GETTING THE DEAL THROUGH

Mergers & Acquisitions

in 58 jurisdictions worldwide

2009

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1 Form

How may businesses combine?

At the outset, it is important to understand the different kinds of companies and entities that operate in India. Under the Companies Act 1956 (the Companies Act), a company can be set up either as a private company or a public company. A private company restricts the number of shareholders and the transferability of its shares, and also prohibits offer of shares to the public and the invitation or acceptance of deposits from persons other than its members, directors or their relatives. A public company under the Companies Act is defined to mean a company that is 'not a private company' and includes a private company that is a subsidiary of a public company. A public company does not necessarily mean that the company is listed on a stock exchange. A public company can subsequently be listed on one or more stock exchanges in accordance with the guidelines prescribed by the Securities and Exchange Board of India (SEBI) and the provisions of the relevant listing agreement executed with the respective stock exchange. In addition, businesses could be set up as partnerships or proprietary concerns, although these are typically used for small businesses since the liability of the partners or founders, as the case may be, are unlimited. Recently, the Limited Liability Partnership Act 2008 has been enacted to provide an alternate platform of operation for small and medium-sized businesses. However, this is a recent development and there are certain ambiguities concerning different aspects, including tax treatment of such limited liability partnerships.

Businesses may combine through mergers, acquisitions or by setting up a joint venture company.

Acquisitions

Businesses are usually acquired through the purchase of shares of the target, or alternatively the acquisition of the assets of the target. An asset acquisition by a foreign company that intends to hold the assets in India and carry on business in India will require the foreign company to have a presence in India either by way of a private company or a public company, which could have tax implications under Indian law. Acquirers look at gaining control over the target company in a variety of ways, including through acquiring a majority shareholding, voting right control, board control, veto rights at the shareholder level, etc.

Merger

The merger or amalgamation of two or more companies into one entity, or the demerger of a business division into a new company, requires the approval of the high courts that have jurisdiction over the companies intending to merge or demerge. Companies intending to undergo a merger, amalgamation or demerger are required to prepare a scheme of arrangement setting out the reasons, terms and conditions of the merger, amalgamation or demerger. The high courts grant approvals after considering the scheme of arrangement submitted by the parties. Moreover, the scheme requires approval of the creditors of the concerned companies, as well as of the holders of at least 75 per cent of the shareholding of each of the companies involved.

Under the Companies Act, the 'transferee company' (being the resultant or the surviving entity) in a scheme of arrangement has to be a company registered under the Companies Act. However, the 'transferor company' can be any body corporate (which includes a foreign company).

Joint venture

Two parties may also enter into a joint venture, subsequent to which a joint venture company may be set up. In a joint venture, normally the rights of the parties would differ depending on the commercial agreement, and the extent of their respective contribution and investment.

The parties to a joint venture typically execute a joint venture agreement setting out the rights and obligations of each party and the provisions governing the management of the joint venture company. Further, the Companies Act, the Indian Contract Act 1872 (the Contract Act) and other relevant legislation would become applicable depending on the terms of the commercial transaction.

Where a foreign joint venture partner has another existing joint venture in the same field as on 12 January 2005, prior approval of the government would be required for further investments in the same field by such foreign entity, subject to certain conditions and the availability of some prescribed exemptions.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

Companies in India are registered and regulated under the provisions of the Companies Act, which applies uniformly across India. The Companies Act provides for the fundamental statutory framework for the investment into, transfer, purchase and sale, winding-up and liquidation of companies. The term 'merger' is not defined under the Companies Act. However, provisions dealing with schemes of arrangement or compromise between a company, its shareholders and its creditors for the purposes of reconstruction and amalgamation govern merger and combination transactions. The Contract Act governs the formation of valid contracts reflecting the understanding of the parties with respect to various business transactions. In addition, there is other specific legislation that deals with different commercial transactions, such as the transfer of property, the sale of goods, partnerships, trusts, etc.

Securities laws

The securities market is regulated by the Securities and Exchange Board of India (SEBI), established under the Securities and Exchange Board of India Act 1992 (the SEBI Act) and the guidelines, rules and regulations made by SEBI (SEBI Regulations). In relation to acquisitions, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 (SEBI Takeover Code) regulate the acquisition of shares and takeovers of listed companies. Further, companies that are listed on the stock exchanges also have to comply with the requirements of the listing agreements entered into with the stock exchanges on which they are listed. The SEBI Act and SEBI Regulations (including the SEBI Takeover Code) apply uniformly across India. Under the SEBI Takeover Code, the acquisition of shares or voting rights of a public listed company over the prescribed percentage triggers the obligation to make a public offer to acquire a prescribed minimum amount of shares from the public shareholders of the company.

