PRACTICE GUIDES

India M&A

Contributing Editor
PM Devaiah

LEXOLOGY®
Getting The Deal Through

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Practice Guide

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Contents

Introduction.......1
PM Devaiah

1 The Avant-Garde General Counsel.......4
PM Devaiah

2 Due Diligence Management, Closing and Post-Closing Management.......10
Eshwar Sabapathy, Vishnu Ravi Shankar, NV Saisunder, Adit N Bhuva and Jayaprakash Rajangam

3 Regulatory Interventions in M&A – including CCI, RBI and SEBI.......23
Rahul Chadha, Neeraj Prakash, Ashish Gupta, Abhishek Singla and Syed Yusuf Hasan

4 Cross-Border Mergers: Old Challenges, New Solutions.......34
Sai Krishna Bharathan and Shivani Kabra

5 Key Challenges in Indian M&A and Exits.......47
Rachael Israel, Pooja Singhania and Prateek Sharma

6 Smart Acquisition Structures in M&A: AIF, FPI and FDI.......61
Vaishali Sharma, Viral Dave, Reshma Simon and Jeel Panchal

7 Representations, Warranties, Indemnities and Insurance in M&A.......74
Sujjain Talwar and Aakanksha Joshi

8 Challenges In Cross-Border Mergers.......85
Vineet Aneja and Neetika Ahuja

9 Procedure and Protection of Intellectual Property in M&A.......95
Shikha Sachdeva

10 Dispute Resolution and M&A and Criminalisation of Civil Disputes.......103
Shreyas Jayasimha, Rajashree Rastogi and Krishnan Shakkottai

About the Authors.......117
Contact Details.......127

Introduction

PM Devaiah[1]

This is the first edition of the *Practice Guide – India M&A* published by Lexology Getting the Deal Through. It provides a contemporary analysis of the legal framework, opportunities, challenges and risks that arise in connection with M&A transactions in India. Each chapter in the *Practice Guide – India M&A* specifically deals with an important segment that forms an integral part of M&A transactions in India. India is endowed with a robust legal system that worships the rule of law in letter and spirit, with governance mandates shared between the union and state levels, with a constitutional mandate of central and decentralised power equations. In addition, there are local bodies, union and state regulators, the Supreme Court, which is the court of final appeal, High Courts at state level and other district courts. These multi-layered interventions have intense impact on the ease of doing business in India owing to their far-reaching supervisory powers. Therefore it is an inevitable benefit to be well advised by relevant and competent advisers and legal counsel to do the right thing at the right time, such that an M&A activity does not fail to meet the mandates of applicable laws and regulations.

As such, the *Practice Guide – India M&A* aims to serve as a snapshot and a useful tool for industry practitioners when doing business in India, giving a nuanced dimension in answering key questions around Indian M&A. Admittedly this is not an exhaustive work, but an attempt to capture the essence of the nature of activities involved in a typical M&A transaction.

I have assisted in the selection of the chapters for the *Practice Guide – India M&A* and in bringing together respective authors known for their involvement in the industry and their expertise in M&A and related fields of law. I am very pleased to have been able to attract these select experts from reputed Indian law firms. I have had the opportunity to work with a few of these learned authors or their law firms on a primary M&A deal or an ancillary part that they supported and led to a successful M&A transaction.

I have been involved and closely associated with Indian M&A for the past three decades. The nature of the assignments that I have worked on with my colleagues and external experts has offered me an invaluable opportunity to deeply understand the Indian legal and regulatory

1 PM Devaiah is a vice chairman and group general counsel with Everstone Capital Advisors.

landscape and the nuances of doing business in India, its political landscape, legal services industry and the multidimensional culture that brings in its own complexities to the game. My current role at Everstone Group as a general counsel over the past decade has given me great opportunity to participate in complex and stimulating M&A deals in India and across the Asia-Pacific region where our investing footfall extends. Everstone is a premier investment group focused on India and South East Asia, with assets in excess of US$ 5 billion across private equity, real estate, credit, infrastructure and venture capital. Everstone has focused on developing a world-class alternative investments platform and, in doing so, the group has ensured that its own business and investments adhere to the highest standard of governance and universally accepted environmental, social and governance criteria. Everstone is committed to a business model of investing in companies and sectors responsibly towards its investors and employees while supporting its local communities. Such responsibility in business brings the need to collaborate with advisers and experts who bring wisdom and knowledge that are at par with global standards. Some of the authors here or the firms that they represent do exactly that.

Furthermore, Everstone is primarily a buyout fund investing in India and the Asia-Pacific region with an India synergy and connection across sectors. As a result, the magnitude of my role is not restricted to the classical M&A of acquisition or investing, but extends to managing the portfolio and participating with its growth story, leading to its harvesting to make the best for the shareholders and stakeholders while also keeping in mind the highest level of governance and compliance standards. I have had the great opportunity of working very closely with deal captains, tax and legal experts and risk managers in India and abroad.

Key legislation

In addition to the various institutions and government initiatives at the union and state levels, some key laws that rule the M&A landscape in India inter alia comprise:

- Companies Act 2013: administered by the Ministry of Corporate Affairs, the Companies Act is the primary legislation governing companies and mergers;
- Securities regulations: the securities markets are regulated by the Securities and Exchange Board of India (SEBI) – the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (the Takeover Code) govern substantial stake acquisitions in publicly listed companies; the SEBI (Delisting of Equity Shares) Regulations 2009 govern take-private transactions;
- Foreign Exchange Management Act 1999 (FEMA): administered by the Reserve Bank of India (RBI) and the government of India, FEMA, the rules issued by the government of India thereunder as well as the associated RBI regulations regulate capital inflows and outflows;
- Competition Act 2002: the Competition Commission of India, the regulator established under the Competition Act, grants antitrust approvals;
- Income Tax Act 1961: administered by the Income Tax Department, the Income Tax Act along with double tax avoidance treaties entered into by the Indian government govern the tax treatment of M&A transactions; and
- Insolvency and Bankruptcy Code 2016 (IBC): administered by the National Company Law Tribunals, the IBC regulates auction sales under a corporate insolvency resolution process.

All these laws and regulations and more have their shades of black, white and grey and at times are highly interpretative, requiring professional intervention to unclog the clutter.

Indian M&A market

The 'India M&A Report 2019' released by Bain & Co said that M&A activity remained buoyant from 2015 well into 2019, with more than 3,600 M&A deals with an aggregate value of more than US$310 billion. Also, the over-US$5 billion investment by Facebook in the telecoms unit of Reliance Industries Ltd, in a deal that gives the social-media giant a firm foothold in a massive fast-growing market and helps the Indian oil-to-telecoms conglomerate to significantly cut debt, is a promising indication of the growing opportunities in India. It is also promising to see how the government of India is focused on high-level policy changes that are trying to balance all constituents in a stressed environment. The renewed concentration on the privatisation of government-controlled corporations amidst national interest issues is a vindication of the impending buoyancy.

Deal-making is gazing at a southward drift, with a third falling in the fiscal year 2020, thanks to the geopolitical differences, fall in consumption, cultural shifts in doing business across the globe, debt distress and, more than anything, the business hibernation that is hovering as a result of the coronavirus pandemic that is still refusing to relent. It remains to be seen what short- and long-term impact the current situation will have on deal activity going forward. The role that M&A experts can and must play in troubled times gains enhanced significance.

Last, I wish to thank and extend my sincere gratitude to all the contributing authors who have shared their experience and expertise and participated in this effort with me and Lexology Getting the Deal Through. Special thanks to the team at Lexology Getting the Deal Through for having invited me to be the contributing editor of the 2020 edition of the *Practice Guide – India M&A*.

1

The Avant-Garde General Counsel

PM Devaiah[1]

Role and responsibility of general counsel

There are enough, more and endless reams of conventional wisdom chronicled depicting the roles and responsibilities of a general counsel (GC) in what we term the new-age business environment. Yet the ever-morphing role of a GC is still an unrivalled enigma considering the range of responsibilities and expectations that shadow the role intermittently and circumstantially. The heightened limelight on the role of a GC is also due to the mutating nature of the prism through which society views changing mores that define the doctrine of impropriety for a corporation. The permissibility, the elasticity and longevity of the stigma attached to breaches and the penal provisions attributed to bad conduct in terms of ostracisation have all undergone a massive transformation, and so has the functional responsibility of GCs in the conduct of business. To list and limit a GC's utility to a corporation and its managers who manage the complex corporate machinery is an avoidable endeavour and an exercise in futility, in my view. It is no exaggeration to mention that a GC is a pivot who holds together the troika comprising the board, the shareholders and the business from knowingly or unknowingly drifting beyond their tolerable perimeters. A GC with a deep understanding of jurisprudence, intuitive to make business calls, with an ear to the practices followed by industry peers, can assist the corporation's CEO to decisively achieve its goals without falling victim to needless interruptions that might undermine a time-sensitive commercial activity. A GC must promptly and responsibly toggle hats to facilitate business on the one hand and, on the other, perform the role of a custodian of law and a conscience-keeper all rolled into one. It is worthwhile for a GC to remain a lawyer at the core and, if necessary, wear a commercial façade responsibly, when called upon to feed such an occasion.

It is no secret that business houses are profit and performance-denominated and flourish on an insatiable desire for returns. I firmly believe that a GC must invariably show commercial acumen by co-nurturing the commercial goals of a corporation along with the business managers while unconditionally submitting to a vast cache of non-commercial callings that are cast upon a

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corporation by national and local laws, regulatory interventions and a series of governance codes prescribed by regulators, institutional investors, lenders and, last but not least, manage public opinion. To remain relevant and being useful to a business environment, a GC must appropriately and effectively, without conflict or prejudice, contribute to a series of multidimensional constituencies that collaborate to seek a common objective. 'A good plan, violently executed now, is better than a perfect plan next week', as General George S Patton, a world-war veteran, said – which would probably be a good scale to measure a GC's value judgement. A key message to my team has always been that paralysis by analysis has no place in modern-day commerce, where time is of the essence to close high-stake deals, particularly when competition is sniffing around to move in. The challenge always is to present oneself as a solution-provider while not falling foul of any interdisciplinary contradictions. It is an delicate tightrope walk between 'shall we do?' on the one hand and 'can we do?' on the other, if a GC must work on a moral compass provided by the organisation. It is important for the board, aided by a GC, to know that values and valuations have their own place in commerce and at what stage which of the two must gain the upper hand.

A GC's responsibility has been amplified in manifold ways with the onset of contemporary canons of doing business such as environmental, social and governance discipline, tighter compliance codes and governance standards. Doctrines such as these have put fetters on the unbridled runway of transacting for profitability with impunity. The unified and rudimentary business goal of profit at any cost as in a typical laissez-faire economy holds no water in the way a 21st-century corporation is expected to conduct itself. Such permissive principles have now faded into oblivion, paving the way to a more transparent, controlled and accountable mode of earning returns in a responsible, ethical and social manner. GCs have the primary role of constantly reminding the business that the philosophy of the end justifying the means is not good enough to be reckoned as a virtue that would log reputational brownie points, earn the respect of the shareholders, stakeholders, regulators and community at large. Institutions that dwell on the philosophy of crony capitalism will seldom enjoy the halo of trust and credibility that any modern-day corporation aspires to earn and wear. A GC is the focal point, working with the board to be an ombudsman and an ethics officer to carry through the message of propriety both in letter and in spirit to bring about the much-needed transformation to achieve such a coveted status.

Apart from the well-established virtue for a GC to work *with* the business as against *for* the business, GCs should be guarded and cautious while getting too transactional functionally so as avoid the thirst of doing business at any cost. Once an ethical flag is unfurled by the GC for the corporation, it must fly high no matter how bountiful the harvest might be in lowering it. The depth and nature of such responsibility far exceeds any arithmetical quantification by its very nature. Among many other things, a good case in point is the duty for compliance with anti-bribery laws or avoidance of conflicts of interest or litigation management in the conduct of business. These areas are the tip of the functional iceberg, nonetheless. It could be a routine business, a merger or an acquisition or any transaction that leads the corporation to an organic or inorganic growth. Doing clean business and adherence to anti-bribery laws is an area that GCs might have to be diligent and very attentive to. The temptation to corruption and to corrupt is the longest-serving bane among mankind, which is frowned upon by institutions of repute and has zero tolerance these days. Proper checks and balances, adoption of compliance codes, carrying the message of the avoidance of bribery across the corporation, periodic training for staff are all initiatives best performed and dispensed by a GC. It is a GC's solemn duty to escalate these governance mandates into an organisational culture that ought to be embedded into its core fabric. Similarly, GCs must ensure proper checks and balances are adhered to in order to resolve conflicts in the conduct of business with utmost transparency, in letter and in spirit. Conflicts in corporate transactions arise when a person's self-interest and professional interest lead to outcomes that are based on the foundation of unfair and unethical presumptions. Conflicts and conflicted decisions can bring about reputational risk and expose the corporation to needless litigation and prosecution. At the minimum, a conflicted decision by a corporation is an antithesis to good governance that can tear apart the very fabric of a corporation's good standing. If circumstances demand, a GC must rise above the ordinary to peel the veneer of optical independence that business managers might contrive and overtly wear to cover up an unjust enrichment, personal or for the corporation. Conflicts have no place in modern-day business practice and every GC is duty-bound to make sure such practices find no free passage. Litigation management by a GC is by far the most intense and complex management science. Gone are the days when a GC could mechanically treat provisions pertaining to applicable laws, preferred jurisdiction, construction and utility of an arbitration and mediation provision, all as a routine boilerplate in contracts.

GCs begin as law officers performing conventional legal work, with not much of business or managerial role, and over time advance into a GC role, with leadership and other additional responsibilities. Invariably, that is the dream metamorphosis leading to an aspirational career mutation. Ironically, some GCs elect to suffer the nostalgia of wanting to remain a pure lawyer for ever, refusing to mutate. Very many times I get to engage with such GCs and transaction lawyers. No prejudice meant, nothing wrong with such an approach, but it has its attendant limitations when one must cohabit within a corporation or for dealings outside. All will agree that it is not uncommon during M&A negotiations for participants to painfully suffer the needless discordant notes created by lawyers and GCs caught up in prescribing endless rituals for fishing while the business is angling for the fish. In commerce, the lack of a virtue called quick decision-making resulting from a fear of an unknown or deficiency of understanding of the realities can delay and defeat the very purpose of a collaboration, thereby muting opportunities irreversibly. GCs fail to break the ice many a time, wanting to play safe without appreciating the legitimacy of hypothetical legal or regulatory risks lurking around or presented half-heartedly by participants. There is no choice for a proficient GC but to break the gridlock of unknown fears and the consequential stalemate creating artificial roadblocks to commercial success. Conversely, inefficiency could creep in when the functional responsibilities fail to converge into a commonality of purpose, creating internal deadlocks. The problem is compounded when business managers get opportunistic, overlook reason and call out the trump card in what is commonly known as a 'conscious business call'. If a GC is unable or refuses to expose the fallacy of an ill-conceived business call that suffers innate ailments such as lack of ethics, prudence or illegality that expose the corporation or the board to consequences, then the GC has failed. If you do not decide, you are damned; if you are overzealous in deciding, you are damned too. It is an unsettling tightrope acrobatic, but an inevitable functional responsibility of a GC.

Exploring avant-garde terrain

Let me now meander a bit into some avant-garde terrains that GCs could and must explore. GCs must routinely unshackle themselves and move out of their functional wraps and rediscover their calling by partnering with the business to create revenue centres as an add-on to their conventional roles of lawyering. The scope and possibility for such an enterprise are infinite and outcomes fertile. Examples of such possibilities are set out below.

Regulatory arbitrage

A well-managed regulatory arbitrage that results in commercial paybacks, plus what is known as regulatory entrepreneurship that creates new horizons to explore for a corporation, are cases in point. Conceiving, advising or even managing a legally justifiable regulatory arbitrage with economic leverage to a corporation is well suited for a GC to lead and to pursue, as long as it does not raise ethical questions. Simplistically speaking, there are two characteristics to a regulatory arbitrage. The first is when a device is created to blatantly exploit a loophole to evade an unfavourable regulation or an unfriendly geography, which is most certainly avoidable. Such an attempt could raise legal and ethical questions. The other is where a business case is conceived with due consideration to applicable regulations such that it is permissive and attires the legitimacy cover. Without indulging in the never-ending cat-and-mouse game of rulemaking and rule evading, it is possible to honourably adorn an arbitrage opportunity onto a business plan that is well considered and executed. Such a product can only be a result of a candid collaboration among business managers and legal minds working together to script a monetary gain ethically. It is commonplace for a GC to be faced with a particular transaction structure under consideration turning out to be illegal in one jurisdiction while flawlessly legal in another. A case in point is the task of acquiring a parcel of agricultural land by a corporation in India for commercial use. In some regions, such acquisition is prohibited under regional land reforms laws, while fully legitimate in some others. Such regulatory differences provide an arbitrage advantage. Similarly, provincial stamp duty laws have differential economic consequences, providing ample opportunity to plan and plot the situs for a concluding transaction. In addition, jurisdiction shopping to gain an advantage arising from the stringency or leniency of ease of doing business matrix, complexity of laws and regulations between two jurisdictions or even differential treatment of an identical theme resulting in economic benefits are all perfectly legitimate if treated with caution.

Regulatory entrepreneurship

While regulatory arbitrage is more of a play with the extant and a tweak in the form of doing business to achieve favourability, regulatory entrepreneurship on the other hand is resource-draining, exploratory and evolutionary and an attempt at reshaping or readjusting the legal environment to suit one's business goals. Where an integral part of a corporation's business plan is pivoted on changing a law or a regulation or bringing in reforms to facilitate an otherwise prohibited or regulated business, such an initiative is called regulatory entrepreneurship. These tasks demand a tall order of engagement with lawmakers and regulators and GCs can play an essential role to establish new streams of revenue or flush out bottlenecks to clear out choked streams. Such assignments require collaboration between policymakers at union, state and local levels and more than anything proactive consumers for such products and services who can influence public opinion in legitimising an otherwise grey area of business. It is common knowledge that the taxi-aggregation business across the globe, for example, gained legitimacy over an extended evolutionary time frame. Uber is a case in point – it initiated a continuous engagement across geographies in stages involving a variety of regulators and regulations, lawmakers and consumers. But for such incessant exertion, taxi-aggregation and hailing services built on smartphone apps would have been considered as an illegal business a few decades ago. The sustained fight by mobile phone service providers in India through the courts, media and public opinion in the mid-90s against a fixed licence-fee regime, which resulted in the grant of migration to revenue share by the Ministry of Telecommunications easing the burden to service providers and establishing a sense of viability into the business, is nothing but a work of regulatory entrepreneurship. The Indian telecoms industry saw similar legal battles when the deemed duopoly rights of the mobile licensees were challenged by the entry of government as a third operator in certain geographies. Innumerable strategic legal battles in various forums were fought on the jurisprudence of level playing field and legitimate expectation. GCs of various private telecoms operators and independent lawyers played a humongous role in bringing about path-breaking reforms in the Indian telecoms sector, completely redefining the economics and the edifice of the Indian telecoms industry. These are game-changing assignments where GCs and the legal community have demonstrated great commercial outcomes by bridging law with business.

GC role classification

Customarily speaking, a GC's role can be categorised into two classes for ease of reference: first, a conventional role and second, an unconventional role. Conventional roles are commonly chronicled and easy to recall. They are broadly predictable in nature as regards the industry category a GC is associated with. Responsibilities include, inter alia, contracts management, routine compliance, board governance and safeguarding against prosecution, litigation management, supporting the corporation's organic and inorganic growth through mergers and acquisitions, intellectual property rights management and protection, employment issues and advising various business heads on the core business activity on a day-to-day basis. Such work content manifests around the nature of the business at play and the interplay of various laws and regulations that have a bearing on the corporation. For example, a manufacturing business will have a series of pieces of labour and factory legislation to adhere to, while a banking business will have to observe laws that specifically govern the sector and comply with various prudential norms prescribed by the sector regulator, the Reserve Bank of India. Similarly, a pharmaceutical, food and drink or insurance company will all have their own respective collection of responsibilities under applicable special legislation monitored by regulators under whose supervision the industry has to conduct its business. Unconventional roles, for instance, are non-recurring and are usually unpredictable. It could be issues that are once in a lifetime, a steep crisis management or a high-profile commercial assignment drawing the attention of everyone, or a project that revolves around a regulatory arbitrage or regulatory entrepreneurship, as discussed above.

Quite often, a GC's role in defusing or managing a perilous crisis goes unnoticed in the swamp of complexities. Some of these crises could be so strangulating that they might make or unmake an organisation. Controversial blow-ups and unpredictable challenges arrive unannounced in the journey of a corporation. Every occurrence is autonomous, has its own surprises and must be addressed differently with different prescriptions. Events could have their genesis in human errors, human frailties or even reasons beyond human control. Whether managing the menace of the Y2K bug, which was a bane as we ushered in the 21st century, or facing the legal fallout of the covid-19 pandemic, GCs have managed the challenges and demonstrated the ability to shoulder the responsibility from a functional perspective. An automobile conglomerate faced with prosecution and public rage for manipulating emission norms to hedge technology costs, a food and beverage player having to recall stocks of food products for botched food safety standards or mislabelling across a large geography and having to face regional-level prosecution simultaneously, or a corporation that is faced with a large-scale financial irregularity are all situations where a GC has to bring forth a high level of jurisprudential acumen, statesmanship and leadership skills to manage and troubleshoot multidimensional interventions and fallouts.

Defending prosecutions, managing the legal aspects of product recalls, defending prosecuted executives and dealing with risk and reputation management all concurrently are a herculean task and hard to define. The age of disruption is here to stay. Trade wars, business redundancy, pandemic, commercial xenophobia, nationalism in commerce, the never-ending hunt for a perfect business plan, new revenue streams, geopolitical realignment among nations and consequential disruptions in the ease of doing business matrix of a particular jurisdiction, both domestic as well as cross-border, relationship management and early resolution of deadlock in adversarial situations call for good planning and vision to resolve differences amicably rather than obstinate enthusiasm to contest. The jurisprudence of liability, responsible investing, privacy, right to information and new-age transparency laws and anti-money laundering laws are all part of the endless themes a GC must be on top of, day in and day out. The art and science of all this are to manage the right mix of preventive and defensive strategies in consultation with the board and appropriate experts.

Summing up, a GC's role cannot and must not be itemised and limited. As a counsel, a compliance and ethics officer and a business call champion, a GC's responsibility cannot be bound by barriers that define the role. Technical skills on the bedrock of gravitas laced with experience and proven wisdom can go a long way in holding the corporate fort during the sunny and stormy days of a corporation's existence. As a caretaker and a responsibility officer, a GC should learn to decipher right and wrong, decisively and in a timely manner, and facilitate the free movement of the wheels of a corporation in compliance with the laws of the land to be effective and successful.

2

Due Diligence Management, Closing and Post-Closing Management

Eshwar Sabapathy, Vishnu Ravi Shankar, NV Saisunder, Adit N Bhuva and Jayaprakash Rajangam[1]

Due diligence

In India, weddings that get solemnised fall into one of the following two categories: where the selection of the bride and the groom involves their parents or the two consenting adults fall in love with each other and decide to get married. Irrespective of the category that the marriage fits into, the parents of both the bride and the groom undertake an exercise to ascertain the suitability of not just the bride or groom, but also of the parents, and the siblings of the bride and groom, to understand the pedigree of all persons involved and to arrive at a conclusion, based on their yardstick, on whether the person to be welcomed into the family possesses the qualities that will fit into the family 'ecosystem'.

The reason that marriage is being talked about in this chapter is because of the similarity of the exercise that is undertaken before the decision is taken to go ahead – be it the wedding or the M&A, which goes under the name due diligence.

Similarity of the approach

This approach drives every due diligence, be it for a domestic or cross-border merger, acquisition or investment, namely, to ascertain the suitability of the target, whether it possesses the necessary qualities that will fit into the ecosystem of the acquirer or investor, and also who the present owners are, their economic health and that of related entities, and what could be the potential disruption that could have been caused in the target.

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1 Eshwar Sabapathy is managing partner, Vishnu Ravi Shankar, NV Saisunder and Adit N Bhuva are partners and Jayaprakash Rajangam is consulting partner with Eshwars | House of Corporate & IPR Laws.

The guiding principle at the time of carrying-out the diligence exercise is caveat emptor,[2] as often businesses wanting to make themselves attractive to a suitor are prone to be 'dressed up' by the management, while the tack changes in drafting and negotiating definitive agreements to uberrima fides.

In this chapter, we give an approach to carrying out legal due diligence in India, discussing the rationales and the sources of information with specific examples peculiar to the Indian context, planning the due diligence and the principles to be adopted to decide on matters that are to be construed to be conditions precedent and conditions subsequent while looking to close transactions in India.

Rationale for the diligence

The broad rationale for carrying out a legal due diligence is to help the acquirer or investor to arrive at an informed judgement on whether:

- the business model, practices and operations as outlined by the target work, factoring in the regulatory environment;
- the risks inherent in the business model of the target are in alignment with investor's appetite – certain acquirers or investors are not amenable to exposure to businesses that have certain types of risk (eg, government contracts);
- to assist the acquirer or investor in ringfencing its investment from any form of litigation or claims arising from past actions of the business or the owners of the business; and
- to carry out early assessment of any post-deal value creation opportunity, and (where it is an acquisition or a strategic investment) enabling commencement of planning for integration.

Stages in the diligence

Every due diligence exercise needs to go through three stages before the transaction is concluded:

- planning the due diligence;
- carrying out the diligence exercise – using publicly available data and information made available by the target; and
- evaluating the findings of the diligence exercise and taking appropriate action.

Planning the diligence

When the diligence exercise is to be carried out by obtaining information from the target, it is important that it is planned in a way that time is spent only on obtaining and perusing information that is proprietary to the company, information that is not publicly available, and to validate compliances that cannot be assessed through publicly available data. The nature of the information to be obtained, and the extent of review of the information so obtained, are also dependent

2 The explanation to section 17 of the Indian Contract Act 1872 states that 'Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud', unless, depending on the circumstances of the transaction, there is a duty to speak or the silence is equivalent to speech. Further, the exception to section 19 of the Indian Contract Act 1872, which deals with voidability of agreements, states that 'If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence'.

on the nature of the transaction and the value proposition or the deal rationale. It is important that these factors are understood and the diligence is carried out to achieve the deal rationale. This approach would assist in administering a questionnaire to the target that is designed to obtain such information to enable decision-making. This approach has two other benefits: first, it brings in a very focused approach and assists evaluation based on the objective to be achieved and second, it saves time and limits the exposure of information by the target. It is important that time is spent in planning the diligence, which would help a quick turnaround of the diligence itself, and mostly the luxury of a detailed diligence would not be offered by the target itself, as the target might be attempting to woo more than one potential suitor. This brings in the next dimension in the need to plan the diligence, where the acquirer or investor may not be the only person vying to acquire or become part of the target. In this case, one may not even have the luxury of seeking information, as the target may present a structured data room, with specified information that is outlined in advance, and there are even times when a specific time frame is also provided to carry out the diligence process. Each of these situations calls for a dynamic approach that is not straightforward for all transactions or limited by the same checklist for all transactions.

Sources of information for the diligence

With most corporate reporting to government agencies having become electronic, a large amount of data about businesses is available online, either on payment of fee or at no cost. It is important that, in addition to the information that will be provided by the target company, these external sources of information are accessed first, and information about the target obtained.

The information available publicly about the corporate form of businesses ranges from charter documents, filings based on their corporate actions and decisions, shareholdings, borrowings, financial data, credit rating, pending cases at specialised tribunals, High Courts and the Supreme Court, to information relating to any filings or registered intellectual property (IP) holdings.

Since the aim in this chapter is not to provide a due diligence checklist, we are refraining from listing external sources of information, but do give certain basic checks that can be carried out using publicly available data.

Certain basic checks with publicly available information

Sherlock Holmes may have said 'It is elementary, Dr Watson', but irrespective of that, there is no denial that information is knowledge. We examine below certain basic checks about the target that an acquirer or investor can carry out using publicly available information, even before any non-disclosure agreement is signed seeking basic information and before any discussions are held that can culminate in a term sheet being signed, which paves the way for the proprietary information to be made available by the target.

The matters dealt with below are only illustrative items, and not an exhaustive attempt at providing all information that can be obtained to evaluate the target at a preliminary stage.

Financial information and details of secured borrowing

It is said that 'the face is the index of the mind', and equally the financial statements are the index of the business. The annual financial statements of a company are publicly available,[3] which also include a cashflow statement, and the acquirer or investor can carry out a complete analysis of the financial statements, which offer a comprehensive insight into multiple aspects of the business. In addition, publicly available information will also provide details of borrowings, if any, by the target, and when such borrowings are secured also offers insights into the nature of the security[4] offered, which presents the details of assets encumbered and also the quality of the assets that the target owns.

Depending upon the deal rationale, the information presented and analysed from the annual financial statements, and the details of borrowings and the nature of assets, the acquirer or investor can form a preliminary view on the target, the deal structure, valuation, etc.

Regulatory environment assessment

Based on the business of the target, one should be able to assess the regulatory environment that affects the business, and in particular the ability of the acquirer or investor to be able to participate in such business. This exercise would be required for the purpose of planning the diligence process to assess the extent of proprietary information that would be required to be obtained from the target.

Over the years, India has relaxed exchange control and welcomes foreign participation in businesses. There are restrictions on investment in certain types of businesses, which can be ascertained from the foreign direct investment (FDI) manual on the website of the Department for Promotion of Industry and Internal Trade,[5] which would help in ascertaining the regulatory environment on foreign investment in the business of the target.

Promoter and shareholder backgrounds and their shareholding

Publicly available data give information about the shareholding of the promoters and other shareholders and the manner of acquisition of such shares (ie, whether allocated by the company or acquired from a third party, and rights associated thereto). These details can be construed using the filings made by the target with the Ministry of Corporate Affairs (MCA),[6] and used to ascertain the title to the shares. Having said that, the proprietary information may have to be used subsequently to validate the same. It is equally possible to carry out background checks on the promoters and other shareholders of the company for any criminal antecedents, and there are many agencies providing background verification as a service.

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3 This information can be accessed on the website of the Ministry of Corporate Affairs, Government of India (MCA), www.mca.gov.in, for a nominal fee. Form AOC-4/AOC-4XBRL will contain the financial statements of a company.

4 Form CHG-1 filed by the target on the MCA website, www.mca.gov.in, will provide this information.

5 The website of the Department of Promotion of Industry and Internal Trade, www.dipp.gov.in, has access to the latest updated master circular on foreign direct investment in India, which, inter alia, contains details of sectoral caps, conditions and restrictions.

6 See footnote 2; this information can be accessed by viewing Form MGT-7/Form 20B and on the website of the Ministry of Corporate Affairs, Government of India, www.mca.gov.in, for a nominal fee.

Compliance checks

The record of information available with the MCA about the company (which is public information available for a nominal fee) will assist the acquirer or investor to carry out a number of compliance checks. Often, companies fail to file their financial reports or annual returns within the prescribed period of time, with the regulator of corporate affairs, the Registrar of Companies. When such filing is not done (of either of the two documents) for a period of three consecutive years, it leads to disqualification of the directors. While the target company may have filed the financial reports or annual returns in preparing for the acquisition, the disqualification of the promoter director may have already occurred owing to the non-filing of these documents in another entity where they hold the position of director. An elementary check of the MCA records[7] would reveal whether the promoter concerned is eligible to hold office as a director. If the promoters are found to be disqualified, then it can change the entire contour of the transaction, as disqualification entails a five-year wait for being eligible for reappointment, and seeking judicial intervention could take anywhere between three to six months, with no guarantee of the desired result.

Intellectual property rights

The information relating to trademarks, copyrights, patents and designs of the target, if the target had filed any applications for registration of any of the above forms of IP, is publicly available.[8] With respect to trademarks that come as a part of the portfolio of the target, it is only from publicly available information that the acquirer or investor can obtain information on whether any of the marks of the target are associated with its other trademarks. This would be essential in a transaction that involves only assignment of the IP, or transfer of a specific line of business with the IP portfolio. As per the provisions of the Trade Marks Act 1999, a trademark that has been associated with another trademark during the registration process has to also be assigned with the other mark and cannot be transferred in isolation, unless necessary steps are taken to dissolve the association between the associated trademarks pursuant to the provisions of the Trade Marks Act 1999.[9] Such information should be used at the evaluation stage and action be taken appropriately with a view to closing the deal.

One should not be surprised if the 'whois'[10] credentials of the domain names owned and operated by the target do not actually reflect the organisation name of the target, as the owner of such domain names only contains the name of the vendor who maintains the website for it, or the name of an employee. Since the whois information evidences the ownership of the domain name online, the famous remark by Sherlock Holmes (noted above) surely comes to mind.

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7 Information can be checked at www.mca.gov.in in the tab 'MCA Services'/View Signatory Details.

8 Publicly available information on trademarks, patents and designs can be accessed at www.ipindia.nic.in. Publicly available information on copyrights can be accessed at www.copyright.gov.in.

9 Relevant provisions of the Trade Marks Act 1999 are sections 2(3), 16, 40, 41, 44 and 55.

10 www.whois.com.

Bankruptcy and shareholder activism litigation

If the target has any pending or resolved bankruptcy proceedings that have been initiated before the appropriate judicial forum (ie, the National Company Law Tribunal,[11] the appellate body, the National Company Law Appellate Tribunal,[12] or a class action suit or disputes with minority shareholders), then the existence of such litigation and the nature of the orders passed are available publicly. However, the nature of the dispute will be known only from proprietary information.

Information that can be obtained only from proprietary information

Statutes requiring financial compliance

While filing and reporting under statutes that require financial compliance are all electronic, the status of compliance can be assessed only through proprietary information and not from publicly available sources. This includes filings under income tax, indirect tax, goods and services tax, payments for retirement benefits and employee health insurance. While the financial statements may reveal the extent of tax refunds due or acknowledged due under the statutes that require financial obligations from the target, and about any pending litigation with the concerned regulatory authority by way of a note under the heading contingent liabilities, the extent of compliance or impact of non-compliance can be assessed only from the returns and assessments, all of which are proprietary information.

It will also be important to look into any potential tax on shares that have been issued at a premium over the face value,[13] that is not backed by an appropriate valuation, which is colloquially referred to as 'angel tax' – a tax enacted to curb money laundering. It is now customary practice for acquirers or investors to obtain tax indemnities to the extent of such potential angel tax liabilities.

Corporate records and the shareholding and related conundrum

The records to be maintained by a company are expected to reveal its entire story since incorporation, as matters of critical importance are required to be approved and recorded in meetings of the board of directors or shareholders of the company. As stated earlier, while details of shareholding will be publicly available to ascertain title, the corporate records are to be used to validate the shareholding title for compliance of procedural compliance in respect of their mode of acquisition.

There are times that such corporate records, or an unstructured data gathering exercise from the records of the target (if the diligence exercise offers such luxury), can reveal commitments, which may be documented or undocumented, on the capital structure of the company. This may include commitments on employee stock options or friends and family commitments. An open discussion might be warranted with the parties concerned about whether such commitments can be fulfilled in light of the proposed transaction. This can also affect the transaction, based on the risk appetite of the acquirer or investor, as a representation or warranty to this effect may not hedge the risk of any imminent litigation on this count.

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11 www.nclt.gov.in – in the tab 'Judgements'/'Orders'.

12 www.nclat.nic.in – in the tab 'Judgements'/'Daily Orders'.

13 This tax arises from section 56(2)(viib) Income Tax Act 1961.

Material contracts

One of the rationales for carrying out the diligence exercise is to ascertain if the business model of the target works. Every business has its material contracts that are essential for scaling up the business and meeting future projections. It is crucial that the contracting structure of the company is in line with its business model. Businesses may require bespoke contractual engagement protecting their interests and revenue collection and to handle future expansion and scaling up of the business. Whether the contracting model of the company captures the aforementioned principles will be a key information to look out for in the due diligence process. Having said this, a very large portion of business in India still happens without detailed contracts, and mostly through rudimentary purchase orders.

