

M&A Hotline

January 07, 2015

M&A LANDSCAPE IN INDIA: WHAT TO EXPECT IN 2015?

Dear Friends,

2014 marked a remarkable change in how the Indian economy was viewed internationally when the largest democracy in the world gave itself a new and stable government. Investor sentiment which changed drastically post the elections continues to be positive. The more encouraging sign from a long term perspective is that the new Government appears to be focused on economic growth and development and improving the business environment. The new Government which has promised efficient and strong governance has in its first seven months undertaken several steps to boost both domestic and foreign investor sentiment and to transform the Indian economy. While no major structural economic reforms have been undertaken primarily because the Government does not have the majority in the upper house (the Rajya Sabha) and it is still early days for the Government to do so, some of the key steps towards reforms include opening up the railways, defense and insurance sectors for foreign investors, land acquisition reforms, labour law reforms and enhancing the ease of doing business through *inter alia* single window clearances.

M&A is a function of corporate confidence, global economic situations and increased competition. While the future of M&A activity/waves is difficult to predict, given the economic climate in India and rest of the world, we feel that deal making in India is likely to witness significant changes in 2015. We have highlighted below some of the key areas that are likely to act as catalyst for M&A activity in India this year.

INTERNATIONAL ECONOMIC FACTORS

Global

While the global deal volume rose two-thirds than in 2013 and the highest since the financial crisis in 2008,¹ the overall global economy is expected to grow at the rate of 3.4% in 2015 and around 3.5% in 2016.² The Euro Zone is in the early phases of recovery and while the economy is expected to remain stable, growth is likely to be weak due to high public and private debt and tight credit conditions.³ The US is expected to grow steadily in 2015 and 2016 and given the strong economic relationship between the US and India, cross border deals between India and US is expected to increase in 2015. The overall foreign investment from Japan into India is likely to increase in 2015 due to a weak Japanese domestic economy and slow growth in China.

BRICS

As regards BRICS, the GDP growth rate in China declined in 2014 and is expected to grow at around 7% in 2015. The real GDP in Brazil declined in the first half of 2014, however the Brazilian economy recovered by the end of 2014. The outlook for the Brazilian economy looks modest and is expected to grow at around 1.5% in 2015.⁴ 2014 was an extremely challenging year for the Russian economy. The falling oil prices and the conflict with Ukraine are expected to hurt investor sentiment and as result the Russian economy is expected to stagnate in 2015.⁵ The South African economy slowed down in 2014 with real GDP growth of around 1.3%. However the economy is expected to rebound to a growth trajectory of 2-3% in 2015 and 2016.⁶

The slow growth in other BRIC countries could benefit India as global investors may have limited investment options in the medium term given the subdued economic outlook for some of the other emerging economies.

INDIAN ECONOMIC, FINANCIAL AND REGULATORY FACTORS

Signs of an economic revival

The trappings of an economic revival in the Indian economy were visible from the deal activity in 2014. In 2013, the value of M&A and private equity deals stood at USD 38 billion involving 949 deals. In 2014, the value of M&A and private equity deals rose by 26% to USD 48 billion and the volume of deals rose by nearly 20% to 1,116 deals.⁷ The number of inbound deals rose by 32% whereas outbound deals dropped by 38% which further reflects the buoyant domestic sentiment. In terms of industries, IT/Tes, pharma, banking and financial services, retail and consumer saw significant increase in M&As. E-commerce, infrastructure and banking and financial services sectors saw robust private equity deal activity. The aggressive fund raising activity in 2014 should lead to increase in M&As in 2015.

Much awaited budget reforms

The next budget for the financial year 2015-16 that will be presented by the Finance Minister sometime in February/March, 2015 is expected to be a '*Watershed Big Bang Reforms Budget*'. In 2015-2016, major economic reforms including implementation of single harmonized indirect tax regime (GST regime) is also expected, more so if

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the ruling BJP Government is able to continue its impressive performance in state elections and as a result increase its seat share in the upper house. The change in the political landscape coupled with the inherently strong fundamentals of the Indian economy should place India on a high growth trajectory in the coming years.⁸

New regulatory changes and developments

The Securities and Exchange Board of India ("SEBI") has also in principle approved changes which would enable take private transactions, easier delisting and squeezing out of the minority shareholders pursuant to a takeover bid.⁹ The new *insider trading regulations* are also going to make due diligence of listed targets simpler. The new Companies Act, 2013 with its bouquet of changes such as enhanced role of directors, squeeze out provisions, class action suits, and specialized forums for adjudication of disputes is likely to influence deal making in 2015 and could also increase M&A litigation.¹⁰ Sectors such as railways, defense and insurance sectors are being opened up for increased foreign participation.