Competition law

The government enacted the Competition Act, 2002, (Competition Act) to replace the existing Monopolies and Restrictive Trade Practices Act, 1969 (the MRTP Act). The Competition Commission of India (CCI) has been established to control anti-competitive agreements, abuse of dominant position by an enterprise and for regulating certain combinations. While the provisions of the Competition Act concerning the establishment of the CCI have been notified and have come into force, the other principal provisions of the Competition Act have not come into force as yet. One of the major changes to be brought in by this legislation will be the pre-merger notification procedure in cases where certain thresholds are exceeded in relation to turnover and market share. The Competition Act also sets out material indicators to determine whether a particular act is anti-competitive or not.

The earlier law, namely the MRTP Act, sought to ensure that there is no concentration of economic power to the common detriment and provides for the prohibition of monopolistic and restrictive trade practices. Currently the MRTP Commission is still dealing with cases under the MRTP Act, and the Competition Act provides for the transfer of all such cases to the CCI.

Exchange controls

For cross-border business combinations and transactions, the implications under the Foreign Exchange Management Act 1999 (FEMA) and the regulations issued thereunder by the Reserve Bank of India (RBI) will have to be considered. Foreign investments in, and acquisitions of Indian companies are now permitted in most sectors without the requirement of any prior approval of either the government or the RBI, subject to compliance with pricing and reporting requirements prescribed by the RBI. The regulations issued under the FEMA also govern any outbound acquisition by Indian companies.

Tax laws

Tax considerations may be crucial to the transaction, particularly in the context of a slump sale or 'cherry picking' of the assets. The Indian Income Tax Act, 1961 (ITA), as amended by the Finance Act enacted every year, is the key legislation in this regard. The ITA also provides for certain beneficial tax treatment to mergers, subject to the fulfilment of certain prescribed conditions. In addition, there is various indirect tax legislation dealing with value-added tax, etc, which may apply depending upon the transaction structure.

Additional issues

Apart from the above, the purchase of shares or assets is not subject to any specific legislation. The legal issues that may arise will vary depending on the manner in which the transaction is structured. Employee-related issues might also require some prior approvals or notifications under the Indian labour laws and need to be kept in mind while structuring a business combination. Further, the provisions of the applicable stamp laws would also have to be complied with. Some labour laws and stamp laws are also regulated independently by certain states in India, and need to be assessed individually depending upon the states involved.

3 Governing law

What law typically governs the transaction agreements?

Typically, the transaction agreements, especially where the agreement deals with acquisition of shares of an Indian company or assets located in India, provide for the laws of India as the governing law. Where agreements provide for the laws of a jurisdiction other than India as the governing law, to the extent the dispute concerns shares of an Indian company or assets in India, the laws of India would automatically become applicable to these particular matters.

Most agreements provide for arbitration as the dispute resolution mechanism, and provide for a neutral venue and law for the arbitration proceedings. In such cases, any dispute arising out of the agreement would have to be resolved in accordance with the rules of arbitration as set forth in the relevant agreement.

A scheme of merger or demerger would be subject to Indian laws.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

Filing requirements

Any changes in the shareholding of a company are recorded with the concerned registrar of companies (RoC) through the annual returns that are required to be filed with the RoC. In the case of mergers, amalgamations or demergers, the order passed by the High Court, approving the scheme of arrangement or compromise should be filed with the RoC. Share transfers need to be notified to the company, and in the case of private companies, such transfers would be subject to the transfer restrictions set forth in the charter documents of the company. The laws governing transfer of shares of an Indian company (by a non-resident shareholder to a resident shareholder and by a resident to a non-resident) have been liberalised, are now substantially covered under the automatic route, and require only a filing with the authorised dealer. However, this liberalisation is not applicable where the company is in the financial services sector (such as banks, non-banking financial companies and insurance companies) or where the acquisition of shares triggers the provisions of the SEBI Takeover Code, in which case the requisite approvals from the RBI or the Foreign Investment Promotion Board (FIPB) would be required.