Separately, it is for the investor or acquirer to determine, based on the diligence exercise on the material contracts, whether the target has been performing and has the ability to perform its obligations under these contracts in accordance with the terms and timelines prescribed therein. This not only includes its business-related responsibilities but also any government consents or approvals to be procured, insurance coverage to be used or compliance with data protection laws.

Stamp duty on certain contracts is a requirement in India,[14] and the non-payment of stamp duty affects the enforceability of the contract. The risk appetite and the business model of the company would determine the manner in which the lack of payment of stamp duty on contracts is dealt with in the definitive agreements.

In addition, the contracts play a role in identifying matters that are required to be conditions precedent and conditions subsequent to the closing. Often, the target may have a long-period lease from a government-owned industrial infrastructure development company (IIDC), most of which have a provision that any change in ownership would require prior approval of the IIDC, with or without payment of additional lease rental, and entering into a fresh lease agreement. Similarly, one needs to watch out for prior consent or intimation requirements under material contracts for change in control of the company, be it with customers or suppliers or lenders. Therefore, identifying the consent or intimation requirements and procedures is necessary in order to identify conditions precedent to closing the transaction.

Related-party transactions

The promoters of the target company may have holdings and interests in several other entities. Not all public searches can reveal such interests because of the way the entities are structured, and considering that disclosure of ultimate beneficial ownership (UBO) is a recent introduction in the statute book,[15] there can still be interests in entities that have not yet crossed the radar of UBO. This may result in several related-party transactions between the entities, either through a subcontracting arrangement or other services being provided to each other, which may not be at arm's length or even relate to the core business operations.

Some related-party transactions may not be booked in the financial records of the company and, in some cases, liabilities may be booked with affiliates. Therefore it becomes crucial to

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14 The relevant statute is the Indian Stamp Act 1899 and each state has its own stamp duty rates for different types of contracts in a specific state stamp duty schedule.

15 Section 90 Companies Act 2013.

examine any transactions involving related entities in forensic detail. In addition, loans or other assets lent or leased to the promoters or other shareholders of the company need to be in line with regulatory requirements.

Labour and employment

India has extensive labour law regulations that attract penalties for non-compliance. Depending on the nature of the business, employee strength and compensation levels, companies need to comply with payment of the provident fund allowance, gratuity, employee state insurance or bonuses.[16] In businesses involving the running of factories, there are additional compliances under factory and industrial workers regulations.[17] Diligence of this aspect is crucial to discover hidden liabilities, if any.

With regard to the employees of the company, apart from applicable employment law compliances, it is essential that the employment contracts contain standard provisions ensuring that any IP developed by employees is 'work made for hire', employees are bound by non-disclosure requirements and non-solicitation and non-compete restrictions, where necessary.

Litigation and disputes

Digitisation of litigation in all courts has started and information is available electronically about existence of litigation in all courts in India. However, owing to the sheer numbers in the courts, it is an enormous task to try and look for the existence of litigation based on the target's name, unless the litigation is in a tribunal or high court, which owing to the lesser numbers is relatively easy to obtain. However, the information as to the nature of the dispute will be available only from proprietary information. The information so obtained would be of use at the evaluation stage of the diligence exercise.

Environmental, social and governance

Environmental, social and governance (ESG) matters are a key part of the due diligence exercise in today's world, especially when it comes to private equity or venture capital investment. While ESG issues involve understanding the sustainability of the business model of the company and go well beyond the scope of a legal due diligence, from the legal perspective it is important to ensure adherence to environmental regulations (including procuring of environmental licences, as necessary), compliance with anti-bribery and anti-corruption laws (including the Prevention of Corruption Act 1988 and Prevention of Money Laundering Act 2002) and applicable labour regulations in specific sectors that relate to factory working conditions, working hours and prevention of child labour.

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16 Relevant labour and employment statutes inter alia include: the Employees' Provident Fund and Miscellaneous Provisions Act 1952; the Payment of Gratuity Act 1972; the Employees State Insurance Act 1948; and the Payment of Bonus Act 1965.

17 Relevant statutes inter alia include: the Industrial Disputes Act 1947; the Industrial Employment (Standing Orders) Act 1946; the Contract Labour (Regulation and Abolition) Act 1970; the Factories Act 1948; and the Payment of Wages Act 1936.

Covid-19

In wake of the covid-19 pandemic, diligence exercises will need to be revamped to take into consideration the impact of the changing shape of the economy, new business sectors of critical importance and market downturn. No matter the business, this pandemic has forced a change in the style of operations, making businesses adapt to a new normal. Diligence on the effect on supply chain, performance of contractual obligations, production and sales networks and analysis of the business impact should be undertaken. This also extends to compliance with existing and new regulations (formulated in light of the pandemic) and fulfilment of financial obligations by the company. Risks arising from delays in loan repayments, regulatory filings, renewal of licences or contracts and potential financial exposure should be reviewed.

Of conditions precedent and post-closing management

The due diligence is only half the exercise, and the remainder is in signing the definitive agreements, duly incorporating the findings of the diligence exercise, into any one of the following five categories:

- matters for which appropriate representations and warranties are to be sought from the target, promoters or founders;
- matters for which indemnities are to be sought from the target, promoters or founders;
- covenants that are to be conditions precedent to the closing;
- covenants that are to be conditions at closing; and
- covenants that are to be conditions subsequent to the closing.

Principles to be followed

We give here the principles to be adopted for evaluating the findings into the above five areas.

Seeking representations and warranties

A finding that is in the nature of a fact, for example, if the target has no immovable property or if the target were to state that it uses only licensed software for the purpose of its business, representation is required to be taken for such facts.

Seeking indemnities

With a finding that relates to the target, for which no remedial action can be taken by the target or the promoter, or if the target or the promoter is not keen on taking any remedial action before closing, and if such finding is likely to have a monetary impact on the target at a future indeterminable time frame (subject to limitation or prescription), and the acquirer or investor does not intend to bear the consequences of the same, the acquirer or investor should then seek indemnity for the same from the promoter or seller.

Covenants that are to be conditions precedent and conditions subsequent to closing

Here it is important to take into account the risk appetite of the acquirer or investor and also its keenness to close the transaction. There is a need to balance the risks and the commercial consequences when deciding to place items in the two broad areas of conditions precedent and conditions subsequent to closing.

Where there are matters that involve the following, they have to be incorporated as conditions precedent:

- regulatory prerequisites to the closing, for example:
  - approval of a regulatory authority under antitrust law, the Competition Act 2002, or government approval under FDI policy;
  - if the acquisition is of the shares of a listed company, compliance with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011; and
  - corporate actions relating to the issue of shares; and
- assumptions made by the acquirer or investor while arriving at the valuation prior to the term sheet, and if the diligence exercise had revealed that the assumption had not been actioned by the target, but material to the investor making the investment itself.

Any matters that do not come within the above, and if included as conditions precedent would only delay the closing of the transaction, should be included as conditions subsequent.

Conditions at closing

Upon completion of the conditions precedent to the satisfaction of the investor or acquirer, a date can be set for closing the transaction. On closing, the key actions include:

- payment of share consideration or remittance of the investment amount, as the case may be;
- allotment or transfer[18] of the securities (including issuing the securities certificate and updating company registers);
- board reconstitution (ie, appointment or resignation of directors or observers);
- board and shareholder meetings approving the above actions; and
- continuation of the existing key managerial personnel, particularly officers at chief experience officer level.

Essential conditions precedent

While we have set out the principles to determine conditions precedent to enable a swift closing of the transaction, there are certain matters that are necessarily to be actioned as conditions precedent to facilitate the closing.

Valuation

As a condition precedent to closing, procuring a report on fair valuation of the shares of the company is a requirement. In the case of shares being issued to a non-resident in an unlisted company, identification of a valuer with the requisite qualification becomes critical considering the different requirements under foreign exchange law and company law. The Companies Act 2013[19] requires that the company's shares be valued by a person who is a valuer registered with the Insolvency and Bankruptcy Board of India. However, the pricing guidelines under the Foreign Exchange Management Act 1999 prescribe that the valuation should be certified by a chartered accountant or a merchant banker registered[20] with the Securities and Exchange Board of India.

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18 There are stamp duty implications for issue of share certificate and share transfer under the Indian Stamp Act 1899.

19 Section 247 Companies Act 2013.

20 SEBI (Merchant Bankers) Regulations 1992.

If the valuation is done using discounted cashflow methodology, then income tax law[21] does not recognise the valuation from a chartered accountant.

To steer clear of non-compliance, the report on fair valuation should best be obtained from a merchant banker whose team includes a registered valuer,[22] if the investment or acquisition is to be made in an unlisted company.

Enabling amendments to charter documents

The memorandum of association (memorandum) of the company defines its broad business objects, and the articles of association (articles) act as the by-laws for the management of company affairs. Depending on the nature of the investment, the memorandum and articles of the target may require amendment to enable the issuance of the necessary instrument carrying the rights as agreed to between the transacting parties.

For example, if convertible preference shares are proposed to be issued carrying voting rights on a fully diluted basis, the articles will have to be amended to specifically include an article specifying that section 47 of the Companies Act 2013 will not be applicable to the target company. As per section 47 of the Companies Act 2013, holders of preference shares have a right to vote only on resolutions placed before the company that directly affect the rights attached to the preference shares, and any resolution for winding up the company or for repayment or reduction of its equity or preference share capital and their voting right on a poll shall be in proportion to their share in the paid-up preference share capital of the company.

Regulatory compliance

Targeting ease of doing business, over the past few years the government has been proactive to the needs of the industry and enabling a liberalised regulatory environment. Compliance with regulations involving foreign investment, company law, securities law and both direct and indirect tax laws need to be ensured to avoid any possible exposure to significant liability.

For example, in the case of change of control of a non-banking financial company, prior approval of the Reserve Bank of India (RBI) is mandated.[23] Another example would be that, if an acquisition falls under the category of a combination[24] under the Competition Act 2002, an application needs to be made to and approved by the Competition Commission of India. Regulations pertaining to the chargeability of tax based on income attributable to Indian business have been brought into effect and upheld by the Supreme Court of India. Thus any transfer of business interest in India through an entity outside India should be analysed for potential Indian tax liability.

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21 Rules 11U and 11UA Income Tax Rules 1962.

22 A registered valuer is governed by the Companies (Registered Valuers and Valuation) Rules 2017.

23 This is mandated by the rules under the Reserve Bank of India Act 1934, specifically Notification No. DNBR (PD) CC.No. 065/03.10.001/2015-16 dated 9 July 2015, accessible on the RBI website, www.rbi.org.in.

24 Sections 5 and 6 Competition Act 2002.

Essential conditions subsequent

As with the essential conditions precedent to closing, there are certain matters that would have to be actioned as conditions subsequent to closing.

Amendments to update the charter documents

The articles of a company, in addition to acting as by-laws of the target, are also a contract between the company and its shareholders. Over the years, there have been multiple decisions of various courts[25] and tribunals that to make certain covenants binding on the company such as transfer of shares, right of pre-emption, matters relating to quorum for meeting and decisions to be taken at meetings, even if there is an agreement to which the target company is a party, it is necessary that those provisions are enshrined in the articles of the target company. Thus it is important that the articles be amended so as to incorporate therein the various provisions of the definitive agreement that bind the target. Such amendment to the articles would assist in seeking specific performance in the case of any breach.

Corporate reporting and filings

The actions at closing, such as appointment of directors representing the acquirer or investor, investment and allotment of shares to the acquirer or investor, etc, entail reporting to the Registrar of Companies. All such corporate reporting and filings are to be properly identified based on the transaction, and enumerated and actioned, so as to ensure that the actions are immediately complied with.

Reporting to the Reserve Bank of India

This is dealt with separately and is not construed as part of the earlier item. Based on the transaction, there are requirements to report the transaction to the RBI and the administrative body for matters related to foreign exchange. It is essential that the transaction be reported and an acknowledgement obtained from the RBI,[26] failing which repatriation of money will become a challenge, and delays in reporting involve payment of compounding fees, which can be equal to the amount of investment. Hence it is essential that reporting to the RBI be done immediately on the closing of the transaction. In the case of a transaction that involves transfer of shares by buying shares from an Indian citizen or entity, the reporting is required to be done immediately after the share transfer proceeds are credited to the account of the seller, and the target can register the share transfer only after acknowledgement is obtained from the RBI.

Conclusion

India is a country comprising 1.3 billion people and 22 major languages, written in 13 different scripts, with over 720 dialects and with seven major religions being practised. Linked to such diversity is a multitude of customs and practices, which can be significantly different in different parts of the country. While India has a unified business, corporate and tax laws, there is significant

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25 *VB Rangaraj v VB Gopalakrishnan and Others*, 1992 73 CompCas 201 and many other cases.

26 The RBI has authorised certain specific banks known as Authorised Dealer Banks to provide this acknowledgement on their behalf.

difference in ground-level practices. Any diligence undertaken has to factor in these differences in practices, and accordingly build the necessary covenants, comforts and conditions.

India's population, its diversity, growing affluence and relatively stable democratic set-up protecting a market-driven economic system are surely indicative of a place on which all businesses should set their sights. And hence we sign off by saying 'Namaste!' – the Indian way of welcoming everyone.

3

Regulatory Interventions in M&A – including CCI, RBI and SEBI

Rahul Chadha, Neeraj Prakash, Ashish Gupta, Abhishek Singla and Syed Yusuf Hasan[1]

M&A transactions in India are likely to increase in the coming years, given the importance of India as a market for global companies. Also, at a time when companies are seeking to diversify and de-risk their supply chains, India is an attractive option for companies to establish their manufacturing operations and expand inorganically.

In the past few years, there have been several legislative, regulatory and procedural reforms with a view to easing doing business in the country. This process may accelerate, as India positions itself to attract more foreign investment and stimulate domestic growth.

As in other jurisdictions, successfully closing an M&A transaction requires the knowledge and understanding of the regulatory requirements, and the ability to navigate the processes efficiently. The regulatory requirements may vary depending upon the type, structure and process of the deal, and the size and market share of the companies involved.

This chapter summarises and provides insights on the important regulatory considerations (apart from tax and other cost aspects) that may help companies plan their Indian M&A transactions.

Key regulations affecting M&A deals in India

Regulations under company law

The Indian Companies Act 2013 (Companies Act) is the primary Indian legislation that provides the general framework for the formation and governance of a company in India. It also contains provisions (sections 230 to 240) and rules that govern M&A transactions. Interestingly, while the Companies Act does not specifically set out the definition of 'merger', it does, in a generic sense, give a broad understanding of a merger to be the transfer of the whole or any part of an

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undertaking, properties and/or liabilities of one or more companies to another existing or new company, or division of the whole or any part of the undertaking, property or liabilities of one or more companies to two or more existing or new companies.[2]

Applicable provisions of the Companies Act differ depending on whether:

- a company is private or public;
- it is listed on a stock exchange;
- it has foreign investment; and
- it is also in the purview of any specific regulator.

These factors will affect the process and manner in which an M&A transaction will proceed.

In addition to any other sectoral regulator or government authorities that may be involved in an M&A transaction depending on the type of entity and the business sector they are in, under the Companies Act, several authorities, such as the Registrar of Companies (ROC), the Regional Director (RD), the Official Liquidator (OL) and the National Company Law Tribunal (NCLT) may have a role to play. The final approval for any merger would be granted by the NCLT.

Companies that propose to merge are required to file a petition (along with a detailed scheme of merger) before the NCLT for sanction of the proposed merger scheme. Before any merger is approved by the NCLT, approval of the shareholders and creditors of the companies representing 75 per cent in value of the creditors or members would be required by conducting their meetings in the manner prescribed by the NCLT.[3] The requirement of holding creditors meetings may be dispensed with by the NCLT at its discretion upon the companies furnishing affidavits of creditors having at least 90 per cent in value confirming their acceptance of the scheme of merger. Although there is no specific provision for dispensation of the meeting of the members, if 90 per cent or more members give their consent for the proposed merger by way of an affidavit, the NCLT may, at its discretion, dispense with the requirement of holding the meeting. Any objection pertaining to the merger can only be made by members who hold not less than 10 per cent of the shareholding, or creditors having outstanding debt amounting to not less than 5 per cent of the total outstanding debt as per the latest audited financial statement.[4]

Notices of the meetings are also sent to the RD and various government authorities or sectoral regulators such as the ROC, the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), the OL, the respective stock exchanges, the Competition Commission of India (CCI), etc, as applicable, so as to receive objections or representations, if any, in relation to the proposed merger within 30 days from the date of receipt of the notice. If no representation is made by any regulator, it is presumed that the said regulator has no representation to make on the proposals.[5] If any of the parties to a proposed merger is a listed company, applicable SEBI regulations must be complied with. Once the order approving the scheme of merger is issued by NCLT, the same needs to be filed with the ROC for registration within 30 days from the date of receipt of the certified copy of the NCLT's order.[6] The completion of the process of merger may

2 Section 232(1) and explanation to section 232(8) of CA.
3 Section 232(1) and section 230(6) of CA.
4 Section 232(1) and proviso to section 230(4) of CA.
5 Section 232(1) and section 230(5) of CA.
6 Section 232(5) of CA.

take a few months to a few years, depending on the complexity of the merger, objections received from stakeholders, the sector in which the companies operate, etc.

To simplify the process of mergers between small companies, or between a holding company and its wholly owned subsidiary, without the intervention of the NCLT, the Companies Act sets out a fast-track merger procedure.[7] In such cases, if no objections are received from the RD, ROC and OL for the scheme of merger, and the same is approved by a majority of members and creditors of the companies representing 90 per cent of their total numbers of shares and 90 per cent in value of their creditors, the scheme is considered to be approved.[8]

The Companies Act also provides for cross-border mergers (ie, a merger between a foreign company and an Indian company or vice versa).

In addition to the merger of companies, another leg of M&A transactions is 'acquisition'. As per market practice, an acquisition is generally effected either by transfer of existing shares or by subscribing to new shares of a company.

Regulations pertaining to M&A involving listed companies in India

An additional layer of regulatory compliances is required to be fulfilled in the case of merger or acquisition of shares of a listed company under the Securities and Exchange Board of India Act 1992 (SEBI Act) and the rules and regulations framed thereunder. The key regulations are: SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Regulations); SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 (ICDR Regulations); and SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (LODR Regulations).

The Takeover Regulations apply to all direct and indirect acquisitions of shares or voting rights or control in a listed company in India, except to companies listed on the institutional trading platform of a stock exchange without making any public issue.[9]

As per the Takeover Regulations, the acquirer is under an obligation to make a public announcement of an open offer for acquiring shares of the target listed company in certain scenarios, such as if an acquirer acquires shares or voting rights in a target listed company that, along with the shares or voting rights, if any, already held by the acquirer and the persons acting in concert (PAC) with the acquirer, entitles them to exercise 25 per cent or more of the voting rights in the target company,[10] or the acquirer acquires, directly or indirectly, control over the target company,[11] or if the acquirer (along with PAC) already holds more than 25 per cent or more voting rights in the target company and desires to acquire more shares or voting rights in a financial year entitling them to exercise more than 5 per cent of voting rights, provided that the aggregate shareholding pursuant to the acquisition does not exceed the maximum permissible non-public shareholding (ie, 75 per cent) except in case of acquisition made pursuant to a resolution plan approved under section 31 of the Insolvency and Bankruptcy Code 2016 (IBC).[12]

7 Section 233 of CA.

8 Section 233(1)(b) and (d) of CA.

9 Regulation 1(3) of Takeover Regulations.

10 Regulation 3(1) of Takeover Regulations.

11 Regulation 4 of Takeover Regulations.

12 Regulation 3(2) of Takeover Regulations.

An open offer for acquiring shares must be for at least 26 per cent of total shares of the target company.[13]

In certain types of acquisitions, such as inter se transfer of shares among immediate relatives, promoters, etc, the Takeover Regulations provide an exemption from the requirement of making an open offer to the shareholders.

An acquirer who already holds (along with PAC) shares or voting rights in a target company entitling them to exercise 25 per cent or more of voting rights, can acquire additional shares in the target company by making a voluntary public announcement of an open offer to the shareholders, provided that the aggregate shareholding post open offer does not exceed the maximum permissible non-public shareholding (ie, 75 per cent).[14] The offer size in case of a voluntary open offer should be for acquisition of at least such number of shares that would entitle the acquirer to exercise 10 per cent voting rights of the target company, provided that the shareholding of the acquirer (along with PAC) post-acquisition does not exceed the maximum permissible non-public shareholding.[15]

As per the Takeover Regulations, the price paid for the shares should include any price paid, or agreed to be paid, to the promoters for their shares or voting rights or control premium, or as non-compete fees, or otherwise.

If an acquirer who makes a public announcement of an open offer to acquire shares of the target company intends to delist the securities of the target company, the acquirer should declare its intention to delist the shares upfront at the time of making the detailed public statement, which must be published not later than five working days from the date of public announcement of the open offer.[16]

In the case of acquisition of shares by way of subscription of shares, the subscription must be carried out in accordance with the ICDR Regulations. The specified securities allotted on a preferential basis and the equity shares allotted pursuant to exercise of options attached to warrants issued on a preferential basis are subject to lock-in for periods ranging between one to three years, as prescribed under the ICDR Regulations.[17]

The ICDR Regulations also provide some exceptions to the transfer restrictions.[18]

In the case of M&A transactions pursued by listed companies in India, the companies are required to comply with the LODR Regulations. As and when a listed company plans to undertake a scheme of arrangement, the listed company is obliged to file the draft scheme of arrangement with the stock exchange or exchanges for the purpose of obtaining an observation letter or no-objection letter.[19] Only after receipt of the observation letter or no-objection letter can the company file a scheme of arrangement before the NCLT seeking its approval.[20] Upon sanction of the scheme, the company is required to inform stock exchanges and file the requisite documents

13 Regulation 7 of Takeover Regulations.
14 Regulation 6 of Takeover Regulations.
15 Regulation 7(2) of Takeover Regulations.
16 Regulation 5A read with regulation 13(4) of Takeover Regulations.
17 Regulation 167 of ICDR Regulations.
18 Regulation 168(1) of ICDR Regulations.
19 Regulation 37(1) of LODR Regulations.
20 Regulation 37(2) of LODR Regulations.

as mentioned in the LODR Regulations.[21] The LODR Regulations provide some exceptions to the above-mentioned obligation in the cases of merger of a wholly owned subsidiary with its holding company and a reconstruction proposal approved as part of resolution plan under section 31 of the IBC, in which case the only requirement is to file the draft scheme of arrangement within the statutory timelines with the stock exchange or exchanges for the purpose of disclosure.[22]

Regulations under competition law

The Competition Act 2002 (Competition Act), read with the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations 2011 (Combination Regulations), requires mandatory pre-notification of all acquisitions (of shares, voting rights, assets or control) and mergers and amalgamations that cross jurisdictional thresholds (Combination(s)) relating to a specified value of assets or turnover, to the CCI for its approval prior to completion of the transaction, unless specific exemptions apply:

In general, the Competition Act prohibits Combinations that cause, or are likely to cause, an appreciable adverse effect on competition (AAEC) within the relevant market in India. Any such Combination is void.

A Combination subject to a notification requirement cannot be consummated until a clearance from the CCI has been obtained, or a review period of 210 calendar days from the date of notification to the CCI has passed, whichever is earlier.

The thresholds for mandatory pre-notification are set out in terms of assets or turnover in India and abroad. These thresholds are as follows:

- at the enterprise level, the parties to the Combination jointly have:
  - in India, assets valued at more than 20 billion Indian rupees or turnover of more than 60 billion Indian rupees; or
  - in India or outside India, in aggregate, assets valued at more than US$1 billion with at least 10 billion Indian rupees in India, or turnover of more than US$3 billion with at least 30 billion Indian rupees in India;
- at the group level, the group acquirer to the Combination jointly has:
  - in India, assets valued at more than 80 billion Indian rupees or turnover of more than 240 billion Indian rupees; or
  - in India or outside India, in aggregate, assets valued at more than US$4 billion with at least 10 billion Indian rupees in India or turnover of more than US$12 billion with at least 30 billion Indian rupees in India.

De minimis exemption, or small target exemption, for a transaction is available and such transaction does not qualify as a Combination under the Competition Act. Accordingly, any enterprises being party to a Combination where the value of assets being acquired, taken control of, merged or amalgamated is not more than more than 3.5 billion Indian rupees in India or where the turnover is not more than 10 billion Indian rupees in India, are exempted from the pre-notification requirement under the Competition Act. The de minimis exemption is currently available until 26 March 2022.[23]

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21 Regulation 37(5) of LODR Regulations.

22 Regulation 37(6) and 37(7) of LODR Regulations.

23 See Notification No. SO 988(E) dated 27 March 2017.

The value of assets and turnover provided above are determined by taking the book value of the assets, as shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of the proposed transaction falls.

A 'group' has been defined as two or more enterprises that, directly or indirectly, are in a position to exercise 26 per cent or more of the voting rights in the other enterprise, appoint more than 50 per cent of the members of the board of directors in the other enterprise, or control the management or affairs of the other enterprise. However, the government of India has exempted groups exercising less than 50 per cent per cent of the voting rights in other enterprises from the provisions applicable on Combinations till 3 March 2021.[24]

Generally, it is the responsibility of the acquirer to notify the CCI, but in cases involving mergers or amalgamations, it is a joint responsibility of all the concerned parties to file the notification.

The notice to the CCI disclosing the details of the proposed Combination is required to be given within 30 days of either the execution of any agreement or other document for acquisition or acquiring of control, or the approval of the proposal relating to merger or amalgamation by the board of directors of the parties concerned. However, to alleviate stringent reporting requirements, the government of India has provided an exemption of giving notice within 30 days as mentioned above, subject to the condition that no Combination shall come into effect until 210 days have passed from the day on which the notice has been given to the CCI or the CCI has approved the Combination, whichever is earlier. Such exemption is currently valid until 28 June 2022.[25]

On receipt of a notice, the CCI conducts its investigation in two phases. In the first phase, the CCI determines, prima facie, whether the proposed Combination is likely to cause an AAEC, within 30 working days from the date of notification. If the CCI is of the opinion that the proposed Combination does not cause an AAEC, it approves the Combination.

If the CCI forms a prima facie opinion that the Combination is likely to have an AAEC, the CCI conducts a second phase of in-depth investigation during a statutory period of 210 calendar days. After investigation, the Combination may be approved or disapproved or approved with modification by the CCI.

The Competition Act has extraterritorial application thereby extending the jurisdiction of the CCI to transactions outside India. The implication is that Combinations where the assets or turnover of the entities involved are in India and where such assets or turnover exceed the prescribed thresholds provided in the Competition Act shall be subject to scrutiny by the CCI, even if the purchasers, sellers or target entities are outside India.

Pursuant to an amendment to the Combination Regulations in 2019, a green channel has been established with the CCI. Under the green channel, for certain categories of Combinations listed below, the parties to such Combinations have the option to opt for green channel approval. Upon filing under the green channel and an acknowledgment being received from the CCI thereof, the proposed Combination is deemed to be approved by the CCI.

Green channel approval may be sought if the parties to the Combination, their respective group entities, and/or any entity in which they, directly or indirectly, hold shares, control or both:

- do not produce or provide similar or identical or substitutable products or services;

24 See Notification No. SO 673(E) dated 4 March 2016.

25 See Notification No. SO 2039(E) dated 29 June 2017.

- are not engaged in any activity relating to the production, supply, distribution, storage, sale and service or trade in products or provision of services that are at different stages or levels of the production chain; and
- are not engaged in any activity relating to the production, supply, distribution, storage, sale and service or trade in products or provision of services that are complementary to each other.

Extent of foreign investment in India and sector-specific regulations

M&A deals in India involving foreign exchange, including cross-border M&As, are subject to a strict framework of regulations and guidelines prescribed under the Foreign Exchange Management Act 1999 (FEMA) administered by India's central bank (the RBI).

The main regulations are the Foreign Exchange Management (Non-debt Instruments) Rules 2019[26] (NDI Rules), the Foreign Exchange Management (Debt Instruments) Regulations 2019[27] (DI Regulations) and Foreign Exchange Management (Cross-Border Merger) Regulations 2018[28] (Cross-Border Merger Regulations).

In addition, the government of India, through the Ministry of Commerce & Industry, Department for Promotion of Industry and Internal Trade, issues policy guidelines from time to time relating to foreign direct investment in India (FDI Guidelines). The FDI Guidelines and the above-mentioned regulations broadly govern the mode through which foreign investment can flow into and out of India, the prescribed instruments that can be used, the sectoral caps for foreign investments and the entry conditions attached thereto. Such conditions may include norms for minimum capitalisation, lock-in period, local sourcing, etc.

Acquisition of an Indian company can be done either through the 'automatic route' or the 'approval route' as mandated by the FDI Guidelines. Under the automatic route, neither the acquirer or non-resident investor nor the Indian company requires any approval from the government of India for the acquisition or investment. Under the 'approval route', prior approval of the government of India is required. The requirement of following the approval route and the extent of acquisition of shares and control of the Indian target or investee company largely depend upon the business activities of the Indian company. In a few cases, it also depends on the source country of the investment flowing into India.

The FDI policy prescribes the sectoral caps for acquisition or investment in the capital of an Indian company. An illustrative list of such caps is as follows:

- manufacturing, including contract manufacturing: 100 per cent through the automatic route;
- single-brand retail trading: 100 per cent through the automatic route, subject to a condition that FDI beyond 51 per cent requires local sourcing of at least 30 per cent of the value of goods procured;
- e-commerce: 100 per cent through the automatic route in marketplace model;
- defence industry: 49 per cent through the automatic route, beyond 49 per cent through government approval; and
- railway infrastructure: 100 per cent through the automatic route.

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26 Notification SO 3732(E) dated 17 October 2019.

27 No. FEMA 396/2019-RB.

28 No. FEMA 389/2018-RB.

There are a few business sectors in which foreign investment is prohibited, such as the lottery business, chit funds, real estate business, manufacturing of cigars, cigarettes, atomic energy, etc.

Recently, the government of India has broadened the country-specific approval requirement to curb opportunistic takeovers of Indian companies that are in financial distress because of the covid-19 pandemic.[29] Accordingly, an entity of a country that shares a land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country can invest only through the approval route. As this requirement is the result of a specific situation, it may be changed or withdrawn later.

Regulations pertaining to cross-border mergers

In order to operationalise the enabling provisions under the Companies Act regarding cross-border mergers, the RBI has issued the Cross-Border Merger Regulations, which provide its operational framework. A cross-border merger is a merger, amalgamation or arrangement between an Indian company and a foreign company. Cross-border mergers could either be inbound or outbound. An inbound merger is a cross-border merger where the resultant company is an Indian company. An outbound merger is a cross-border merger where the resultant company is a foreign company. Resultant company means an Indian company or a foreign company that takes over the assets and liabilities of the companies involved in the cross-border merger.

In the case of an inbound merger:

- The resultant Indian company is allowed to issue or transfer any security to a non-resident outside India in accordance with the pricing guidelines, entry routes and sectoral caps as per the NDI Rules.
- An office of the foreign company situated outside India is deemed to be a branch of the resultant Indian entity post-merger, and the resultant Indian entity is permitted to undertake any transaction through such foreign branch as permitted under FEMA.
- Any borrowings of the foreign company from overseas sources that become borrowings of the resultant Indian entity, or are entered into the books of the resultant Indian company pursuant to the merger, are required to comply with the guidelines for external commercial borrowing of the RBI within a period of two years, provided that no remittance for repayment of such liability is made from India within such period of two years.
- Any asset or security that is acquired abroad by the resultant Indian company owing to the cross-border merger, which is not permitted to be held by it under FEMA, is required to be sold within a period of two years from the date of sanction of the scheme of merger by the NCLT, and the sale proceeds are required to be remitted to India. Similarly, any liability outside India that cannot be held by the resultant Indian company must be extinguished from the sale proceeds of the aforementioned overseas assets within a period of two years from the date of the NCLT's sanction of the scheme of merger.

In the case of an outbound merger:

- A person resident in India is allowed to acquire securities of a foreign company as per the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations

29 Notification SO 1278 (E) dated 22 April 2020.

2004, or within the limit prescribed under the Liberalised Remittance Scheme, namely up to US$250,000 per financial year.

- An office of the Indian company in India is deemed to be a branch office of the resultant foreign company and is governed by the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations 2016.
- Any outstanding borrowings or guarantees of the Indian company that become the liabilities of the resultant foreign company pursuant to the cross-border merger are required to be repaid by the resultant foreign company as per the scheme of merger sanctioned by the NCLT.
- Any asset or security that is acquired in India by the resultant foreign company pursuant to the merger that cannot be held by it as per FEMA is required to be sold within a period of two years from the date of sanction of the scheme of merger and proceeds must be repatriated outside India. Any Indian liabilities may be repaid from such sale proceeds within the said period of two years.
- An Indian company is permitted to merge with a company incorporated in any of the notified foreign jurisdictions. The notified foreign jurisdiction include countries:
  - whose securities market regulator is a signatory to the Multilateral Memorandum of Understanding of the International Organization of Securities Commissions or a signatory to the bilateral memorandum of understanding with SEBI; or
  - whose central bank is a member of Bank for International Settlements; and
  - that are not identified in the public statement of the Financial Action Task Force (FATF) as a jurisdiction having strategic anti-money laundering or combating the financing of terrorism deficiencies to which counter measures apply, or a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies.

If any transaction on account of a cross border merger is undertaken in accordance with the above-mentioned regulations, it is deemed to be approved by the RBI.

Court or tribunal involvement

The process of mergers in India, including cross-border mergers, is court-driven and required to be sanctioned by the NCLT. The process may be initiated by an agreement between the parties, but that would not be sufficient to provide legal validity to the transaction.

The NCLT inter alia takes the following aspects into consideration while supervising the process of mergers:

- determining the class of creditors or of members whose meetings have to be held for considering the proposed merger;
- determining the values of the creditors or the class of members whose meetings have to be held;
- fixing the quorum, procedure and voting mechanism to be followed at the meetings of shareholders and creditors; and
- issuing notices to the central government, the ROC, Income-tax authorities, the RBI, SEBI, the CCI and stock exchanges, as may be applicable;

The NCLT also has the power to direct provisions relating to dissenting persons to the transaction and the treatment of employees.

On sanction of the scheme of merger by the NCLT, it becomes binding on all the creditors, shareholders and companies involved in the merger.

Acquisition of distressed assets through corporate insolvency resolution process

The prime objective of the IBC is to provide a consolidated legal framework for reorganisation and insolvency resolution of companies. While the IBC does not directly deal with M&A, the insolvency process creates an opportunity for potential acquirers to acquire assets of stressed companies, whereby the acquirer may be able to acquire assets at a lower valuation than in ordinary circumstances.

The process of acquisition of a company (corporate debtor) under the IBC begins with the submission of a resolution plan by the potential acquirer (resolution applicant) to the resolution professional proposing the acquisition, followed by an approval of such resolution plan by the committee of creditors of the corporate debtor and, finally, sanction of the resolution plan by the NCLT.

Any person can be a resolution applicant, except a person who is disqualified to be a resolution applicant as per the IBC, such as a person who is an undischarged insolvent, is a wilful defaulter in accordance with the guidelines of the RBI, is prohibited by SEBI from trading in securities or accessing the securities markets, has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place, who at the time of submission of the resolution plan, has an account which is classified as a non-performing asset in accordance with the guidelines of the RBI, etc.

An acquisition by way of implementation of a resolution plan has been granted various regulatory exemptions, including under the Takeover Code, the ICDR Regulations, and the Companies Act (seeking of shareholders' approval). However, if the combined values of the assets or turnovers of the resolution applicant (potential acquirer) and the target (corporate debtor) cross the thresholds prescribed under the Competition Act (as explained above), it will be mandatory for the resolution applicant (potential acquirer) to obtain prior approval for the proposed acquisition from the CCI, and till then, the committee of creditors cannot approve the resolution plan.