The Reserve Bank of India ("RBI") is already contemplating bank financing for M&As which will act as a first step for creating a market for leveraged buyouts and provide a great fillip to domestic M&As.¹¹ The growing clout of the Competition Commission of India ("CCI") in regulating the M&A activity and shareholder activism that is fuelled by proxy advisory firms and a robust media is also likely have a significant impact on M&As.

Friendly Tax Environment

While GAAR remains a concern, the overall tax environment in the country is likely to improve. The Government has assured that there will ordinarily be no retrospective taxation and that tax administration would be non-adversarial. As we discuss in this piece, thus far the Government has honored its pledge. A simple and non-adversarial tax regime should attract foreign investors back into India especially those who had after the retrospective tax controversies in 2012 decided to shelve their India plans.

In this our annual piece we have examined and discussed evolving trends and lessons from the past for the Indian M&A industry and how such experiences are likely to affect M&As in 2015. We hope stakeholders will find this useful while preparing for deals in 2015.

BEST WISHES & HAPPY NEW YEAR,

M&A Team, Nishith Desai Associates

I. 2014 AND LESSONS FROM THE PAST

Identifying and evaluating the risks for undertaking M&A especially cross border M&A in any jurisdiction at an early stage is critical to deal making and India is no different. Several key considerations such as regulatory, economic and political must be borne in mind before undertaking a deal. Some of key trends in the Indian deal making landscape are discussed below.

A. Due Diligence

In recent years, acquirers especially foreign acquirers have lost significant value by entering into transactions without conducting adequate due diligence on target companies and the controlling shareholders (also referred to as promoters in the Indian context). For example, the *Daiichi-Ranbaxy deal* went sour when the US FDA clamped down on certain manufacturing concerns leading to a serious erosion of value of Ranbaxy's shares within months from the closure of the deal.¹²

In India, due diligence of public listed companies is not a straightforward process as there is uncertainty under the insider trading regulations over whether an acquirer could have access to unpublished price sensitive information during the course of the diligence. Further, the problem is compounded by the fact that the quality of disclosures made by some of the listed companies is not adequate to undertake a fair assessment of the target.

Recent regulatory proposals will address some of these concerns. SEBI has approved the new insider trading regulation¹³ which allows an acquirer to undertake due diligence on a listed Indian target subject to satisfaction of certain conditions. Additionally, the new corporate governance norms prescribed by SEBI should result in an improvement in the quality of disclosures made by listed companies. These regulatory changes should enable a foreign acquirer to undertake a robust due diligence on a listed Indian target.

In our observation, in recent years the scope of the due diligence apart from covering conventional aspects is also extending to (i) background checks on the controlling shareholders and management of the target; (ii) target's level of compliances with anti-bribery laws and (iii) corporate governance standards maintained by the target company.

B. Deal Structures

Based on the commercial requirements of the parties, like globally, M&As in India can be implemented in various ways. While court approved merger, amalgamations or share acquisitions still remain the conventional options, in the last few years we have seen an increase in spin-offs in the form of court approved demerger or transfer of business as a going concern.¹⁴ Spin-offs have proved to be helpful for entities that wish to exit a non-core business and unlock value. Spin-offs have also helped facilitate a more focused capital raising. In 2014, several listed companies spun-off their non-core businesses to focus on core businesses. For example, *Marico* spun off its skincare and wellness division and *Gulf Oil* demerged its lubricants business into another focused listed entity.¹⁵ Several companies also undertook restructuring of their group operations to align their businesses with the corporate structure of the group.

Predominately, cross border deals involving a foreign acquirer and an Indian target were implemented as share acquisitions due to regulatory restrictions on share swaps and the ability of an Indian company to merge with a foreign entity.