Under the listing agreement, the companies that are listed on the stock exchanges have to notify the stock exchanges in the event of any change in the character of the business of the company. In cases where the proposed business combinations contemplate shares being listed, approval of the relevant stock exchange for listing will be required.

Under the SEBI Takeover Code, an acquirer of shares or voting rights of an Indian listed company, which entitle the acquirer to more than 5, 10, 14, 54 or 74 per cent of the shares or voting rights of the company, in any manner whatsoever, shall disclose at each stage of acquisition the aggregate of his shareholding or voting rights in that company to the company, and to each of the stock exchanges on which the company's shares are listed.

With respect to an acquisition, any acquirer who has acquired shares or voting rights of a company under the provisions of the SEBI Takeover Code shall disclose purchase or sale aggregating 2 per cent or more of the share capital of the company to the company, and the stock exchanges where shares of the company are listed. These disclosures have to be made within two days of such purchase or sale, along with the aggregate shareholding after such acquisition or sale.

On a continual basis, every person who holds more than 15 per cent of the shares or voting rights in any company shall within 21 days from the financial year ending March 31 make yearly disclosures to the company, in respect of his holdings as on March 31. A promoter or every person having control over a company shall, within 21 days from the financial year ending March 31, as well as the record date of the company for the purposes of declaration of dividend, disclose the number and percentage of shares or voting rights held by him and by persons acting in concert with him, in that company to the company. Every company whose shares are listed on a stock exchange, shall within 30 days from the financial year ending March 31, as well as the record date of the company for the purposes of declaration of dividend make yearly disclosures to all the stock exchanges on which the shares of the company are listed of changes in respect of the above.

Under the SEBI (Prohibition of Insider Trading) Regulations 1992 (the Insider Trading Regulations), any person who holds more than 5 per cent shares or voting rights in any listed company shall, within two working days of any change, disclose to the company the number of shares or voting rights held and change in shareholding or voting rights in excess of every 2 per cent from the last disclosure, even if such change results in shareholding falling below 5 per cent. This disclosure has to be made to the target company, which in turn is required to disclose the same within two working days of the receipt of such information, to each of the stock exchanges on which the company's shares are listed.

Stamp duty

Stamp duty is regulated both at a central and state level in India. Stamp duty payable on the transfer of shares is regulated by the Indian Stamp Act 1899 and is currently stipulated at 0.25 per cent of the aggregate consideration. However, this stamp duty is only payable when the shares are in a physical form. If the shares that are transferred are in a dematerialised form, no stamp duty is attracted, though a securities transaction tax will be payable by both the purchaser and the seller. Additionally, certain states, such as the state of Maharashtra, have provided for stamp duty payable at the prescribed rates on records of transactions, whether electronic or otherwise, effected by a trading member of a stock exchange, through a stock exchange. Stamp duty payable on the transfer of assets would vary depending on the assets to be transferred and the mode of the transfer, as well as the prevailing stamp duty rates in the state in which the assets are located. Normally stamp duty rates are higher on the transfer of immoveable property than on the transfer of moveable property. Stamp duty payable on the transfer of assets pursuant to a scheme of amalgamation or merger approved by the high court could be lower than the stamp duty payable on a simple asset transfer agreement.

One may also be required to pay value-added tax at the applicable rates on the transfer of assets.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

The obligation of public companies to make information available to their shareholders is regulated by the Companies Act, SEBI Regulations and the listing agreements executed with the stock exchanges. Companies registered under the Companies Act must also make certain filings with the RoC, including annual returns and annual accounts. These filings are made available to the public. Public companies are also required to maintain certain statutory registers, which must be open to inspection by the shareholders and the public. Under the provisions of the listing agreements, companies must disclose to the stock exchanges any change in the structure of the company, including capital, ownership, constitution of the board, etc, and all such information that will have a bearing on the price of the securities of the company.

In terms of the provisions of the Insider Trading Regulations, the company is required to disclose all price-sensitive information regarding the company to the stock exchanges at the earliest opportunity so that incidences of insider trading are minimised.

Please also see question 4 for disclosures under the SEBI Takeover Code and Insider Trading Regulations.