Other regulatory considerations

Sector-specific regulations

There are some sector-specific regulations, and regulators to regulate acquisitions in such sectors. Accordingly, additional approvals from such regulators may be required for completing an M&A transaction. For example, in the context of acquisition of an insurance company, approval from the Insurance Regulatory and Development Authority of India is required. RBI approval is required for acquisition of banking companies and non-banking financial companies (NBFCs).

The sector-specific regulations for insurance companies are triggered on the basis of the percentage of shareholding being acquired by the acquirer, and prescribe certain lock-in requirements, infusion of capital at periodic intervals, etc.

Similarly, the RBI's Master Direction – Amalgamation of Private Sector Banks, Directions 2016[30] provide guidelines for the amalgamation of two banking companies, the amalgamation of an NBFC with a banking company, and the amalgamation of a banking company with an NBFC.

Employment-related regulations

In the context of M&A transactions, section 25FF of the Industrial Disputes Act 1947 provides that when the ownership or management of an undertaking is transferred to a new employer, an eligible employee is entitled to notice and retrenchment compensation from the employer of such undertaking. However, such compensation is not applicable if the service of the employee:

- has not been interrupted by such transfer;
- the new terms and conditions of service applicable to the employee after such transfer are not less favourable to the employee; and
- the new employer is, under the terms of such transfer, legally liable to pay compensation to the employee in the event of his or her retrenchment.

However, the Supreme Court[31] has observed that without their consent, employees cannot be forced to work under a different management, and if they do not give their consent to such transfer, those employees are entitled to retrenchment compensation.

The NCLT is also empowered to issue necessary directions on treatment of the workforce while sanctioning a scheme of amalgamation.

30 RBI/DBR/2015-16/22.

31 *In the matter of Sunil Kr Ghosh v K Ram Chandran* (2011) 14 SCC 320.

4

Cross-Border Mergers: Old Challenges, New Solutions

Sai Krishna Bharathan and Shivani Kabra[1]

The general cross-border M&A climate – an introduction

According to the United Nations Conference on Trade and Development (UNCTAD), India attracted foreign direct investment of US$49 billion in 2019, representing an increase of 16 per cent compared with the previous year. The sectors that drew the most investment were the services industries and information technology. When juxtaposed with the global data on foreign direct investment, which according to UNCTAD remained flat in 2019, it appears that the M&A climate in India is thriving.[2]

UNCTAD had expected foreign investment into India to increase at a moderate level in 2020.[3] However, at the time of writing, the world is caught in the throes of the covid-19 pandemic, making any projections for the next 12 to 18 months difficult.

While, historically, India may have been an attractive destination for foreign investment, such investment is not without significant risk. Investors have been concerned with certain factors such as the high debt accumulation, reactionary approach to legislation and protectionist policies pursued by the government.[4] This chapter will explore some of the key legal and regulatory challenges faced by foreign investors when investing in Indian businesses. This chapter focuses on investments in equity instruments.

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1 Sai Krishna Bharathan is a senior partner and Shivani Kabra is a partner with AZB & Partners.

2 Suneja K, 'India attracted US$49 billion FDI in 2019, among top 10 recipients of overseas investment', UNCTAD, 20 January 2020, *The Economic Times*, available at https://economictimes.indiatimes.com/news/economy/indicators/india-attracted-49-billion-fdi-in-2019-among-top-10-recipients-of-overseas-investment-unctad/articleshow/73441481.cms?from=mdr.

3 ibid.

4 ibid.

Foreign exchange – regulatory framework

Introduction

At the outset, it should be noted that the Indian economy is a regulated one and any foreign investment from other countries into India is regulated under the Foreign Exchange Management Act 1999 read with the Foreign Exchange Management (Non Debt Instruments) Rules 2019 (NDI Rules) and the Foreign Exchange Management (Debt Instruments) Rules 2019 (DI Rules), issued by the Department of Economic Affairs, Ministry of Finance, Government of India.

The NDI Rules set out the basis on which foreign investment can be made into India and, generally speaking, divide foreign investment on the following basis:

- foreign direct investment (FDI);
- foreign portfolio investment (FPI);
- foreign venture capital investment (FVCI); and
- investments by non-resident Indians.

The NDI Rules also deal with foreign investment in units of investment vehicles (which are, essentially, entities registered and regulated by the Securities and Exchange Board of India (SEBI) and includes alternative investment funds (AIFs), real estate investment trusts (REITs) and Infrastructure investment trusts (InVITs)).[5]

Foreign direct investment

FDI may be made by an investor into equity instruments[6] issued by Indian private and public (including listed) companies and into limited liability partnerships (LLPs), provided that investment in a listed company should be 10 per cent or more on a fully diluted basis to qualify as FDI.[7]

Foreign portfolio investment

An FPI vehicle that is registered with SEBI is permitted to invest in equity instruments of an Indian company listed or about to be listed on a recognised stock exchange in India, subject to certain conditions and, in particular, the individual and aggregate limits noted in the chapter 'Smart Acquisition Structures in M&A: AIF, FPI and FDI'. This route has been made available to enable trading of listed securities by foreign players on the stock exchange. In addition, an FPI can invest in Indian depository receipts of companies resident outside India and listed on Indian capital markets, or units issued by domestic mutual funds, Category II AIFs, REITs or InVITs, subject to the terms and conditions set out in the NDI Rules.[8]

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5 Rule 2(ae), NDI Rules.

6 Defined as equity shares, convertible debentures, preference shares and share warrants issued by an Indian company under Rule 2(k) of the NDI Rules.

7 Rule 2(r), NDI Rules.

8 Paragraph 1, Schedule II, NDI Rules.

Foreign venture capital investment

FVCI vehicles that are registered with SEBI are permitted to invest in:

- securities of Indian companies that are engaged in certain specified sectors;
- units of venture capital funds or of Category I AIFs or units of scheme or of a fund set up by a venture capital fund or Category I AIF; and
- equity or equity-linked instrument or debt instrument of Indian startups irrespective of the sector in which such startup is engaged in.

Some of the key benefits of using an FVCI vehicle to invest in India include the fact that the pricing guidelines on issuance or transfer of Indian securities do not apply and the FVCI vehicle has the opportunity to invest in different types of equity and equity-linked instruments of the Indian company and is not restricted to just equity instruments.[9] This enables an FVCI to invest in optionally convertible instruments such as optionally convertible debentures, which are redeemable in nature. See further details on pricing guidelines below.

The chapter 'Smart Acquisition Structures in M&A: AIF, FPI and FDI' explores some of the common acquisition structures that can be used for routing foreign investment into India, within the constraints of the NDI Rules, in further detail. The rest of this chapter will delve into some of the issues under the NDI Rules that affect FDI into Indian entities.

Regulatory interventions and challenges

Foreign direct investment into an Indian company

Prohibited sectors for foreign investment

Foreign investment and foreign technology collaboration is prohibited in certain sectors or activities (Prohibited Sectors), such as atomic energy or railway operations, lottery business including government or private lottery, online lotteries, gambling and betting business including casinos, the manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes, chit funds and Nidhi companies, trading in transferable development rights, real estate business[10] or construction of farmhouses.

Automatic route versus approval route

Sector norms

With respect to certain other sectors (Specified Sectors), the NDI Rules specify the level of foreign investment permitted in such sector (ie, the sectoral cap) and whether such foreign investment is permitted under the automatic route (ie, without the requirement of obtaining any regulatory approval) or under the approval route (where prior permission of the government would be required before foreign investment can be received by the Indian company operating in such

9 Schedule VII, NDI Rules.

10 Paragraph 2(a), Schedule I, NDI Rules states that 'real estate business' means dealing in land and immovable property with a view to earning profit therefrom and does not include development of townships, construction of residential or commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure or townships.

sector). Further, the NDI Rules also contain FDI-linked performance conditions (eg, a minimum capitalisation requirement) that must be complied with when investing in a Specified Sector.[11]

Where foreign investment with respect to a Specified Sector is under the automatic route, such investment can be made without prior approval of the government, provided that the sectoral caps are not breached and the FDI-linked performance conditions are complied with. If a particular sector is not in the list of Prohibited Sectors, Specified Sectors or otherwise dealt with in the NDI Rules, then generally speaking, 100 per cent foreign investment is permitted in such sector under the automatic route.[12]

Investment in holding entities

It should be noted that if foreign investment is proposed to be made into an Indian investing company not registered as a non-banking financial company (NBFC) with the Reserve Bank of India (RBI) or in core investment companies, prior government approval will be required.[13]

In order to infuse foreign investment into Indian companies that do not have any operations and also do not have any investments in other Indian entities, government approval is not required for undertaking activities that are under automatic route and are without FDI-linked performance conditions, regardless of the amount or extent of foreign investment. However, approval of the government will be required for infusion of foreign investment in such companies for undertaking activities that are under the approval route, regardless of the amount or extent of foreign investment.[14]

Non-cash consideration

Under the automatic route, the Indian company may issue equity instruments to persons resident outside India against swap of equity instruments, import of capital goods, machinery or equipment (excluding secondhand machinery) or pre-operative or pre-incorporation expenses, without having to obtain any government approvals.[15]

Indirect foreign investment

The NDI Rules also set out the manner in which indirect foreign investment in Indian companies and the transfer of ownership or control from residents to non-residents in Indian companies is calculated. This may have an impact on whether government approval is required in certain types of companies and may also affect the quantum of foreign investment in certain sectors. For further details on indirect foreign investment, see below.

11 Schedule I, NDI Rules.

12 Paragraph 3(b)(iii), Schedule I, NDI Rules.

13 Paragraph3(b)(v), Schedule I, NDI Rules.

14 Paragraph 3(b)(vi), Schedule I, NDI Rules.

15 Paragraph 1(d), Schedule I, NDI Rules.

Recent amendments further restricting foreign investment

Pursuant to a recent amendment to the NDI Rules notified on 22 April 2020,[16] any foreign investment by an entity resident in a country that shares a land border with India[17] or where the beneficial owner of such foreign investment is a person situated in or a citizen of such country, can only be undertaken with the prior approval of the government, irrespective of the sector or quantum of foreign investment. Additionally, any direct or indirect transfer of existing or future FDI that would result in the beneficial ownership resting with a person situated in, or a citizen of such country would require prior government approval.

This amendment has given rise to major concerns about its manner of application, not in the least because it is unclear what the government means by 'beneficial ownership'. Other concerns include the following:

- there is no ownership threshold or percentage above which such government approval is triggered;
- not only FDI but also indirect foreign investment (ie, by virtue of a multijurisdictional acquisition of an offshore target that has a direct or indirect Indian subsidiary) will be affected;
- additional capital infusion in a company by existing investors from the restricted countries (either by way of a rights issue or preferential allotment), is also likely to require prior government approval. It remains to be seen whether a bonus issue of securities by an Indian company to a shareholder that is from the restricted countries would also fall within the restrictions imposed by amendment; and
- as no carve-outs have been made for transfers to affiliates, it is likely that transfers to affiliates of existing investors from the restricted countries would also be affected and would require prior government approval.

At the time of writing, we understand that the government is considering issuing clarifications, although it remains to be seen whether all of the concerns will be adequately addressed. In the absence of any clarification, at-risk investors must be prepared to apply for government approval and be ready for its consequent impact on the timelines for deal closure.

Pricing guidelines

Foreign investors must keep in mind that any foreign investment into India (except if being routed through an FVCI vehicle) will be subject to the pricing guidelines set out in the NDI Rules.[18]

The table below summarises the restrictions on pricing of equity instruments that are:

- issued by listed and unlisted Indian companies to persons resident outside India (NR);
- proposed to be transferred by a person resident outside India (NR) to a person resident in India (R); and
- proposed to be transferred by a person resident in India (R) to a person resident outside India (NR). The pricing guidelines do not prescribe any restrictions when it comes to a transfer of equity instruments between two persons resident outside India.

16 F No. 01/05/EM/2019-Part (1).

17 Namely Afghanistan, Bangladesh, Bhutan, China, Myanmar, Nepal and Pakistan.

18 Rule 21, NDI Rules.

Pricing guidelines

	Issuance to NR	Transfer from NR to R	Transfer from R to NR
Listed company	Floor price Price to not be less than the price calculated in accordance with the guidelines issued by SEBI	Cap on price Price to not be more than the price calculated in accordance with the guidelines issued by SEBI	Floor price Price to not be less than the price calculated in accordance with the guidelines issued by SEBI
Unlisted company (private or public)	Floor price Price to not be less than the price arrived by a practising cost accountant, chartered accountant or SEBI-registered merchant banker, as per any internationally accepted pricing methodology	Cap on price Price to not be more than the price arrived by a practising cost accountant, chartered accountant or SEBI-registered merchant banker, as per any internationally accepted pricing methodology	Floor price Price to not be less than the price arrived by a practising cost accountant, chartered accountant or SEBI-registered merchant banker, as per any internationally accepted pricing methodology
	NR – person resident outside India R – person resident in India		

As will be noted from the table, there is a cap on the price at which a foreign investor can exit its investment in an Indian entity in favour of a person resident in India.

As per the NDI Rules, the guiding principle is that the foreign investor must exit at the fair market price prevailing at the time of such exit. Importantly, an investor cannot be promised any kind of assured return on exit, at the time of making its investment.[19]

Where the Indian company is proposing to issue securities that are compulsorily convertible into equity shares, then the conversion formula must be determined upfront. Further, the price at which equity shares are issued on conversion of convertible instruments cannot exceed the fair market value of such equity shares as of the date of issue of such convertibles.[20]

Deferred consideration, use of escrows and treatment of indemnities

The NDI Rules set out certain rules governing deferred consideration, use of escrows and treatment of indemnities. These requirements limit the types of alternative pricing structures that can be used for routing foreign investment into Indian companies – in particular, the earn-out structures that are preferred in other jurisdictions.

Where a transaction involves the transfer of equity instruments between a person resident in India and a person resident outside India, an amount not exceeding 25 per cent of the total consideration may be paid by the buyer to the seller on a deferred basis or settled through an escrow arrangement between the buyer and the seller. Further, where structures involve deferred consideration or escrow arrangement restricted to amounts equal to or below 25 per cent, the deferred consideration must be paid, and the escrow arrangement must be settled,

19 Rule 21(2)(c)(iii), NDI Rules.
20 Rule 21(2)(a), NDI Rules.

within a period of 18 months from the date of the transfer agreement (and not the date of transfer).[21]

With respect to indemnities, if the buyer has paid the consideration in full, then the NDI Rules permit the buyer to be indemnified by the seller for a period not exceeding 18 months from the date of payment of the full consideration, provided that, the aggregate indemnity amount does not exceed 25 per cent of the total consideration paid for the purchase.[22]

All of the above is subject to the overall principle that the net amount received by the seller should not be in violation of the pricing guidelines discussed above.

Structuring put and call options

The NDI Rules provide that a person resident outside India who holds equity instruments in an Indian company, which equity instruments are subject to put option or call option rights, may only transfer such equity instruments upon the exercise of the relevant option right after a minimum lock-in period of one year has passed. Further, the transfer of such equity instruments shall be subject to the pricing guidelines set out in the NDI Rules and will not involve any assured return for the exiting investor.[23] This severely curtails the ability of investors to structure 'down-side protected' investments, where they are allowed to exit at a mutually agreed floor price that may be higher than the fair market value at the time of exit.

In the event that the put or call option is over equity instruments of an Indian public limited company, then note should also be taken of a circular issued by SEBI in this respect.[24] This circular prescribes additional conditions that apply irrespective of whether the person holding the equity instruments is resident in or outside India. These conditions include:

- the ownership of the underlying securities must be continuously held by the selling party for a minimum period of one year from the date of the option agreement;
- the price payable for the purchase of the undertaking securities pursuant to the exercise of the option is in compliance with all applicable laws; and
- the sale and purchase is settled by actual delivery of the underlying securities.

Creating pledge over Indian securities

The NDI Rules also prescribe the circumstances in which a pledge can be created over the equity instruments of an Indian company or units of an investment vehicle, as follows:[25]

- Where the Indian company has raised external commercial borrowing from a person resident outside India, then the promoter of such Indian company may pledge the shares of such Indian company or that of its associate resident companies for the purposes of securing the external commercial borrowing, subject to certain conditions.
- Any person resident outside India may create a pledge over equity instruments of an Indian company or units of investment vehicle in favour of:

21 Rule 9(6), NDI Rules.
22 Rule 9(6)(iii), NDI Rules.
23 Rule 9(5), NDI Rules.
24 SEBI Circular No. LAD-NRO/GN/2013-14/26/6667, 3 October 2013.
25 Rule 9(8), NDI Rules.

- a bank or NBFC in India to secure credit facilities being extended to such Indian company for bona fide purposes; and
- an overseas bank to secure credit facilities being extended to such person or a person resident outside India who is the promoter of such Indian company or the overseas group company of such Indian company.

Other than as set out above, it is not permitted for persons resident outside India to create security over the equity instruments of an Indian company or units of an investment vehicle held by them. On the invocation of the pledge, any transfer of equity instruments of the Indian company or units of the investment vehicle must be in accordance with the sectoral caps, pricing guidelines and other related conditions set out in the NDI Rules.[26]

Indirect foreign investment into an Indian company

Meaning of indirect foreign investment or downstream investment

Indirect foreign investment or downstream investment means an investment made into the capital instruments or capital of an Indian entity (ie, the receiving entity) by:[27]

- another Indian entity that has received foreign investment and is not owned and controlled by resident Indian citizens or is owned and controlled by persons resident outside India (FOCC); and/or
- an investment vehicle whose sponsor or manager or investment manager is not owned and controlled by resident Indian citizens or is owned and controlled by persons resident outside India.

The NDI Rules define ownership by reference to the beneficial holding of more than 50 per cent of the equity instruments[28] and control as the right to appoint majority of directors or to control the management or policy decisions of the company, including by virtue of their shareholding or management rights or shareholders agreement or voting agreement.[29] Given the ambiguous definition of control, there has been considerable debate on the contours of this term – especially around veto rights that are commonly found in joint venture agreements and whether negative control (by virtue of such veto rights) would amount to control for the purposes of the NDI Rules.

For the purposes of calculating foreign investment, foreign currency convertible bonds and depository receipts, being in the nature of debt, will not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement will be reckoned as foreign investment.[30]

26 Rule 9(8)(iii), NDI Rules.
27 Explanation (i), Rule 23, NDI Rules.
28 Explanation (a), Rule 23, NDI Rules.
29 Explanation (d), Rule 23, NDI Rules.
30 Rule 23(3), NDI Rules.

Conditions relating to downstream investment

The Indian entity that has received the indirect foreign investment is required to comply with the entry route, sectoral caps, pricing guidelines and FDI-linked performance conditions set out in the NDI Rules. In other words, downstream investment by such Indian entities will be treated on a par with foreign investment into an Indian investee company. Key points to note in the context of downstream investments[31] are as follows:

- The Indian entity making the downstream investment (ie, the FOCC) is required to bring the necessary funds for investment from outside India and is not permitted to use funds borrowed on the domestic Indian markets. However, the FOCC is permitted to make downstream investments through its internal accruals (ie, profits transferred to reserve account after the payment of taxes).
- The equity instruments of an Indian entity that has received indirect foreign investment may be transferred by an FOCC to:
  - a person resident outside India, without adhering to the pricing guidelines;
  - a person resident in India, subject to adherence of the pricing guidelines; or
  - another FOCC, without adhering to the pricing guidelines.
- The equity instruments of an Indian entity that has received indirect foreign investment may be transferred to an FOCC by a person resident outside India, without adhering to the pricing guidelines, or a person resident in India, subject to adherence to the pricing guidelines.

Additional listed company considerations

In addition to the matters outlined above, where the foreign investment is being proposed in listed securities, the rules and regulations issued by SEBI (which regulates entities whose securities are listed or about to be listed on any recognised stock exchange in India) also need to be taken into consideration.

Lock-in under the ICDR Regulations

In the event that an investment into a listed Indian company involves a preferential allotment of equity shares or instruments that are convertible into equity shares of such company, then there are certain lock-in restrictions under the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (ICDR Regulations) that must be kept in mind. Under the ICDR Regulations, the securities so issued to the investor (not being a promoter of the listed entity) will be locked in for a period of one year from the date of trading approval.[32] In cases where the investor held any equity shares in the listed company prior to such issuance, such equity shares will be locked in from the relevant date until passage of six months from the date of trading approval.[33]

Where such securities are issued to the promoter or promoter group on a preferential basis, the lock-in period is three years from the date of trading approval. However, no more than 20 per cent of the share capital of the listed company can remain locked in for a period three years from date of trading approval other than any equity shares allotted pursuant to the exercise of a

31 Rule 23, NDI Rules.

32 Regulation 167(2), ICDR Regulations.

33 Regulation 167(6), ICDR Regulations.

conversion right, which must remain locked in for a period of one year from the date of trading approval.[34]

Takeover Regulations

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Regulations) apply to any direct or indirect substantial acquisition of voting rights, or control of a company whose securities are listed on any recognised stock exchange in India. In such a situation, the Takeover Regulations require the acquirer to make an open offer to further acquire at least 26 per cent of the voting capital of such company.[35] Essentially, the Takeover Regulations protect the interests of the public shareholders by requiring acquirers to provide an exit opportunity to them, in the event of an acquisition of substantial voting rights or control over a listed company.

Under the Takeover Regulations, the obligation to make such a mandatory open offer by an acquirer is triggered upon the occurrence of the following events:

- if an acquirer, either by itself or along with persons acting in concert, intends to acquire shares or voting rights in a listed company to exercise 25 per cent or more of the voting rights in such company;
- if an acquirer, who already holds 25 per cent or more but less than 75 per cent of the shares or voting rights in a listed company, intends to acquire additional shares or voting rights that would entitle the acquirer (along with persons acting in concert) to exercise more than 5 per cent of the voting rights in such target in any financial year;[36] or
- if an acquirer intends to acquire control over the target by appointing majority directors, controlling management, policy, etc.[37]

However, the Takeover Regulations also set out some exemptions from the obligation to make a mandatory open offer,[38] which should be explored in the context of any M&A transaction triggering one of the conditions set out above.

The Takeover Regulations also permit a voluntary public offer to be made in respect of a listed company where an acquirer holds more than 25 per cent but less than 75 per cent of the shares or voting rights in a listed company, and wants to consolidate its holding in the target company.[39] The acquirer may do so by making a public announcement to acquire a minimum of an additional 10 per cent of the total shareholding of the target company.

Insider Trading Regulations

The other key legislation to bear in mind when considering an investment in a listed company in India is the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 2015 (Insider Trading Regulations). The Insider Trading Regulations govern the manner in which

34 Regulation 167(1), ICDR Regulations.
35 Regulation 7, Takeover Regulations.
36 Regulation 3, Takeover Regulations.
37 Regulation 4, Takeover Regulations.
38 Regulations 10 and 11, Takeover Regulations.
39 Regulation 6, Takeover Regulations.

unpublished price-sensitive information may be disclosed or procured.[40] It further prevents any person who holds unpublished price-sensitive information with respect to a listed entity from dealing in the securities of such listed entity.[41] Accordingly, the Insider Trading Regulations should be carefully explored so that any investor is not inadvertently made an insider, restricting its ability to invest in any given listed entity.

Direct or indirect foreign investment into an Indian LLP

Conditions

As a general rule, FDI in LLPs does not require any prior government approval. However, investment in LLPs is not permitted under the FPI or FVCI route. Further, FDI in LLPs is subject to certain conditions, such as:

- FDI is permitted in LLPs operating in sectors or activities where 100 per cent FDI is permitted under the automatic route and there are no FDI-linked performance conditions. Government approval is required for FDI in LLPs if the above condition is not satisfied.
- An LLP or Indian company having foreign investment is permitted to make downstream investment in another company or LLP in sectors in which 100 per cent FDI is allowed under the automatic route and there are no FDI-linked performance conditions, subject to certain conditions.
- FDI in LLPs is subject to compliance with conditions of the Limited Liability Partnership Act 2008.

The NDI Rules permit the conversion of an LLP having foreign investment and operating in sectors or activities where 100 per cent FDI is allowed through automatic route and there are no FDI-linked performance conditions into a company under the automatic route. Similarly, the conversion of a company having foreign investment and operating in sectors or activities where 100 per cent FDI is allowed through the automatic route and there are no FDI-linked performance conditions into an LLP is also permitted under the automatic route.[42]

Pricing

Foreign investment in an LLP, whether by way of capital contribution or a secondary acquisition from a person resident in India, cannot be less than the fair price as calculated an approved valuer, chartered accountant or a practising cost accountant as per any valuation methodology that is internationally accepted or otherwise adopted in accordance with market practice.[43]

M&A in the context of the IBC

Resolution process pursuant to the IBC

The introduction of the Insolvency and Bankruptcy Code 2016 (IBC) has brought about a significant change in the Indian M&A landscape. The IBC is a single code that attempts to consolidate existing laws relating to the reorganisation and insolvency resolutions of corporates and partnerships as well as individuals. The entire process, including the institution of insolvency

40 Regulation 3, Insider Trading Regulations.
41 Regulation 4, Insider Trading Regulations.
42 Schedule 6, NDI Rules.
43 Paragraph (g), Schedule 6, NDI Rules.

proceedings until approval of a resolution plan (resulting in a reorganisation) or liquidation is intended to work in a time-bound manner and, hopefully, provide respite to various stakeholders otherwise submerged under the burden placed by the stressed assets.

The main advantage of the IBC resolution process is the extinguishment of all historical liabilities of the corporate debtor if and to the extent provided for under the resolution plan. This was further clarified by the Insolvency and Bankruptcy Code (Amendment) Ordinance 2019, which states that the effect of the approval of a resolution plan by the relevant authority should result in:

- the extinguishment of all liabilities of the corporate debtor existing at or relating to the period prior to the insolvency commencement date; and
- no action being taken against the property of the corporate debtor, in relation to the offences committed in the period prior to the insolvency commencement date.

However, this immunity is available only in cases where the resolution plan specifically provides for change in the management or control of the corporate debtor to a person not being a promoter managing or controlling the corporate debtor or any related party or a person against whom a complaint or report has been filed before the relevant authority in relation to the aforementioned offence.[44]

Corporate Insolvency Resolution Process

The IBC provides for the insolvency resolution process known as the Corporate Insolvency Resolution Process (CIRP) pursuant to which any financial or operational creditor, or the corporate debtor itself, may file an application before the National Company Law Tribunal (NCLT) to commence the CIRP of a corporate debtor on a payment default of 10 million Indian rupees.[45] This limit was previously 100,000 Indian rupees and was increased to 10 million Indian rupees as a result of the covid-19 pandemic.[46] However, it remains to be seen whether such limit will be brought down again in the future.

The NCLT, after determining the existence of a debt and if a payment default has taken place, will pass an order admitting the insolvency application and for commencement of CIRP against the corporate debtor (ICD).[47] From the ICD, a moratorium becomes operative for a period of 180 days (extendable up to a maximum of another 90 days) (CIRP Period). During the CIRP Period, no suit or legal proceeding can be commenced (including any action to enforce security interest) against the corporate debtor and no pending proceeding can be proceeded with against the corporate debtor.[48]

44 Section 32A, IBC.

45 Sections 7, 8, IBC.

46 Ministry of Corporate Affairs Notification No. SO 1205(E), 24 March 2020, available at https://ibbi.gov.in//uploads/legalframwork/48bf32150f5d6b30477b74f652964edc.pdf.

47 Where a financial creditor has demonstrated a payment default, the NCLT is under an obligation to admit the insolvency petition under section 7(5)(a), IBC.

48 Section 14, IBC.

On the ICD, a resolution professional (RP) takes over the management of the corporate debtor and ensures that the corporate debtor remains a going concern.[49] The RP invites resolution plans for the corporate debtor, which ultimately is put before the committee of creditors. The resolution plan approved by the committee of creditors is put before the NCLT. Once the resolution plan is approved by the NCLT, it will be binding on all parties involved and be implemented by the successful applicant.[50] In order to aid this process, SEBI has amended the Takeover Regulations to include an exemption from the requirement to make a mandatory open offer if the acquisition of securities of the listed entity is pursuant to a resolution plan that is approved by the NCLT under the IBC.[51]

At the time of writing, the government has suspended initiation of fresh insolvency proceedings for defaults occurring on or after 25 March 2020 for a period of six months, which may be extended to one year at the discretion of the government.[52] A separate framework for insolvency resolution of micro, small and medium-sized enterprises is also being proposed.[53]

49 Section 17, IBC.

50 Sections 30 and 31, IBC.

51 Regulation 10(1)(da), Takeover Regulations.

52 The Insolvency and Bankruptcy Code (Amendment) Ordinance 2020, No. 9 of 2020, 5 June 2020.

53 'Government to exempt coronavirus-related debt of companies from insolvency law ambit', 17 May 2020, *The Economic Times*, available at https://economictimes.indiatimes.com/news/economy/policy/no-fresh-insolvency-to-be-initiated-for-1-year-under-ibc-fm/articleshow/75791544.cms?from=mdr.

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Key Challenges in Indian M&A and Exits

Rachael Israel, Pooja Singhania and Prateek Sharma[1]

Market overview

2019 emerged as the second-best year for M&A activity in India after 2018 with aggregate deal value reported to be in excess of US$73 billion,[2] despite global macroeconomic challenges and the onset of an economic slowdown in India. While the year-on-year decline was pronounced in strategic M&A, private equity (PE) and venture capital investments retained their 2018 momentum.

Two of the three largest M&A deals resulted from insolvency proceedings in the steel sector, including the US$7.21 billion joint acquisition of Essar Steel by ArcelorMittal and Nippon Steel,[3] one of the few successfully concluded transactions under the Insolvency and Bankruptcy Code 2016 (IBC), India's revamped insolvency regime. Other sectors such as financial services, information technology, infrastructure and energy also saw significant M&A activity (both public and private), with domestic consolidations being predominant.

Five of the top 10 PE deals in 2019 were in the infrastructure sector (including Brookfield's buyout of Reliance Jio's tower assets, the largest ever PE deal in India).[4] In a first, the proportion of buyout and control deals in total PE investments was the highest. Platform deals through infrastructure investment trusts also contributed significantly by value to deal activity.

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1 Rachael Israel is a partner and Pooja Singhania and Prateek Sharma are associates at S&R Associates.

2 'Deals in India: Annual review and outlook for 2020', PricewaterhouseCoopers, www.pwc.in/assets/pdfs/services/deals/deals-in-india-annual-review-and-outlook-for-2020.pdf, accessed on 10 May 2020.

3 'ArcelorMittal Nippon Steel India Rs502.31 billion acquisition of Essar Steel India', IFLR1000, www.iflr1000.com/Deal/Profile/23415?SEOtitle=ArcelorMittal-Nippon-Steel-India-Rs502-31-billion-acquisition-of-Essar-Steel-Indi#undefined, accessed on 10 May 2020.

4 '2019 Annual Deal Report', VCCEdge.

Amid a drop in initial public offerings (IPOs), PE exits were at a four-year low, with the largest share of exits by value (more than 40 per cent) achieved through open market sales, followed by negotiated secondary sales, strategic sales and IPOs.[5]

Regulatory considerations

While the regulatory framework has evolved and the market is more mature, M&A transactions still face challenges on account of a multiplicity of regulators, interpretational uncertainty and long-drawn-out approval processes. The regulatory framework that governs M&A in India, both private and public, is described below.

Companies Act

The Companies Act 2013 (Companies Act) and the rules issued thereunder regulate the process for issuance and transfer of securities and implementation of schemes of arrangement such as mergers and demergers. They also set out a corporate governance framework for Indian companies. While schemes of arrangement are court-driven processes and need to be approved by the shareholders and lenders before they see the light of the day, share acquisitions can be privately negotiated and do not require court approval. In relation to schemes, the Companies Act provides for the role of the National Company Law Tribunal (NCLT) – the forum responsible for approving schemes through its regional benches, protection of minority shareholders and a fast-track process in certain cases. In relation to squeeze-out of minority shareholders in unlisted companies, a helpful mechanism has been recently notified – shareholders with at least 75 per cent voting shares can now buy out the minority shareholders pursuant to a court-approved compromise or arrangement that includes a takeover offer.[6] One of the key challenges in implementing schemes of arrangement remains the timing uncertainty owing to delays involved in the NCLT approval process.

Foreign exchange laws

With progressive liberalisation of its foreign investment regime, India has been at the forefront of deal-making in Asia in recent times and has attracted significant funding from bulge-bracket PE funds.

Foreign investment in equity instruments (ie, equity shares, compulsorily convertible preference shares, compulsorily convertible debentures and share warrants) issued by Indian companies is regulated by the Foreign Exchange Management Act 1999 and the rules and regulations issued thereunder and the foreign direct investment policy framed by the government from time to time. The Foreign Exchange Management (Non-debt Instruments) Rules 2019 vest the Ministry of Finance with powers to regulate non-debt instruments (with debt instruments being regulated by the Reserve Bank of India (RBI), the central bank).

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5 'Deals in India: Annual review and outlook for 2020', PricewaterhouseCoopers, www.pwc.in/assets/pdfs/services/deals/deals-in-india-annual-review-and-outlook-for-2020.pdf, accessed on 10 May 2020.

6 Certain other methods that are generally considered for buying out minority shareholders include a selective reduction of share capital under section 66 of the Companies Act, which requires NCLT approval (and of which there are several instances) and purchase of minority shareholding by a majority shareholder holding 90 per cent or more of the share capital under section 236 of the Companies Act (which is largely untested).

Depending upon the nature of the proposed investment, a foreign investor may choose to invest in India directly, or as a foreign portfolio investor registered with the Securities and Exchange Board of India (SEBI), the securities market regulator. Investment of less than 10 per cent in the shares of a listed company by a SEBI-registered investor is treated as foreign portfolio investment (FPI), while foreign investment in an unlisted company or in 10 per cent or more of the shares of a listed company is treated as foreign direct investment (FDI).

Foreign investment under the 'automatic route' (ie, without prior government approval) is permitted in most sectors ranging from agriculture and manufacturing to civil aviation and B2B e-commerce. However, the government continues to prohibit foreign investment in certain sectors where it believes there are national security implications[7] or public policy considerations.[8] The government has restricted investment in certain other sectors through the requirement of:

- prior government approval;[9]
- caps on the maximum percentage of foreign shareholding;[10] and/or
- compliance with certain conditions.[11]

Sector-specific caps on investments are, in general, composite in nature and include all types of foreign investment (ie, both FDI and FPI are counted towards such caps).

Recently, with the background of the covid-19 pandemic, the government has issued guidelines to curb 'opportunistic takeovers/acquisitions of Indian companies' by requiring government approval for all investments (including by way of secondary transfers) by entities incorporated in a 'country which shares land border with India'[12] (including China) or 'where the beneficial owner of an investment into India is situated in or is a citizen of any such country'. While intended to increase regulatory oversight over investment from these countries, the guidelines currently lack clarity on how beneficial ownership will be assessed (whether based on control or a specified shareholding threshold or in some other manner). Clarification from the government is expected in this regard, including on treatment of existing investments from these countries.

The foreign exchange laws also specify pricing guidelines and reporting requirements. As a general matter, the consideration payable by a foreign investor for any unlisted equity instruments issued by an Indian company or transferred by an Indian resident cannot be less than the fair market value of such equity instruments determined pursuant to a valuation in accordance with any 'internationally accepted pricing methodology'. For a transfer of equity instruments by a foreign investor to an Indian resident, such fair market value serves as the ceiling. These pricing guidelines are not applicable to a transfer of equity instruments between two non-resident entities. Separate pricing norms are applicable to listed securities. While cash remains the most common form of consideration, share swaps also find a place in transaction structuring.

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7 For example, atomic energy and railway operations.

8 For example, betting and gambling and manufacture of tobacco products.

9 For example, publication of facsimile editions of foreign newspapers.

10 For example, up to 51 per cent foreign investment is permitted in multi-brand retail trading. For telecoms services, foreign investment up to 49 per cent is permitted under the automatic route and in excess of 49 per cent with government approval.