C. Deal Terms

In the last few years, the documentation involving M&A deals in India has increasingly become sophisticated and complex. Some of deal terms that are occupying significant negotiation time are as follows:-

- **Indemnity and R&W Insurance:** The negotiation around minimum and maximum indemnity cover has intensified. Given, the tax concerns in India, tax indemnity has also occupied a central theme in the negotiations. Sellers and targets are more reluctant to provide a full indemnity cover for an open ended duration. Therefore, parties are increasingly relying on R&W Insurance to bridge the gap. In some instances, acquirers have held back a certain portion of the consideration in escrow as cover for the indemnity obligations of the seller.
- **MAC-** In recent years due to increased global uncertainty and volatility, the material adverse change (MAC) clause has emerged as the single most important covenant in deal documents. The MAC clause serves as an important function in risk allocation. Acquirers have used MAC clauses to either not close a deal or re-negotiate a lower consideration. Whilst, MAC clauses have not been tested in India courts, the Indian takeover code tacitly recognizes such arrangements as it allows an acquirer to withdraw an open offer if the underlying transaction which triggered the open offer falls through. In 2013-14, India's *Apollo Tyres* was able to walk out of a deal with US based *Cooper Tire* by relying on a MAC clause.
- **Termination Fees-** Termination fees i.e. the fee paid by the seller in the event the seller does not complete a transaction is becoming increasingly common in both domestic and cross border transactions. Similarly, in some deals, reverse termination fees are also being negotiated.
- **Earn-Outs-** Indian businesses are still reliant on the founding families (also promoters). Further, foreign acquirers may not always have the local knowledge or expertise that is required to run a business in India. In order to bridge these gaps and other valuation concerns, parties are increasingly negotiating earn-out covenants in deal documents. While earn outs help keep the promoter on board and therefore the new acquirer benefits from the knowledge of the existing management, it has largely been used in domestic deals since an acquisition of shares by a foreign acquirer from a resident seller for a deferred consideration requires prior RBI approval which approval is not granted very often. Although there are various ways of structuring earn outs in cross border deals, the above restriction has made deferred consideration and earn out covenants in cross border M&A deals difficult.

D. Anti-Trust Assessment

In 2014, the CCI was perhaps the most active regulator in the M&A space in India. Thus far in its short three and a half year history the CCI has prima facie raised concerns on only two transactions (phase II investigation) that being in the pharmaceutical and cement sectors. In the recent *Sun-Ranbaxy merger*, CCI has asked the parties to divest some businesses before consummating the merger in order to remove the potential appreciable adverse effect on competition.

CCI has levied fines on parties for giving effect to a transaction before obtaining CCI's approval i.e. *gun jumping*. In the *Thomas Cook-Sterling* deal, CCI imposed a fine for gun jumping on the acquirer for making market purchases prior to approaching the CCI for a subsequent negotiated deal involving the same target company as the CCI viewed the market purchases as a composite and inter-connected transaction. This ruling may likely affect hostile bids as typically in a hostile bid the acquirer takes up a certain shareholding position in the company before making a hostile bid. Apart from gun-jumping, in deals in the pharmaceutical sector, CCI has also raised concerns on non-compete covenants and has asked the parties to modify the non-compete covenants in the transaction document(s).

E Tax Challenges

For M&As, primarily the principal tax consideration is income tax which is governed by the Income Tax Act, 1961 ("ITA").¹⁶ The ITA permits a tax neutral merger or spin-offs in the form of demergers if certain conditions are satisfied.

In the last few years, India has witnessed several high profile M&A tax controversies. The income tax authorities have been very aggressive and proactive in scrutinizing deal structures on the grounds of tax avoidance. While the new Government has promised to address the issue of overreach by the tax authorities, it still remains unclear whether the general anti avoidance rules ("GAAR") will be implemented from April 1, 2015. GAAR gives wide powers to the income tax authorities to challenge the "commercial substance" of a transaction and thereafter re-characterize the transaction if the deal structure is found to be an "impermissible avoidance arrangement".

Apart from GAAR, the other areas where parties have had to be watchful are (A) the incidence of tax in the case of (i) indirect transfers i.e. transfer of foreign securities which derives substantial value from underlying Indian assets or (ii) undervaluation of shares, (B) tax withholding obligations and (C) transfer pricing adjustments in the case of group transfers.

