **Could demerger have been an alternative?**²⁶

Piramal directly demerging the Formulation Business into AHPL or into a new company to be floated by AHPL



- One alternative is to structure the sale of the Formulation Business as a demerger pursuant to a scheme of arrangement under Section 391 to 394 of the Companies Act (“**Scheme**”);

- Pursuant to the Scheme, the entire Formulation Business can be demerged from Piramal Healthcare and transferred as a going concern into either AHPL or into a new company (“**New Co.**”) floated by AHPL or Abbott Lab. Such a demerger would require approval of the shareholders and creditors of both the demerged and resulting entity and should also be approved by the High Court;
- All the assets and liabilities pertaining to the Formulation Business, will have to be transferred to AHPL or the New Co., as the case may be, to ensure compliance with the requirements of sections 2(19AA) and 72A of the IT Act;
- As consideration for the demerger under the Scheme, AHPL or the New Co., as the case may be, shall issue its shares to all the shareholders of Piramal Healthcare based on a predetermined valuation. The benefits of demerger under the IT Act would be available only when the consideration for demerger are shares and not cash;
- Issuance of shares pursuant to a scheme of arrangement under Section 391 – 394 is an exempted transaction under the SEBI Takeover Code²⁷.

Challenges with a scheme of demerger for Formulations Business

Transfer of Formulation Business by way of a demerger may not have been a commercially viable option due to the following reasons:

- (i) Demerger, being a court approved process, takes around 5 – 7 months for completion and is subject to numerous approvals including approval of the High Courts. Time being an essence in such a big ticket deal, a simpler route such as a slump sale would have got commercial preference;
- (ii) The consideration for a demerger should be issuance of shares to all the shareholders of the demerged entity²⁸ for availing the tax benefits under the IT Act. Accordingly, for a scheme to be qualified demerger under the IT Act, the shares of AHPL or the New Co. should have to be issued to all the shareholders of Piramal Healthcare. This would involve significant dilution of Abbott Lab in AHPL or the New Co. and commercially it may not be desirable for the shareholders of Piramal Healthcare (including its promoter group viz. the Piramal Group) continuing to hold shares in AHPL or the New Co. post the sales. Further, Abbott Lab would want to have 100% control over AHPL or New Co. which would not be possible if shares are issued to the shareholders of Piramal Healthcare.
- (iii) Currently, there are around 84,000 shareholders in Piramal Healthcare. Issuance of equity shares of AHPL or the New Co. to all these shareholders could also result in Piramal

²⁷ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

²⁸ In this case, Piramal Healthcare.

Healthcare or the New Co. opting for an automatic listing²⁹, which may not be commercially viable for the acquirers.

Challenges with a scheme of demerger for remaining business of Piramal Healthcare

Similarly, one can also think of an option of demerging the remaining business of Piramal Healthcare (other than Formulation Business) into a separate entity and AHPL acquiring thereafter acquiring the shares of Piramal Healthcare. However, this would require two fold process – one, demerger of remaining business into a separate entity and second, open offer by Abbott Lab and AHPL to acquire the shares of Piramal Healthcare (which would post demerger include only the formulation business). This again may carry the same challenges of a demerger as mentioned. Further, this would also result in an open offer under the Takeover Regulations and Abbott Lab may run the risk of not being able to control 100% of Piramal Healthcare due to presence of public shareholders. Also, under this option Piramal Healthcare may not have received consideration directly to use for future expansion of its remaining business as consideration for demerger will be paid to the shareholders.

CHRONOLOGY OF EVENTS

We have summarized below the chain of key events in relation to the deal:

Date	Events
May 21, 2010	Board of Piramal Healthcare approved the sale and transfer of Formulations Business by way of Business Transfer to AHPL. The approval of the board was intimated to BSE. BTA was executed between Piramal Healthcare and AHPL.
May 27, 2010	Piramal informed BSE that the shareholders will consider the Transaction for their approval by way of postal ballot. Notice of postal ballot dispatched to the shareholders.
June 11, 2010	PHL Holdings Limited and Swastik Safe Deposits and Investments Ltd. together acquired more than 2% stake in Piramal.
June 25, 2010	Result of postal ballot was declared. Shareholders approved the BTA and the payment of Non-Compete and guarantee fees.

This mega pharma deal structured as a business transfer, has been a fast track transaction in comparison to the earlier Ranbaxy Laboratories Ltd.- Daiichi-Sankyo deal which took almost an year to complete.

²⁹ SEBI Circular SEBI/CFD/SCRR/01/2009/03/09 dated September 3, 2009

EPILOGUE

This deal, commanding one of the most expensive valuations in the recent times in India, has once again put the Indian pharmaceutical sector on global limelight. The entry into Indian market has its inherent economic and business advantages for foreign acquirers including geographic expansion and access to lucrative emerging markets. Ranked 4th in the world pertaining to volume of sales³⁰, the lucrative Pharmaceutical Industry in India has clearly captured the fascination of global MNCs. With each concluded deal, the quest for space in this rapidly growing Indian pharmaceutical market is further gaining momentum and it is expected to see many more pharmaceutical deals in India in the days to come.

*Team M&A would like to thank Khushboo Baxi, member of our Pharma and Life Science practice for her contribution in this dissection.

As you would be aware, we have been providing regular information on latest legal developments. M&A Lab is our initiative to provide you knowledge based analysis and more insight on latest M&A deals. You can direct your views / comments / suggestions on our initiative to siddharth@nishithdesai.com, nishchal@nishithdesai.com, vaidhyanadhan@nishithdesai.com and aruns@nishithdesai.com.

³⁰ http://www.investmentcommission.in/pharmaceuticals_&_biotechnology.htm