The disclosure requirements highlighted above are mandatory, regardless of the structure adopted for the business combination.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

As discussed earlier, the SEBI Takeover Code requires the acquirer to make disclosures whenever his or her acquisition of shares or voting rights exceeds the 5, 10, 14, 54 and 74 per cent thresholds. Furthermore, any person who holds more than 15 per cent of the shares or voting rights in any company and a promoter having control over a company, must, within 21 days from the end of each financial year (ie, 31 March), make disclosures about their holdings to the company and to the stock exchanges, and the company in turn is required to notify these changes to the stock exchanges where the shares of the company are listed.

Further, under the Insider Trading Regulations, any person holding more than 5 per cent of the shares or voting rights in any listed company must disclose to the company the number of shares or voting rights held by such person, on becoming such holder, within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights. Additionally, any change in such shareholding or voting rights in excess of 2 per cent from the last disclosure (even if such change results in the shareholding or voting rights falling below 5 per cent) is required to be disclosed to the company within two working days of the receipt of intimation of allotment of shares, or the acquisition or sale of shares or voting rights, as the case may be. The company is also required to disclose such information received from its shareholders within two working days of the receipt of such information, to the stock exchanges on which the company's shares are listed.

Additionally, in January 2009, the SEBI Takeover Code was amended to include an additional disclosure requirement vis-a-vis share pledge, for promoters and every person forming part of the 'promoter group'. Pursuant to this amendment, promoters and persons forming part of the promoter group are required to disclose details of any pledge of shares of the company, to that company within seven working days of creation of the pledge and seven working days of invocation of such pledge, as applicable. The company has to disclose such information to the relevant stock exchanges within seven working days of receipt of such information.

Any changes in the shareholding of the company must be disclosed in the annual returns that are to be filed with the RoC. There are no additional disclosure requirements for large shareholders in the light of a potential business combination.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

The general principle established under the Companies Act is that the directors owe a fiduciary duty to the company and must exercise their powers in the best interests of the company, that is, taking into consideration the interests of the various stakeholders of the company (shareholders, creditors, employees and the public interest). The directors of the company must take the requisite steps to fulfil the obligations of the company under the Companies Act, the SEBI Act and the regulations notified thereunder and the relevant listing agreement.

The Insider Trading Regulations provide that a director or officer of a listed company must disclose to the company the number of shares or voting rights held by the director or the officer, within two working days of becoming a director or officer of the company. Under the Companies Act, the directors must disclose to the company the nature of their interest in any contract or arrangement that the company proposes to enter into. The directors must abstain from participating in discussions on contracts or arrangements in which they have a personal interest at board meetings and must also not vote on such contracts or arrangements.

Under the SEBI Takeover Code, the board of directors of the target company have the option to send their comments and recommendations about the offer of the acquirer to the members of the target company. Further, a director who represents or has an interest in the acquirer is bound to excuse himself and not participate in any matter relating to the offer under the SEBI Takeover Code.

Once the open offer to the public commences, the board of directors of the target company cannot, without the approval of the shareholders, after the date of the public announcement of the offer: deal with the assets of the company, other than in the ordinary course of business; issue or allot authorised (but unissued) securities carrying voting rights; enter into material contracts; or appoint any such person to the board having a relationship or interest with or in the acquirer. These restrictions shall be in force for the entire offer period.

The controlling or majority shareholders in the company have a duty not to oppress the minority shareholders or mismanage the company. Any shareholder who is oppressed by the actions of the other shareholders or directors can make an application to the Company Law Board for relief.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Approval from the shareholders will be required in the event of the proposed disposal of a business division of a public company.

Any merger and amalgamation, arrangement or demerger of business divisions or compromise with creditors and members will require the approval of the shareholders by means of a special resolution (approval by a three-quarters majority) under the Companies Act.

An Indian acquirer will also require the approval from its shareholders, by way of a special resolution, in the event that its investment in the target company exceeds 60 per cent of the paid-up capital and free reserves of the acquirer.

In addition, any approvals required from the shareholders under the articles of association of a company will also have to be obtained. Further, in a public company or a private company that is a subsidiary of a public company, the issue of shares to persons other than the existing shareholders under a proposed business combination will require the approval of the existing shareholders by means of a special resolution.

9 Hostile transactions

What are the special considerations for unsolicited (hostile) transactions?

The SEBI Takeover Code does not distinguish between a hostile takeover and a solicited offer for takeover. A number of provisions in the SEBI Takeover Code can be used as defences in the event of hostile takeovers, subject to the restrictions on the activities of the board of directors of the target company as mentioned above. Competitive bids are allowed under the SEBI Takeover Code.