In order to mitigate some of the tax risks, parties have in the past (i) negotiated specific tax indemnities in the deal documents and/or (ii) have approached the Authority for Advance Ruling ("AAR") to seek clarity on their tax liabilities and/or (iii) get a legal opinion from a reputed law firm and/or (iv) held back a certain portion of deal consideration in escrow and/or (v) have taken tax insurance to cover potential tax risk.

F. Shareholder Activism

In 2014, India witnessed an increase in shareholder activism. The tightening of the laws providing more voice and rights to the minority shareholders has acted as a catalyst. While shareholder activism has increased, the areas that have come under shareholder scrutiny are related party transactions and executive compensations and notable M&As thus far have not been seriously affected by shareholder activism except in a few isolated instances such as the *USL-Diageo* and *Holcim-Ambuja* deals. Proxy contests in India to replace the management of a company are seen rarely, if any.

Post the acquisition of a controlling stake in USL, Diageo sought the approval of the public shareholders for certain related party transaction involving licence and distribution arrangements with some Diageo group entities. Under the new corporate governance norms embodied in the new Companies Act, 2013 and the revised listing agreement, Diageo was mandatorily required to get the approval of the non-controlling public shareholders, which approval was not granted. Whilst the shareholder activism in this instance was not intended to cause a change in management or block Diageo's potential acquisition, it certainly reflects the post-acquisition integration challenges that acquirers are

increasingly facing in India.

In the *Holcim-Ambuja*, the merger came under direct scrutiny of the public shareholders wherein many proxy advisors firms advised the public shareholders to vote against the merger. While eventually the public shareholders approved the deal, it certainly sent some shock waves across corporate India.

G. Squeezing Minority Shareholders

Squeezing the minority shareholders pursuant to M&A is well recognized globally as it provides operational flexibility to the acquirers post the acquisition. However, in India squeezing minority shareholders has proved to be extremely difficult if not insurmountable. Under the current regulatory framework, a take private transaction is not permissible. In other words, an acquirer cannot take a listed company private pursuant to a share acquisition and a subsequent open offer. Post the acquisition the acquirer is required to maintain a maximum shareholding of 75% in the target company and thereafter, launch a separate delisting offer after a period of one year.¹⁷ As per the current delisting regulations, a delisting offer needs to be approved by at least 2/3rd of the public shareholders and an offer is deemed to be successful only if the shareholding of the promoter reaches the higher of (i) 90% of the total issued capital of the company or (ii) the aggregate percentage of pre offer promoter shareholding and 50% of the offer size. The "reverse book building" pricing methodology for arriving at the delisting offer price has also historically proved to be onerous for the controlling shareholders. The problem is further compounded by the fact that even after the completion of a delisting offer the remaining shareholders cannot automatically be squeezed out.

The issues relating to squeeze out are best illustrated by the *Cadbury Case*¹⁸ wherein the promoters of Cadbury India pursuant to open offer acquired more than 90% of Cadbury India and obtained approvals to delist, however they were still unable to squeeze out the minority shareholders. Finally, the promoters initiated a selective capital reduction (akin to a share repurchase) to squeeze out the minority shareholders. The minority shareholders contested the valuation at which the share repurchase plan was contemplated to be undertaken and were able to obtain a verdict from the Bombay High Court requiring the promoter to pay a 50% premium over the original offer price. However, the matter even after 5 years from the date on which the share purchase was initiated remains unresolved as the minority shareholders have further challenged the court verdict.

The other methods of squeeze-out which are practically available for unlisted companies such as compulsory acquisition and scheme of arrangement have also hardly been successful due to onerous requirements. For example, a compulsory squeeze out can be only undertaken if 90% of the shareholders to whom the offer is made accept the offer.

II. 2015 AND THE FUTURE AHEAD

Based on macro-economic indicators, it does appear that India is likely to witness strong M&A activity in 2015. Whilst the macro-economic environment appears favorable, deal making will remain complex but the regulatory challenges are not likely to be insurmountable. Based on past experience, we have elaborated below key trends and considerations.