11 For example, minimum capitalisation norms or a lock-up period for the investment.

12 Namely, Afghanistan, Bangladesh, Bhutan, China, Myanmar, Nepal and Pakistan.

Sector-specific laws

Investments in certain sectors (such as financial services, telecoms services and insurance) are subject to incremental restrictions and conditions imposed by the relevant sectoral regulators. For instance, the RBI monitors the management and ownership of banks and non-banking financial companies (NBFCs) in India and prior RBI approval is required for change in shareholding and/or management linked to specified thresholds. Similarly, prior approval of the Insurance Regulation and Development Authority of India is required for acquisition of an interest in excess of specified thresholds in insurance companies. Investments in the telecoms sector need to comply with licence and security conditions prescribed by the Department of Telecommunications.

Tax considerations

Taxation is a significant factor in structuring M&A deals and exit transactions. A transfer of securities of an Indian company for gain generally attracts capital gains tax in India in the hands of the seller. The capital gains tax rate varies depending on the period for which the securities were held. Additionally, there is an obligation on the purchaser to withhold taxes from the consideration payable to a non-resident seller. Investments into India are often structured through vehicles incorporated in jurisdictions such as Singapore and Cyprus with which India has double taxation avoidance agreements (DTAAs). Since the Indian tax authorities have questioned the applicability of DTAAs in certain cases, purchasers frequently seek to withhold taxes even if treaty benefits are available; where this is resisted by the seller, parties resort to obtaining a 'nil withholding' opinion from an accounting firm or a certificate from the Indian tax authorities. Since the general anti-avoidance rules became operational in India effective April 2017, substance-based parameters have become increasingly important as tax authorities seek to deny tax benefits arising from 'impermissible avoidance arrangements' that, among other things, lack commercial substance.

In a sale of listed shares, the mode of implementing the transaction also determines the tax incidence – in general, on-market transactions are more tax efficient than transactions consummated off-market.

Additionally, tax by way of stamp duty is required to be paid on every instrument (including transaction agreements and instruments for issuance and transfer of securities), which could considerably increase the transaction costs. Effective 1 July 2020, transfers of securities in dematerialised or electronic form (which were previously exempt from stamp duty) are also subject to stamp duty. Insufficiency of stamp duty would not invalidate such instruments or documents but may render them inadmissible in Indian courts in a dispute situation.

Antitrust issues

An M&A transaction will require notification to, and approval of, the Competition Commission of India (CCI), India's antitrust authority, if the assets or turnover of the parties to the transaction exceed certain specified thresholds. Combinations that cause (or are likely to cause) an 'appreciable adverse effect on competition' in India are void and prohibited. There is no specific timeline within which notifications are required to be made to the CCI; however, transactions that trigger a CCI approval may not be completed without such approval. This notification and approval requirement is subject to certain exemptions, including based on the target company's assets or turnover in India. Certain other safe harbours may also be available subject to certain conditions, such as where the acquirer holds less than 25 per cent of the shares or voting rights of the target company following the transaction or intra-group transactions. Where a notification requirement is triggered, parties will need to be mindful of cooperation or conduct that may be viewed as 'gun jumping' prior to receipt of CCI approval.

The CCI has recently introduced a green channel or deemed approval process for transactions between parties that do not have any horizontal, vertical or complementary business overlaps in India (which would therefore be unlikely to cause an 'appreciable adverse effect on competition') – such deemed approval becomes effective upon submission to, and acknowledgment by, the CCI of a short-form filing.

Additional considerations for transactions involving listed companies

On-market versus off-market deals

Apart from schemes, an M&A deal can be concluded:

- on the floor of the stock exchanges (often preferred owing to tax benefits), including through block trades or bulk deals;[13] or
- as privately negotiated off-market deals.

A foreign investor can acquire shares on-market through the FPI route or the FDI route if such investor already has (and continues to hold) control over the target company in accordance with the SEBI regulations. In other words, a foreign investor that is not registered with SEBI as a foreign portfolio investor and does not have control over the target company can only complete such transaction off-market. A question that therefore becomes relevant is how an investor can demonstrate control in order to undertake the transaction on-market.

The SEBI regulations define control to include both de jure control by way of entitlement to exercise 25 per cent or more of the voting rights in a listed company and de facto control through control over management and policy decisions. In the absence of bright-line tests to determine de facto control, the special rights contractually granted to an acquirer need to be carefully considered. The acquisition of control of a listed company has significant implications – among others, it would trigger a mandatory tender offer (MTO) under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Regulations) and it could result in an investor being categorised as a promoter for purposes of the SEBI regulations.

13 Bulk deals are large transactions where the shares transacted (through one or more trades executed during the day in the normal market segment) constitute more than 0.5 per cent of the equity shares of the target company. Block trades are trades with a minimum order size of 100 million Indian rupees, and are consummated on a separate window of the stock exchange. While block trades are subject to pricing restrictions of ±1 per cent of the prevailing closing price or trading price prior to the relevant block deal window, bulk deals are not subject to pricing restrictions. However, bulk deals present the risk of leakages since there is no separate trading window for executing such trades and orders with the same price and quantity are matched on a time-priority basis. This risk is minimised in the case of block trades that occur through a special trading window. In general, bulk deals may be subject to greater scrutiny owing to regulatory concerns surrounding synchronised trades (where buy/sell orders are placed at substantially the same time for the same price and quantity). Indian courts have considered the legality of such trades in the context of the Securities and Exchange Board of India (Fraudulent and Unfair Trade Practices) Regulations 2003 (FUTP Regulations). While courts have held that synchronised trades are not illegal per se, deliberate attempts to interfere with the free and fair operation of the market (even if not actually resulting in manipulation of market price) would be a violation of the FUTP Regulations.

Mandatory tender offer requirement

Under the Takeover Regulations, a person acquiring control[14] over a listed company is required to provide an exit opportunity to the public shareholders by offering to additionally acquire at least 26 per cent of the shares of such company through an MTO. The Takeover Regulations also incorporate the chain principle (ie, indirect acquisition of an Indian listed company would also trigger the MTO requirement). The prescribed formula for determining the MTO price is based on, inter alia, the agreed transaction price and the trading price of the shares during a specified look-back period. With a view to treating public shareholders equitably, any non-compete fees, control premium or other amount payable to any person in connection with the transaction is required to be added to the MTO price.

Subject to certain exceptions, an acquirer is not permitted to complete the underlying transaction until the MTO is completed. The acquirer is permitted to consummate the underlying transaction pending MTO completion either:

- by depositing cash in escrow equivalent to 100 per cent of the MTO consideration (assuming 100 per cent acceptance of the MTO); or
- through a preferential issue of fresh shares or a secondary sale through the stock exchange settlement process subject to such shares being kept in an escrow account and the acquirer not exercising any voting rights over such shares.

The Takeover Regulations permit the acquirer to withdraw an MTO on specified grounds, including if:

- statutory approvals for the transaction are finally refused; or
- the purchase agreement is rescinded pursuant to any pre-closing conditions not having been met for reasons outside the reasonable control of the acquirer.

As a practical matter, there has not yet been an instance where SEBI has permitted withdrawal of an MTO on account of non-fulfilment of a pre-closing condition. In one instance,[15] an acquirer was not permitted to withdraw the MTO despite a discovery of fraud by the promoters of the target company.

Uncertainties around the uptake in the MTO, the restrictions on closing the underlying transaction pending completion of the MTO and the limited circumstances in which SEBI permits withdrawal of an MTO often render control transactions in public M&A unattractive for investors.

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14 It is uncertain whether affirmative voting rights granted to an investor could constitute control. In the case of *Subhkam Ventures v SEBI*, Appeal No. 8 of 2009 (Securities Appellate Tribunal), the Securities Appellate Tribunal (SAT) distinguished 'protective rights' (meant to protect the interests of minority shareholders) from 'participative rights', which grant day-to-day operational control over the business of the target. It held that protective rights alone would not amount to control. In disposing of an appeal from the SAT order in this matter, the Supreme Court of India left this question of law open. Recently, the Supreme Court of India, in the case of *ArcelorMittal v Satish Kumar Gupta* (2018 SCC OnLine SC 1733) analysed control under the IBC and held that the term 'control' for purposes of such legislation denotes only positive control and the mere power to block special resolutions of a company does not amount to control. Given that this judgment was delivered in the context of the IBC, its relevance to the interpretation of the term 'control' under the Takeover Regulations may be limited.

15 *Nirma Industries Limited and Another v SEBI*, Civil Appeal No. 6082 of 2008 (Supreme Court of India).

Acquisitions pursuant to schemes of arrangement are, subject to certain conditions, exempt from the MTO requirement – public M&A transactions are often structured with this in mind. In addition to the existing exemptions available for acquisitions pursuant to resolution plans approved under the IBC, SEBI has recently exempted allottees in preferential issues by listed companies with stressed assets[16] from MTO obligations and has also eased the pricing norms for preferential issues of shares by such companies. These relaxations are expected to provide a greater impetus to M&A involving distressed assets.

Minimum public shareholding requirement

Every listed company in India is required to maintain a minimum public float of 25 per cent. Under the Takeover Regulations, an acquirer is not permitted to acquire or enter into an agreement to acquire shares or voting rights that would result in the maximum permissible non-public shareholding of 75 per cent being breached. If an MTO results in a breach of such non-public shareholding threshold, the acquirer is required to bring down the non-public shareholding to 75 per cent within 12 months from the date of breach. SEBI has prescribed a number of ways to undertake such a dilution or sell-down, including offers for sale to the public through a prospectus or various primary issuances. Non-compliance with the minimum public float requirement can, among other things, result in imposition of fines by the stock exchanges, freezing of the promoter shareholding, and ultimately delisting. This minimum public float requirement further complicates the issues already at play in public M&A deals.

Prohibition of insider trading

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 2015 (Insider Trading Regulations) prohibit trading (which is broadly defined to include not just subscribing, buying or selling or agreeing to subscribe, buy or sell, but also dealing or agreeing to deal) in listed or to be listed securities when in possession of unpublished price-sensitive information (UPSI).[17] Insider trading is a rebuttable presumption – innocence may be established by demonstrating, for example, that Chinese walls were in place. For transactions that do not trigger an MTO, UPSI needs to be whitewashed at least two days prior to execution of definitive agreements in respect of the transaction. In MTO-triggering transactions, UPSI is deemed to be whitewashed when the MTO is made. Investors and insiders (including promoters and management) have to be equally mindful about inadvertent communication of UPSI during management discussions and/or the due diligence exercise and subsequent trading in securities when in possession of UPSI in the absence of appropriate checks and balances.

16 An entity fulfilling any two of the following three conditions is eligible for the MTO exemption: (1) any listed company that has made disclosure of defaults on payment of interest or repayment of principal amount on loans from banks, financial institutions, certain NBFCs and/or listed or unlisted debt securities, and such default is continuing for a period of at least 90 calendar days; (2) existence of inter-creditor agreement in terms of the RBI directions in this regard; and (3) downgrading of credit rating of the financial instruments (listed or unlisted), credit instruments or borrowings (listed or unlisted) of the listed company to 'D'.

17 UPSI is any information relating to a company or its securities that is not generally accessible to the public that, upon becoming generally available, is likely to materially affect the price of the securities.

Disclosure requirements

The SEBI regulations prescribe events-based disclosure requirements (eg, completion of an acquisition transaction) as well as certain continual disclosure requirements (eg, shareholding of a significant shareholder) for listed companies, their promoters and significant shareholders.

Structuring and other considerations

The current legal framework affords flexibility to investors to structure their transactions based on the size of investment, the investment horizon and the desired outcome of the investment. Control deals or joint ventures pursuant to schemes of arrangement are more commonplace in strategic transactions. Where the objective is short-term financial returns, investors take a minority interest with basic protective rights. In recent times, there is an increasing interest from PE funds in control transactions with a view to creating value for Indian businesses, improving governance standards and bringing in a level of sophistication to an otherwise promoter-driven Indian market.

Choice of equity instrument

In addition to equity shares, investors have the option to invest in compulsorily convertible securities. Such instruments provide investors with the ability to convert at a price that is linked to the achievement of agreed performance milestones and/or the valuation of the company (subject to applicable pricing restrictions). Equity-linked convertible instruments also provide investors with the right to receive dividends or coupons and liquidation proceeds in preference to equity shareholders. Subject to certain conditions, Indian companies may also issue warrants or partly paid-up shares. In either case, at least 25 per cent of the consideration has to be paid upfront, with the balance amount payable to the company within 18 months (in the case of warrants) and 12 months (in the case of partly paid-up shares). Convertible instruments and share warrants afford useful structuring options in the public M&A space as well, where MTO obligations under the Takeover Regulations are not triggered at the time of their issuance (since such instruments typically do not carry voting rights) but at the time of their conversion (which may be staggered over a period of 18 months).

Deferred consideration arrangements

Investors often seek to defer payment of a portion of their purchase consideration to hedge their investment risks. Such deferral could be warranted until the occurrence or non-occurrence of specific events (such as achievement of certain financial targets, procurement of a critical regulatory approval in relation to the business, publication of audited financials or disposal of a material ongoing litigation). In transactions involving foreign buyers, up to 25 per cent of the purchase consideration can be held back for a period of up to 18 months from the date of the share purchase agreement without prior RBI approval. From a seller's perspective, an escrow mechanism may be preferred (as compared with a holdback by the buyer) as an independent third party controls the escrowed consideration and is required to release the escrow at predefined milestones. Alternatively, if the full consideration is paid by the buyer upfront, the seller can provide an indemnity for up to 25 per cent of the total consideration for a period of up to 18 months from the date of payment of the consideration in full. As a mechanism for risk allocation between parties, this enables greater flexibility in payment structuring in secondary transactions and also facilitates post-closing purchase price adjustments and earn-outs.

Promoter and management incentives

Promoters of an Indian company are not eligible to be issued stock options. Some investors agree to share a portion of the upside realised at exit with the promoters (in case of listed companies, such arrangements require prior approval of the company's board of directors and public shareholders and in an MTO-triggering transaction, any non-compete or other fees paid to a promoter will be considered in determination of the MTO price). Promoters may also be compensated through brand licence fee arrangements. Management personnel are typically incentivised through performance-linked management fees and/or stock options.

Due diligence

It is important to carry out a legal, accounting and financial diligence exercise in relation to the Indian target company prior to making an investment, including in relation to assets and liabilities, statutory records, litigation, contracts and agreements, local regulatory compliance and, where relevant, compliance with any laws of the jurisdiction of the foreign investor in relation to anti-corruption. Since certain laws in India (such as labour and employment laws) may vary from state to state, such exercises are best carried out in association with counsel well-versed in local laws.

There is no centralised registry for land records in India; typically, local counsel are engaged to review land and revenue records. Similarly, there is no centralised database for litigation records. Foreign investors sometimes also consider engaging investigative agencies to conduct background checks on the Indian target company and its promoters.

Due diligence of a listed company is subject to the Insider Trading Regulations, as discussed above. A potential investor may be provided with access to UPSI if the board of directors of the company is 'of the informed opinion that the proposed transaction is in the best interests of the company'; there is an additional exemption for communicating or procuring such information if it is in 'furtherance of legitimate purposes, performance of duties or discharge of legal obligations'. The availability of these exemptions will need to be evaluated, and persons accessing such information would need to enter into confidentiality and standstill agreements (agreeing not to trade in the listed company's securities for a specified period).

W&I insurance

While the traditional protection afforded by indemnity-backed representations and warranties have a strong foothold in the M&A landscape, warranty and indemnity (W&I) insurance is gaining traction in India. W&I insurance is perhaps more relevant in the Indian context given the chequered history of Indian promoters in honouring their indemnity obligations and the requirement of RBI approval for indemnity payouts by an Indian resident to a non-resident. This product has also assumed relevance where sellers (particularly PE funds with limited fund lives) are looking for clean exits without any residual liabilities.

Dispute resolution

Owing to the backlog of cases before the Indian courts, litigation in India is protracted and may not be an efficient means of obtaining relief in disputes. It could also be used effectively by an opponent as an instrument to delay transactions or contractually agreed processes. From a foreign investor's perspective, foreign-seated arbitrations under an institutional framework[18] are preferred. Indian courts generally adopt a pro-arbitration approach in relation to enforcement of foreign awards in India. Pursuant to the Arbitration and Conciliation Act 1996 (Arbitration Act), Indian courts have the power to grant interim relief to parties even in foreign-seated arbitrations, unless otherwise agreed by the parties to the arbitration agreement. In contracts among Indian parties, ad hoc arbitration under the Arbitration Act is popular, although parties also refer disputes to Indian arbitral institutions.[19] The Arbitration Act requires arbitral tribunals to render an award within 12 months of completion of pleadings, extendable by six months by agreement of the parties and thereafter only by the jurisdictional court. This 12-month period is directory (not mandatory) where one or more parties to the dispute are foreign.

Exits

2019 was a slow year for PE exits in general, and exits through IPOs in particular. As a general matter, strategic sales and sales on stock exchanges have had a comparatively higher share in PE exits (by value) in recent times.[20] From the perspective of an Indian promoter, an IPO may be the preferred means of providing an exit to an investor although it involves significant time and effort as compared with a secondary sale or strategic sale (involving entry of new investors) or a put option or buyback (involving payments from the promoter or the company). An Indian promoter may be reluctant to facilitate non-IPO sale processes for various reasons such as resistance to being traded from one PE sponsor to another (in a secondary sale) or apprehensions about the prospective acquirer's role (in a strategic sale).

Offers for sale in IPOs

In order to undertake an IPO, a company is required to satisfy certain eligibility criteria in relation to profitability, net worth and net tangible assets, and the IPO valuation is dependent on prevailing market conditions. Certain issues to consider in respect of an offer for sale through an IPO are set out below.

In order to be eligible to be offered for sale in an IPO, subject to certain exceptions, the equity shares should have been held by the selling shareholder for a period of at least one year prior to the date of filing of the draft red herring prospectus (DRHP). For such calculation, the holding period of convertible securities prior to conversion into equity shares will be considered in the case of compulsorily convertible securities, but not in the case of optionally convertible securities. This could affect the DRHP filing timeline if the exiting investor is considering an internal restructuring prior to the IPO (such as a transfer to an affiliate) or conversion of optionally convertible securities. No convertible securities are permitted to remain outstanding as on the date of filing the red herring prospectus – in the event that the IPO is unsuccessful, this could be an issue to consider for the investor as it will no longer enjoy the benefits of holding a convertible instrument.

18 Commonly used arbitral institutions for international commercial arbitration in India include the International Chamber of Commerce, the London Court of International Arbitration, the Singapore International Arbitration Centre and the Hong Kong International Arbitration Centre.

19 For example, the Indian Council of Arbitration, the Nani Palkhivala Arbitration Centre, the Delhi International Arbitration Centre and the Mumbai International Arbitration Centre.

20 '2019 Annual Deal Report', VCCEdge.

The offer documents are required to identify one or more promoters, who are required to hold at least 20 per cent of the post-issue capital in the company for a period of three years after the IPO (this is termed promoters' contribution, and identification of such shares for purposes of the three-year lock-in is subject to prescribed eligibility norms). Promoter is defined to include person(s) directly or indirectly in control of the issuer company, person(s) in accordance with whose advice, directions or instructions the board of the company is accustomed to act and those named as promoters in offer documents or annual returns of the company. In addition to being subject to the three-year lock-in, entities that are named as promoters in the offer documents will also be:

- required to provide certain disclosures and negative confirmations from entities identified as part of the promoter group;
- subject to an obligation to provide an exit offer to dissenting shareholders if the company proposes to amend the disclosed use of proceeds after the listing; and
- subject to ongoing obligations under the Takeover Regulations, the Insider Trading Regulations and the listing regulations.

SEBI typically requires special rights to select shareholders (eg, PE funds) to fall away upon IPO listing and trading and/or may require that approval be sought of the post-listing public shareholders for any rights that SEBI may permit to survive post-listing. Typically, PE investment agreements specify that the investor will not be considered a promoter in an IPO or otherwise. However, given the scope of the promoter definition, the nature of rights available to an investor will be subject scrutiny to determine whether such rights are likely to constitute control, and whether, therefore, such investor should be classified as a promoter.

In addition to the promoters' contribution, the entire pre-issue share capital of the company is required to be locked in for a period of one year after the IPO. Equity shares held by venture capital funds, category-I or category-II alternative investment funds (AIFs)[21] and foreign venture capital investors are exempt from such requirement if the shares have been held by them for a period of at least one year from the date of purchase – the investor entity seeking to use such exemption should have a valid SEBI registration certificate and its initial investment in the company should have been classified under the appropriate exempted category in its filings with regulatory authorities. In addition to the statutory lock-in, the IPO investment banks usually seek a contractual lock-up on the company and the selling shareholders in the transaction agreements in order to have an orderly after-market.

The selling shareholder will need to reach an understanding with the company on its involvement in key IPO-related decisions (such as determination of the IPO price and size) and the sharing of expenses in the IPO (the Companies Act prohibits financial assistance by a company for purchase of its own shares).

Although a selling shareholder may seek to limit its contractual liability in the IPO agreements and only certify statements or undertakings made in the offer documents about or in

21 Category-I AIFs include funds that invest in start-ups, early stage ventures, social ventures, small and medium-sized enterprises, infrastructure or other sectors considered by the government socially or economically desirable, and Category-II AIFs include private equity funds, real estate funds and funds for distressed assets.

relation to itself and the equity shares offered for sale by it in the IPO, there are statutory provisions governing prospectus liability (including civil and criminal penalties) that should be kept in mind. There is little case law guidance in India on liability of a non-promoter selling shareholder in an IPO. However, civil and criminal liability of directors could remain relevant where the investor has a nominee director on the board of the company. There may also be liability issues to consider in jurisdictions outside India where the equity shares in the IPO are offered and sold.

A selling shareholder can access funds from the public issue account only after receipt of listing and trading approvals. If such funds are to be paid into an account outside India, discussions with the relevant authorised dealer bank that will remit funds outside India will need to be initiated early to mitigate the risk of delays.

Sales on stock exchanges

In case of a listed company (and following the expiry of IPO-related lock-ins), an investor may sell its equity shares to any third party on the screen-based trading platforms of the stock exchanges pursuant to block trades or bulk deals through a stockbroker, who may require the seller to execute a placement agreement with certain representations, warranties and indemnities. Bulk deals are generally preferred owing to pricing flexibility as compared with block trades.

Secondary sales and strategic sales

In any sale process, whether strategic or other, a selling shareholder will require the active assistance of the promoters and management team. Given that promoters often resist providing such assistance (even where they are contractually required to facilitate an exit), PE sellers would be well advised to discuss the sale process with the promoters and management team at an early stage, and analyse existing rights for possible leverage in connection with the exit. Promoters and senior management personnel may also wish to monetise their shares and exit along with the PE seller, although a purchaser would typically require such persons to continue in the company and execute non-compete undertakings prior to closing. Accordingly, an incentives package (together with the provision of some liquidity) may need to be considered.

In the transaction documents, PE sellers often seek to limit their representations and warranties to certain fundamental title and tax matters, even where they hold a majority interest in the company. Indemnity caps and baskets are heavily negotiated and the outcome is typically influenced by the deal size, the number of bidders, the reputation of the company and its management team, due diligence findings and the profile of the industry in which the company operates. Due diligence red-flag issues and regulatory approvals and contractual consents (if applicable) are typically reflected as pre-closing conditions.

Auction processes (typically assisted by investment banks) are gaining traction in India from the perspective of potentially better valuation and deal terms and protection against the risk of a single seller pulling out of the transaction at the last minute. Although there is no formal regulatory view (including from SEBI) regarding break fees and reverse break fees, such deal-protection devices are often discussed and negotiated; payment of such fees by an Indian resident to a non-resident will require RBI approval. Some PE investors also prefer a dual-track process of simultaneously preparing for both an IPO and a secondary sale.

Put options

PE investors sometimes have the right to put their shares to the company's promoters if the promoters have been unable to deliver any other exit within a specified time period. Put options over shares of an Indian company are enforceable, subject to satisfaction of certain conditions including that the seller must have held the relevant securities for at least one year prior to the sale. Additionally, applicable pricing restrictions under the foreign exchange regulations must be complied with. Assured or guaranteed returns are not permitted. The successful exercise of such options also depends on the cooperation of the promoters against whom the put is sought to be enforced. In recent judgments, courts have taken a pro-enforcement view of foreign seated arbitral awards involving breach of put option clauses by Indian promoters;[22] however, given that legal proceedings can be long drawn-out, in certain cases PE investors have exited at a lower return than initially agreed pursuant to out-of-court settlements. Remittance of sale proceeds to a non-resident may be subject to RBI approval and the RBI is likely to consider whether the remittance complies with the principle of 'no assured return'. Given the risks and limitations associated with this option (particularly the cap on price where a foreign seller is involved), this is among the less favoured exit options.

Buybacks

Buybacks by Indian companies are subject to several restrictions and are typically the exit of last resort where there is no prospect of an alternative exit at an attractive valuation but the company has sufficient reserves to fund a buyback. A buyback offer is required to be made to all shareholders on a proportionate basis (and not selectively).

The statutory limit for a buyback is 10 per cent (or 25 per cent if approved by a 75 per cent shareholders' majority) of the aggregate of the company's total paid-up capital and free reserves; for this reason, PE investors typically obtain contractual commitments from promoters and other shareholders agreeing not to tender their shares in any buyback so as to not exhaust the statutory buyback limit. A one-year cooling-off period is required between successive buybacks. Companies also need to fulfil certain other eligibility requirements in order to undertake a buyback, including in relation to a good compliance track record in the preceding three years and the permissible post-buyback debt:equity ratio. A buyback can be funded from the company's free reserves, securities premium account or proceeds of issue of shares or other specified securities (but not the proceeds of an earlier issue of the same kind of securities); money borrowed from banks or financial institutions is not permitted to be used to fund the buyback.

There are additional regulations governing buybacks by listed companies, including the modes through which such buybacks can be implemented. These include buyback from existing shareholders on a proportionate basis through a tender offer (which involves a SEBI review process) or from the open market through a book-building process.

Opportunities and closing thoughts

Despite a marked slowdown in economic growth, the year 2019 saw PE investments retaining their momentum from the record 2018 levels. India's place in the World Bank's ease-of-doing-business

22 Judgments of the High Court of Delhi in *Cruz City 1 Mauritius Holdings v Unitech Limited* (2017 SCC OnLine Del 7810) and *NTT Docomo Inc v Tata Sons Limited* (2017 SCC OnLine Del 8078).

rankings for 2020 rose to 63 out of 190 countries.[23] Large control deals by PE investors showed a shift in focus from pure financial returns to value creation. Despite the insolvency resolution process proving to be much slower than the 270 days envisaged under the IBC, distressed assets presented attractive opportunities for several investors. These were encouraging trends going into 2020, despite global headwinds and challenges faced domestically, which were particularly pronounced in the banking, NBFC, infrastructure and real estate sectors.

Deal activity has reduced drastically in the wake of the covid-19 pandemic, with investors looking to recalibrate their strategies amid the economic slowdown and liquidity crunch. In the first quarter of 2020, PE and M&A investments reduced by 65 per cent and 29 per cent respectively as compared with the first quarter of 2019.[24]

While the outlook for sectors worst affected by the pandemic, namely, aviation, tourism and hospitality remains uncertain, there is a renewed focus on sectors such as healthcare, pharmaceuticals, insurance, essential consumer goods, technology and telecoms (including sub-sectors such as ed-tech, e-commerce, health-tech and diagnostics). For example, in April–June 2020, a group of investors led by Facebook announced cumulative investments in excess of US$15 billion in Jio Platforms (telecoms)[25] and Carlyle announced a buyout of SeQuent Scientific (healthcare).[26] It is likely that the M&A space will see significant consolidation activity as several businesses will struggle to survive the crisis and will be absorbed by larger competitors with greater liquidity.

Investors are likely to have greater leverage as companies compete for capital funding, and tranched closings and/or deferred consideration arrangements may become more common as investors may be more conservative in their risk assessment prior to deploying capital. Due diligence processes are likely to involve a greater focus on compliance with obligations under key business contracts, debt/insolvency risk, compliance with covid-19-related government directives and compliance with data protection laws.

In addition, increased regulatory oversight on investments from China pursuant to the recent FDI guidelines will also have an impact on deal structuring, and clarity will be required from the government in relation to the precise contours of the restriction.

It is likely that investors will hold onto their portfolio positions in the medium term until valuations improve rather than exit their positions at deep discounts, although funds close to the end of their fund lives may be forced to evaluate secondary sales to specialist funds. The outlook for recovery of Indian capital markets currently remains uncertain, especially since the fiscal stimulus announced by the government to date to address the current crisis is likely to be deficient.

23 This is based on data collected during May 2018 to May 2019, which saw major improvements in India's scores relating to starting a business and insolvency resolution: 'Doing Business 2020', World Bank Group, www.doingbusiness.org/content/dam/doingBusiness/country/i/india/IND.pdf, accessed on 19 May 2020.

24 'Quarterly Deal Update Q1 2020', VCCEdge.

25 'Reliance Jio Platforms says $15.2 billion fundraise is good for now', *Tech Crunch*, https://techcrunch.com/2020/06/19/reliance-jio-platforms-says-15-2-billion-fundraise-is-good-for-now/, accessed on 24 June 2020.

26 'Carlyle to take over SeQuent Scientific in its biggest India control deal' *VCCircle,* www.vccircle.com/carlyle-to-take-over-sequent-scientific-in-its-biggest-india-control-deal/, accessed on 10 May 2020.

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Smart Acquisition Structures in M&A: AIF, FPI and FDI

Vaishali Sharma, Viral Dave, Reshma Simon and Jeel Panchal[1]

Introduction

Pursuant to the liberalisation of India's foreign policies in 1991 married with the government's fervent efforts to improve ease of doing business and introduce progressive reforms, India has emerged as an attractive investment destination. According to the 'India M&A Report 2019' published by Bain & Company in association with the Confederation of Indian Industry, India's attractiveness as one of the fastest-growing large economies has resulted in a steady flow of inbound M&A, which surged from 9 per cent in 2015 to 20 per cent in 2018, with acquirers making acquisitions for India market entry being almost 1.5 times more likely to outperform their local indices.[2]

However, because of market uncertainties caused by the covid-19 pandemic, one might expect to see changing landscapes of not just India M&A, but M&A globally. With the country already embarking on its journey to become self-reliant in a big push for the government's 'Make in India' initiative, it remains to be seen how Indian policymaking adjusts to this new normal. Having said that, investors continue to show tremendous confidence in India even as global economies reel under the present dealmaking slowdowns. In May 2020, Jio Platforms Limited, the digital services arm of Reliance Industries Limited (RIL), has attracted investments worth US$10 billion from leading tech investors such as Facebook, KKR & Co, Silver Lake, Vista Equity Partners and General Atlantic,[3] and is also reportedly in the process of negotiating another investment from one of the most valuable companies in the world.

Thus India M&A proves to be beneficial in many ways as India's regulatory infrastructure offers multiple investment routes, with diverse categorisations, depending upon the nature of the investment vehicle used. This allows investors, both Indian and foreign, to tap into India's

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1 Vaishali Sharma is partner, Viral Dave and Reshma Simon are senior associates and Jeel Panchal is an associate with Agram Legal Consultants.
2 www.bain.com/globalassets/noindex/2019/bain_report_india_m_a_report_2019.pdf.
3 www.bseindia.com/xml-data/corpfiling/AttachHis/e4462504-9546-494b-858e-064155e1fd73.pdf.

fast-growing sectors through smart structuring strategies in order to realise their investment objectives. Some of these investment vehicles are discussed below.

Alternative investment funds

In recent times, the Indian alternative investment fund (AIF) sector has witnessed phenomenal growth trends. As per the statistics published by the stock market regulator, the Securities and Exchange Board of India (SEBI), the total funds raised by AIFs between 31 March 2018 and 31 December 2019 have doubled to a staggering 1.7 trillion Indian rupees.[4] This is attributable to the conducive legislative reforms introduced by SEBI in 2017 pursuant to the recommendations made by the Alternative Investment Policy Advisory Committee under the chairmanship of the Indian IT mogul Narayana Murthy.[5]

Background

Prior to the notification of the SEBI (AIFs) Regulations 2012 (AIF Regulations), there was a paucity of comprehensive investment management regulations in the non-retail segment in India. Thus an urgent need was felt to recognise AIFs as a distinct asset class and appropriately regulate the various domestic funds in order to promote the fair and efficient functioning of the financial markets.[6] It was in this background that the AIF Regulations came into force, in supersession of the SEBI (Venture Capital Funds) Regulations 1996.

AIFs and their categories

AIFs are defined to mean privately pooled investment vehicles that collect funds from investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of their investors, excluding funds operating in the retail segment such as mutual funds, collective investment schemes and other SEBI-regulated fund management activities.

In India, AIFs have the flexibility of being incorporated through different corporate structures such as companies, limited liability partnerships, bodies corporate and even as trusts (except family and employee welfare or gratuity trusts). Here, it is pertinent to note that since an AIF cannot make an invitation to the public at large to subscribe to its units or securities or partnership interest, as the case may be, its charter documents must necessarily prohibit it from making such invitation or solicitation to the public.

The AIF Regulations mandatorily require all AIFs to be registered with SEBI and procure a certificate of registration in order to carry on their investment activities. Entities desirous of being registered as AIFs may seek to be registered in one of the following three categories:

- Category I – for AIFs proposing to invest primarily in unlisted securities of startups or early stage ventures, social ventures, small and medium-sized enterprises, infrastructure or other sectors that the government or other regulators consider as socially or economically desirable. Category I AIFs are generally perceived to have positive spillover effects on the

4 www.sebi.gov.in/statistics/1392982252002.html.

5 www.sebi.gov.in/reports/reports/dec-2016/2nd-report-submitted-by-alternative-investment-policy-advisory-committee_33746.html.

6 www.sebi.gov.in/reports/reports/aug-2011/concept-paper-on-proposed-alternative-investment-funds-regulation_20484.html.

economy and may be eligible for incentives and concessions offered by the government or other regulators.

Category I AIFs must necessarily be close-ended (ie, units offered to investors by such AIFs must be for a limited period only and cannot be offered indeterminately). Further, such AIFs (including schemes launched by them) must have a minimum tenure of three years. Thus, on the expiry of its tenure, the AIF must necessarily be wound up in accordance with the AIF Regulations. Also, Category I AIFs are prohibited from borrowing funds, directly or indirectly, or engaging in any leverage, except for meeting temporary funding requirements that cannot exceed 30 days, on not more than four occasions per year, and cannot be more than 10 per cent of the AIF's investible funds.[7]

- Category II – for AIFs that fall neither under Category I or Category III, such as private equity funds or debt funds and for which no specific incentives or concessions are given by the government or other regulators. Like Category I AIFs, Category II AIFs also primarily invest in unlisted securities and are also subject to the same requirements, as set out above, in relation to their tenure and borrowing restrictions.
- Category III – for AIFs that undertake diverse or complex trading strategies and may employ leverage, including through investments in listed or unlisted companies, structured products and, since 21 June 2017, even in the commodity derivatives market on fulfilling certain conditions.[8] A Category III AIF may engage in leveraging or borrowing subject to consent from its unitholders, provided that such leverage is not in excess of twice its net asset value.[9] Further, unlike Category I and II AIFs, Category III AIFs need not adhere to any minimum tenure requirements. In other words, they may opt to be open-ended and offer their units to investors on a continual basis without any fixed maturity period. However, if Category III AIFs choose to be close-ended, then they will be required to comply with the tenure-related requirements of the AIF Regulations as elaborated above.

Thus, based on the foregoing, a prospective investor may choose to invest its funds by subscribing to units of whichever category of AIFs is suitable to its investment objectives. Additionally, it is also important to take into account certain other regulatory aspects of AIFs, as specified below.

Key regulatory aspects of AIFs

Minimum corpus and investee companies

All AIFs, except angel funds,[10] are required to have a minimum corpus of 200 million Indian rupees. Further, Category I and II AIFs cannot invest more than 25 per cent of their investible

7 As per the AIF Regulations, 'investible funds' means the corpus of the AIF net of estimated expenditure for its administration and management.

8 www.sebi.gov.in/legal/circulars/jun-2017/participation-of-category-iii-alternative-investment-funds-aifs-in-the-commodity-derivatives-market_35146.html.