Further, the target company may, during the offer period, with the approval of the shareholders, sell, transfer, encumber or otherwise dispose of the assets of the company. Also, with the shareholders' approval, the target company can, during the offer period, issue or allot any authorised but unissued securities carrying voting rights. The target company may also issue shares upon the conversion of debentures that have already been issued, or issue shares carrying voting rights upon exercise of options under pre-existing warrants.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed? What are the limitations on a company's ability to protect deals from third-party bidders?

Break-up fees and reverse break-up fees are not provided for statutorily. However, parties can agree contractually to the same. In India reverse break fees are not yet commonplace. Under the Contract Act, damages are generally limited to compensation for such losses as are reasonably foreseeable as the natural loss resulting from non-performance. In most cases, the party breaching the letter of intent or memorandum of understanding is required to reimburse the expenses incurred by the other party in connection with the transaction. Competitive bids from third-party bidders are allowed under the SEBI Takeover Code. Consequently, third-party bids from bidders complying with these provisions cannot be blocked by the company. However, in private limited companies, the restrictions on transferability of shares makes it relatively difficult for third-party bidders to acquire the company. However, if the non-breaching party is a foreign party and the party making the payment is an Indian company, the prior approval of the RBI may be required to make the payment of the break-up fees. Indian banks are not permitted to fund companies for the purposes of making a public offer unless it is in the context of a privatisation transaction (ie, where the government is selling its shares under the disinvestment programme), subject to certain conditions.

11 Government influence

Other than through relevant competition (antitrust) regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations including for reasons of national security?

The government and regulatory agencies are fairly active in regulating a business combination where a foreign entity is involved from the Indian exchange control perspective. For example, any purchase of existing shares of an Indian company requires filings to be done with the details of the transaction and as discussed above, requires the prior approval of the FIPB and the RBI in certain instances. Apart from the above, where the business combination is between two Indian resident entities or parties, there may be a few compliance and filing requirements depending upon the areas of activity of the combining entities. If the transaction is structured as a merger or an amalgamation, the approval of the relevant high court is required. Further, the Competition Act, 2002, stipulates certain pre-merger notification procedures in cases where the merged entity crosses certain thresholds in relation to turnover and market share.

Furthermore, in sectors which have a bearing on national security, such as in telecom (including telephony and broadcasting) and defence, the government typically imposes additional restrictions and conditions for foreign investments in these sectors.

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

In accordance with the provisions of the SEBI Takeover Code, an acquirer who has acquired, 15 per cent or more but less than 55 per cent of the shares or voting rights in a listed company, cannot acquire, either by himself or through persons acting in concert (PAC, as defined under the SEBI Takeover Code), additional shares or voting rights entitling him to exercise more than 5 per cent of the voting rights, in any financial year ending on March 31, or who holds 55 per cent or more but less than 75 per cent of the shares or voting rights in a target company, cannot acquire either by himself or through PAC, any additional shares or voting rights therein, unless the acquirer makes a public announcement to acquire shares of the company in accordance with the Takeover Code (subject to the exclusions mentioned hereunder). In such a case the acquirer is generally required to make an offer for at least 20 per cent of the total shares of the target company. However, this requirement is not applicable if the acquirer is making an offer that is conditional upon a minimum level of acceptances. Further, pursuant to a recent amendment, any person holding 55 per cent or more (but less than 75 per cent) shares of the listed company is permitted to further increase his or her shareholding by not more than 5 per cent in the listed company without making a public offer for the acquisition of shares from the public shareholders, subject to fulfilment of certain prescribed conditions. A public offer would also not be required if the shareholding of any shareholder holding 55 per cent or more is increased by up to 5 per cent due to buyback of shares by such listed company. The acquirer is, however, restricted from increasing his or her shareholding to more than 75 per cent without making a public offer.

In cases where the acceptance is conditional, the acquirer will be required to deposit in cash a sum that is equivalent to 50 per cent of the consideration payable under the public offer in an escrow account with the SEBI. The SEBI Takeover Code also prescribes that a public offer can be withdrawn if there is a competitive bid, or the statutory approval required for the offer has been refused, or in any other circumstances as the SEBI may deem fit.