A. Sectors and Industries

In 2015, several sectors are likely to see increased deal activity. The war in the e-commerce space to capture market share has intensified and 2014 saw a spate of both M&A and private equity deals in the e-commerce space. The trend is likely to continue given the fact that some e-commerce companies are flooded with cash funded by private equity investors. With the Government's intent to fix supply side constraints, one could witness increase in deal activity in the logistics sector. With the liberalization of the sectoral restrictions in the insurance sector and the increased competition in the banking sector, the financial services industry is likely to see enhanced deal activity too in 2015.

Conventional sectors such as healthcare, pharmaceuticals and IT/ITes should continue to see deal activity in 2015. The telecom sector is in dire need of consolidation and if the M&A norms which were released in 2014 are reworked, the telecom industry could see a spate of M&As.

B. Managing Deal Risk

The acquirer will have to navigate through regulatory risks that arise in large M&A transactions involving different regulators. For e.g. in the Jet-Etihad case, the CCI and SEBI had a different view on control thus resulting in unwarranted uncertainty. One of the ways to mitigate these risks is to have a formal consultation with the regulators before undertaking a transaction. Some regulators such as the CCI formally recognize such prior consultations.

India has a very independent and robust print and electronic media and almost all large and sensitive deals are discussed in the media, therefore acquirers should consider engaging a reputed PR agent at an early stage to manage different constituencies such as the Government, regulators, media, shareholders, employees, customers, suppliers etc.

The acquirers must also continue to assess the corporate governance standards of target companies. Additionally, one of the key aspects that acquirers must consider is the dependence of the target company on the contracts with the other promoter entities. If the target company relies heavily on contracts with promoter entities then it must be assessed if such contracts are at arms-length otherwise it could result in significant erosion of value. In 2014, the Indian laws relating to related party transactions were tightened significantly and public shareholders are now required to approve such related party transactions. This aspect has to be borne in mind by an acquirer as it may affect post acquisition integration plans.

In manufacturing sectors, acquirers will also have to consider the risks posed by employee trade unions (see section I below). Cross border deals involving sensitive sectors such as defense, pharmaceuticals, civil aviation etc., will have to address socio-political risks.

C. Role of the Board of Directors

Perhaps, the most important theme in 2015 will be- '*The role and liability of Boards*'. With the dilution in promoter stakes (controlling shareholders) in companies coupled by the regulatory changes, shareholder activism is likely to

play a significant role in deal making and thereby will increase the role and liability of the Board. The new Companies Act, 2013 specially recognizes class action suits and contemplates setting up of a tribunal to resolve class action suits.¹⁹ Therefore it is likely that there will be an increase in M&A litigation in the country with the role of the board and the controlling shareholders subjected to a closer scrutiny.

In a secondary share acquisition, the Board does not play any significant role. Only the independent directors of listed companies are required to provide their recommendation on the open offer made to the public shareholders. However, the role of the Board could be profound in case of a hostile takeover, going private transactions or any other case where the acquirer has to depend on a successful open offer to achieve the desired result.

In the context of mergers, spin-offs and acquisition by way of primary capital infusion, the role of the board is more profound and direct in the Indian context as all these transactions practically have to go through the board. While, the role of the Board is well entrenched in the context of general governance matters i.e. the Board is required to use its business judgment, due and reasonable care in arriving at decisions and must act in the interest of the company, **all** its shareholders, employees and the community, the jurisprudence is not entirely clear in context of M&As especially when a transaction is likely to result in a conflict between the rights of the aforementioned stakeholders. For example, there could be a deal which may enhance shareholder value but could be unfavourable for the employees. In such a situation, the Board will have to carefully examine the pros and cons of a deal before approving or disapproving the same.

