

M&A Hotline

May 21, 2009

NEW GOVERNMENT TO SPUR M&A REFORMS

On May 18, the day immediately after the election results were declared manifesting that UPA will indeed form the next government, the Indian stock markets buoyantly jumped 2111 points on a single day of trading, relenting only after trading on the bourses was suspended for the day. The bull-run at the bourses was largely attributable to the anticipated economic reforms that the new government, now unfettered by allies, is likely to introduce.

Herein below, we provide a perspective on few of the regulatory changes that are on the anvil, which may have a significant bearing on M&As in India, both domestic and cross border, in the coming few months:

(1) Company Law

The Companies Bill, 2008 ("Bill"), which was introduced around the end of last year is likely to be notified on priority now. Few implications of introduction of the Bill that may have a bearing on M&As in India may be:

- **Merger approvals:** The Bill proposes National Company Law Tribunal ("NCLT") as the sole authority to facilitate single window clearance for all mergers and amalgamations. The concept of "deemed approval" has also been proposed for mergers of holding and wholly owned subsidiary companies or mergers of two or more small companies, if no objection is raised by the Official Liquidator. Currently, even for mergers of group companies and small companies, High Court approval is required which usually takes 4-6 months thereby prolonging the group restructuring process.
- **Outbound Mergers:** Currently, an Indian company is not allowed to merge with a foreign company. As per the Bill, an Indian company can merge with a foreign company subject to satisfaction of certain conditions. This would provide significant flexibility in structuring cross border M&As.
- **Elimination of shares with differential rights:** The Bill proposes to eliminate the issuance of shares with differential rights to shareholders to bring equality amongst the shareholders for creating shareholders democracy. This proposal could hamper structuring of M&As.
- **Corporate governance:** The Bill proposes that one third of the total directors on Board of the company should be independent directors.
- **Special Courts:** The Bill proposes to set up special courts to deal with other issues under the Companies Act related to mergers and amalgamations, reduction of capital, insolvency, et al which could significantly shorten the M&A transaction timeline.

(2) Competition Law

A vigorous antitrust regime having significant repercussions on the cross border and domestic M&As is expected to come into force soon vide the notification of the substantive provisions of the Competition Act, 2002 ("Competition Act") which shall replace the extant Monopolies and Restrictive Trade Practices Act, 1969 ("MRTP Act"). The Competition Act shall seek to prohibit anti-competitive agreements including cartels; prohibit abuse of dominant position and regulate combinations (mergers and amalgamations, and acquisitions). The Competition Act presently prescribes for a waiting period of 210 days within which the Competition Commission of India ("CCI") is required to pass its order approving / disapproving or suggesting suitable changes in the scheme of combination, failing which the proposed combination shall be deemed to be approved. This prolonged period of 210 days to approve a combination could act as an impediment to cross border M&As in India. It is expected that the above period of 210 days could get further reduced to bring it in line with the international standards.

The Competition Act also has an extra territorial reach and the CCI has the power to look into anti-competitive agreements, practices amounting to abuse of dominant position and combinations outside India which have an appreciable adverse effect on the relevant market in India.

(3) Sector-wise implications

- **Banking Sector:** Significant M&A activity may be seen in the banking space as the new government, as it appears, will be keen to progressively follow the policy of consolidation in the banking sector by encouraging the merger of large public sector banks with small state-run entities and private players. Further, the Banking Regulation (Amendment) Bill, which will be reintroduced in the new Lok Sabha, proposes to do away with the current 10 percent voting right cap for any investor in a bank, irrespective of its shareholding. The removal of voting right cap will act as a shot in the arm for M&As in banking sector.
- **Retail Sector:** Government, as it appears, has been keen to go ahead with its initiative of permitting FDI in the multi-brand retail sector (or as a tentative step permit in certain specific goods). The single-brand retail industry may also

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receive an impetus in the form of further raising of the present FDI cap of 51% to 100%. If the retail sector is liberalized as above for foreign investment, we can expect significant foreign investments in Indian retail sector from giant retailers like Walmart, TESCO, Carrefour, etc.

- **Aviation Sector:** At present, foreign airlines are not permitted to hold equity, either directly or indirectly, in domestic airlines, although foreign investors are allowed to invest within an FDI cap of 49%. The aviation ministry is expected to take a policy decision with regard to permitting overseas airlines to buy stakes in local carriers which would help bring in much needed capital in the cash-starved Indian aviation industry. The ongoing consolidation in this sector could throw up interesting acquisition opportunities for foreign airlines thereby increasing the pace of acquisitions in this space.
- **Commodities Markets:** With a view to provide more autonomy to the Forward Markets Commission and enable trading in commodity-related intangibles like commodity options, the Government may consider the passage of the Forward Contracts (Regulation) Amendment Bill, 2008. While currently, trading in commodity futures exchanges covers only 'goods' that are physically deliverable the proposal is to permit 'commodity derivatives' (commodity options, weather derivatives, index futures and other such intangibles) by amending the definition of forward contract, thereby enabling banks and mutual funds to invest in such markets.
- **Insurance:** The Insurance (Amendment) Bill, 2008 primarily envisages an increase in foreign investment limit to 49% from 26%. This will surely increase the interest of foreign insurers in the lucrative and promising Indian insurance sector. If enacted, the Indian insurance sector would see a flurry of domestic and cross border M&A deals.

With the new Government winning the elections with a thumping mandate, it will indeed have a free hand to carry out the above economic reforms resulting in a spurt in domestic and cross border M&A activity in India.

- Team M&A

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