In the case of acquisitions (through purchase of shares or assets), the contracts between the parties may provide for an escrow arrangement or hold back condition, whereby a certain portion of the purchase price is retained or deposited in an escrow account, to be released or adjusted pursuant to specified conditions or milestones.

13 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

If any acquisition of shares of a company, scheme or arrangement, results in the public shareholding falling below the minimum limit specified in the listing conditions or listing agreement at the time of its listing, then the acquirer has an option to make an offer to the existing shareholders to delist the company and buy out the shareholders at a price determined through the book building process in accordance with the SEBI (Delisting of Securities) Guidelines 2003 (Delisting Guidelines). The acquirer will be required to submit a letter of offer to the shareholders in this regard. Further, if the minimum public shareholding limit has been breached, it could trigger the compulsory delisting provisions under the Delisting Guidelines, under which a company would have to be delisted; however, such a decision is at the discretion of the relevant stock exchanges and SEBI.

Provisions of the Companies Act also facilitate the acquisition of 100 per cent of the shares or a class of shares of the target company and provide a way to acquire shares of shareholders dissenting from a scheme of arrangement or contract of acquisition approved by the majority shareholders. In such an arrangement, the usual mode is for the acquiring company (acquirer) to make an offer to the shareholders of the target company (target) to purchase their shares in the target at a stated price, which is usually higher and more attractive than the prevailing market price. The offer so made usually specifies a time within which the offer is to be accepted, with a condition usually added to the effect that if a specified percentage of the shareholders do not accept the offer, the offer is to be void. If the offer is accepted by all the shareholders of the target, then the acquirer can proceed to acquire all the said shares and thereby taking over the target. If the required minimum percentage of the target's shareholders accept the offer, the acquirer can purchase their shares and then compel the dissenting shareholders to transfer their shares to the acquirer in the manner provided under the Companies Act. The merit of these provisions is that a complete takeover or squeeze-out could be effected without resorting to tedious court procedures.

Timing

In accordance with the provisions of the Companies Act, after the acquirer makes an offer to the shareholders of the target to acquire their shares, the offer shall be approved within four months by holders of not less than nine-tenths in value of the shares; shares already held by the acquirer or its nominee or subsidiary shall not be taken in to account. Within two months after the expiry of the aforesaid four months, the acquirer shall give notice to the dissenting

Update and trends

The global credit crisis, the consequent economic slowdown, and events such as terrorist attacks, elections, etc, have compelled acquirers and investors to adopt a cautious approach; these have adversely impacted the upsurge in M&A activity witnessed in India in the past few years. Further, there appears to be some disparity between the promoters of Indian companies and acquirers and investors with respect to valuation.

Institutional research suggests that the total value of M&A transactions (domestic and cross-border) has declined by 40 per cent in 2008 to US$30.72 billion as compared to US$51.11 billion in 2007. The total number of M&A deals also appears to have declined by 52 per cent to 445 in 2008 against 676 in 2007 (see www.epwrf.res.in/upload/MER/mer10812011.pdf).

While M&A activities in general have suffered a setback, India's automobile sector has reported a rise in outbound transactions, in order to penetrate newer markets and leverage its cost advantage. While Tata Motors, with its acquisition of luxury brands Jaguar and Land Rover from Ford Motor, emerged as the frontrunner in terms of value, Mahindra & Mahindra (M&M) with its three Italian acquisitions – Grafica Ricerca, Metalcastello and Engines Engineering, scored higher on the number of deals. JK Tyre's acquisition of Mexican company Tornel for US$67 million and Daimler AG's 26 per cent stake in Sutlej Motors and Carburettors were other highlights of the Indian M&A market.

Regulatory framework and other developments

The recent case of Satyam Computers Services' CEO admitting to falsifying and overstating cash reserves by nearly US$1 billion has been cited as the worst fraud in corporate India's history. This has urged regulators to bring about regulatory reforms with respect to corporate governance and enhance the confidence of stakeholders; immediately following the Satyam case reforms such as requirement of disclosures on shares pledged, etc, have been introduced.

The *Vodafone* case in which the Indian tax authorities pulled up Vodafone for not withholding tax on the consideration paid for the acquisition of a Cayman Islands company through its Netherlands entity, a seemingly tax-free transaction so far as India's fiscal shores are concerned, has made investors and acquirers reconsider cross-border tax planning. However, to what extent it should raise concerns can be appreciated only after the tax authorities have made a determination on this issue.