Till such time as the Indian jurisprudence develops on the subject, Indian boards would do well to learn from global experiences in order to avoid class action suits/derivative claims from activist shareholders. Some of the key measures that boards must take are as follows:-

- The board must have constant dialogue with the shareholders and discuss the company's long term strategy and understand shareholder concerns;
- Board should ensure that the best practices are established in so far as risk management systems are concerned;
- The board should undertake a periodic self-evaluation and should assess whether the composition of the Board is diverse and has the necessary collective competence;
- In the context of M&As, the Board must ensure that the company and/or all the shareholders, as the case may be get the "best price" and therefore must take all necessary measures to ensure that the value is fair and recommended by a reputed valuer;

D. Friendly Tax Environment

While GAAR remains a concern, the overall tax environment in the country is likely to improve. The Government has assured that there will ordinarily be no retrospective taxation and that tax administration would be non-adversarial. Thus, far the Government has lived up to its pledge and the following actions are illustrative of that:-

- The Government has decided not to appeal the decision of the Bombay High Court in the *Shell* and *Vodafone* transfer pricing cases wherein the Bombay High Court had ruled against the Government.²⁰
- The Government has categorically stated that all cases arising out of the retrospective amendments of 2012 will be examined by a high level committee;²¹
- The Government has given categorical instructions to all income tax officials for creating a "non-adversarial" tax system. One of instructions requires officers to carefully and judiciously examine cases before scrutinizing them or appealing before the higher courts.²²

While it is still unclear whether GAAR will be implemented, in 2015, we should nevertheless see deal structures implemented in a manner that are likely to withstand a GAAR scrutiny. The rationale for this is fairly simple: even if GAAR is implemented in 2015 or later, all structures implemented after August 30, 2010 will be subject to GAAR scrutiny if income from these structures arises post GAAR becoming effective.

Although, the tax environment is likely to improve, the tax risk mitigation strategies that have been undertaken by the stakeholders in the past and discussed above will continue in 2015.

E Take Private Transactions

As discussed earlier, the current takeover and delisting regulations do not permit the acquirer to take the company private pursuant to an open offer. However, recently SEBI has in principle approved of regulations permitting a take private transaction directly pursuant to an open offer under the takeover code. The regulatory change could potentially act as a catalyst for take private transactions in the coming year. Having said that, whether such transactions can be undertaken practically will depend on the shape and form the final regulations take and the ability of the acquirers to raise the necessary financing.

F. Deal Financing

1. Leveraged Buyouts

In India, private equity investors have largely provided growth capital thus far and leveraged buyouts in the classic sense have been absent. This is because domestic banks are not allowed to lend for the acquisition of shares and under the current laws an Indian company is not allowed to provide any financial assistance including security for the acquisition of its shares.

M&A financing for inbound cross border deals has largely been through offshore holding structures wherein the acquirer has raised debt in its home country or some other suitable intermediate jurisdiction. However, in such structures creation of security in favour of the lender at times proves to be an insurmountable challenge given the Indian extant exchange control laws do not automatically (an approval is required) permit a creation of security over the assets or shares of the Indian company in favour of a non-resident.

The RBI is mulling a change in the regulations whereby domestic banks may be allowed to finance M&As. This could act as a catalyst for other legal changes that will then act as enablers for leveraged buyouts. In 2015, the seeds of leveraged buyouts may perhaps be sown.

2. Private Equity and Public Offerings

With the revival of the primary market, Indian companies may also explore raising capital through public offerings to finance deals. In 2014, several companies were able to raise capital due to the buoyant economic sentiment. Indian companies may also consider tapping the overseas market through American depository receipts (ADRs) or Global depository receipts (GDRs) for financing deals.

3. Stock as Deal Currency

In 2014, stocks were increasingly used as deal currency, one of the most notable being the *Sun-Ranbaxy merger*. In the context of cross border deals, stock has not been preferred as deal currency since the acquisition by way of a share swap requires regulatory/government approvals. Having said that, share prices of most listed companies in India have accelerated in the last 6- 8 months and given the bullish market sentiment one would expect the stock prices to rise further in 2015. Therefore, if the share prices continue to remain steep and the rupee remains strong, foreign and domestic acquirer may have to consider using stocks as currency for M&As.

G. Hostile Bids

India has not witnessed classic hostile bids in the form and manner seen in other developed economies such as US and the UK. While theoretically possible, hostile bids are rare in the Indian M&A landscape because majority of Indian listed companies have a concentrated shareholding i.e. there exists a controlling shareholder/promoter that holds a majority of the shares as opposed to the companies in other developed jurisdictions such as the UK and the US where the companies mostly have a dispersed shareholding pattern with no identifiable controlling shareholder. Additionally, some Indian listed companies may even have camouflage shareholding i.e. shares owned by distant family members and friends of the promoter which makes assessing the success of a hostile takeover extremely difficult.