9 www.sebi.gov.in/legal/circulars/jul-2013/circular-for-operational-prudential-and-reporting-requirements-for-alternative-investment-funds_25105.html.

10 Under the AIF Regulations, angel funds are permitted to have a lower minimum corpus, as compared with the other AIFs, of 50 million Indian rupees.

funds in one investee company, and Category III AIFs cannot invest more than 10 per cent of their investible funds in one investee company.

Minimum investments and maximum investors

AIFs cannot accept an investment value less than 10 million Indian rupees from an investor and cannot have more than 1,000 investors in the fund.[11]

'Flesh in the game'

The AIF Regulations have vested the sponsor or manager of an AIF with multifarious fiduciary obligations, with the mandatory continuing interest requirement being the most notable one. Thereby, the sponsor or manager of a Category I and II AIF is required to have a continuing interest of not less than 2.5 per cent of the corpus or 50 million Indian rupees, whichever is lower, as an investment in the AIF. In the case of Category III AIFs, such continuing interest of the sponsor or manager must be at least 5 per cent of the corpus or 100 million Indian rupees.

Cross-border investments

Since 2 July 2018,[12] AIFs have been permitted to make investments abroad to the extent of US$750 million (as enhanced from the erstwhile limit of US$500 million), provided that AIFs desirous of making such offshore investments must inter alia submit their investment proposal in the specified format to SEBI for prior approval and make mandatory disclosures of utilisation of investment limits to SEBI.[13] However, no separate permission from the Reserve Bank of India (RBI) is necessary in this regard.[14]

Benefits of AIFs

With the AIF Regulations considering only those applicants eligible for registration that have an adequately experienced investment team and are fit and proper persons,[15] AIFs are professionally managed investment vehicles. Further, all AIFs are required to adhere to high standards of transparency and make compulsory periodic disclosures to their investors in relation to the investment activities undertaken by them, including conflicts of interest. Therefore the AIF structure provides investors with the necessary comfort in relation to the proper management of their

11 If the AIF is incorporated as a company, then the provisions of the Companies Act 2013 will apply (ie, if the AIF is incorporated as a private company, then it cannot have more than 200 investor shareholders).

12 www.sebi.gov.in/legal/circulars/jul-2018/overseas-investment-by-alternative-investment-funds-aifs-venture-capital-funds-vcfs-_39424.html.

13 www.sebi.gov.in/legal/circulars/jul-2018/overseas-investment-by-alternative-investment-funds-aifs-venture-capital-funds-vcfs-_39424.html.

14 www.sebi.gov.in/legal/circulars/oct-2015/guidelines-on-overseas-investments-and-other-issues-clarifications-for-aifs-vcfs_30772.html.

15 As per Schedule II of the SEBI (Intermediaries) Regulations 2008, the 'fit and proper' person criteria inter alia require the applicant and its key management team to be persons of integrity, reputation and character; not have any convictions or restraint orders against them; be financially competent; and not be categorised as wilful defaulters. This is similar to the concept of 'accredited' investors in foreign markets.

funds. In order to further enhance investor confidence in AIFs, SEBI regularly issues circulars to inter alia strengthen their stewardship responsibilities.[16]

Moreover, Category I and II AIFs enjoy certain tax benefits under the Income Tax Act 1961 whereby any income (except income chargeable under the head 'profits and gains of business and profession') accrued to the investors from their investments in the aforementioned AIFs is taxed in the hands of the investors as if the investments made by the AIFs were directly made by the investors.[17] This tax pass-through has made Category I and II AIFs increasingly popular since 2015. Additionally, where Category I and II AIFs acquire shares of a listed entity, they are exempt from paying securities transaction tax at the time of acquisition of shares to be able to take adantage of long-term capital gains tax exemption.[18]

Notable acquisitions by AIFs

As per the latest report published by the Indian Private Equity and Venture Capital Association, the top investment involving AIFs in January to March 2020 was valued at US$567 million, whereby Varde Partners and Goldman Sachs (Category II AIF) acquired the debt of the distressed power producer, RattanIndia Power Limited, from its lenders.[19] This acquisition is noteworthy on account of its being the biggest debt resolution transaction outside the Indian insolvency and bankruptcy framework without any change in the existing management and is the first successful scheme to have been closed under RBI's Prudential Framework for Resolution of Stressed Assets.[20] Further, the Indian ed-tech startup, Unacademy, raised US$110 million in its latest funding round from Facebook, General Atlantic, Blume Ventures (Category I AIF) and others.[21] This has made Unacademy one of the highest valued ed-tech startups in India at a post-money valuation of US$510 million, after Byju's, which is valued at US$8.2 billion.[22] This will prove to be advantageous to the Indian education sector as the nation increasingly becomes dependent on e-learning portals not only on account of technological advancements, but also in the aftermath of the covid-19 pandemic.

Foreign portfolio investment

A foreign investor or a group of investors looking to invest in economies outside their own may explore entering the Indian securities market by seeking registration from SEBI as a foreign portfolio investor (FPI) in order to be able to acquire stocks and bonds of listed Indian entities. Unlike foreign direct investment (FDI), foreign portfolio investment is a short-term investment that is made by a foreign investor who is not involved in the day-to-day management of the investee

16 www.sebi.gov.in/legal/circulars/dec-2019/stewardship-code-for-all-mutual-funds-and-all-categories-of-aifs-in-relation-to-their-investment-in-listed-equities_45451.html. This circular shall come into effect from 1 July 2020.

17 Section 7 of the Finance Act 2015, as notified by the Ministry of Law and Justice on 14 May 2015.

18 Notification SO 1789(E) dated 5 June 2017 issued by the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance.

19 https://ivca.in/wp-content/uploads/2020/05/IVCA-PE-VC-Report-Q1-2020.pdf.

20 www.bseindia.com/xml-data/corpfiling/AttachHis/8af3790c-a169-47ed-8b43-92eb5dc775cd.pdf.

21 ibid.

22 https://tech.economictimes.indiatimes.com/news/startups/ed-tech-startup-unacademy-raises-new-funds-now-valued-at-500-million/74210285.

company. These transactions are also referred to as portfolio investments, which form part of India's capital account, and are shown on its balance of payments (ie, a calculation of the amount of money flowing from India to other countries in a financial year).

Sometimes, depending on market volatility, portfolio investments involve transactions in highly liquid securities (ie, securities which can be bought and sold very quickly). Thus foreign portfolio investment is affected by high rates of returns and reduction of risks through geographic divergence and exchange rates. This is evidenced by the fact that during the first three quarters of the financial year 2019–20, as per the data published on the website of the National Securities Depository Limited, India saw a considerable spike in its foreign portfolio investments, with a record high of approximately 230 billion Indian rupees in November, 2019,[23] thereby making it one of the top emerging markets for FPIs. However, with the covid-19 pandemic leaving the world in disarray, an enormous number of FPIs pulled out their investments, with foreign portfolio investment in India falling in negative as of April 2020 and May 2020.[24]

Background

Foreign portfolio investment in the Indian capital market has been permitted for more than two decades, although under different nomenclature. Until 2014, portfolio investments were made by foreign institutional investors (FIIs) and qualified foreign investors (QFIs). Thereafter, in order to harmonise and simplify the various available routes for foreign portfolio investment in India, a new class of foreign investors, namely the FPIs, was introduced by SEBI by virtue of the SEBI (FPI) Regulations 2014 (2014 Regulations), which subsumed FIIs as well as QFIs within its ambit.

A need was felt to review, streamline and simplify the 2014 Regulations and therefore SEBI constituted a working group under the chairmanship of Harun Khan, retired deputy governor of the RBI. Pursuant to the recommendations of the group,[25] the SEBI (FPI) Regulations 2019 (FPI Regulations) were notified on 23 September 2019 in supersession of the 2014 Regulations.

Key regulatory aspects of FPI

Mandatory registration

As per the FPI Regulations, it is mandatory for an FPI to procure a certificate of registration from a designated depository participant on behalf of SEBI by applying either under Category I or Category II.

Category I comprises pension funds, university funds and appropriately regulated entities while Category II covers endowments, charitable organisations, corporate bodies, family offices, etc, which also includes appropriately regulated entities investing on behalf of their client. Moreover, the FPI Regulations have classified government and government-related investors such as central banks, sovereign wealth funds, international or multilateral organisations, including entities controlled by or having at least 75 per cent direct or indirect government or government related investor(s) ownership as Category I FPIs.

23 www.fpi.nsdl.co.in/web/Reports/Yearwise.aspx?RptType=6

24 ibid.

25 www.sebi.gov.in/reports/reports/may-2019/report-of-working-group-on-fpi-regulations-seeking-public-comments_43107.html.

Here, it is important to mention that as per the Consolidated FDI Policy (last updated on 28 August 2017) issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry (FDI Policy),[26] the FDI sectoral caps (ie, the maximum amount that can be invested by foreign investors in an entity), unless provided otherwise, subsume all types of foreign investments, including investments made by FPIs, subject to sector-specific conditionalities.

Eligibility criteria

An overseas resident of India cannot apply for registration as an FPI. However, Indian residents, non-resident Indians (NRIs) and overseas citizens of India (OCIs) may be constituents of the applicant, subject to compliance with conditions specified by SEBI from time to time. In this regard, it has also been clarified that applicants or their underlying investors contributing 25 per cent or more in the corpus of the applicant or identified on the basis of control cannot inter alia be persons mentioned in the Sanctions List notified by the United Nations Security Council. Further, foreign central bank applicants will be eligible applicants even if they are not members of the Bank for International Settlements.

Permissible investments and other conditions

An FPI is permitted to invest in capital instruments such as shares, perpetual debt instruments, government securities, commercial papers, unlisted non-convertible debentures (subject to certain conditions), security receipts, derivatives, units of mutual funds, units of real estate investment trusts (REITs) and infrastructure investment trusts (InvITs), Indian depository receipts, interest rate swap, etc. Having said that, any unlisted holdings of FPIs are treated as FDI as per the FPI Regulations.

Further, offshore derivative instruments can be issued to, subscribed by or otherwise dealt with only by FPIs registered under Category I or by those entities having investment managers belonging to member countries of the Financial Action Task Force on Money Laundering.

Investment limits

As per the FPI Regulations, the total equity holding of a single FPI (including its investor group[27]) is capped at 10 per cent of the total paid-up equity capital of an Indian entity, on a fully diluted basis. Further, under the Foreign Exchange Management (Non-debt Instruments) Rules 2019 (Non-Debt Rules), the aggregate equity holding of all FPIs put together, including any direct or indirect foreign investments in an Indian entity permitted under the Non-Debt Rules, is capped at 24 per cent of the total paid-up equity capital of the said entity on a fully diluted basis. Notwithstanding this aggregate investment limit of 24 per cent, the same may be increased, with prior approval of the board and shareholders of an Indian entity, up to the sectoral cap applicable to such entity as per the FDI Policy.

26 As may be updated from time to time through issuance of Press Notes by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry.

27 Multiple entities registered as foreign portfolio investors and, directly or indirectly, having common ownership of more than 50 per cent or common control shall be treated as part of the same investor group and the investment limit of all such entities shall be clubbed at the investment limit as applicable to a single foreign portfolio investor.

If an FPI exceeds the above-mentioned limits, in the absence of the requisite approval, the portfolio investment will be treated as FDI unless the investor divests the excess shareholding within five trading days from the date of settlement of the trades. Additionally, such investment will be calculated towards the sectoral cap and rules prescribed by the RBI from time to time and that particular FPI will no longer be permitted to deal in the securities of that specific Indian entity under the FPI route.

Thus the Finance Minister's proposal in the Union Budget for 2019–20 to allow FPIs to invest in REITs and InvITs has found statutory recognition under the FPI Regulations. However, the proposal to increase the above-mentioned investment limits has not yet been implemented.[28]

Benefits of FPI

From the point of view of a foreign investor, investing through the FPI route provides access to a bigger market as well as the flexibility to invest in sectors that may otherwise be prohibited for FDI. Further, this avenue involves less regulatory approval while dealing in securities and is generally a more efficient mode of secondary acquisition of listed securities. Wealthy investors with adequate holding capacity would view the falling prices of the Indian securities as an opportunity to buy in bulk at a much lower price and earn higher returns by selling the securities as soon as the prices begin to rise. On the other hand, higher inflow of foreign portfolio investment not only aids in boosting the Indian capital market but also helps the equity prices to positively reflect the value of the Indian entity.

Notable acquisition by an FPI

China's central bank, the People's Bank of China (PBOC), raising its stake to 1.01 per cent in India's largest housing finance lender, the Housing Development Finance Corporation Limited (HDFC), made headlines in April 2020 and arguably induced the government to revise its FDI policy (as discussed below). The PBOC now holds around 17.5 million equity shares of HDFC worth approximately 30 billion Indian rupees.

Foreign direct investment

Like all other developing countries and developing markets that thrive on foreign investments, India has been consistently taking steps and introducing norms to attract FDI. From 2000 until December 2019 the FDI inflow into the country totalled US$65 billion, and between April 2019 and December 2019 India snagged approximately US$3.6 billion through FDI.[29]

Background

The legal framework regulating and governing FDI is laid down under the FDI Policy and the Foreign Exchange Management Act 1999 (FEMA) (including relevant rules, regulations, circulars, etc issued thereunder). As per the Non-Debt Rules, FDI means investment through equity instruments by a person resident outside India in an unlisted Indian company, or in 10 per cent or more of the post-issue paid-up equity capital on a fully diluted basis of a listed Indian company.

28 See paragraph 38: www.indiabudget.gov.in/budget2019-20/doc/Budget_Speech.pdf.
29 https://dipp.gov.in/sites/default/files/FDI_Factsheet_December-19_5March2020.pdf.

Key regulatory aspects for FDI

Restrictions on FDI from neighbouring countries

With effect from 22 April 2020, prior permission of the government of India is required for investment by an entity of a country sharing a land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country. Additionally, in the case of any transfer of ownership of existing or future FDI in an Indian entity, directly or indirectly, resulting in the beneficial ownership being in the hands of citizens of such bordering countries, such subsequent change in beneficial ownership will also require governmental approval.[30]

Prohibited sectors

FDI is expressly prohibited in the following sectors:

- lottery business including government or private lottery, online lotteries, gambling and betting including casinos, etc (including foreign technology collaborations);
- chit funds;
- Nidhi company;
- trading in transferable development rights;
- real estate business or construction of farm houses;
- manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes; and
- atomic energy and railway operations (not open for private investment).

With respect to non-prohibited sectors, foreign investors will have to adhere to the sectoral caps and FDI-linked performance conditions, if any, before investing in Indian entities.

Investment by non-residents

According to the Non-Debt Rules, any investment made by a person resident outside India on a repatriable basis in equity instruments of an Indian company or towards the capital contribution of a limited liability partnership (LLP) is considered as foreign investment. Hence, non-resident entities looking to tap into the Indian market and seeking to establish a long-term interest may invest in Indian companies or LLPs in accordance with, inter alia, the FDI Policy, Non-Debt Rules, Companies Act 2013 (Companies Act), Limited Liability Partnership Act 2008 (LLP Act), SEBI regulations in case of FDI in listed entities and the Competition Act 2002 (Competition Act).

Investment by NRIs and OCIs

NRIs and OCIs may invest in an Indian company or contribute to the capital of an Indian LLP on either a non-repatriable or repatriable basis. If investment by NRIs and OCIs in Indian entities is on a non-repatriable basis, this will be considered as domestic investment.

30 https://dipp.gov.in/sites/default/files/pn3_2020.pdf.

FDI in an Indian company

As per the Non-Debt Rules, non-resident entities are permitted to invest in equity instruments (through subscription, purchase or sale) of an unlisted Indian company or, in the case of listed Indian companies, invest 10 per cent or more in its equity capital, subject to compliance with the Companies Act, SEBI Regulations and the Competition Act. Enumerated below are various modes through which a non-resident entity may acquire a stake in an Indian company:

Primary acquisition

An acquisition by any person resident outside India of equity instruments issued by an Indian company must be in compliance with the FDI Policy, FEMA laws including pricing guidelines, sectoral caps, prior government approvals (if applicable), entry restrictions, reporting requirements and such other conditions as maybe specified by the central government from time to time.

Persons resident outside India may also subscribe to partly paid shares or share warrants issued by Indian companies.[31] According to the Non-Debt Rules, Indian companies can issue partly paid shares to a person resident outside India that must be fully called up within 12 months of such issue or as per such time period specified by the RBI. However, 25 per cent of the total consideration amount of such partly paid shares (including share premium) must be paid upfront. Similarly, in the case of issuance of share warrants, at least 25 per cent of the consideration must be paid upfront and the balance amount within 18 months of such issuance.

Secondary acquisition

Any transfer of equity instruments between persons resident outside India and persons resident in India should adhere to the sectoral caps, pricing guidelines and other conditionalities as set out under the Non-Debt Rules and the FDI Policy. Additionally, such transfer can be on a deferred consideration basis (subject to the total consideration being based on the pricing guidelines prescribed by the Non-Debt Rules) such that an amount not exceeding 25 per cent of the total consideration may be:

- paid by a non-resident buyer on a deferred basis within a period not exceeding 18 months from the date of the transfer agreement;
- settled through an escrow arrangement between a non-resident buyer and a resident seller for a period not exceeding 18 months from the date of the transfer agreement; or
- indemnified by the resident seller for a period not exceeding 18 months from the date of the payment of the full consideration, if the total consideration has been paid by the non-resident buyer to the resident seller.

Cross-border merger

The Companies Act permits mergers and amalgamations between companies incorporated in India and companies established in foreign jurisdictions, provided the foreign company[32] may, with the prior approval of the RBI, merge into an Indian company or vice versa. Accordingly,

31 Explanation to Rule 2(k) of Non-Debt Rules describes a 'share warrant' as those issued by an Indian company in accordance with the regulations by SEBI.

32 Explanation to Section 234 of Companies Act 2013 clarifies a 'foreign company' to mean any company or body corporate incorporated outside India whether having a place of business in India or not.

the RBI issued the Foreign Exchange Management (Cross Border Merger) Regulations 2018 to govern and regulate cross-border mergers.[33]

FDI through joint ventures

Foreign investors may also partner with strategic Indian partners to build and expand their scope of business in India through a joint venture, subject to entry route restrictions, sectoral caps and conditionalities, pricing guidelines, etc as identified under the FDI Policy and the Non-Debt Rules.

FDI in an Indian startup

To ease fundraising for Indian startup companies[34], the Non-Debt Rules provide for issuance of convertible notes[35] by Indian startups to non-resident entities subject to sectoral and entry caps.

According to the Non-Debt Rules, a person resident outside India, other than an individual who is citizen of Pakistan or Bangladesh or an entity that is registered or incorporated in Pakistan or Bangladesh, can purchase convertible notes issued by an Indian startup company for an amount of 2.5 million Indian rupees or more in a single tranche. An NRI or an OCI may acquire convertible notes on non-repatriable basis without any limit. Also, such investment in convertible notes by a person resident outside India will require the prior permission of the government of India, if the startup company falls within the sector that requires such approval. Further, a person resident outside India may acquire or transfer by way of sale, convertible notes, from or to, a person resident in or outside India, provided the transfer takes place in accordance with the entry routes and pricing guidelines.

If the convertible notes are converted into equity shares, then issuance of such equity shares must be in accordance with the relevant entry route, sectoral caps, pricing guidelines and other attendant conditions for foreign investment applicable to India.

FDI in an Indian LLP

An LLP is another form of investment vehicle that non-resident entities may consider for the purposes of FDI. As per the FEMA laws, subject to the provisions of the LLP Act, any person resident outside India (except citizens of Pakistan or Bangladesh and entities incorporated in these countries) is permitted to invest by way of either capital contribution or acquisition or transfer of profit shares of an LLP in sectors where 100 per cent FDI is permitted through the automatic route and there are no sector-specific FDI conditions. However, FPIs and foreign venture capital investors are not permitted to invest in an LLP.

33 Regulation 2(iii) defines a 'cross-border merger' as any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules 2016 notified under the Companies Act 2013.

34 GSR 127(E) dated 19 February 2019.

35 Rule 2(e) of the Non-Debt Rules describes a 'convertible note' as an instrument issued by a startup company acknowledging receipt of money initially as debt, repayable at the option of the holder, or that is convertible into such number of equity shares of that company, within a period not exceeding five years from the date of issue of the convertible note, upon occurrence of specified events as per other terms and conditions agreed and indicated in the instrument.

Foreign investors looking to invest in an LLP will be required to ensure that their investment is not less than the fair market price as determined by the valuation norms prescribed by the Non-Debt Rules. However, in the case of transfer of capital contribution or profit share from a person resident outside India to an Indian resident, the transfer consideration cannot exceed the fair market price.

Benefits of the FDI route

In the recent past, India has greatly relaxed its FDI norms (including further liberalisation of sectors such as contract mining, single-brand retail, civil aviation, etc)[36] with a view to facilitating ease of doing business for foreign and domestic players. FDI in India can boost the Indian economy as, inter alia, it promotes access to advanced technologies and technical know-how, provides a gateway to global platforms, employment opportunities, higher capital inflow, etc.

Notable M&A deals

The India M&A landscape has many noteworthy deals involving FDI. For instance, Walmart's acquisition of Flipkart in 2018, for a enormous US$16 billion, was the world's biggest purchase of an e-commerce company and is India's largest acquisition in the retail sector.[37] Further, in 2019, the takeover of Essar Steel by ArcelorMittal Nippon Steel India Limited for US$7 billion was one of the largest M&A deals within the Indian insolvency and bankruptcy framework.[38] Additionally, the acquisition by Canadian investment firm Brookfield Asset Management Inc (Brookfield) of RIL's telecom tower assets for approximately US$3.66 billion was one of India's biggest private equity deals.[39]

Conclusion

In light of the foregoing, it is pertinent to note that while India has robust inbound M&A opportunities, acquisitions by domestic companies have a significant impact on India M&A. In this context, we must mention the contentious hostile takeover of Mindtree Limited by Larsen and Toubro Limited in 2019, valued at approximately 107 billion Indian rupees, which was the first of its kind in the information technology sector. This takeover is also a testament to the fact that acquirers (including foreign investors complying with the extant investment limits) as persons acting in concert may, directly or indirectly, cooperate with other shareholders in order to fulfil the common objective of acquiring shares, voting rights or exercising control over the listed Indian entity, subject to compliance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011.

On one hand, while the Indian regulatory sphere allows resident entities to explore diverse structures through companies, LLPs, joint ventures and trusts to acquire a stake in other Indian entities, these broad-based norms as applicable to them may not always be applicable to foreign investors. This is because India is an exchange-controlled regime, with the entry into certain

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36 https://dipp.gov.in/sites/default/files/pn4_2019.pdf; https://dipp.gov.in/sites/default/files/pn1_2020.pdf.

37 www.vantageasia.com/deals-year-2018/#MA02.

38 www.vantageasia.com/deals-year-2019/#insolvency01.

39 www.vccircle.com/brookfield-inks-3-7-bn-deal-to-invest-in-reliance-s-telecom-tower-assets/.

sectors being highly regulated, if not prohibited.[40] Having said this, by employing the smart structures discussed in this chapter, investors may make successful investments and positively partake in India's growth story. This can be seen from the strong foothold that Brookfield has in India, with its aggregate investments in 2019 amounting to approximately US$6.2 billion.[41]

40 The extant FDI Policy prohibits foreigners from investing in Indian trusts except through AIFs, REITs, InvITs and mutual funds.

41 www.livemint.com/companies/news/brookfield-overtakes-blackstone-as-largest-private-investor-in-india-11581443602793.html.

7

Representations, Warranties, Indemnities and Insurance in M&A

Sujjain Talwar and Aakanksha Joshi[1]

A common feature of M&A transactions in India is a robust set of representations and warranties (R&W) backed by indemnities. R&W allocate risks between the acquirer and the seller, target entity or both (warrantor or warrantors), where the warrantor assumes the risk of the veracity of certain statements. R&W are provided as an inducement to enter into a transaction, and their inaccuracy could entitle the promisee to relief, both under contract and law. The preferred contractual remedy for inaccuracy of R&W is an indemnity. However, the lack of an indemnity does not preclude relief in the form of damages or specific performance. In this chapter, we deal with the role and efficacy of these provisions in M&A transactions given common contractual practices as well as their interplay with statute and judicial precedent. We also examine insurance in relation to R&W in M&A transactions.

R&W explained

R&W are statements relating to a period prior to a transaction, asserted to be true on the execution of contract and at the time of completion. The terms are not specifically defined under the Indian Contract Act 1872 (ICA), the statute that primarily governs Indian contract law. However, the ICA is not exhaustive, and contract law is wider than what is contained in the ICA. Therefore, through practice and judicial precedents, principles have evolved in relation to R&W. Additionally, where the transaction relates to the sale of goods, the Sale of Goods Act 1930 (SOGA) would apply. Shares are considered as goods under the SOGA and hence transactions involving share transfers would necessarily attract its provisions.[2]

1 Sujjain Talwar, Darshan Upadhyay and Aakanksha Joshi are partners with Economic Laws Practice.

2 Section 2(7) SOGA defines 'goods' as every kind of movable property including inter alia stocks and shares.

Although the terms are used interchangeably, they have distinct meanings and their inaccuracy would result in specific consequences under law. Simply put, a 'representation' is a statement of fact relating to an existing or past event based on which an acquirer is induced into entering the contract, while a 'warranty' is an assurance of the continued existence of a certain state.

Representation and warranty: statutory meaning

Although the term 'representation' is not statutorily defined, reference may be made to section 18 of the ICA, which defines 'misrepresentation' inter alia as 'a positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true', and 'causing, however innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement'. From this, it can be gleaned that a representation would refer to a positive statement or assertion or any act or conduct relating to the substance of the contract. Certain representations may constitute a condition, defined under the SOGA as a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.[3]

The SOGA defines a 'warranty' as a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.[4]

R&W in M&A transactions

R&W in M&A transactions cover a wide range of subjects touching upon every aspect of the target business and the capacity of the parties to enter into the contract. R&W typically provided by parties in M&A transactions are briefly touched upon below.

Sellers' and target warranties

The acquirer enters into a contract assuming that certain facts are true. Given that the acquirer is a stranger to the business, the warrantor, being in the know, assures the acquirer of their veracity. The warrantor further assures the acquirer of its legal capacity and authority to enter into the contract and the absence of any restrictions under contract, law or judicial pronouncements to do so. Further, since insolvency or other analogous proceedings impose restrictions that may affect the warrantor's ability to perform, R&W in this regard are included. An important representation provided by the warrantor relates to the clear and marketable title to the assets or shares being sold as well as the authority of the warrantor to make such a sale. In this context, it is important to note that section 14 of the SOGA clearly provides that, subject to a contract to the contrary, there is an implied condition that the seller has title to sell the goods as well as implied warranties as to the quiet possession (meaning devoid of the possibility of third-party claims) and the absence of encumbrances in relation to such goods.

Additionally, R&W relating to the target are given by the warrantor. These include matters ranging from compliance with secretarial matters, the target's financial conditions and position, indebtedness, material contracts and related-party contracts, compliance with laws and business licences, title and condition of assets and their fitness for purpose, due payment of

3 Section 12(1) SOGA

4 Section 12(3) SOGA.

taxes, intellectual property rights, employment matters and claims and litigation involving the warrantor.

In some cases, acquirers also seek a representation to the effect that the facts and information disclosed by the warrantor are all the matters that are material and necessary for the acquirer to make its decision. Such a representation could support a claim of fraud if any information is not disclosed, although within the warrantor's knowledge, where the acquirer states that such information was material.

R&W are provided by sellers where they control the target. Sometimes where the sellers retain a stake in the target, the target also provides R&W. However, where acquirers obtain a stake in the target, they prefer obtaining R&W from the sellers exclusively to ensure that the value of their investment value is unaffected.

R&W typical to M&A transactions have evolved with time in order to keep pace with regulatory and business practice changes. For instance, following the implementation of the General Data Protection Regulation by the European Union in 2018, R&W relating to compliance with data privacy laws as well adoption of stringent security protocols have become the norm. Further, considering tax implications, R&W relating to residence are not uncommon. The business being acquired as well as specific factual circumstances could also dictate R&W being required by the acquirer.

To cater to changing circumstances, a warranty as to the absence of material adverse changes (being events that affect the target's business, its financial position or the transaction) is included. Warrantors resist this as it affects transaction certainty and hence negotiate for certain exceptions.

Acquirer's warranties

Although R&W are primarily a mode through which risk is assumed by the warrantor, the warrantor also relies on the acquirer's ability to perform. Consequently, acquirers represent and warrant as to their legal capacity and authority to enter into the contract without any restrictions. Since the warrantor relies on the acquirer's ability to pay consideration, R&W relating to the absence of insolvency or analogous proceedings, and in some cases (excluding financial investments), its financial wherewithal, are also obtained.

R&W and due diligence

In most M&A transactions, acquirers conduct a due diligence (DD), that is, a review of information relating to the target (and to a limited extent, the seller) to appraise its assets and liabilities, financial position as well as legal risks and have them addressed either through the contract or otherwise. A question may arise as to why a party would conduct a DD despite the warrantor's providing R&W.

Need for DD; Interplay with R&W

A DD exercise is carried out since a seller is not required to disclose all relevant facts relating to goods being sold (ie, the principle of caveat emptor or buyer beware is a part of applicable jurisprudence). Although there are implied warranties of title, the law does not imply any other R&W. The exception to section 19 of the ICA provides that if consent to a contract is caused by misrepresentation or silence, fraudulent within the meaning of section 17 of the ICA, the contract would not be voidable if the relevant party had the means of discovering the truth with ordinary diligence. Therefore, unless there is a positive affirmation made without belief in the truth, without the acquirer having undertaken a due diligence, relief may be difficult.

A DD usually involves the acquirer or its advisers posing broad questions about the target. If the warrantor does not respond with adequate disclosures, it is easier for an acquirer to claim an active concealment of fact, bringing it within the realm of fraud under section 17 of the ICA. The questions would evidence diligence on the part of the acquirer. Further, in case of active misrepresentation (where the party knew the fact to be false), it is not required that the defrauded party prove that it had no means of discovering the truth with ordinary diligence.[5]

An acquirer may seek specific representations or specific indemnities arising out of the matters discovered during the DD. Where material issues are uncovered during a DD, the acquirer may choose to require the warrantor to resolve or mitigate the issues prior to the transaction or, in some cases, even choose to walk away.

Limitations of DDs

However, DDs are limited in scope and heavily reliant on the information provided. Further, where the target is listed, restrictions are placed on information disclosure to prevent insider trading, inhibiting the DD process.[6] Publicly available information may provide some direction but is usually inadequate for discovery of all material risks.

A common question that arises is whether an acquirer can claim relief for a breach of representation, where it knows of its falseness. A DD can yield information that flies in the face of representations made. Where a person knows of facts contradicting a representation, but still elects to stand by the contract, he or she is deemed to have ratified the contract and cannot rescind it.[7] This makes acquirers nervous about DDs as it would be open to a warrantor to claim that the acquirer had knowledge of the facts disclosed. A failure to appreciate the materiality or implication of a certain fact learned during a DD could affect the acquirer's rights.

For this purpose, sandbagging provisions are included in contracts.

Sandbagging and anti-sandbagging provisions

A sandbagging provision provides that an acquirer can seek indemnities from a warrantor for a breach of R&W even where it knew the truth.

An anti-sandbagging provision in contrast clarifies that the acquirer would not be entitled to relief where it knows of the inaccuracy of any representation or warranty prior to consummation of the transaction. An anti-sandbagging provision aligns closely to the Indian law position disentitling an acquirer from relief where it had knowledge.

However, it may still be useful to include sandbagging provisions from an acquirer's perspective as it may bring indemnification claims against breach of warranties as specific indemnities (discussed below).

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5 *Niaz Ahmad Khan and Ors v Parsottam Chandra and Ors*, AIR 1931 All 154.

6 Regulation 3 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 2015 prohibits the communication, provision or allowing of access to any unpublished price-sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

7 *Ganga Retreat and Towers Ltd v State of Rajashtan* (2003)12SC C 91.

Consequences of a breach under law

A misrepresentation can entitle the innocent party to rescind a contract,[8] while a breach of warranty would sound in damages.[9] However, a party may choose not to rescind a contract and require performance despite the misrepresentation, insisting that it be put in the same place as if the statement it relies upon is true (ie, such a party may claim compensation).[10]

A representation may be inaccurate either with or without the belief of the person making the statement. Where a person is induced into entering a contract based on a fact which is untrue, suggested by a person who does not believe it to be true or a fact is actively concealed by a person having knowledge, with the intent to deceive, the contract is vitiated by fraud[11] and be rescinded in the same manner as in the case of a misrepresentation. In case of a fraudulent misrepresentation as against a misrepresentation under section 18 of the ICA, a claim for consequential losses may be made.[12]

In claims for damages for a breach of R&W, the principles of section 73 of the ICA would apply.[13] This provision limits damages to those that naturally arose in the usual course of events from such breach or which the parties knew would be likely to arise. It expressly excludes remote and indirect loss or damages .

Contractual relief; rescission of contract and indemnity

In addition to the statutory reliefs, contracts may provide specific consequences that are discussed below.

Rescission of contract

Most contracts permit an acquirer to terminate the contract prior to consummation if any representation or warranty is untrue prior to such time. In some rare cases, even after consummation, the contract allows rescission.

Although applicable statutory provisions themselves permit rescission of contracts, it is preferable to specify such a relief in the contract considering the following:

- Breach of warranties can only entitle the acquirer to damages under law. By including the right of termination, a party would no longer be restricted to termination only in case of breach of representations.
- Not every misrepresentation permits a party to rescind a contract under law. Section 19 of the ICA permits a party to avoid a contract if the consent of the party to enter into such contract was caused by the fraud or misrepresentation in question. It has been held that

8 Section 19 ICA.

9 Section 59 SOGA.

10 *RC Thakkar v The Bombay Housing Board*, AIR 1973 Guj 34.

11 Section 17 Contract Act.

12 *National Highways Authority of India v Pune Sholapur Road Development Company*, 2019 (2) ArbLR 382 (Delhi).

13 It has been held that damages for a breach of warranty for a sale of goods would be subject to the principles of section 73 ICA (*Thyssen Krupp Materials Ag v The Steel Authority Of India*, 2017 (3) ARB LR 255 (Delhi)).

the inaccuracy in a representation that is not material would not allow a party to avoid the contract.[14] Such a contractual right would avoid any controversy in this regard.

Indemnity provisions

The term 'indemnity' in its widest sense means recompense for any loss or liability incurred by any person. In M&A transactions, an indemnity is provided against breach of R&W (ie, the promisors undertake to save the promisee from liabilities arising by reason of any breach of R&W).

Indemnification provisions are a part of several commercial contracts and have achieved primacy in M&A transactions owing to certain features that are considered more beneficial as compared with statutory claims for damages.

Indemnities are discussed in more detail below.

Indemnities

The ICA recognises indemnities in section 124 as a contract by which one party promises to save the other from loss caused to it by the conduct of the promisor itself, or of any other person. However, the scope of most contractual indemnities extend beyond a person's conduct, covering a wide range of circumstances, including acts and circumstances within and beyond the promisor's control.

Very early on, it was held that the ICA provisions were not exhaustive of the law of indemnity and courts would apply the same equitable principles as those applied by English courts.[15] Therefore indemnities for the extensive R&W typical to M&A transactions would be enforceable.

Reasons for inclusion of indemnities

Even though breach of R&W has statutory remedies in the form of damages, indemnification provisions are preferred for the following reasons:

- An indemnified party can call upon the indemnifier to make the payment once the liability has accrued. The concept of accrual of loss or liability and the attendant obligation to indemnify can be contractually agreed by the parties. Courts have time and again taken the position that an indemnity holder is entitled to sue the indemnifier even before incurring any actual damage or loss, and an indemnity is not necessarily given by repayment after payment. In contrast, damages can be claimed only after the claimant has suffered actual loss and not merely on accrual of loss.[16] When a person contracts to indemnify another, the latter may compel the indemnifier to place him or her in a position to meet the liability that may be cast upon him or her without waiting until the indemnity holder has actually discharged that liability.[17] The only requirement is that the liability be absolute.[18] However, often words are included that result in restricting the indemnified party from only recovering actual losses.