Until recently, the manner of computing indirect foreign investment in Indian companies has been restrictive and ambiguous. It has now been clarified that downstream investment by companies not 'owned' or 'controlled' by non-residents would not be considered foreign indirect investment. In this regard, 'control' has been defined as ability to appoint a majority of directors and 'owned' has been defined as equity ownership of more than 50 per cent of the holding company. However, in the case of investment into sectors requiring prior approval, FIPB has retained the right to examine the extent of control given to foreign investors under shareholder agreements through disproportionate voting rights, etc. The government has recently suggested that the press notes that brought about these changes may undergo some review.

The RBI has relaxed some of the end-use restrictions under the prescribed guidelines for external commercial borrowings, opening up greater avenues for foreign funding. The RBI has also permitted the prepayment of foreign currency convertible bonds by way of a buyback prior to the expiry of the minimum average maturity subject to certain conditions for a limited time period.

To bridge the disconnect between the prevailing market price of a share and the minimum price at which they are to be offered under law, SEBI has passed amendments to bring the issue price under certain private placements of listed companies closer to the market price (reduced from a six-month to a two-week average). However, volatile market conditions coupled with SEBI's steps to boost debt investments have made debt an attractive investment alternative.

Irrespective of the global economic slowdown, India continues to offer great investment opportunities not only in the IT and ITES sectors, but now also in more traditional sectors such as manufacturing, banking, pharmaceuticals and others. The regulators also appear to be willing to go the extra mile to facilitate an inflow of investments into the country.

shareholders that it desires to acquire their shares. The dissenting shareholders must, within one month of such notice, apply to the concerned authority seeking to interdict the purchase, failing which they will be bound by it. If no application is made to the authority, or the application is dismissed within one month of issue of the notice, the transferee company is entitled and bound to acquire the shares of the dissenting shareholders. If there is no order to the contrary then, either after the expiry of the one month period or after the date of the receipt of such an order, the acquirer shall transmit a copy of the notice along with an instrument of transfer executed on behalf of the dissenting shareholder by any person appointed by the acquirer to the target along with the consideration payable. The target would be obliged to record and register the transfer in favour of the acquirer. This procedure is subject to the conditions and terms set forth in the Companies Act.

14 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Cross-border transactions are also regulated by the provisions of Indian exchange control regulations. In the context of the transfer of shares, the details have been set out in the earlier responses. Asset acquisitions by foreign acquirers will also require prior regulatory approval, and could require the foreign acquirer to set up a presence in India, which could have tax implications under Indian tax law.

15 Waiting or notification periods

Other than competition laws, what are the relevant waiting or notification periods for completing business combinations? Are companies in specific industries subject to additional regulations and statutes?

Other than competition laws, the only relevant waiting periods would be in cases where the transaction requires the prior approval of the FIPB or the RBI from the Indian exchange control perspective, if applicable. The SEBI Takeover Code also prescribes certain minimum notification periods for the shareholders in the case of a public offer. Companies operating in certain industries of social, strategic or environmental concern, such as the explosives industry and hazardous chemicals industry, etc, require industrial licensing under the provisions of the Industries (Development and Regulation) Act.

16 Tax issues

What are the basic tax issues involved in business combinations?

Any capital gains realised by a person resident in India and any gain arising out of the transfer or sale of a capital asset located in India (whether held by a person resident in India or a non-resident) is subject to tax in India under the Indian Income Tax Act 1961 (the ITA).

Capital gains tax liability would arise when all of the following conditions are satisfied:

- there should be gains or profit on the transfer of the capital assets;
- the asset transferred should fall within the meaning of capital assets, which is defined under the ITA to mean property of any kind held by a person, whether or not connected with that person's business or profession; and
- there should be a transfer of capital assets which is defined to include: the sale, exchange or relinquishment of the asset; or the extinguishing of any rights therein. There are certain transactions that are specifically exempted from being regarded as a transfer for the purposes of the ITA, such as the transfer of shares in a scheme of amalgamation by an Indian amalgamating company to the amalgamated company, etc, subject to fulfilment of conditions as specified. In these cases, capital gains tax will not be payable.

