

M&A Interactive

June 09, 2016

RULES OF M&A GAME GET SOPHISTICATED

A quarter of a century ago, India made a new and renewed "Tryst with destiny" when she embarked on the path of economic liberalization, a path that the country has vigorously maintained amid the so called "chaotic" democratic setup and for the most part a gloomy global environment. The tectonic shift in the economic landscape and the subsequent pace of cross border investment activity brought teething legal problems. In the last few years however, we have witnessed that the teething legal problems of the last twenty five years are now giving way to more sophisticated and nuanced legal challenges in the M&A space in light of the spate of legal and macro-economic changes.

In recent times, there has been a spate of new legislations such as the companies' law, insider trading law, listing regulations and changes to the foreign investment policy, takeover code, delisting regulations, ownership rules for insurance and banking companies. Before that, in 2011 the country had a new takeover code and a modern anti-trust regime. The changes have been so dynamic that in the last fortnight itself, we have witnessed the passage of a new bankruptcy law, the re-negotiation of the coveted India-Mauritius tax treaty (which also has a direct impact on the India-Singapore tax treaty) and formation of new tribunal to adjudicate corporate law disputes.

These changes have increased the sophistication in deal making in India. Some of the key trends that we are witnessing off late are as follows:-

KEY TRENDS

- Corporate & Regulatory Dynamics and Early Assessment-** A decade ago, the broad terms of the M&A deal could be finalized in a few meetings between the principals (promoters) and thereafter the advisors would be called on board to execute the deal and complete the paperwork. However, now the controlling shareholders by themselves are not necessarily in a position to have a complete sway over the deal making process. With enhanced corporate governance requirements and potential liabilities, the board is increasingly asserting itself on M&A deals. However, we do see an inverse co-relation between the level of promoter shareholding and the influence of the board i.e. higher the shareholding of the promoter the lesser the independent influence of the board. With the rise of proxy advisory firms and the increase in institutional shareholding/participation, we are also witnessing an increase in the influence of the minority shareholder or the non-controlling shareholders. The stringent corporate governance rules such as the requirement of the "majority of the minority" has given minority shareholder significant ammunition and a seat at the table.

Board and shareholder dynamics aside, the identification of regulatory concerns is also occupying management time at a very early stage in the deal. For e.g. what information can the potential acquirer receive or target share as part of the deal evaluation? What are areas that would concern the anti-trust regulator and what could be the potential remedial measures? What are different tax consequences? Are there any softer concerns on the public relations front?

We are seeing that these aspects are now being discussed and considered at an early stage of a transaction and rightly so, as some of these aspects if identified at an early stage may not be insurmountable but if one is caught off guard could expose the parties to enormous monetary and reputational risks.
- Qualitative Evaluation**—Earlier, an acquirer would appoint legal and financial advisors to conduct customary diligences on the target which would include identifying legal non-compliances and financial discrepancies. While these old practices continue and for the right reasons, we are witnessing an increase in qualitative assessment of the target and its practices especially given the unfortunate corporate scandals in the country which surfaced some years back. The acquirers are now evaluating more closely the background of the controlling shareholders, members of the board, corporate governance practices and financial controls within the target. These exercises are not purely academic or check the box items anymore but there are instances of deals being called off purely on qualitative grounds.
- Cross Border Legal Evaluation**— In the last few years, Indian companies have increased their overseas business presence at a phenomenal pace. This has resulted in an increased complexity in inbound transactions as well. Today, an acquirer is not just required to grapple with Indian laws while evaluating an inbound M&A but also needs to evaluate if the laws of other jurisdictions would also apply by virtue of the Indian target's direct or indirect business interests in other jurisdictions. We are seeing an increase in global anti-trust, securities law and tax assessments as also an increased focus on compliance with the UK Bribery laws, FCPA etc. some of which have extra-territorial application.
- Assessing M&A Litigation Risks-** While, M&A's in India are still not matters which are litigated upon aggressively, with the increase in shareholder participation, the hawkish regulatory environment and bid like

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situations we are seeing an increase in potential M&A litigations. The changes in the judicial process (creation of commercial courts and now national company law tribunal) and the recent non-interventionist attitude of the higher judiciary towards international arbitrations has allowed stakeholders, who would once sit on the fence (for the fear of going through the Indian judicial process), to voice their concerns and if required litigate them.

AREAS OF DEVELOPMENT

While, these trends are indeed going to have a compelling effect on M&As in India, some of the areas that many stakeholders would like to see change and which has hardly seen any serious deliberation from the lawmaker's are:-

1. **Deal Financing & Leveraged Buyouts**:- As we have discussed in the past, there are several restriction under Indian corporate and banking laws which makes a leveraged buyout impossible and this has no doubt affected M&A activity in India. This issue would require an open discussion amongst all stakeholders as leveraged buyouts could create economic value especially in an environment where the banks are looking to clean up the pile of NPAs.
2. **Referee Cannot Play the Game & Litigation Funding**:- While international litigation funds see India as an attractive jurisdiction, the regulatory impediments have not allowed the concept of litigation funding to fully realize it's potential. With the changing landscape, it will be crucial to evaluate if litigation funding is a natural and necessary development to implement some of the corporate governance reforms. Currently, SEBI appears to be at the forefront of protecting the rights of the minority shareholders, however the referee cannot play the game for too long and the right environment needs to be created for the minority shareholders to enforce their own rights.

ROAD AHEAD

After twenty five years as the dust settles and all stakeholders mature, the next phase of deal making will be complex, sophisticated and as always, exciting. The question is – how prepared are we to play the Game?.

– Ankit Mishra & Simone Reis

You can direct your queries or comments to the authors

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