14 *Bhagwani Bai v Life Insurance Corporation of India*, Jabalpur AIR 1984 MP 126.

15 *Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri*, AIR 1942 Bom 302.

16 *Osman Jamal & Sons Ltd v Gopal Purshattam* (56 (1928) Cal 268); *Khetarpal Amarnath v Madhukar Pictures*, AIR 1956 Bom 106; *Jet Airways (India) Limited v Sahara Airlines Limited* (2011) 113 (3) BLR 1725.

17 *Ultratech Cement Ltd v Sunfield Resources Pty Ltd*, 2018 (3) ARB LR 394 (Bom).

18 *Reliance Industries Limited v Balasore Alloys Limited*, 2014 (1) Arb LR 457 (Bom).

Words such as 'make good' or 'compensate' can be interpreted to only obligate indemnification of actual losses, thereby diluting its efficacy.

- Section 73 of the ICA limits a party to recovering losses that arose in the natural course and specifically excludes remote or indirect losses. An indemnity, as usually worded, includes all losses and not just direct losses. Therefore, an indemnity could permit the recovery of remote, consequential or indirect losses and damages, although this position is not free from doubt. However, words excluding indirect losses are often included that would result in the indemnified party being limited to direct losses as under section 73 of the ICA.
- Section 73 of the ICA requires that the loss naturally arise from usual course of things from such breach. Accordingly, a clear nexus between the loss and breach would need to be established. However, depending upon the wording of the indemnity (with phrases such as 'arising out of', 'in connection with' and 'as a result of'), this requirement can be diluted.
- By inclusion of a sandbagging provision, even where the indemnified party knows of information rendering a representation or warranty inaccurate, it may be entitled to relief on the basis that the indemnity, being a specific indemnity, is not restricted by the provisions of section 19 of the ICA.
- A contract of indemnity is separate from the main contract and hence is not subject to the same limitation as the main contract. This would mean that, depending on the contract's terms, a claim for an indemnity may subsist even after claims are not admissible in relation to the main contract.[19]

Indemnities for breach of contract

Contracts contain several covenants in addition to R&W and indemnities. Sometimes indemnification is also sought for breach of contract in addition to R&W to enable a claim for damages beyond the remit of section 73 of the ICA.

In typical M&A transactions, there are standstill covenants prior to consummation and conditions subsequent thereafter. These are sought to be brought within the indemnification umbrella.

Duty to mitigate

Parties providing indemnities should consider that, in a claim for damages, the means which existed of remedying the inconvenience caused by the non-performance of the contract would be taken into account for estimating damages under section 73 of the ICA. This indirectly places upon the promisee an obligation to mitigate its losses. Losses under indemnity may not need to take into account mitigation measures and hence an indemnifier may require the inclusion of such a position in order to limit its liability.

Specific indemnities

In addition to the general indemnification for R&W, where specific risks are identified prior to execution of the contract (usually during the DD process), acquirers seek specific indemnities against such risk. This ensures that the acquirer can claim indemnity against such risk despite its knowledge thereof. Further, it is not uncommon for specific indemnities to be unlimited.

19 *Deepak Bhandari v Himachal Pradesh State Industrial Development Corporation Limited*, AIR 2014 SC 961.

Third-party beneficiaries

Indemnities often include parties other than the acquirer as beneficiaries, such as its affiliates, officers and employees. Although the doctrine of privity of contract is well recognised in India, third-party beneficiaries are permitted to sue under contracts. There are mainly three types of third-party beneficiaries; first, where the performance of the promisee constitutes a gift to the beneficiary, the beneficiary is a donee beneficiary. Second, if the performance of it will satisfy an actual or supposed asserted duty of the promisee to the beneficiary, the beneficiary is a creditor beneficiary. Third, in all other cases, the beneficiary is deemed to be incidental beneficiary. A donee or creditor beneficiary has a right to enforce contracts made by others for its benefit.[20]

Indemnity payments to non-residents

Indemnity payments from resident warrantors to foreign acquirers are restricted under extant foreign exchange laws. Until 2016, indemnity payments would require the prior approval of the Reserve Bank of India (RBI). However, on 20 May 2016, the RBI issued a notification providing that in a share sale, an indemnity may be provided for up to 25 per cent of the sale consideration and for 18 months from the date of the contract without approval. Any indemnity payments beyond this limit and indemnities in other M&A transactions would still require approval of the RBI.

Qualifications and limitations of liability

Transaction documentation contains provisions that limit the liability of the warrantor, usually including the following. Any clauses that limit the liability of parties to a contract are to be strictly construed.[21]

Disclosures

Parties making representations are permitted to disclose facts as against representations provided. The other party, having knowledge of such facts, is then precluded from making claims based on such facts being contrary to representations provided. Acquirers prefer that such disclosures are as specific as possible to narrow the scope of defence. However, warrantors seek to enlarge the scope to include publicly available information and DD information . However, DD information is often voluminous, and the acquirer being a stranger to the business may be unable to assess each risk from it. Hence from the acquirer's perspective, this should be avoided. Warrantors often seek the right to update their disclosures with matters occurring between the signing of the contract and consummation of the transaction, to which acquirers are sometimes resistant.

Knowledge

Warrantors seek to limit certain representations with reference to their specific knowledge on the concerned matter. The rationale for this is that it may not be possible for the warrantor to know of certain things such as claims filed against it for which no notice is received or latent defects. By limiting the representation to knowledge, the acquirer cannot claim relief if there is a breach of a representation that is unknown to the warrantor. Warrantors seek to define knowledge as

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20 *Essar Steel Ltd v Gramercy Emerging Market Fund,* 2003 116 CompCas 248 Guj.

21 *United Insurance Company Limited v Blue Dart Express Limited* in CS (OS) 78/2002 in Delhi High Court.

actual knowledge as against the acquirer who seeks to define knowledge as constructive knowledge (ie, knowledge the warrantor is presumed to have or ought to have regardless of whether it actually has it (eg, patent defects)).

Materiality thresholds

Warrantors seek to limit claims from acquirers to only material claims by including the term 'material' in the representations and warranties. Considering the subjectivity of the term 'material', a monetary threshold is agreed upon and claims below this amount cannot be brought against the indemnifier. Such a threshold can be made to apply to a single claim or a cluster of claims. The concept of a tipping basket – the ability of the indemnified party to seek indemnity for claims below the threshold where aggregate claims exceed the agreed threshold – is often seen. The thresholds are either expressed as a definite number or a percentage of the consideration value.

Caps

The overall liability under indemnification is usually capped to a definite amount, expressed as a percentage of the consideration. The cap usually ranges from 25 to 100 per cent depending on the transaction size. Often certain R&W, contractually termed as 'fundamental warranties' (relating usually to title and capacity), and liability for fraud are uncapped or capped at 100 per cent (while the rest of the warranties have a lower cap).

Periods of limitation

As indemnity contracts are independent of the main contract and hence not bound by the same periods of limitation, it becomes necessary to contractually limit the period of its applicability. Warrantors need certainty of the period of their liability. It is usual to align the contractual limitation periods to statutory periods for such claims (which vary depending on the R&W being covered). Usually fundamental warranties are unlimited in time, while other R&W are limited to 18 to 36 months, except tax warranties for which seven years is the norm. In cases where the seller is seeking a complete exit from the relevant jurisdiction, shorter timelines are sought.

Exclusive remedies

In order to ensure that acquirers are restricted to the remedies prescribed within the contract, an agreement is sought to the effect that the acquirer is only entitled to such remedies. While it is debatable whether such an exclusion of statutory remedies is enforceable, acquirers often seek the ability to go beyond the contract for non-monetary reliefs including specific performance and injunctions.

Restitution

Where an indemnified party later recovers the claim amount (through dispute resolution process or insurance), an indemnifier who has honoured the indemnity could require restitution (ie, repayment of such amount by the indemnified party).

Joint versus several liability

Where there is more than one seller, the sellers may insist that their liability is several and not joint. This would mean that claims may be made against them only to the extent of the obligations taken on by them. This would result in a seller being liable only for specific representations provided by it or where the representations are joint, then only to the extent of the ratio of consideration paid to it (when read in conjunction with the liability cap). Joint liability, on the other hand, would make all the sellers liable to the full extent of the liability. Joint and several liability would leave it open for the indemnified party to apportion a part or whole of the liability to any one or more of the sellers. Where the target is one of the warrantors, the acquirer should insist on several liability.

Safeguards sought by acquirers

Acquirers seek to limit recourse by the sellers to the target by disallowing restitution where the target is a warrantor. Further, where there are liabilities imposed on the company, acquirers may seek a gross-up of claim amounts and, in some cases, require the sellers to pay into the target.

Insurance

Increasingly, M&A transactions in India are being covered by R&W insurance or warranty and indemnity (W&I) insurance, given the increase in the sophistication of the transactions and parties in this jurisdiction. This insurance covers the seller's liabilities arising from the R&W and indemnities in the contract. A large part of the negotiation of M&A transactions revolves around these provisions and their limitations, and they are often hotly debated. The availability of insurance can drastically reduce the time taken for negotiations and can also affect the price, since sellers often price their post-transaction risks into the consideration sought. These policies enable an acquirer to claim beyond limitations in the contract. However, any information that an acquirer knows would disentitle an acquirer from making a claim and therefore specific indemnities would not be covered. Where the seller obtains the insurance, the seller is liable for claims under the contract beyond the insurance policy. Further, if the seller knows of any inaccuracy in any R&W, no claims can be made.

Although both parties can obtain such insurance, usually acquirers prefer that the sellers obtain such insurance since the acquirer would have recourse to the seller if the insurance claim is rejected.

R&W insurance and W&I insurance typically have limitations, including retentions and de minimis thresholds built in. The time limitations mirror those under the main contract subject to a maximum of seven years for fundamental and tax warranties and three years for the remaining. Insurers also undertake their own DD to assess their risks.

In this context it is pertinent to note that contracts for insurance are considered as uberimmae fidei (ie, contracts of utmost good faith). The insurer's liability is voided if any facts are either omitted, hidden, falsified, distorted or incorrectly presented by the insured. The insured and the insurer would both have to disclose all facts relevant.[22] Where the seller obtains R&W or W&I insurance, it is duty-bound to make as many disclosures as possible to ensure that it can claim the insurance. Towards the acquirer, it is adequate that any non-disclosure is not fraudulent

Although more prevalent, parties are still wary of such insurance considering that it requires the conduct of a detailed DD and it would not usually cover undisclosed liabilities.

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22 *Modern Insulators Ltd v Oriental Insurance Co Ltd*, 2000 (2) SCC 734.

Conclusion

R&W and indemnities in M&A transactions in India follow well established principles arising from both law and practice. They have evolved over time in line with changed developments in law and business practices. India, being a dynamic jurisdiction, has witnessed increasing M&A activity through the years (many involving foreign jurisdictions), leading to a greater exchange of ideas and adoption of international contractual developments. However, this dynamism is attended by a lack of uniformity and therefore many approaches to these typical issues are common. Reliance on insurance has brought around some amount of consistency owing to strict requirements from insurers. In any case, a cautious and careful approach towards these provisions is required to ensure fair allocation of risk, which is the raison d'être of R&W, indemnities and insurance.

8

Challenges In Cross-Border Mergers

Vineet Aneja and Neetika Ahuja[1]

Background

While the Companies Act 1956 (1956 Act) permitted an inbound merger,[2] there was no provision for an outbound merger.[3] However, with the implementation of the Companies Act 2013, which replaced the 1956 Act, outbound as well as inbound cross-border mergers[4] are now permitted. In March 2018, the Reserve Bank of India (RBI) issued the Foreign Exchange Management (Cross Border Merger) Regulations 2018 (Cross Border Merger Regulations) to regulate cross-border mergers.

This chapter deals with regulatory framework relating to, as well as issues that need to be considered in, a cross-border merger (whether inbound or outbound).

Permissibility of cross-border mergers and demergers under Companies Act 2013

Chapter XV (Compromises, Arrangements and Amalgamations) of the Companies Act 2013 (2013 Act) read with the Companies (Compromises, Arrangements and Amalgamations) Rules 2016 (Merger Rules) deals with mergers, amalgamations, compromises and arrangements.

Section 234 of 2013 Act read with rule 25A of the Merger Rules sets out the enabling framework for mergers and amalgamations between an Indian company and a foreign company.

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2 The term 'inbound merger' is defined under the Cross Border Merger Regulations to mean a cross-border merger where the resultant company is an Indian company. The term 'resultant company' is defined in the Cross Border Merger Regulations to mean an Indian company or a foreign company that takes over the assets and liabilities of the companies involved in the cross-border merger.

3 The term 'outbound merger' is defined under the Cross Border Merger Regulations to mean a cross-border merger where the resultant company is a foreign company.

4 The term 'cross-border merger' is defined under the Cross Border Merger Regulations to mean any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules 2016 notified under the Companies Act 2013.

Cross-border merger is permitted only if the relevant foreign company is incorporated in any of the following jurisdictions:

- those whose securities market regulator appears in the list of Appendix A signatories to the multilateral memorandum of understanding of the International Organization of Securities Commissions (IOSCO) or one that is a signatory to a bilateral memorandum of understanding with the Securities and Exchange Board of India; or
- those whose central bank is a member of the Bank for International Settlements.

Further, such a jurisdiction must not have been identified in any public statement of the Financial Action Task Force (FATF) as:

- a jurisdiction having strategic anti-money laundering or combating the financing of terrorism deficiencies to which counter measures apply; or
- a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies.

However, the extant regulations do not deal with cross-border demergers (ie, demerger of an undertaking from Indian company to foreign company or vice versa). Additionally, while the National Company Law Tribunal (NCLT) (Ahmedabad Bench) in its order (*In the matter of Sun Pharmaceutical Industries Limited*) approved a scheme of inbound demerger of an Indian company, in a subsequent order (*In the matter of Sun Pharmaceutical Industries Limited*) the same bench of the NCLT rejected a scheme of outbound demerger of the same Indian company on the ground that cross-border demergers are not permitted. These conflicting orders have resulted in lack of clarity as regards permissibility of cross-border demergers.

Key provisions of the 2013 Act that are applicable to cross-border mergers

A scheme of cross-border merger needs to comply with the provisions relating to domestic mergers as prescribed under the 2013 Act.

Consequently, a scheme of cross-border merger requires approval of the board of directors of the Indian company. Further, the scheme would also need to be approved by the majority of persons representing 75 per cent in value of the shareholders as well as creditors (if applicable). The respective meetings of the creditors or the members, as the case may be, of the relevant Indian company are convened and held as per the directions, and under the supervision, of the NCLT. This requirement of convening meetings can, however, be dispensed with by the NCLT where the creditors (having at least 90 per cent share in outstanding debt) and the shareholders agree and confirm to the scheme.

Besides the above, a scheme of cross-border merger would require approval or no-objection of other authorities including the Regional Director, the Official Liquidator, the income tax authorities, the RBI (if applicable) and other regulators (such as the Competition Commission of India (CCI)), if any.

In the case of a listed Indian company proposing a scheme of cross-border merger, a draft of the scheme along with other prescribed documents and fees needs to be filed with the relevant stock exchange or exchanges for obtaining a no-observation or no-objection letter prior to filing the scheme with the NCLT. The relevant listed Indian company is required to file the scheme with the NCLT within six months from the date of issuance of the no-observation or no-objection letter by the stock exchange. However, the requirement of no-observation letter or no-objection letter does not apply in the case of a merger of a foreign wholly owned subsidiary with its listed Indian holding company, but the draft scheme still has to be filed with the stock exchange for disclosure purposes.

An order of the NCLT sanctioning the scheme may provide for the transfer of assets and/or the liabilities of the transferor company to the resultant company. In the case of an outbound merger, the relevant Indian company would be dissolved without winding-up upon the scheme of cross-border merger becoming effective, and any legal proceedings pending by or against the relevant Indian company would continue in the name of the resultant company.

A scheme of cross-border merger, once approved by the NCLT, would be deemed to be effective from the appointed date, which could either be a specific calendar date or an event-based date linked with certain conditions or events.

The relevant foreign company would also need to obtain the requisite approvals that it may require in its home jurisdiction in relation to a scheme of cross-border merger.

Further, a scheme of cross-border merger would need to comply with the conditions set out in the Cross Border Merger Regulations related to inbound and outbound mergers.

Last, in the case of cross-border mergers, a valuation has to be conducted (in accordance with internationally accepted principles of accounting) by a member of a recognised professional body in the jurisdiction of the resultant company. A scheme of cross-border merger may, among other things, provide for the payment of consideration to the shareholders of the transferor company in cash, by way of depository receipts, or a combination thereof. If the scheme of cross-border merger provides for payment of consideration by the resultant company in the form of fresh securities then the provisions of the foreign exchange regulations of India would also become applicable.

Issues under the Cross Border Merger Regulations

The Cross Border Merger Regulations prohibit:

- a person resident in India (PRI) from acquiring or transferring any security or debt or asset outside India; and
- a person resident outside India (PROI)[5] from acquiring or transferring any security or debt or asset in India, on account of cross-border mergers,

unless such acquisition or transfer is either permitted under the Foreign Exchange Management Act 1999 (FEMA), or allowed by the RBI by way of any general or special permission.

However, any transaction on account of a cross-border merger (inbound or outbound) shall be deemed to have prior approval of the RBI (as required under rule 25A of the Merger Rules) if the conditions set out in the Cross Border Merger Regulations are fulfilled. If these conditions are not fulfilled, then the requirement of obtaining specific prior approval of the RBI would become applicable.

5 Bodies corporate incorporated or registered outside India are covered within the meaning of person resident outside India. Residential status of a foreign individual as a person resident outside India or a person resident in India would depend on the purpose and period of stay in India of such foreign individual. If a foreign individual stays in India for a period of 182 days or more during the preceding financial year for employment, carrying out business or other purpose, then such foreign individual would become a person resident in India.

Conditions for deemed RBI approval in the case of inbound merger

The Cross Border Merger Regulations have set out, among other things, the following conditions for deemed approval of the RBI in the case of inbound merger:

- Where the scheme of inbound merger provides for issuance of shares or securities by the resultant Indian company to the securities holders of the foreign company, the resultant Indian company would have to comply with the pricing guidelines, sectoral caps, attendant conditions and reporting requirements as set out under foreign direct investment (FDI) Norms (discussed below).
- The resultant Indian company would also need to comply with the conditions set out in the overseas direct investment (ODI) Norms (discussed below) where the relevant foreign company is a joint venture (JV) or wholly owned subsidiary (WOS) of the Indian company.
- If the inbound merger of the JV or WOS results in acquisition of the step-down subsidiary of the JV or WOS of the Indian party by the resultant Indian company, then such acquisition should be in compliance with the ODI Norms.
- The guarantees or outstanding borrowings of the foreign company from overseas sources must conform to the external commercial borrowing (ECB) norms (discussed below) or trade credit norms or other foreign borrowing norms (including guarantee regulations) within a period of two years. No outward remittance is permitted towards repayment of such liability within such period of two years; however, the condition related to end use as set out in the ECB norms would not apply to such overseas borrowings.
- The resultant Indian company can acquire, hold and transfer any foreign asset or security only if it is permitted under the FEMA provisions. If it is not permitted to do so under FEMA, the resultant Indian company would have a period of two years to sell such asset or security and repatriate the sale proceeds to India. Repayment of foreign liabilities from such sale proceeds within the said period of two years is also permissible.
- The resultant Indian company can open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross-border merger for a maximum period of two years from the date of sanction of the scheme by the NCLT.
- Prior to the merger, all the companies involved in the inbound merger must complete all the regulatory actions with respect to non-compliance, contravention, violation, as the case may be, of the FEMA provisions.

Conditions for deemed RBI approval in the case of outbound merger

The Cross Border Merger Regulations have set out, among other things, the following conditions for deemed approval of the RBI in case of outbound merger:

- If the scheme of outbound merger provides for issuance of shares or securities by the resultant foreign company to the shareholders of the relevant Indian company, such acquisition or holding of shares or securities of the resultant foreign company must be in compliance with the ODI Norms. Further, a resident individual is permitted to acquire foreign securities only if their fair market value is within the limits set out in the liberalised remittance scheme.
- Indian offices of the Indian company may be deemed to be branch offices of the resultant foreign company. Accordingly, the resultant foreign company can undertake only such transactions that a branch office is permitted to undertake in terms of the Foreign Exchange

Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations 2016.[6]

- The guarantees or outstanding borrowings of the Indian company shall be repaid as per the scheme sanctioned by the NCLT. The resultant foreign company cannot acquire any rupee liability towards an Indian lender, if such liability is not in accordance with the FEMA provisions. Further, a no-objection certificate or letter to this effect should be obtained from the Indian lenders of the Indian company.
- The resultant foreign company may acquire, hold or transfer any asset in India as permitted under FEMA. If it is not permitted under FEMA, then the resultant foreign company would have a period of two years to sell such asset or security and repatriate sale proceeds outside India. However, repayment of Indian liabilities from sale proceeds of such assets or securities within the said period of two years is permissible.
- The resultant foreign company may open a special non-resident rupee account in accordance with the Foreign Exchange Management (Deposit) Regulations 2016 for the purpose of putting through transactions under the Cross Border Merger Regulations for a maximum period of two years from the date of sanction of the scheme by NCLT.
- Prior to the merger, all the companies involved in the outbound merger must complete all the regulatory actions with respect to non-compliance, contravention, violation, as the case may be, of the FEMA provisions.

Key provisions of the FDI Norms

An investment by a non-resident through permitted equity instruments in an unlisted Indian company, or 10 per cent or more of the post-issue paid-up equity capital on fully diluted basis of a listed Indian company, qualifies as FDI and has to comply with the FDI Norms (including, without limitation, the pricing guidelines, sectoral caps, attendant conditions and reporting requirements as set out in FDI Norms).

Since the non-resident securities holders of foreign company would acquire shares or securities of the resultant Indian company (pursuant to a scheme of inbound merger), such issuance of shares or securities by the resultant Indian company to the non-resident securities holders of a foreign company would have to be in compliance with the FDI Norms.

The regulatory framework governing foreign investment in India is set out under the Foreign Exchange Management (Non-Debt) Instrument Rules 2019 and the consolidated FDI policy issued by the Department for Promotion of Industry and Internal Trade (collectively referred to as the FDI Norms).

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6 An Indian branch office of a foreign company is permitted to undertake certain activities including, among others, the export or import of goods, providing professional or consultancy services, acting as buying or selling agent of a foreign company, rendering technical support to the products supplied by parent or group companies and representing a foreign airline or shipping company.

As per the FDI Norms, Indian companies can issue only the following equity instruments to PROIs:

- equity shares (including partly paid shares);
- fully, compulsorily and mandatorily convertible debentures;
- fully, compulsorily and mandatorily convertible preference shares; and
- share warrants.

Any instrument that is non-convertible, optionally convertible or partially convertible is considered as foreign debt and not treated as FDI.

FDI is permitted under the 'automatic route', the 'government or approval route', or both in all sectors except prohibited sectors or activities.[7] In sectors or activities where foreign investment is permitted under the automatic route no prior government approval is required. However, prior government approval[8] is required, among others, for investment in sectors that fall within the approval route or where the foreign investment does not comply with the sectoral caps, the conditions set out for investment under the automatic route, or both.

Therefore a scheme of inbound merger would not be permitted if such inbound merger is likely to result in PROIs acquiring equity instruments in the resultant Indian company that is engaged in a sector where FDI is prohibited. Further, if the resultant Indian company is engaged in a sector falling under the approval route, prior government approval would be required before implementation of such scheme of inbound merger.

In terms of the recent amendment to the FDI Norms, apart from the sector or activity-specific restrictions, prior government approval would be required in the case of:

- any investment in an Indian company by an entity that is resident in a country sharing a land border with India (Restricted Territory) or the beneficial owner of the investment is a resident or citizen of a Restricted Territory; or
- any transfer of shares of an Indian company that, directly or indirectly, results in a resident or citizen of a Restricted Territory becoming the beneficial owner of the shares.

In view of the above, prior government approval would also be required where, pursuant to a scheme of inbound merger, the resultant Indian company proposes to issue equity instruments to a non-resident entity that is a resident of a Restricted Territory or where the beneficial owner of the such equity instruments would be a resident or citizen of a Restricted Territory.

The FDI Norms regulate the price at which a PROI can acquire or transfer the permitted equity instruments in Indian companies. The pricing guidelines provide for:

7 Prohibited sectors or activities include lottery business, gambling and betting, manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes, real estate business (other than development of townships, construction of residential or commercial premises, roads or bridges and real estate investment trusts), chit funds and Nidhi companies.

8 Prior to its abolition, in May 2017, the relevant authority was the Foreign Investment Promotion Board (FIPB). After abolition of the FIPB, the relevant authority to grant approval for foreign investment is the relevant department or ministry that is concerned with the sector in which the relevant Indian company, in which foreign investment is proposed to be made, is engaged.

- a floor price in the case of acquisition of permitted equity instruments (either by way of subscription or by way of purchase from resident shareholders) by a non-resident investor, and
- a ceiling in the case of sale of permitted equity instruments by a non-resident seller to a resident purchaser.

In the case of convertible equity instruments, the price or conversion formula is required to be determined upfront at the time of issue of the instruments, and the conversion price cannot be less than the price arrived at when the instrument is issued.

Therefore, while determining the share exchange ratio in the case of scheme of inbound merger, the pricing guidelines as set out in the FDI Norms would also need to be complied with.

Reporting and filing requirements

Every Indian company issuing equity instruments to a PROI under the FDI route is required to file Form FC-GPR (in the Single Master Form[9]) within a period not exceeding 30 days from the date of issue of the equity instruments. The resultant Indian company issuing permitted equity instruments to non-resident securities holders of the foreign company would also need to comply with the reporting requirements.

Key provisions of the ODI Norms

The Cross Border Merger Regulations provide that in the case of a scheme of outbound merger, the Indian resident shareholder may need to comply with the provisions of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations 2004 and the Master Direction on Direct Investment in JV or WOS abroad issued by the RBI (collectively referred to as the ODI Norms). Any investment outside India by a PRI is regulated by the ODI Norms.

The ODI Norms provide for two routes of making ODI, the automatic route and the approval route (which requires prior approval of the RBI).

Under the automatic route, ODI is permitted provided the total amount of ODI made by an Indian party is within the prescribed ceiling, which is as follows:

- the total financial commitment[10] of the investing Indian party should not exceed 400 per cent of the net worth of the Indian party as per the last audited balance sheet; and
- the annual financial commitment of the Indian party should not exceed US$1 billion.

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9 Every Indian company that has received or expects to receive foreign investment or indirect foreign investment is required to file the Entity Master on the FIRMS (Foreign Investment Reporting and Management System) platform at https://firms.rbi.org.in.

10 'Financial commitment' means the amount of direct investment by way of contribution to equity (equity shares, compulsorily convertible preference shares and other preference shares), loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an Indian party to or on behalf of its overseas JV or WOS.

Further, an Indian party is prohibited from making investment (or financial commitment) in a foreign entity engaged in real estate[11] or banking business, without the prior approval of the RBI.

Separately, the Cross Border Merger Regulations also provide that in the case of individuals resident in India, the market value of the securities that the individual resident can acquire in the case of outbound merger must not exceed the prescribed limit (which is US$250,000 per financial year). The limit of US$250,000 is the aggregate limit and is applicable for all permitted capital account and/or current account transactions that may be undertaken by a resident individual in a single financial year.

In view of the above it is unclear whether an Indian company or an individual resident in India can acquire shares the market value of which exceeds the prescribed thresholds. Accordingly, if a scheme of outbound merger contemplates an all-stock transaction, it is advisable that the parties should obtain clarity on this from the RBI before proceeding with the transaction.

Brief overview of ECB norms relevant to cross-border mergers

An Indian company is permitted to borrow money from overseas lenders subject to compliance with the ECB framework.[12]

In the case of inbound merger, where the overseas borrowings of the foreign company become liabilities of the Indian company, then such overseas borrowings would need to comply with the ECB framework within a period of two years.

The ECB framework sets out certain parameters (such as eligible lenders, minimum average maturity and all-in-cost ceiling) that need to be complied with by an Indian company in order to raise ECB under the automatic route (ie, without prior approval of the RBI). If any of these parameters is not met, then the Indian company would be required to obtain prior approval of the RBI in order to raise ECB.

An ECB can be raised by only those Indian entities that are eligible to receive FDI. Under the automatic route, an Indian company is permitted to raise ECB from a non-resident person if such non-resident person is:

- a resident of a FATF or IOSCO-compliant country;
- multilateral and regional financial institutions where India is a member country; or
- an individual provided that such individual is foreign equity holder of Indian borrowing entity, or subscribes to bonds or debentures that are issued by an Indian borrowing entity and listed abroad.

11 'Real estate business' means buying and selling of real estate or trading in transferable development rights but does not include development of townships, construction of residential or commercial premises, roads or bridges.

12 The ECB framework of India comprises of the Foreign Exchange Management (Borrowing and Lending) Regulations 2018, and the Master Direction-External Commercial Borrowings, Trade Credits and Structured Obligations issued and updated by the RBI from time to time.

All-in cost of ECB cannot exceed the benchmark rate[13] plus 450 basis points spread. Prepayment charge or penal interest, if any, for default or breach of covenants cannot exceed 2 per cent over and above the agreed rate of interest on the outstanding principal amount.

The minimum average maturity period (MAMP) for ECB cannot be less than three years. However, for certain specified categories of ECB, different MAMP has been specified under the ECB norms (for example, MAMP is one year only in the case of ECB raised by manufacturing companies up to US$50 million or its equivalent per financial year, and five years in the case of ECB raised by an Indian entity from a foreign equity holder for working capital purposes, general corporate purposes or for repayment of rupee loans).

Stamp duty implications in the case of cross-border mergers

Both inbound and outbound mergers may also have implications in India under the legislation related to stamp duty, which is the Indian Stamp Act 1899 (Indian Stamp Act). In India, both the central legislature as well as the state legislatures can frame the law on stamp duty. Accordingly, almost every state has enacted its own law on stamp duty.

While some states have adopted their own stamp acts, certain other states have adopted the Indian Stamp Act and have merely revised the schedule on the stamp duty rates. Some states have specifically provided for levy of stamp duty on court orders approving scheme of merger or amalgamation, although there are still several states that do not have a specific entry for stamp duty on court orders approving schemes of merger or amalgamation.

The Supreme Court of India has, in the past, held that court orders approving schemes of amalgamation or merger are subject to stamp duty, which is calculated on the basis of the consideration received by shareholders of the transferor company. Accordingly, an order of the NCLT approving a scheme of cross-border merger may attract stamp duty.

Implications under merger control framework

Both inbound and outbound mergers would also be subject to the merger control framework of India if the proposed transaction meets the jurisdictional thresholds. These thresholds are revised from time to time by the government of India, in consultation with the CCI.

The merger control framework is governed by the Competition Act 2002 and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations 2011 (Combination Regulations). Any transaction (including mergers and amalgamations) that meets the jurisdictional thresholds, and is likely to have an appreciable adverse effect on competition (AAEC) within the relevant market[14] in India is prohibited under the merger control framework.

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13 Benchmark rate in the case of foreign currency ECB/trade credit (TC) refers to six-month LIBOR rate of different currencies or any other six-month interbank interest rate applicable to the currency of borrowing (for example. EURIBOR). Benchmark rate in case of rupee-denominated ECB/TC will be prevailing yield of the government of India securities of corresponding maturity.

14 The term 'relevant market' means the market that may be determined by the CCI with reference to the relevant product market or the relevant geographic market or with reference to both the markets. 'Relevant product market' means a market comprising all those products or services that are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or

The current jurisdictional thresholds are:

- at the individual level:
  - the parties have combined assets of more than 20 billion Indian rupees or combined turnover of more than 60 billion Indian rupees in India; or
  - the parties have combined assets of more than US$1 billion, including at least 10 billion Indian rupees in India, or combined turnover of more than US$3 billion, including at least 30 billion Indian rupees in India;
- at the group level:
  - the group has assets of more than 80 billion Indian rupees in India or turnover of more than 240 billion Indian rupees in India; or
  - the group has worldwide assets of more than US$4 billion including at least 10 billion Indian rupees in India or worldwide turnover more than US$12 billion including at least 30 billion Indian rupees in India.

A transaction (including cross-border merger) meeting the prescribed threshold is required to be notified to the CCI, and cannot be effective until a period of 210 days has passed or the CCI has approved the proposed combination (whichever is earlier).

Schedule I of the Combination Regulations, however, sets out certain categories of combinations that are ordinarily deemed to have no AAEC in India. There is no requirement to notify such categories of combinations to the CCI. In addition to this, the government of India has exempted any transaction involving acquisition or merger or amalgamation from the notification requirement where the value of assets being acquired, taken control of, merged or amalgamated is not more than 3.5 billion Indian rupees in India or turnover is no more than 10 billion Indian rupees in India.

Conclusion

In the case of domestic mergers, there are certain tax benefits available under Indian income tax laws. However, similar benefits are not available in the case of outbound mergers. As a result, not many Indian companies are currently keen to opt for outbound mergers in the absence of tax reliefs.

Further, in the case of inbound mergers, the resultant Indian company is not permitted to repay overseas borrowings for a period of two years. This could result in entities facing challenges in obtaining approvals or consents from foreign lenders to such condition. If the foreign lenders do not accept this condition, parties may have to restructure the terms of such overseas borrowings in order to bring them in line with the provisions of the Cross Border Merger Regulations.

services, their prices and intended use. 'Relevant geographic market' means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogeneous and can be distinguished from the conditions prevailing in the neighbouring areas.

9

Procedure and Protection of Intellectual Property in M&A

Shikha Sachdeva[1]

Introduction

M&As are an integral part of a growing economy and take place both during times of rapid economic growth and when there is turbulence in the economy. M&As pave the way for the expansion and sometimes survival of businesses by enhancing business synergies and maximising returns to key stakeholders. The Indian corporate sector experienced a boom in cross-border M&As after the liberalisation of the Indian economy in 1991. In 2019, there were close to 50,000 M&As,[2] worth US$3.7 trillion[3] in the world economy and of those 1,684 were in India, with a value of US$75.52 billion.[4]

In today's brand- and innovation-driven world, the intellectual property (IP) of a business is its source identifier and, in most cases, one of its most valuable assets, although an intangible one, primarily on account of the goodwill associated with it. An organisation that has a well-managed IP portfolio can realise a lot of value from it in M&As.

An M&A with a target having a well-curated IP portfolio is the swiftest and the surest way of gaining access to a new product line, competencies, technology, marketplace, customer base or geography. The brand recognition and goodwill associated with the acquired IP assist in gaining a foothold in the new sector and steadily expanding.

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1 Shikha Sachdeva is managing partner with ASM Law Offices.

2 Number of merger and acquisition deals worldwide 1985–2019, M Szmigiera, 24 February 2020, available at www.statista.com/statistics/267368/number-of-mergers-and-acquisitions-worldwide-since-2005.

3 Value of mergers and acquisitions worldwide from 1985 to 2019, M Szmigiera, 24 February 2020, available at www.statista.com/statistics/267369/volume-of-mergers-and-acquisitions-worldwide/.

4 M&A Statistics by Countries, Institute of Mergers, Acquisitions and Alliances, available at https://imaa-institute.org/m-and-a-statistics-countries/.

Typically, in M&As, the IP transaction is captured in the license or sale agreement. While doing an IP transaction, the applicable laws of the jurisdiction where the IP is registered and that jurisdiction's reciprocal obligations need to be factored in.