Loss of tax benefits for software companies

Indian software companies benefit from certain significant tax incentives under Indian tax laws. These tax incentives include up to 10 years' tax holiday until 31 March 2010 from payment of Indian corporate income taxes for income from operations of export-oriented undertakings or units located in software technology parks. A special tax regime is also carved out for units located in special economic zones, in which case the tax holiday may extend beyond 2010.

While the tax holiday continues without regard to any change in the beneficial ownership of the company, in the case of asset purchases or reconstructions of business, the tax holiday may be lost under certain circumstances.

Carry-forward and set-off of business losses

India does not recognise carry-back of tax losses. However, tax losses arising from business can be carried forward for eight years following the year in which such a loss arose. In the case of a private limited company or a company not listed on the stock exchange, the benefit of carrying-forward of losses is lost if there is a change in shareholding beyond 51 per cent.

Unabsorbed depreciation is added to the depreciation allowance of the next year, and is deemed to be part of depreciation for that year.

17 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

Indian law protects the interests of 'workmen' through a variety of statutes. These statutes have different definitions of 'workmen'. With respect to employees who do not fall within the definition of 'workmen', under these statutes, there is no protection as such except as may be provided in the applicable local shops and establishments act and the employment contract, if any. One of the significant pieces of Indian labour legislation in the context of a merger or acquisition is the Industrial Disputes Act 1947 (the IDA), which applies only to workmen, and defines them to mean any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work but does not, inter alia, include any such person who is employed mainly in a managerial or administrative capacity or who, being employed in a supervisory capacity, draws wages exceeding 1,600 Indian rupees per month or exercises functions of a mainly managerial nature.

In the case of a business combination, the relevant provisions would be those relating to the 'transfer of an undertaking' under the IDA. This section provides that, where there is a transfer of the ownership or management of a company, a workman who has been in continuous employment with the company for not less than a year preceding the date of the transfer, is entitled to notice and compensation unless all of the following conditions are fulfilled:

- the service of the workmen is not interrupted by the transfer;
- the terms and conditions of service applicable to the workmen after the transfer are not in any way less favourable to the workmen than those applicable to them immediately before the transfer; and
- the new employer is, under the terms of the transfer or otherwise, legally liable to pay compensation to the workmen, in the event of their retrenchment, on the basis that their service has been continuous and has not been interrupted by the transfer.

In the event that the proposed transfer of the business fails to comply with the conditions set out above, the original employer is obliged to:

- give one month's notice in writing to the workmen indicating the reasons for the transfer or wages in lieu of such notice; and
- pay compensation equivalent to 15 days average pay for every completed year of continuous service or any part thereof in excess of six months.

In a recent High Court judgment the court recognised that the workers of a company cannot be mandatorily transferred from one company to another, when two companies are merged or amalgamated, under the Companies Act. The court has stated that the workers must have the option not to join the new company, and if the worker exercises this option he will be entitled to retrenchment compensation.

In addition to the above, the IDA also provides for notice requirements and compensation to be paid to the workmen in the case of the termination of their employment by way of a lay-off, retrenchment or closure of the company.

In addition to the IDA, the state-specific shops and establishment acts also specify the employer's obligations upon termination of service.

18 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

As per the provisions of the Sick Industrial Companies Act 1985 (the SICA), if the target company becomes a 'sick industrial company' (defined to mean an industrial company being a company registered for not less than five years, which has at the end of a financial year accumulated losses equal to or exceeding its entire net worth), then within 60 days of the company becoming sick, the board of the company must make a reference to the Board for Industrial and Financial Reconstruction (BIFR). Once the restructuring proceedings commence before the BIFR, the target company is protected from suits, recovery proceedings and winding up petitions. Any sale of assets by the target company during the interim period pending reorganisation will require the special approval of the BIFR, which may be granted on a discretionary basis. The BIFR has the power to restrict the sale of the assets if it is of the view that the sale would not be in public interest.

An insolvency law, which would be appended to the Companies Act, and an Act to repeal to SICA bave been passed. However, the notification to give effect to the SICA Repeal Act has been held up, pending resolution of certain disputes pertaining to the constitution of the alternate mechanism.

Winding-up

In the event that a winding-up of the target company has commenced, whether voluntary or involuntary, the prior approval of the official liquidator appointed by the High Court of the state where the registered office of the company is situated, will be required for any merger or acquisition. The sale of the assets or shares of a company in winding-up will require the special approval of the official liquidator, and will be granted only if it is in the public interest.

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