In recent years and in 2014, hostile bids in India were seen more in nature of competing bids. Competing bid is one where a hostile bidder makes a counter/competing offer to the offer made by the controlling shareholder of the company. For example, the hostile takeover battle between *Deepak Fertilizers* and *Saroj Poddar and Vijay Mallaya* to takeover Mangalore Chemicals. This is not to say that hostile takeovers are not possible in the near future. The dilution in aggregate promoter shareholding in some significant listed companies and the improvement in the quality of disclosures coupled with increase in shareholder activism makes a hostile takeover theoretically possible. For example several iconic companies such as *Infosys, ITC, HDFC, ICICI Bank* are managed by professionals with no identifiable controlling shareholder. There are several other companies where the promoter shareholding is less than 50%.

The Indian market for corporate control is likely to unfold in the manner the Japanese hostile takeover landscape did in the 1990s-2000s. Japan had a similar share ownership structure whereby shares of publicly traded firm were held by connected shareholders (referred to as *Keiretsu*). However, in 1990s the share ownership structure of publicly traded firms in Japan changed significantly wherein the holdings of Japanese financial institutions (considered more aligned to *keiretsu*) reduced and the ownership of foreign institutional investors increased. This change in the corporate ownership structure coupled with the rise in corporate governance standards and increased shareholder activism created a robust market for corporate control. Some of these ingredients are already taking shape in India.

While hostile bids are possible, the Indian regulations prohibit conventional defenses such as the "poison pill". However, "white knight" has been successfully used as a takeover defense in India. The other takeover defense that may possibly work in India is a "poison put". *Poison Put* are covenants in debt documents which states that if there is a change in control then the debt will be immediately bought back ("put" part) at a premium ("Poison" part) and therefore such covenants could potentially be used as takeover defenses in India.

H. Anti-Trust Assessment

In light of the recent trends, the parties should at a fairly early stage examine the anti-trust implication of the transaction including the need and timing of the filing and actions that can be undertaken prior to obtaining CCI's approval to avoid gun jumping. If the parties foresee an anti-trust implication, then the parties must allocate the anti-trust risk by either (a) negotiating a general *hell and high water* clause which requires the buyer to undertake all measures including divestures to comply with anti-trust requirement or (b) agreeing to a set of divestures as a condition precedent in order to mitigate any anti-trust concern. Further, deal documents including board resolutions should be carefully drafted to ensure that transactions are accurately characterized and composite or inter connected transactions are not consummated prior to CCI's approval.

In competitive bids, parties and the target company's board must examine the anti-trust implications and the certainty of consummation of the transaction before recommending a deal to the shareholders.

I. Human Resource Considerations

While share acquisitions resulting in a change of control rarely results in any significant employee related issues except some post-integration changes, other forms of corporate restructuring such as merger, spin-offs raise a number of employee related issues which parties should address at the earliest.

India has strong trade unions and in the past these unions have had profound impact on deal structures. The concern is more acute in the case of spin-offs as it results in the transfer of employees from one company to another company. It is important for the parties while deciding on a deal structure to calibrate the employment related risks. Even in global corporate restructurings, if the entities have employees in India then these risks have to be assessed.

III. CONCLUSION: KEY TAKEAWAYS FOR 2015

It would not be an exaggeration to suggest that the M&A market in India is at the crossroads. With the positive change in the economic climate and spate of regulatory changes in the pipeline, India is poised for a new era of deal activity. Significant economic and regulatory factors that will influence deal activity are as follows:-

- Government's ability to undertake and implement more structural economic reforms such as the GST;
- Government's ability to rationalize the Companies Act, 2013 and thereafter implement the law in totality including

setting up the specialized tribunals for corporate dispute resolution as proposed i.e. NCLT and NCLAT;

- RBI's ability to relax the restrictions on domestic banks for financing M&As.
- SEBI's ability to enact clear regulations for take private transactions and delisting;

In so far as the stakeholders are concerned, the following are the key takeaways:-

- **Boards**:- Under the current landscape, the Board will play a more central role in deal making and in protecting the interests of all the stakeholders and therefore will have to make considered decisions.
- **Controlling Shareholders/Promoters**:- With the increase in shareholder activism, promoters will have to, at a very early stage in the M&A process, examine all the aspects of the deal including how the public shareholders, proxy advisory firms and the employees are likely to perceive the deal;
- **Acquirers** will have to examine the deal more closely including the target's corporate governance standards and post-integration challenges and will also have to be more vary in structuring transactions in order to address GAAR and anti-trust aspects;
- **Public Shareholders**:- While the law has conferred enormous powers on the public shareholders, public shareholders will have to exercise their rights judiciously.