Some successful examples of IP-driven M&As in the Indian context in recent times are of Marico Ltd, one of India's leading fast-moving consumer goods (FMCG) companies. From 1995 to 2018, Marico had successfully acquired various well-known brands, which included SIL from KFL, Hindustan Lever Limited's Nihar, Zed Lifestyle's male grooming brand Beardo, Set Wet, Livon and Zatak and certain other personal care brands owned by Reckitt Benckiser.[5]

Additionally, Star India, a unit of 21st Century Fox, acquired the entire broadcast business of MAA Television Network Ltd. MAA TV had four Telugu entertainment channels – MAA Gold, MAA Music, MAA Cinema and MAA General Entertainment. The MAA TV acquisition gave Star access to the 20 billion Indian rupees Telugu television market, India's second-largest regional TV market in terms of revenue. Before this acquisition, Star did not have a Telugu channel under its portfolio.[6] This strategic decision was taken to strengthen its portfolio and pave its way into a critical market.

In similar vein, Havells India Limited, India's leading electronics company, acquired Lloyd Consumer Durable Business Division (Lloyd Consumer). The acquisition was executed at an enterprise value of16 billion India rupees on a debt-free, cash-free basis. Havells acquired the entire consumer business infrastructure, which included the absolute, exclusive ownership and rights to the entire intellectual property of Lloyd Consumer, its logo, trademark, goodwill and attendant rights. Through this acquisition, Havells made a foray into the consumer durables industry currently estimated at US$15 billion.[7]

Leading world brands have also been active in India. Hindustan Unilever Ltd (HUL) completed the merger of GlaxoSmithKline Consumer Healthcare Limited (GSKCH) with itself for 317 billion India rupees and additionally paid 30.45 billion Indian rupees to acquire the Horlicks brand for India from GSKCH. Other brands such as Horlicks, Boost and Maltova, all owned by GSKCH, are now a part of HUL's food and refreshments business falling under the nutrition category and HUL will also distribute GSK's brands such as Eno, Crocin, Sensodyne, etc. The merger was first announced in December 2018, making it one of the biggest deals in India and giving HUL, already India's largest packaged consumer goods company, more room to dominate.[8]

In another example of a brand-driven acquisition, Dabur India acquired three Balsara Group companies, which gave it access to seven well-entrenched brands – Promise, Babool and

5 Marico Limited Company History, *Business Standard*, available at www.business-standard.com/company/marico-12585/information/company-history.

6 Star India acquires MAA TV's broadcast business for Rs 2.5k cr, *Business Standard*, available at www.business-standard.com/article/companies/star-india-acquires-maa-tv-broadcast-business-for-around-rs-2-500-crore-115021100616_1.html.

7 Havells completes acquisition of Lloyd Consumer Durable Business, available at www.havells.com/HavellsProductImages/HavellsIndia/pdf/About-Havells/News_media/press-release/2017-2018/Havells%20completes%20acquisition%20of%20Lloyd-May%208.pdf.

8 HUL-GSK merger complete, FMCG giant buys Horlicks brand for Rs 3,045 crore, *Live Mint*, Suneera Tandon, available at www.livemint.com/companies/news/hul-acquires-horlicks-as-company-completes-merger-with-gsk-consumer-11585732372435.html.

Meswak toothpastes, Odonil air freshener, Odopic utensil cleaner, Sanifresh toilet cleaner and Odomos insect repellent.[9]

IBM acquired Daksh e-Services, the third-largest Indian call centre and back-office service provider, and thus not only gained a core competency but also Daksh's copyrighted software codes and related IP.[10] This acquisition was more technology-driven.

This brings us to the question of what requires primary focus while traversing an IP-driven M&A. In our experience, the critical pivots of a transaction of this nature are a robust IP due diligence and sound IP valuation.

IP due diligence in M&As

Often the IP analysis and valuation in M&As is merely a proforma component of the due diligence. Many M&A companies do not look at the IP portfolios involved from the point of exploitation or valuation.

This is sometimes true even in the drug industry, where companies live or die on the strength of their patent holdings. According to Cynthia O'Donohue, principal information specialist at global drug company Allergan, businesses do not always look closely enough at the patent issues involved in a merger or acquisition. 'A company may see that the firm it wants to buy has all these wonderful patents', she explains, 'but sometimes they don't ask when those patents expire. And especially if they're acquiring a smaller firm, executives have to ask if the company has maintained its patents. If the maintenance fees are not paid, then those patents have elapsed. What's more, can those patents be invalidated? Are there loopholes or improper claims or prior art errors in them? If you can invalidate them, so can someone else.'[11]

A comprehensive IP due diligence (DD), on the other hand, in an M&A can very well steer the course of the transaction by ascertaining the health of the IP portfolio of the target. It helps identify and mitigate the potential risks associated with the transaction. For this reason, it is advisable to conduct the IP DD at the start of the transaction, so all facts are on the table in the early stage of the transaction.

From the perspective of the company acquiring the IP, a DD with special focus on IP is crucial, since it helps assess its current status, intrinsic value and more importantly status of the IP of the target in all geographies being covered in the M&As. The acquirer gets a complete understanding of the target's IP and more importantly if the target has the requisite IP for conducting the business that is of interest to the acquirer.

From the seller's perspective, an IP DD is crucial, since it assists in determining the value of the IP assets involved as part of the transaction and thereby optimises the value of the entire transaction.

9 B Rajesh Kumar, *Mergers and Acquisitions Text And Cases 325* (Tata McGraw Hill Education Private Limited, 2011).

10 IBM to Acquire Daksh eServices, *The Hindu*, 8 April 2004, www.hindu.com/2004/04/08/stories/2004040804721800.htm.

11 Kevin G Rivette, Henry R Nothhaft and David Kline, 'Discovering New Value in Intellectual Property', *Harvard Business Review* (January–Feburary 2000 Issue), available at https://hbr.org/2000/01/discovering-new-value-in-intellectual-property.

A classic example often cited for a DD not conducted comprehensively is that of Volkswagen's acquisition of the Rolls-Royce Motor Car business from the conglomerate Vickers plc for US$790 million. The deal left out one critical asset, the Rolls-Royce brand. The trademark was controlled by British jet engine maker Rolls-Royce plc, which instead transferred the Rolls-Royce Motor Cars brand to BMW for US$66 million. Volkswagen owned the Rolls-Royce car business and could make and sell the same Rolls-Royce cars from the same manufacturing facility as Rolls-Royce Motor Cars had done, but it could not use the name. Volkswagen reached a settlement with BMW enabling Volkswagen to use the Bentley name, but Volkswagen lost perhaps the most valuable asset of the business: the brand recognition and goodwill associated with the Rolls-Royce name. It was a significant embarrassment for the Volkswagen Group, a coup of sorts for BMW and a significant lesson for the M&A professionals involved.[12]

Before commencing IP DD, our firm encourages multiple interactions with the client to ensure that the team conducting the DD process is well aware of the purpose that the transaction is seeking to achieve and, more importantly, have a clear understanding of the role of IP in the overall transaction. Based on our experience, an IP due diligence involves ascertaining the following:

- key IP assets of the target;
- health of the IP portfolio of the target;
- monetary value that can be attached to the IP of the target; and
- the goodwill and brand recognition associated with the IP of the target.

Steps in conducting due diligence

Signing of a non-disclosure agreement

Prior to commencing the IP due diligence process, a mutual non-disclosure agreement should be signed between the acquirer and the target. This is required to protect the information disclosed during the process in case the transaction does not materialise.

A perfect case highlighting the importance of executing a non-disclosure agreement is that of *Stac v Microsoft*. Microsoft expressed a will to cooperate with Stac on a data-compression program called Stacker, planning to include it in Microsoft's MS-DOS 6.0, a 1993 update of the operating system used in most personal computers. However, the licence agreement was never concluded and several months later, Microsoft introduced the update of the operating system containing DoubleSpace, a compression program based on the same algorithm as Stacker. Stac sued Microsoft for several infringements including patent infringement, copyright infringement and trade secret violations based on the information received during the due diligence process. Stac managed to win compensatory damages of US$120 million on account of patent infringement and a permanent injunction to stop further infringements. Afterwards Microsoft was forced to 'lobotomise' its operating system and remove DoubleSpace from the software package. This decision is often perceived as a new paradigm of the David and Goliath story, as Stac was able to save itself from annihilation by a considerably more powerful counterparty and enforce its rights in the courtroom.[13]

12 Nader A Mousavi, 'The evolving role of intellectual property in M&A transactions', *Intellectual Asset Management* magazine issue 48 (July/August 2011) 31 (2011).

13 Glazier, SC, *Technology Deals*, LBI Law And Business Institute, 2nd Edition, 2003, p10.

Identifying the IP assets of the target

The IP assets of the target should be disclosed honestly and transparently by the target to the acquirer. This can be done by the circulation of a comprehensive list detailing all assets by the target in the data room. A questionnaire can also be circulated by the acquirer, detailing the information required. IP as an asset category broadly includes trademarks, copyrights, designs, patents and trade secrets.

Evaluating the IP title and ownership

Evaluation of the IP title determines whether the target has the necessary IP ownership to enhance and facilitate the business of the acquirer. If the target does not have the requisite rights in the IP, which is the crux of the transaction, the question of transferring any right, interest or title in the same to the acquirer does not arise. The evaluation process involves:

- review and analysis of the registrations and pending applications pertaining to the IP portfolio, with special attention to :
  - registrations: whether they are valid and subsisting or have expired. The registrations that are valid are of prime value. The registrations that have expired are equally important from the point of view of the acquirer, as the same will not be of any value; and
  - pending applications: the stage and the likelihood of the pending applications successfully maturing to registration, as it is the registration that accords statutory rights; and
- proprietor, as it appears in the records of the Intellectual Property Office. Often the target, unknown to the acquirer, is operating on the IP of another entity. These arrangements are relatively common in the case of group companies, where the IP is in the name of one company and the same is used by the other group companies, often without any formal arrangement regarding the terms of use. Moreover, in home-grown businesses, the IP is generally registered in the name of the promoters. The IP that forms the crux of the transaction, if not in the name of the target, should meticulously and validly be assigned to the target. If the IP rights are in the name of the target, can they be validly transferred further.

All of the above play an important part in the valuation of the IP of the target and determining the monetary value of the transaction. See 'IP valuation' later in the chapter.

Evaluation of the IP rights of the target in different jurisdictions

IP rights are territorial in nature and valid for a limited period. It is therefore crucial to evaluate the IP rights of the target in the jurisdictions where the rights are proposed to be exploited by the acquirer. This involves, among other things, identifying the jurisdictions in which the acquirer intends to exploit the IP rights; ascertaining and evaluating the IP assets of the target in those jurisdictions; and evaluating the IP title and validity in those jurisdictions.

A well-known example of territorial due diligence being ignored in a transaction is that of the Sanofi-Aventis Pharmaceuticals mega-merger, which was locked in patent challenges regarding its three biggest selling drugs, because product clearance and due diligence were not carried out in each geographic market, which resulted in the drugs generating no revenue.[14]

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14 Sanofi, Aventis to Merge, *Philadelphia Business Journal*, 26 April 2004, www.bizjournals.com/philadelphia/stories/2004/04/26/daily4.html.

Evaluation of third-party rights in the IP of the target

It is of paramount importance to evaluate the existence of any third-party rights in the IP of the target. If third-party rights exist, their nature and extent need to be examined, as they might well obstruct the rights of the acquirer to exploit the IP. The analysis and review of agreements entered into by the target with third parties, including distribution agreements, packaging agreements, licensing agreements, contractual agreements with third parties and internal employee agreements are generally sufficient to analyse and ascertain the existence of any external rights in the target's IP.

Evaluating IP infringements and reviewing litigation documents

The evaluation and analysis of the likely results of an existing dispute or a potential dispute are important as they can have a severe impact on the freedom of the acquirer to use the IP post-acquisition. In the trademark sense, if there is a dispute pending with respect to the brand that is the mainstay of the transaction, and it is likely that the use of the brand might be compromised or injuncted as a result of the litigation, in this scenario it would not make sense to acquire the disputed brand, as the acquirer's rights to the brand will be not be unfettered. If the acquirer decides to proceed with the acquisition, despite the pending litigation, the time and costs likely to be entailed to contest the litigation after the acquisition should be factored in, as the same should not outweigh the benefits of the acquisition; if they do, then it makes no sense to acquire the brand.

A classic example of these aspects is when Viacom had launched a US$1 billion action against Google following its US$1.6 billion purchase of YouTube, on the basis that YouTube had infringed its rights. Google's acquisition process had not taken into account YouTube's business conflicts with other parties.[15]

Final due diligence report

Once all the aspects of the due diligence are covered, the final due diligence report is prepared documenting the results. The final due diligence report, as a general practice, sets out the potential risks, liabilities and benefits associated with the transaction; as well as strategies to mitigate those risks and liabilities and whether it would make business sense to go ahead with the acquisition.

IP valuation

After completion of the due diligence, the parties have a clear idea for undertaking the tricky task of IP valuation. The value of IP is the monetary value of the IP that is expected to be received from the licence or transfer of the IP.

IP valuation presents a dilemma, as there is no standardised method for doing so. In particular, challenges arise when the IP valuation has to be done across jurisdictions, as valuation methods will vary depending upon the jurisdiction involved (ie, tax and other regulations, government policies and the market trends applicable). There are three methods of IP valuation:

15 Viacom Will Sue YouTube, *BBC News*, 13 March 2007, http://news.bbc.co.uk/2/hi/business/6446193.stm.

- cost method, which is usually chosen when the IP is at a nascent stage and has not been in extensive and lengthy use. In such cases the cost of creating the IP is taken into account, often known as the historic cost and how much it would cost to recreate it at the current rates;
- market approach, which is based on market insights, comparison of values of similar transactions and industry benchmarking; and
- income Method, also known as the economic benefits method, which looks at the historic revenues generated by the IP and calculates the future revenues the IP will generate and the cost of generating that income. This method uses the IP future prospects as the basis of the valuation.

These methods can be concurrently used to arrive at a final IP valuation. To value the IP, the results of the DD are relied upon as they set out in detail the status of the IP portfolio of the target, as discussed above.

Smith and Parr have estimated the percentage of the value created by intangible assets in several renowned companies such as Johnson & Johnson (87.9 per cent), Procter & Gamble (88.5 per cent), Merck (93.5 per cent), Microsoft (98.7 per cent) and Yahoo! (98.9 per cent). This sample proves that the prevalence of intangible assets is imminent across the industries, not being limited to pharmaceutical, software or internet companies. Moreover, the same result of IP dominance could be expected in the case of innovative startups whose core value often reaches 100 per cent in intangibles. Whether being an experienced player in the market or a venture capitalist, valuation of intangible assets appears to be strategic dilemma.[16]

IP warranties and indemnities

Before the closure of the transaction, it is necessary that the relevant IP warranties and indemnities be executed by the parties. The IP warranties in a transaction should include warranties stating explicitly that the target is the lawful proprietor of the IP being assigned or transferred, the said rights are sufficient to conduct the proposed business utilising the said rights and the IP rights being assigned or transferred do not infringe any third-party IP rights and the rights to use the same are unfettered.

An IP indemnification is taken from the target (assignor) to indemnify the acquirer (assignee) against any third-party infringement claims with respect to the IP rights assigned. The indemnification can be limited to a certain period following the transaction closing date and does not need to be in perpetuity.

It is crucial that the IP warranties and guarantees with respect to the transaction be as clear and specific as possible in order to avoid ambiguity and post-transaction litigation.

Transfer of IP in the name of the acquirer post-M&A

The intellectual property rights of the target company must be transferred into the name of the buyer in every jurisdiction where such rights exist. Timely recording in the appropriate jurisdictions of the change of ownership is essential for protecting the ongoing validity of the IP and enforcing the IP rights by the acquirer.

16 'Intellectual Property in Mergers and Acquisitions: Deal Maker or Deal Breaker? A Substantive Analysis of Due Diligence in IP-Driven Mergers and Acquisitions', Ivona Skultetyova, Tilburg University.

Moreover, if the recordal of the change is not done in a timely manner, it may result in the following:

- lapse of any deadline of renewals or deadline-specific actions that can be carried out only by the proprietor on record;
- enforcement of an IP right that can be done only at the instance of the proprietor can be lost, in the absence of timely recordal. For example, in the case of an infringement of the acquired IP, if the acquirer is not on record as the proprietor of the IP or the relevant documents for recordal of the IP have not been filed before the concerned Intellectual Property Office, then enforcing the same would be extremely cumbersome for the acquirer;
- adversely affect any transaction that the acquirer may want to enter with respect to the acquired IP with a third party, since the acquirer will not be on record as the proprietor of the same; and
- valuable IP rights could be lost owing to the lapse in recordal of the same by the acquirer post-acquisition.

The recordal of the IP rights in the name of the acquirer is usually done at the acquirer's expense. This should be specified in the agreement.

Conclusion

As the world moves towards brand-centric and innovation-driven economies, the value and importance of IP assets keeps increasing in leaps and bounds day by day.

For IP owners looking to realise the monetary value for their intangible assets, the range is greater than ever before. This in turn makes it essential to protect IP, especially when it comes to M&As where IP assets are often referred to as the ultimate M&A dealbreaker. The power of IP to influence or even determine the outcome of an M&A is only going to grow in the future. Thus the IP of a company should be well protected and be primed especially where an M&A is anticipated and is part of the growth plan of the company.

Organisations that manage their IP portfolios efficiently will ultimately be the winners, as a majority of M&As in times to come will take place only to acquire the IP of the target, leading to rapid growth on this basis.

10

Dispute Resolution and M&A and Criminalisation of Civil Disputes

Shreyas Jayasimha, Rajashree Rastogi and Krishnan Shakkottai[1]

Part 1 – Dispute resolution and M&A

Introduction

Driven by macroeconomic factors, with India being one of the fastest-growing emerging economies and the ever-growing demand for energy resources to sustain that growth, there is a great deal of focus on renewable energy (which accounts for 23 per cent of installed capacity) and efforts to channel foreign investment into the energy sector,[2] which in turn provides ripe opportunities for M&A activity in the sector. While at a high level there are positive drivers, the complex regulatory environment of India does entail some challenges, particularly to foreign investors, and consequently identification of some of those issues is critical to managing the risk of litigation or disputes that may arise.

M&A disputes typically involve issues relating to failure to disclose all relevant information on account of fraud or misrepresentation, breaches of warranties, price adjustments, etc. While in principle disputes can arise both before and after closing a deal, typically M&A disputes with a nexus in India fall in the latter category. The various issues that typically arise in the context of M&A in India are sector-agnostic and thus all issues relating to dispute resolution in this chapter are not just applicable to the energy sector. However, some peculiarities do exist specific to the energy sector given the highly regulated nature of the sector and the heavy presence of state entities in the supply chain.

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2 Kelvin Ross: 'The changing face of India's power sector', *Smart Energy International* (3 April 2020), www.smart-energy.com/industry-sectors/policy-regulation/the-changing-face-of-indias-power-sector/.

Modes of acquisition

As in many other jurisdictions, acquisitions may be carried out through various modes, which ultimately have a significant bearing on the mode of dispute resolution in relation to such acquisitions. The typical modes of acquisition include:

- acquisition of shares of a listed or unlisted company;
- acquisition of a business by distress sale; and
- merger and amalgamation as under schemes of arrangement.

M&A activity pursued under the schemes of arrangement provisions of the Companies Act may in certain circumstances require disputes to be necessarily referred to Indian courts, as certain disputes have been held to be incapable of reference to arbitration.

Statutory framework

The statutory framework governing M&A is quite broad and it is not feasible to lay out an exhaustive list. However, the key relevant legislation, especially concerning disputes related to M&A transactions, is as follows:

- Companies Act 2013 (CA 2013);
- SEBI (Substantial Acquisition of Shares and Takeover) Regulations 2011 (Takeover Regulations);
- Income Tax Act 1961;
- Exchange Control Regulations and Foreign Exchange Management Act 1999 (FEMA); and
- Competition Act 2002.

In the case of acquisition of stressed assets, the Insolvency and Bankruptcy Code 2016 comes into play.

M&A under CA 2013 are effected under Chapter XV on 'Compromises, Arrangements and Amalgamations'. The terms 'merger'" or 'acquisitions', while not defined under CA 2013, are referred to as arrangements given that they involve an arrangement between the companies that are to be merged and their respective shareholders. The National Company Law Tribunal (NCLT) is the tribunal vested with the authority to approve such schemes, which will be duly considered when a 75 per cent majority of shareholders or creditors proposes to undertake such a scheme.

As per section 234 of CA 2013, the provisions under Chapter XV apply mutatis mutandis to M&A by foreign companies. The preconditions for such acquisitions are that the foreign company must be from a jurisdiction notified by the central government and that prior approval of the Reserve Bank of India (RBI) must be procured.

The Takeover Regulations regulate the acquisition of shares, control and voting rights in listed companies. A mandatory open offer requirement is triggered where a company acquires shares in a listed company in excess of 25 per cent of the total holding or equivalent voting rights. The Takeover Regulations do provide for some exemptions from the open offer requirement, with acquisitions by scheme of arrangement being one among them.[3]

3 Regulation 10(1)(d).

Disputes in M&A

M&A disputes are broadly contractual in nature, such as breach of a warranties, post-deal price adjustments, etc, which are typically resolvable by arbitration or a civil suit. However, there are some disputes that are not purely contractual in nature and that usually involve rights in rem, which have been determined by courts to be inarbitrable and therefore necessarily are required to be litigated. Further there are some disputes that may arise entirely relating to regulatory issues, such as under securities laws, competition regulations, tax laws, etc, that will require acquirers to engage in litigation in Indian courts.

Contractual disputes

Contractual issues that are to be decided inter se between the acquirer and the target are generally preferred to be settled by arbitration. The terms set out in the contract largely determine the kind of disputes that may arise.

Concealment of material information and misrepresentation

In 2008 Daiichi Sankyo, a Japanese entity, acquired a majority stake in an Indian company, Ranbaxy Laboratories Ltd. After the completion of the acquisition, a dispute arose out of the share purchase and share subscription agreement wherein the acquirer claimed that the sellers made false representations and fraudulently induced the transaction by concealing the genesis, nature and severity of pending investigations by the US Food and Drug Administration and Department of Justice against Ranbaxy. The matter was referred to a Singapore-seated arbitration under ICC Rules with an award passed in favour of Daiichi Sankyo. The arbitral tribunal had concluded that even though Daiichi Sankyo exercised majority control of the board of Ranbaxy, owing to the compartmentalised nature of information and communications within Ranbaxy Laboratories Ltd made available to it, the fraud and misrepresentation could not have been discovered at an earlier time even on reasonable diligence. Daiichi Sankyo was subsequently successful in securing enforcement of the award by the Delhi High Court, wherein the court held that it 'is not for this court to dwell deep into these aspects while considering objections under section 48 of the Arbitration Act'.[4]

Contractual provisions and statutory violations – Securities and FEMA Regulations

There have been issues with put or call options that are commonly found in M&A share purchase agreements that have since been clarified by the Securities and Exchange Board of India (SEBI) to be valid and enforceable.[5] However, there were some doubts as to the validity of such a provision entered into prior to 2013 (which are also not covered by SEBI's clarification as it was only prospective) given the prohibitions against contracts in derivatives not traded on the stock exchanges and earlier circulars by SEBI.

In 2007 Edelweiss Financial Services Limited entered into a share purchase agreement with Percept Finserve Private Limited for purchase of certain shares of Percept Limited, which inter alia provided that upon breach of certain conditions by Percept, the acquirer would have the option to resell the shares back to the seller at such price as would give the acquirer an internal

4 *Daiichi Sankyo Company Ltd v Malvinder Mohan Singh & Ors*, Delhi High Court, 31 January 2018.

5 SEBI Notification LAD-NRO/GN/2013-14/26/6667 dated 3 October 2013.

rate of return of 10 per cent. Non-adherence to the terms led to the same being referred to arbitration where ultimately the arbitrator held the put options to be illegal, as such options constituted forward contracts, which were prohibited. This award was subject to set-aside proceedings under section 34 of the Arbitration and Conciliation Act, where the Bombay High Court set aside the arbitral award on the ground of 'patent illegality', as it found that there was no general prohibition of such options contracts even prior to 2013 and such contracts are valid and enforceable.[6] More recently, in *Banyan Tree Growth Capital LLC v Axiom Cordages Ltd & Ors*,[7] in relation to the enforcement of a Singapore-seated foreign award rendered by a tribunal constituted under Singapore International Arbitration Centre Rules, the Bombay High Court dismissed the respondent's challenge made on the ground that the put options deed entered into by the parties to a shareholders' agreement (SHA) was illegal and violative of public policy of India. The court upheld the validity of put options entered into in 2008 by the petitioner, who was a foreign private equity investor, with the promoters of Axiom Cordages Ltd under the Indian securities regulations inter alia on the basis that the Securities Contract Regulation Act intended to prohibit speculative transactions, and put options of the kind found in an SHA providing an investor an exit opportunity do not amount to such a speculative trade. The court further held that the SEBI notification dated 3 October 2013 reflected 'a complete statutory recognition in regard to shareholders' contracts for purchase or sale of securities, containing a put option and permitting an exercise of option under such agreement' and that it was also applicable to agreements entered into prior to the issuance of the notification. The *NTT Docomo Inc v Tata Sons Ltd* decision by the Delhi High Court in relation to enforcement of an award by the London Court of International Arbitration is another instance where put options were not considered to be violative of the FEMA Regulations and thus did not attract any ground for non-enforcement under section 48 of the Arbitration and Conciliation Act.[8]

In *Vijay Karia*,[9] the Supreme Court considered an award that was made in a dispute arising out of an SHA involving promoters of an Indian company and an Italian corporate buyer. The final award directed the Indian promoters to sell shares held by them at a discounted rate to the Italian corporate buyer. The aggrieved party sought to resist enforcement of the award on the basis that it violated rule 21 of the Foreign Exchange Management (Non-debt Instrument) Rules 2019. However, the court noted that there is no provision in FEMA that automatically voids transactions that are in violation of its provisions. The court observed that the scheme of the legislation allows for permission for such transfer of shares to be sought from the regulatory authority (ie, RBI) ex post facto and therefore held that a rectifiable breach under FEMA cannot be considered a violation of the fundamental policy of Indian law that would render the award unenforceable (while noting that the RBI may exercise its regulatory authority and insist that the shares be sold at market value).

6 *Edelweiss Financial Services P Ltd v Percept Finserve P Ltd*, 2019 SCC Online Bom 732.

7 *Banyan Tree Growth Capital LLC v Axiom Cordages Limited, Responsive Industries Limited & Wellknown Business Ventures LLP, Bombay High Court judgment dated 30 April 2020.*

8 *NTT Docomo Inc v Tata Sons Ltd*, 241 (2017) DLT 65.

9 *Vijay Karia v Prysmian Cavi E Sistemi SRL*, 2020 SCC Online SC 177.

This decision of the Supreme Court is consistent with the judgment of the Delhi High Court in *Cruz City 1 Mauritius Holdings v Unitech Ltd*,[10] which held that an arbitral award that required the honouring of a clause mandating guaranteed returns, even if found violative of foreign exchange regulations, does not amount to a violation of public policy to justify its non-enforcement.

Bank guarantees

The unconditional bank guarantee is considered to be among the most secure forms of protection against various risks in M&A transactions. However, there are occasions where there may arise differences over interpretation of contractual clauses, which can muddy the waters on such provisions. However in the context of bank guarantees, the courts will rarely interfere in their invocation and there are only a few circumstances where a grantor of a bank guarantee can prevent the beneficiary from obtaining payment, such as where it is shown that the invocation is vitiated by egregious fraud or there exist 'special equities' such that invocation of the bank guarantee would result in irretrievable injury to the guarantor.[11]

Material adverse event clauses

Material adverse event or material adverse change (MAC) clauses are commonly found in contracts to withdraw from contractual obligations under some specified material change to circumstances. For a MAC clause to have effect, it has to be in relation to specified aspects that are provided for within the terms of the agreement and the change ought to be a material one compared with the situation at the time of signing the agreement. The burden of proof as to material change is upon the one who invokes such a provision to be excused from performance. In the Indian context, while there are no decisions directly on point, the Supreme Court's position in the context of the Takeover Regulations is that only in instances of impossibility might non-performance of an obligation be permitted and would consequently have to meet the high threshold under section 56 of the Indian Contract Act, which relates to the doctrine of frustration.[12]

Shareholder disputes – contractual versus oppression and mismanagement claims

In the context of M&A, it is common to find SHAs, joint venture agreements, or even articles of association of companies to contain arbitration clauses, wherein the parties agree to refer contractual disputes to arbitration. However, not all shareholder disputes, whether in the context of M&A or otherwise, are arbitrable per se. As a matter of Indian law, generally rights in rem are inarbitrable and therefore civil suits and arbitrations are permissible only where it is with respect to rights inter se the parties (ie, rights in personam). Based on the principle noted above, the Supreme Court has identified certain classes of disputes to be prima facie non-arbitrable, namely:

- criminal offences;
- matrimonial disputes;
- insolvency and winding-up petitions;

10 2017 SCC Online Del 7810.

11 *Himadri Chemicals Industries Ltd v Coal Tar Refining Co*, AIR 2007 SC 2798; *UP State Sugar Corporation v Sumac International Ltd*, (1997) 1 SCC 568; *Vinitec Electronics P Ltd v HCL Infosystems Ltd*, (2008) 1 SCC 544; *Svenska Handelsbanken v M/s Indian Charge Chrome*, (1994) 1 SCC 502.

12 *Nirma Industries Ltd & Ors v SEBI*, (2013) 8 SCC 20.

- testamentary matters;
- intellectual property rights;[13] and
- the court has also observed that disputes that are subject to the exclusive jurisdiction of specially constituted statutory tribunals may also not be arbitrable under Indian law.[14]

In respect of shareholder disputes where there is some overlap of issues between contractual claims and claims of oppression and mismanagement under the Companies Act, the issue of arbitrability is less than clear, with contradictory judgments in Indian courts.

In *Siddharth Gupta & Ors v Getit Infoservices & Ors*, a dispute arose out of an SHA entered into by the existing shareholders of Getit Infoservices Private Limited with an investor that contained an arbitration clause providing for disputes to be referred to arbitration administered by the Singapore International Arbitration Centre, with its seat in Singapore. The investor acquired a shareholding of 50.1 per cent in the respondent company in accordance with the SHA, which was subsequently increased to 76 per cent. Some of the existing shareholders alleged that the investor's increased shareholding was at a substantial discount to the true value of the shares and filed a petition alleging oppression and mismanagement against the respondent company and the investor before the Company Law Board (CLB), and further contended that the dispute could not be referred to arbitration since the reliefs for oppression and mismanagement could only be granted (by a court) under the Companies Act 1956.

The CLB held that the reliefs sought fell squarely within the scope of the arbitration clause of the SHA and that the allegations in any event were merely of contractual violations and thus allowed the arbitration to proceed. The CLB observed that the 397/398 petition appeared to be a 'dressed up' one and that 'when a party seeks reference to arbitration, obligation is cast upon the court to see whether any prima facie case made under 397/398, if not, then it shall forthwith refer the same to arbitration'. The CLB held that a 397/398 petition can be entertained only if the alleged violations are tainted by malfeasance or malice to cause oppression and if not the arbitration clause is triggered into action.

On the other hand, in *Malhotra v Malhotra*, the Bombay High Court placed emphasis on the nature of reliefs that might be granted in a derivative action for oppression and mismanagement.[15] The thrust of the decision is that arbitral tribunals are not empowered to exercise the broad powers available to a statutory tribunal in an action for oppression and mismanagement such as the ability to appoint an administrator, an observer, or a special committee to oversee the affairs of a company, etc and that 'no arbitration agreement can vest an arbitral tribunal with the powers to grant the kind of reliefs against oppression and mismanagement' like that of a statutory tribunal, and where claims may relate to non-contractual actions that result in the oppression of minority shareholders or mismanagement of the affairs of the company the same is not capable of being referred to arbitration.

However, the court also observed that dressed-up petitions that are filed in the guise of oppression and mismanagement claims in order to oust a valid arbitration agreement, where found to be vexatious, oppressive, and mala fide, reference of the dispute to arbitration may be

13 *Booz Allen and Hamilton Inc v SBI Home Finance*, (2011) 5 SCC 532.
14 *A Ayyasamy v A Paramasivam*, (2016) 10 SCC 386.
15 *Rakesh Malhotra v Rajinder Kumar Malhota*, 2014 SCC Online Bom 1146.

possible. The decision is also founded on the principle that there is no provision in a self-contained code that is the Arbitration and Conciliation Act for the splitting-up of cause of action based on the reliefs sought.[16]

Oppression and mismanagement

Apart from the purely contractual disputes, shareholder disputes may also arise owing to litigious action by minority shareholders of a target company. Such disputes are governed by the provisions of the Companies Act and are subject to the original jurisdiction of the NCLT and the appellate jurisdiction of the National Company Law Appellate Tribunal.

The shareholder of a company who is denoted as a member under the Companies Act may apply to the NCLT under section 241 Companies Act, seeking an order under section 242 Companies Act subject to the criteria stipulated in section 244. In the case of shareholders, 100 members or 10 per cent of the total number of members, whichever is less, or members holding at least 10 per cent of issued share capital may initiate such claims and the NCLT is further empowered to waive these minimum requirements. Although the provisions dealing with shareholders' disputes are dealt with under Chapter XVI titled 'Prevention of Oppression and Mismanagement', the statute does not define either term and thus judicial precedent is the guide as to what constitutes oppression and mismanagement.

The Supreme Court has observed that oppression can occur when the affairs of the company are carried on without probity and fair dealing towards minority shareholders[17] or where it is shown that minority shareholders have been prejudiced in the exercise of their legal and proprietary rights as shareholders, although it has been clarified that the legality of a particular action by the management of the company has no bearing on whether the affairs of the company have been conducted in a manner oppressive to its members.[18]

A claim of mismanagement is brought where the minority shareholders wish to challenge a change in management of the company, composition of the board of directors, or the shareholding pattern of the company. It has been held that directors of a company have a fiduciary duty towards the shareholders of the company (ie, they must act on behalf of the company with the utmost care, skill and due diligence) and that directors owe a primary duty to shareholders to make full and honest disclosure on all important matters. More specifically, the Supreme Court has held applied the doctrine of 'proper purpose', whereby directors owe it to shareholders to only issue shares for a proper purpose.[19]

Most commonly, claims for oppression and mismanagement are brought where shareholders allege exclusion from management,[20] dilution of shareholding,[21] or unauthorised actions by the board of directors.[22] In determining whether there exist just and equitable grounds for ordering the winding-up of a company, Indian courts generally follow the principles laid down by those in the

16 *Sukanya Holdings P Ltd v Jayesh H Pandya*, (2003) 5 SCC 531.
17 *Shanti Prasad Jain v Kalinga Tubes*, AIR 1965 SC 1535.
18 *Needle Industries (India) Ltd v Needle Industries Newey (Holdings) Ltd*, (1981) 3 SCC 333.
19 *Dale & Carrington Invt P Ltd v PK Prathapan*, (2005) 1 SCC 212.
20 *Vikram Bakshi v Connaught Plaza Restaurants Ltd*, [2017] 140 CLA 142.
21 See note 10.
22 See section 180, Companies Act 2013.

United Kingdom.[23] Generally, oppressive conduct is limited to that which is outside the scope of the constitutional documents of a company; however, there may be situations where there are understandings that are not expressly part of the constitutional documents that have been breached.[24]

Issues of control

Under the Takeover Regulations, in respect of acquisition of listed companies, a mandatory open offer is triggered in the following scenarios:

- the moment an acquirer's stake amounts to over 25 per cent of voting rights;
- where an acquirer holds 25 per cent of voting rights, acquisition of 5 per cent additional voting rights in a financial year; and
- where acquirer exercises control over the target.

In regard to the last criterion, the Takeover Regulations define control in a broad way that reads as follows:

> *Control includes the right to appoint majority of directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.*

Given the wide and inclusive definition of the word control, the jurisprudence on what amounts to control has been somewhat subjective. In *Subkham Ventures v SEBI*, the Securities Appellate Tribunal (SAT) on a perusal of the various agreements and provisions arrived at a conclusion that those rights did not amount to control. The SAT distinguished between rights that were meant to protect the interest of an investor (by reference to the contractual provision titled 'Protected Provisions') from rights that provided for day-to-day operational control.[25] However, on account of an out-of-court settlement by the parties, an appeal filed by SEBI at the Supreme Court was dismissed and the Supreme Court recorded that the order passed by SAT 'will not be treated as a precedent'.