- M&A Team

You can direct your queries or comments to the authors

¹ See 'Multibillion cross-border deals make a return after five years' available at <http://www.ft.com/intl/cms/s/0/49a2843a-484a-11e4-ac9f-00144feab7de.html#axzz3M2jCAJY>

² See Economic Outlook available at <http://www.oecd.org/economy/economicoutlook.htm>

³ *Id.*

⁴ See OECD Economic outlook, analysis and forecasts available at <http://www.oecd.org/eco/outlook/brazil-economic-forecast-summary.htm>

⁵ See OECD Economic outlook, analysis and forecasts available at available at <http://www.oecd.org/eco/outlook/russian-federation-economic-forecast-summary.htm>

⁶ See OECD Economic outlook, analysis and forecasts available at <http://www.oecd.org/economy/south-africa-economic-forecast-summary.htm>

⁷ See '**M&A, PE deals by Indian companies surge 26 per cent: Report**' available at http://articles.economictimes.indiatimes.com/2014-12-28/news/57462648_1_pe-deals-business-sentiment-indian-firms

⁸ See NDA Hotline on '**INDIA ELECTION 2014: BJP'S LANDSLIDE WIN – WHAT TO EXPECT?**' available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/india-election-2014-bjps-landslide-win-what-to-expect.html?no_cache=1&cHash=799e635f87036f9c3e2becf048c27434

⁹ See NDA Alert- '**THE BIG BANG OF THE INDIAN CAPITAL MARKET**' available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/the-big-bang-of-indian-financial-markets.html?no_cache=1&cHash=38ccb69bcf0f8c3533ea792c129e5df9

¹⁰ It is to be noted that all the provisions of the new Companies Act, 2013 are not in force but can be expected to come in force in 2015.

¹¹ See '**Govt wants banks to fund local M&As**' available at <http://timesofindia.indiatimes.com/business/india-business/Govt-wants-banks-to-fund-local-MAs/articleshow/35920319.cms>. However, it is to be noted that amendments need to be made to the Companies Act, 2013 to make leveraged buyout transactions possible.

¹² See 'Daiichi chief defends Ranbaxy deal' available at <http://www.ft.com/intl/cms/s/0/79d5a0fc-90d4-11de-bc99-00144feabd00.html#axzz3NetRjhr8>

¹³ *Supra* Note 6.

¹⁴ In India, a business transfer as a going concern is commonly referred to as "slump sale".

¹⁵ See '**Spin-off season on Dalal Street**' available at http://www.business-standard.com/article/markets/spin-off-season-on-dalal-street-114070700920_1.html

¹⁶ It is to be noted that for spin-offs there are other local taxes such as value added tax and stamp duty that needs to be considered.

¹⁷ As per the applicable securities law, unless specifically exempted by SEBI, every listed company is required to maintain a minimum public shareholding of 75%.

¹⁸ See Cadbury India Limited available at <http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvanVkZ2VtZW50cy8yMDE0LyZmbmFtZT1PU0NBOTAxMC5wZGYmc21mGFnPU4=>

¹⁹ The provisions are not in force as on this date.

²⁰ See 'Government Unlikely to Appeal' available at http://articles.economictimes.indiatimes.com/2014-11-27/news/56515373_1_caim-india-judgements-direct-taxes

²¹ Budget 2014-14, Speech of Shri Arun Jaitley, Minister of Finance available at <http://indiabudget.nic.in/ub2014-15/bs/bs.pdf>

²² See CBDT Office Memorandum dated November 7, 2014 available at <http://www.incometaxindia.gov.in/news/departmental-news-further-steps-towards-a-non-adversarial-tax-regime-7-11-2014.pdf>

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