Thus there are only decisions of SEBI as guidance, which tend to deal with the issue on a case by case basis. While in the *Jet–Ethihad*[26] Case, SEBI concluded the covenants do not amount to control, in the *NDTV*[27] case SEBI observed inter alia that the subsistence of the agreement even beyond the loan repayment for the exercise of a call option indicates that the said transaction amounts to control. Acquisitions carried on-market thus risk having certain contractual rights including the exercise of options being classified as de facto control, which ultimately may trigger open-offer obligations.

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23 *Ebrahimi v Westbourne Galleries Ltd*, 1973 AC 360 (HL); *Re Saul D Harrison & Sons Plc* [1994] BCC 475; *Hind Overseas P Ltd v Raghunath Prasad Jhunjhunwalla* (1976) 3 SCC 259.

24 ibid.

25 *Subhkam Ventures v SEBI*, SAT, Order dated 15 January 2010.

26 *Re Tailwinds Ltd & Ors and Etihad Airways PJSC*, SEBI WTM Order dated 8 May 2014; see also *Re Kamat Hotels (India)*, WTM Order dated 31 March 2017.

27 *Re NDTV Ltd*, SEBI WTM Order dated 26 June 2018.

Taxing troubles

In the context of cross-border acquisitions, there are few provisions under the Income Tax Act that may lead to disputes between the parties. The following provisions can in particular have an impact on acquisitions:

- as per section 195, a resident payer (buyer) has an obligation to withhold taxes applicable to a transaction with a non-resident payee (seller);
- according to section 163, a resident buyer may be treated as an agent of a non-resident seller and accordingly be assessed for liability to pay tax;
- acquisition of assets from a seller who is subject to pending tax proceedings or demand can be held to be void; and
- transfer pricing issues relating to transactions carried out by related parties of a company prior to acquisition.

In the recent past there have been several instances where tax liabilities have emerged out of past transactions of a company that has since either merged or been acquired, thus leading to post-deal disputes. At the same time, insurers are reluctant to provide tax-liability coverage in the cross-border context owing to the prevalence of such cases.[28] Further there are limits imposed by the RBI regarding deferment of any part of consideration in relation to a holdback for any contingent liabilities or indemnification (currently 25 per cent of consideration value may be set aside for a maximum period of 18 months under the FEMA Regulations).[29] Thus the likelihood of disputes relating to indemnity of tax risks in the context of cross-border acquisitions is significant even in cases where there are clearly worded indemnity provisions in underlying agreements.

Part 2 – Criminalisation of civil disputes

Introduction

With the advent of liberalisation, India has seen an unprecedented growth in its industrial, financial and other sectors. There has been a rapid increase in the influx of foreign investment and the business ecosystem of India has undergone a revolutionary change. Consequently, there have been changes in the legal framework to ensure regulatory compliance and to protect the public at large from corporate wrongdoing.

Various statutes in India prescribe criminal liability for non-compliance of provisions contained in such legislation. The intent of such penal provisions is to not only make corporations accountable for their actions but also to deter them from conducting business in an unscrupulous and improper manner.

Over the years, these criminal sanctions have, however, been manipulated and utilised as a tool to intimidate the other party and also to file frivolous and in many cases malicious

28 'Tax horrors keep insurers away from M&A deals in India', Livemint (11 August 2015) www.livemint.com/Industry/1Jq34yUPpdk7odpBSdlN6N/Tax-horrors-keep-insurers-away-from-MA-deals-in-India.html.

29 Rule 9(6), Foreign Exchange Management (Non-debt Instrument) Rules 2019; Regulation 10A, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2016.

proceedings. More often than not, criminal complaints are also filed in matters of pure commercial civil disputes with a view to either avoid a civil liability, delay legitimate proceedings or to get the other party to the negotiating table. Furthermore, in the wake of a number of widely publicised financial frauds, regulatory defaults that could earlier be addressed through penalties have now been made punishable with a fine, imprisonment or both, by over-zealous regulatory authorities. Furthermore, frequent delays in disposal of cases do not help matters. These issues no doubt pose a concern in the conduct of business, particularly for those from abroad looking to invest in India.

Having said that, with the government's initiative of promoting 'Ease of Doing Business' in India, the need to decriminalise technical defaults and make them compoundable through levy of penalties only has led to the 2019 amendments to CA 2013. Certain offences, such as the issuance of shares at a discount, failure to file annual returns, etc, have been recategorised as civil defaults. Moreover, the power to adjudicate such offences has been moved from the NCLT to central government.

Evolution of corporate criminal liability in India

In this background, it is important to understand the evolution of corporate criminal liability in India. This concept, derived from section 11 read with section 2, Indian Penal Code 1860 (IPC), explains that every person including any company or association, whether incorporated or not, shall be liable to punishment. This principle has also been adopted in CA 2013 as well as the Income Tax Act 1961. The Supreme Court, in the case of *Assistant Commissioner, Assessment-II, Bangalore and Ors v Velliappa Textiles Ltd and Ors*,[30] held that a company cannot be prosecuted for offences requiring imposition of mandatory term of imprisonment coupled with a fine. In a subsequent decision, in *Standard Chartered Bank and Ors v Directorate of Enforcement and Ors*,[31] the Apex Court overruled the above proposition of law. The court observing the definition of the word 'people' in section 11, IPC and section 3(42), General Clauses Act 1897 held that the term includes any company or association of body of person and hence, in cases of offences that mandate both imprisonment and fine, the companies shall be penalised with a fine.

Furthermore, in *Iridium India Telecom Ltd v Motorola Incorporated Co*,[32] the Apex Court held that:

> *a corporation is virtually in the same position as any individual and may be convicted of common law as well as statutory offences including those requiring mens rea. The criminal liability of corporation would arise when an offence is committed in relation to the business of the corporation by a person or body of persons in control of its affairs. In such circumstances, it would be necessary to ascertain that the degree and control of the person or body of persons is so tense that a corporation may be said to think and act through the person or the body of persons.*

Hence the requirement to impose criminal liability in relation to a corporation would encompass the following:

30 AIR 2004 SC 86.

31 AIR 2005 SC 2622.

32 (2005) 2 SCC 145.

- the alleged illegal act should be done within the scope of employment;
- it should cause or accrue a benefit to the company either directly or indirectly; and
- mens rea behind the alleged illegal act. Mens rea is attributed to corporations on the principle of alter ego of the company.

The issue of criminal liability in the case of companies remains controversial and challenging in nature. In its 47th report, the Law Commission of India provided a number of recommendations for the effective resolution of the dispute on the criminal liability of companies in socio-economic crimes.

Criminal liability under the Companies Act 2013

In relation to offences under CA 2013, as stated above, through the 2019 amendments to the Act, various provisions that imposed imprisonment as well as a fine have now been restricted to the payment of penalties. Several offences have been recategorised as civil defaults with the aim to ensure compliance as well as to prevent repetition by imposition of stricter penalties. While many provisions have been decriminalised, the amendment to section 135 introduces imprisonment for three years of an officer in default of the corporate social responsibility directives prescribed under the Act as well as the amendments. This amendment has, however, not yet been notified.

The Company Law Committee set up on 18 November 2019 has made recommendations to the government on further recategorisation of several more criminal compoundable offences to civil wrongs carrying civil liabilities, to facilitate and promote ease of doing business as well as to declog the special courts and the NCLT. While fraudulent activities committed by a company are serious allegations that continue to require criminal sanction, procedural, technical and minor non-compliance such as defaults related to corporate governance norms, etc, have been considered as offences that can be dealt by the civil judicial mechanism. There is, therefore, no change in the treatment of non-compoundable offences. Clearly, a distinction is sought to be made between offences that are mere civil defaults and those that show a premeditated intent to defraud and deceive stakeholders. Such classification eliminates fear of prosecution particularly among investors and provides a boost of encouragement to invest in Indian businesses.

The Companies (Amendment) Bill 2020, based on these recommendations, is pending approval of the Lok Sabha, the lower house of parliament. The Bill further seeks to remove penalties for certain offences and reduce them for certain classes of companies. The penalties shall be levied not only upon the corporation but also every officer in default of the requisite compliance.

While these reforms are welcome and the need of the hour, it is equally true that criminal complaints are resorted to by parties in matters of a civil nature. Such complaints are filed not only against the corporation but also all the directors, including foreign investor nominees, with a view to procure a settlement of the (civil) disputes that may have arisen between the parties or in some cases plainly with a view to harass the other party.

Judicial approach

Indian courts have condemned such abuse of the process of law. Although the quashing of criminal proceedings depends on the circumstances of each case, the Indian courts have laid down principles for quashing a First Information Report (FIR) and resultant criminal proceedings when the underlying issues are of a civil nature. In *Alpic Finance Ltd v P Sadasiva & Anr*, [33] the Supreme Court set out the principles under which a criminal complaint may be quashed:

- *Where the allegations made in the complaint or the statements of the witnesses recorded in support of the same taken at their face value make out absolutely no case against the accused or the complaint does not disclose the essential ingredients of an offence which is alleged against the accused;*
- *where the allegations made in the complaint are patently absurd and inherently improbable so that no prudent person can ever reach a conclusion that there is sufficient ground for proceeding against the accused;*
- *where the discretion exercised by the Magistrate in issuing process is capricious and arbitrary having been based either on no evidence or on materials which are wholly irrelevant or inadmissible; and*
- *where the complaint suffers from fundamental legal defects, such as, want of sanction, or absence of complaint by legally competent authority and the like.*

In a landmark judgment, in *State of Haryana v Bhajan Lal*,[34] the Supreme Court has laid down circumstances under which courts can quash an FIR to prevent abuse of the process of any court or otherwise to secure the ends of justice. The court illustrated the following circumstances:

- *Where the allegations made in the first information report or the complaint, even if they are taken at their face value and accepted in their entirety, do not prima facie constitute any offence or make out a case against the accused.*
- *Where the allegations in the first information report and other materials, if any, accompanying the FIR do not disclose a cognisable offence, justifying an investigation by police officers under Section 156(1) of the Code except under an order of a Magistrate within the purview of Section 155(2) of the Code.*
- *Where the uncontroverted allegations made in the FIR or complaint and the evidence collected in support of the same do not disclose the commission of any offence and make out a case against the accused.*
- *Where the allegations in the FIR do not constitute a cognisable offence but constitute only a non-cognisable offence, no investigation is permitted by a police officer without an order of a Magistrate as contemplated under Section 155(2) of the Code.*
- *Where the allegations made in the FIR or complaint are so absurd and inherently improbable on the basis of which no prudent person can ever reach a just conclusion that there is sufficient ground for proceeding against the accused.*
- *Where there is an express legal bar engrafted in any of the provisions of the Code or the Act concerned (under which a criminal proceeding is instituted) to the institution and continuance of the proceedings and/or where there is a specific provision in the Code or Act concerned, providing efficacious redress for the grievance of the aggrieved party.*

33 *Alpic Finance Ltd v P Sadasiva*, (2001) 3 SCC 513.

34 ibid 3.

- *Where a criminal proceeding is manifestly attended with mala fide and/or where the proceeding is maliciously instituted with an ulterior motive for wreaking vengeance on the accused and with a view to spite him due to private and personal grudge.*

Further, in *Lalita Kumari v Govt of UP*,[35] the Supreme Court laid down the scope of preliminary inquiry required while filing an FIR. If the offence does not seem to be cognisable, the police must undertake a preliminary inquiry before filing the FIR. The court also provided an illustrative list of circumstances where such a preliminary inquiry must be conducted. These include cases of matrimonial disputes or family offences, commercial offences, medical negligence cases, corruption cases, cases where there is abnormal delay or laches in initiating criminal prosecution, etc.

Conversely, in *Sau Kamal Shivaji Pokarnekar v The State of Maharashtra*,[36] it was held that criminal complaints cannot be quashed merely because the allegations made therein appear to be of a civil nature. A criminal complaint or an FIR cannot be quashed merely on the ground that a civil suit is pending and that a mere allegation of mala fide intention against the informant is of no consequence that could be the basis for quashing the proceedings.[37] In *State of Kerala and Ors v OC Kuttan and Ors*[38] it was expounded that the power of quashing a criminal complaint should be exercised only in the rarest of cases.

Thus, where a civil dispute is made into a criminal manifestation, in order to recover dues, out of vengeance to harass or in impediment of a settlement by threatening criminal charges, such criminal suit, FIRs or proceedings are likely to be quashed by the court as vexatious in nature.[39] Cases where a party has a mala fide intention for filing the criminal complaint, in a dispute of purely civil nature, shall be considered as an abuse of process of law.[40] However, where the dispute contained a genuine criminal ingredient and the allegations made by a party in their criminal complaint had sufficient ingredients in proving the allegation, the same would not be quashed. In such circumstances, the courts will quash the complaint only in the rarest of cases.

Apart from CA 2013, criminal sanctions find place in various other business laws. An easier solution to curb the abuse of the process of law as well as to promote investor confidence appears to be removal of such sanctions from relevant business and economic statutes. To this end, the Confederation of Indian Industry (CII) has presented 12 alternative ways for decriminalisation of business and economic legislation to the Indian Prime Minister and Finance Minister. In its report, the CII has recognised 37 Acts, ranging from the Partnership Act 1932, Securities and Exchange Board of India Act 1992, the Securities Contracts (Regulation) Act 1956 to the Insolvency and Bankruptcy Code 2016, and has recommended that offences in these statutes that are of a technical nature or do not affect public interest prejudicially should be decriminalised.[41]

35 *Lalita Kumari v Govt of UP*, 2014 (2) SCC 1.

36 Criminal Appeal No. 255 of 2019 (Arising out of SLP (Crl) No. 7513 of 2014).

37 *State of Andhra Pradesh v Golconda Linga Swamy and Ors*, (2004) 6 SCC 522.

38 *State of Kerala and Ors v OC Kuttan and Ors*, (1999) 2 SCC 651.

39 *Hriday Ranajan Prasad Verma and Ors v State of Bihar and Anr*, (2000) 4 SCC 168; ibid 1; *Anand Kumar Mohatta and Anr v State (Govt of NCT of Delhi)*, SLP (CRL) No. 3730 of 2016; *G Sagar Suri v State of UP*, (2000) 2 SCC 636; *Indian Oil Corporation v NEPC India Ltd & Ors*, (2006) 6 SCC 736.

40 ibid.

41 CII Report, February 2020; CII Media Release, 10 February 2020.

The points envisioned by CII that can be actioned to replace the current criminal provisions are as follows:

- provide for many summons cases concerning relatively minor offences to be compoundable;
- revisit or prescribe limitation periods for assuming jurisdiction;
- introduce a transparent mechanism for no-guilt admission and settlement of technical offences with penalties and not prosecution;
- introduce a dispute settlement mechanism – deferred prosecution agreements (with exceptions);
- introduce one-time settlement schemes;
- consider making summons cases compoundable by expanding the scope of section 320 of the Criminal Procedure Code 1973;
- award costs where courts have observed that there is frivolous litigation or dilatory tactics;
- fill vacancies expeditiously to ensure that benches act at full strength;
- create a process for without-admission-of-guilt settlement of tax and economic offences (with exceptions) to reduce the backlog of future matters and remove some pending matters;
- increase the role of technology in courts with e-filings and the like; and
- introduce plea bargaining and settlement mechanisms.

The objective of such decriminalisation is to avoid civil cases being treated as criminal in nature and to alleviate the fear of prosecution among entrepreneurs, foreign investors and independent directors, which it is hoped will lead to economic growth and prosperity.

Conclusion

Being tough on crime requires making intelligent distinctions between conduct that truly threatens the public and conduct that is better handled by fines or civil law.[42] The responsibility for making this distinction and promulgating suitable laws lies with the legislature, and the implementation of such laws on the parties and their advisers.

42 *Business Standard*, 12 August 2019.

Appendix 1

About the Authors

Neetika Ahuja
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Neetika Ahuja is an associate partner at Clasis Law. Neetika has extensive experience of advising multinational companies on entry and exit strategies, overseas direct investment by Indian companies as well as advising clients in various areas of law such as the Companies Act, foreign exchange and securities laws. Her practice area includes general corporate, regulatory and capital market matters.

She advises clients across various sectors including information technology, telecommunications, infrastructure, manufacturing, services, retail, hospitality and pharmaceuticals. Her scope of work includes conducting legal due diligence, corporate and compliance audits, compliance management and corporate governance matters, in addition to general corporate advisory.

Vineet Aneja
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Vineet Aneja, who is the managing partner as well as the head of the corporate practice at Clasis Law, has over 20 years' experience in a range of areas, including M&A, joint ventures, private equity, corporate advisory, employment and investment funds.

His skill set includes a deep transactional understanding as well as significant industry expertise across industries as diverse as manufacturing, media, medical devices, fashion, technology, telecommunications, infrastructure, hospitality, retail and financial services. Client feedback has highlighted the value his experience adds to both the legal and commercial sides of transactions.

Vineet has been recognised as one of the top 100 lawyers in India by *India Business Law Journal*'s (Vantage Asia) A-List for 2018 and 2019.

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Sai Krishna Bharathan is a senior partner based at the Mumbai office. His practice focuses on foreign investments, offshore and domestic fund formation, and joint ventures, acquisitions and similar investment transactions.

Sai has advised several foreign and domestic investors including sovereign funds, pension funds, strategic investors and private equity funds in a variety of sectors including the real estate and allied space and in other sectors such as financial services, pharma, etc. Sai also advises major offshore and domestic sponsors on the establishment of investment funds.

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Adit N Bhuva is a partner at Eshwars. Adit has hands-on experience in corporate laws, and also in laws relating to capital markets and foreign investment. He has a track record of advising listed entities in making bonus issues, rights issues, preferential offers and has arranged their listing on India's premier stock exchanges. Apart from advising listed companies on their compliance requirements under the Share Based Employee Benefits Regulations, Insider Trading Regulations and Takeover Code, he also advises market intermediaries such as portfolio managers and many unlisted companies on their compliance requirements. Adit also advises foreign companies having a presence in India in their compliance requirements of the foreign exchange laws in India. Adit also leads a team that provides assistance on the compliance requirements under non-tax corporate laws to various business houses.

Rahul Chadha

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Rahul Chadha is the managing partner of Chadha & Co. He works closely with senior management of leading multinational companies on strategy formulation, M&A, infrastructure projects, private equity and venture capital, corporate governance, government policy, and regulatory and management issues that affect their business in India.

Rahul is a member of the board of directors of the Indian subsidiaries of several leading multinational companies. He has served on the board of a leading international association of law firms, accounting firms and tax advisers. Rahul is actively involved in mentoring startups and is a Charter Member of The Indus Entrepreneurs (TiE) and co-founder of the joint mentoring programme of IIM Bangalore and IIT Delhi for startups. He is a sought-after speaker and is the author of several articles and chapters on Indian laws and regulations for domestic and international publications.

In addition to his degree in law, Rahul holds a bachelor's degree in electronics and communication engineering from University of Delhi and an MBA from Indian Institute of Management Bangalore.

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Viral Dave is a senior associate with Agram Legal Consultants. She focuses on areas such as mergers and acquisitions, insolvency and bankruptcy, dispute resolution and securities law.

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M Devaiah is a vice chairman and group general counsel with Everstone Capital Advisors. He joined Everstone in 2007 as general counsel. He leads Everstone's legal and compliance team in their advisory work across investments, diligence, risk and day-to-day operations. Devaiah has over 30 years' experience across a variety of industries, including telecommunications, power, IT services, fast-moving consumer goods, manufacturing, private equity, real estate and multi-modal transport. He previously worked for multinational and leading businesses including Tata Projects, Hindustan Unilever, Carlyle Group, ICICI Venture and BPL, an IT and telecommunications company in India. Devaiah holds a bachelor of commerce, bachelor of laws and master of laws from the University of Mysore.

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Ashish Gupta is a partner in the corporate practice of Chadha & Co, with over 19 years' experience in corporate and commercial matters, advising foreign companies doing business in India.

Ashish's practice encompasses cross-border transactions, M&A, joint ventures, foreign collaborations, technology transfers, private equity, complex due diligence, real estate, banking and various other types of commercial transactions. He has been involved in advising multinational corporations on their business formation, strategic corporate investments, advice on company laws, securities laws, exchange control and foreign investment laws, employment laws, private equity, etc.

Ashish is also a qualified company secretary, and with his team, handles secretarial matters of the client companies including maintaining all statutory records and making regulatory filings with government authorities. He has extensive experience in dealing with ministries, government departments and government authorities.

Syed Yusuf Hasan

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Syed Yusuf Hasan is an associate with Chadha & Co, with over three years' experience as a corporate and commercial lawyer. Yusuf's practice areas include M&A and joint ventures (both domestic and cross-border), corporate laws and governance, infrastructure projects, contracts, foreign exchange control, and competition law.

Yusuf has advised clients and worked on transactions in various sectors including infrastructure (in particular, railways and energy), manufacturing, healthcare, e-commerce, fast-moving consumer goods, automobiles, retail and aviation.

Rachael Israel

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Rachael Israel is a partner at S&R Associates. Her areas of practice include mergers and acquisitions, joint ventures, private equity, commercial contracts and general corporate matters. Rachael has been recognised as a leading lawyer by RSG India Report for Corporate M&A and Private Equity; and by IFLR 1000 for Private Equity and M&A.

Rachael has experience in public and private M&A, venture investments, growth deals and late-stage investments. Her work has included transaction structuring, due diligence, drafting and negotiation of transaction documentation, closing assistance and advice on the takeover code, insider dealing issues, exits and shareholder disputes. She also has experience in advising clients on transactions with government entities from the bidding stage onwards.

She has advised clients on various corporate matters, including under the companies act, the exchange control regulations, various SEBI regulations, privacy and data protection regulations and labour and employment legislation.

In 2012, Rachael was a visiting foreign lawyer at Slaughter and May in London, where she worked on general corporate matters. She is qualified to practise in India and is also qualified in England and Wales.

Shreyas Jayasimha

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Shreyas Jayasimha is the founding partner of Aarna Law LLP. Shreyas read law at the National Law School of India University and was a Chevening Scholar at the University of Warwick. With 20 years' experience in litigation and domestic and international dispute resolution, Shreyas has advised and represented clients across a variety of industrial sectors. He is a trained mediator and has been appointed as an arbitrator in India and internationally. He is currently a co-counsel for a state party in two significant ongoing investment treaty arbitrations.

Shreyas spearheads Aarna Law's banking, finance and insolvency practice. He advises an array of clients including banks, financial institutions and non-banking financial companies, including assisting banks and asset recovery companies in India to recover wrongfully retained assets presently concealed abroad, or round-tripped back to India.

Shreyas has been a member of the Foundation for International Arbitration Advocacy, Geneva since 2012, is the National Coordinator for the UNCITRAL National Coordination Committee of India and is a member of the Mumbai Centre for International Arbitration Council. Shreyas is the only India-based representative of the ICC-FraudNet, which formed the Asset Recovery Group India (ARGI) to pursue substantial value cross-border asset recovery claims for Indian banks, ARCs and other creditors. ARGI comprises specialist fraud and asset recovery lawyers from various jurisdictions who provide superior legal representation to financial institutions, corporations and individuals in securities litigation and arbitration. Shreyas regularly provides advisory and opinions to corporations on issues relating to insider trading, regulatory investigations, securities fraud, corporate governance and other complex issues in relation to securities laws and regulations, and represents clients before various tribunals, High Courts and the Supreme Court.

Shreyas recently established Aarna ADR in Maxwell Chamber Suites, Singapore.

Aakanksha Joshi

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Aakanksha Joshi is a partner in the energy and infrastructure, hospitality, corporate and commercial, private equity and real estate practices of Economic Laws Practice (ELP).

Aakanksha has been involved in various infrastructure, corporate and hospitality transactions ranging from drafting and review of fuel supply agreements, power purchase agreements, construction contracts, concession agreements, bid documents and hotel agreements. She also advises on joint venture and private equity transactions, primarily in the infrastructure and hospitality space. She has represented various kinds of clients ranging from government bodies, international cement companies, construction companies, power generation companies, international hotel management companies, hotel owners and private equity funds.

Aakanksha has been ranked by *Chambers Asia–Pacific* for her expertise in projects, infrastructure and energy. The *IFLR1000 Energy & Infrastructure guides* have recommended her as a Rising Star in India and she has been recognised as a Next Generation Partner by *The Legal 500*.

Prior to joining ELP, Aakanksha served with DSK Legal, where she worked on corporate and real estate transactions.

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Shivani Kabra, a partner in the Mumbai office, has significant experience in cross-border M&A and private equity across sectors and, more particularly, in real estate. Shivani is dually qualified to practise law in India and England and Wales.

Shivani advises a range of Indian and foreign investors across sectors such as hospitality, financial services, infrastructure and real estate (including commercial, retail and warehousing).

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Jeel Panchal is an associate with Agram Legal Consultants. She advises clients on general corporate matters, regulatory compliances and mergers and acquisitions.

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Neeraj Prakash is a partner at Chadha & Co, with more than 16 years' experience of successfully practicing corporate and commercial law. Neeraj practises in the areas of infrastructure projects, M&A, joint ventures, government tenders, corporate and commercial transactions (including deal structuring, negotiation, documentation and execution of transactions), foreign direct investment and setting up of businesses in India, competition law and general corporate legal and regulatory advisory.

Neeraj has represented companies ranging from start-ups to multinationals and leading Indian corporates, and has practised in industries including infrastructure (with special focus on the construction, railways and power sectors), manufacturing, automobiles, logistics, healthcare, retail, consumer electronics and banking, and is regularly involved in cross-border matters.

Jayaprakash Rajangam

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Jayaprakash Rajangam a consulting partner at Eshwars. Jayaprakash is a finance and risk management professional with more than 18 years' experience. He worked in a leadership position with BDO Global (fifth-largest accounting and consulting network) in India and the United Kingdom. He was one of the youngest professionals to be promoted as partner in his firm in India.

Jayaprakash has thrived in playing the role of consultant and interventionist. He has personally led and delivered engagements involving formulating and implementing India-focused business strategy for various clients. He has also advised cross-border transactions cumulatively worth more than US$2 billion in various capacities. He specialises in working with small and emerging business houses on their inorganic growth strategies. He has been involved in successful fundraising in the sub-US$10 million category. Jayaprakash also leads a consulting and outsourcing practice that delivers a virtual chief financial officer service. This involves managing a range of processes for various organisations, including book-keeping, compliance, reporting and business support functions involving financial modelling. He also actively consults with companies on issues with respect to financial derivatives (accounting and valuation). He has also helped financial services companies in formulating their policies around risk management.

Jayaprakash is currently consulting with many startups and emerging companies to assist them in their M&A, restructuring and financing strategies. Jayaprakash also advices companies with respect to risk management frameworks and financial derivatives. On an as-needs basis he provides assistance in due diligence and independent valuation processes to various clients. He is known for partnering with his clients and providing end-to-end solutions.

Rajashree Rastogi

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Rajashree Rastogi is an advocate with Aarna Law LLP. Rajashree has over 15 years' experience as a legal adviser. She has attended matters in courts and tribunals relating to company law, banking laws, debt recovery, intellectual property rights, real estate, civil and criminal laws, arbitration, information and technology and employment law.

Rajashree advises on matters of corporate advisory, undertakes drafting and reviewing of diverse types of contracts, spearheads transactions of mergers, acquisitions and equity investments, due diligence, provides opinion on various aspects of law and attends to civil as well as criminal litigation matters. She advises clients on both small strategic engagements and large-scale delivery projects and has worked across a range of industries, including banking, insurance, engineering and construction and e-commerce, as well as with leading industrial and corporate houses.

Eshwar Sabapathy

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Eshwar Sabapathy is managing partner at Eshwars. Eshwar is also a Fellow of the Institute of Company Secretaries of India. The firm today is one of the leading boutique legal consulting firms in India, offering specialised services in corporate and IPR laws, apart from litigation. The firm advises some of the leading companies in technology, power, finance and many other industries. The firm has a 360-degree view on corporate compliance, corporate governance and commercial contracts.

The firm has successfully advised many multinational corporations in their Indian venture and continues to support them. The firm believes 'God is in the detail' and understands the corporate personality well, be it demanding, self-critical or even little paranoid. The firm has been able to bring in different dimensions in disputes and litigations and has to its credit many reported judgments that stand as a testimony to the manner in which it approaches litigation.

Eshwar leads the M&A practice of the firm, and has advised many investments and acquisitions, and also works with young entrepreneurs in their journey. He is regularly invited to speak at various seminars and forums to share his knowledge and thoughts in his areas of practice. He is also sought after in mediating disputes between family members who carry on business together.

Shikha Sachdeva
ASM Law Offices

Shikha Sachdeva is the founder and managing partner of ASM Law Offices, a boutique intellectual property firm established in 2008. Shikha is an accomplished lawyer who has dedicated her professional journey towards furtherance of IP rights of her clients and patrons. She has been at the forefront of handling IP matters both on contentious and non-contentious issues. She holds special expertise in matters pertaining to trademarks, where she has hand-held some of the most iconic brands during both pre- and post-registration stages. While IP litigation remains her forte, Shikha is also the preferred choice of many clients when it comes to designing IP strategy or advisory with respect to IP enforcement and litigation.

She has been innovative in her approach towards IP solutions. Having appeared as counsel in many landmark decisions, her ability to discern complex IP issues with her legal perspective, the expanse of her experience and her negotiation skills have proven to be an asset for clients looking for efficient redressal of their concerns.

Shikha is a member of the International Trademarks Association and was also a member of the Legal Subcommittee of the Commonwealth Games held in India in 2010. Additionally, she was a member of the management committee of a renowned group of educational institutions in India.

NV Saisunder
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NV Saisunder is a partner at Eshwars. Saisunder is a fourth-generation lawyer and leads the technology, media and intellectual property law practice of the firm. His core competency lies in drafting, reviewing, vetting and negotiation of all kinds of information technology, telecommunications, film and media-related contracts. He has also assisted companies in establishing their international franchises by structuring their franchising and distributorship agreements. He has been involved in several crucial projects in diverse areas of law including telecommunications, the power and energy distribution sectors and intellectual property law, its protection, enforcement and dispute resolution and has represented business houses before WIPO and other international arbitration forums for the resolution of domain name disputes. He has also provided strategic legal advice to property developers and property owners on various issues relating to real estate transactions and regularly undertakes due diligence of properties.

Krishnan Shakottai

Aarna Law LLP

Krishnan Shakkottai is an advocate with Aarna Law LLP. Krishnan is a former investment professional turned counsel with strong experience in the energy sector across the EMEA and BRICS regions. He is an integral part of Aarna Law's investor-state disputes practice and also handles international commercial arbitrations, securities and corporate disputes. Prior to his arrival at Aarna Law, his international arbitration experience includes time spent at the Investment Division of the Energy Charter Secretariat, Brussels as its Special Representative to the Republic of India, and as a trainee counsel at an international arbitration firm in Beirut and a leading arbitral institution in the MENA region focused on construction, oil and gas and real estate disputes under institutional rules of the International Chamber of Commerce, London Court of International Arbitration and Singapore International Arbitration Centre. Krishnan also trained with some of the leading members of the Indian Bar, including KK Venugopal SA, Darius Khambata SC and Arvind Datar SA. He also brings a wealth of experience from the financial services sector in the UK and the Netherlands, which includes investment roles at a merchant bank and a major Dutch private equity group focused on the clean energy sector.

He holds a masters in finance and is a graduate of ILS Law College, Pune where he was awarded prizes for best academic performance in public international law and law of contracts and is also a recipient of the 'Honourable Mention Best Advocate' award at the FDI International Arbitration Moot held in London, ranked in the top five of over 150 oral advocates.

Vishnu Ravi Shankar

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Vishnu Ravi Shankar is a partner and head of the M&A practice at Eshwars. He co-chairs the mergers and acquisitions practice at the firm. He leads a team advising on all transactions for mergers, acquisitions, private equity and venture capital investments and debt financing. Vishnu has handled many transactions in his near-decade-long career from end to end, including legal diligence, structuring of investments, acquisitions and mergers, drafting of definitive agreements, negotiations and closing. Vishnu provides legal advice focusing on the larger commercial aspects of the transaction and advises his clients holistically, with the aim of taking the transaction to closure in the best interests of his client.

In addition, Vishnu advises businesses operating in diverse fields on various aspects of corporate law, especially contract management, helping to structure their contracting processes and drafting and vetting their commercial contracts.

Vishnu is a 2011 graduate of the prestigious National Law University, Jodhpur, graduating with a BA LLB (Hons) degree specialising in business laws.

Prateek Sharma

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Prateek Sharma is an associate at S&R Associates. His corporate practice includes mergers and acquisitions, foreign investments, capital markets and general corporate matters.

Prateek has experience in public and private M&A transactions, and public offerings and private placements of securities. His work has included due diligence, drafting and negotiation of transaction documents, closing assistance and advice on regulatory, securities laws and corporate law issues.

Prateek has advised clients on various corporate matters, including under the Companies Act, the exchange control regulations, securities laws (including regulations on corporate governance, merger schemes, takeovers, insider trading and buybacks) and laws relating to employment and data privacy.

Prateek is an alumnus of the National Law School of India University, Bangalore. He is admitted to practise law in India and is enrolled with the Bar Council of Delhi.

Vaishali Sharma

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Vaishali Sharma is the founding partner of Agram Legal Consultants. She has been practising corporate law for over 20 years and has been involved in a wide variety of matters and various high-value acquisitions (both domestic and cross-border) and complex corporate restructurings. Her experience includes advising on foreign direct investment in various sectors, securities laws, insurance laws, financial services, defence and regulatory advice and approvals. She has advised various multinationals, private equity players and foreign clients on entry strategies, structuring of investments, regulatory compliances, exit options, contract negotiations, joint venture fund formation, debt restructuring, corporate and commercial matters and antitrust laws.

Reshma Simon

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Reshma Simon is a senior associate with Agram Legal Consultants, and she regularly advises on transactions such as mergers and acquisitions, joint ventures, private equity and general corporate law.

Pooja Singhania

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Pooja Singhania is an associate at S&R Associates. She has over eight years' experience in facilitating a wide range of strategic and financial mergers and acquisitions, private investment in public equity, private equity and other corporate transactions across India and South East Asia with a special focus on impact investment.

Pooja has worked extensively with leading private equity and venture capital investors, development financial institutions, financial advisers, prominent corporations and investee companies across sectors including consumer, energy, infrastructure, manufacturing, healthcare, hospitality, information technology and financial services. Her work includes structuring and transactional advice, due diligence, documentation and negotiation, exit-related advice and other transaction-related compliances.

Abhishek Singla

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Abhishek Singla is a principal associate with Chadha & Co, with over 11 years' experience in advising domestic and international clients across a broad spectrum of corporate work including private equity and venture capital, acquisitions, joint ventures (domestic as well as cross-border), IT/ITES-related corporate transactions, corporate due diligences and corporate commercial contracts. His experience also includes rendering advisory services on foreign exchange, infrastructure and project finance.

Abhishek has advised various companies, entrepreneurs and investment funds in a variety of industry sectors including e-commerce, infrastructure, information technology, manufacturing and hospitality. He has also advised various Indian lenders on various aspects of funding including project finance.

Sujjain Talwar

Economic Laws Practice

Sujjain Talwar is a co-founding partner of Economic Laws Practice (ELP) and is responsible for transactions primarily in the infrastructure and hospitality sectors. With over 25 years' experience, Sujjain is a qualified solicitor in India as well as in England and Wales.

Sujjain has worked extensively on infrastructure projects in the region, including in Djibouti, Fujairah, the Maldives and Yemen. He has also been instrumental in developing ELP's hospitality practice and has acted (usually for owners) in several hotel transactions involving almost every international hotel operator in India. He also serves as an independent director on some boards.

Prior to ELP, Sujjain worked as a qualified English solicitor with Pinsent Masons, UK, where he served for nine years. He trained as a solicitor with Crawford Bayley & Co, Mumbai.

Appendix 2

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