

# Private Mergers and Acquisitions in India - Key Considerations

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## Overview

Mergers and Acquisitions (“M&As”) have gained substantial importance in today’s corporate world. Some factors that play a role in facilitating M&As are government policies and regulations, economic conditions and stability, liquidity in the corporate sector, and so on.

As one of the top investment destinations with a high return potential, investors across the globe have been closely tracking M&A opportunities in India.

In addition to providing an overview of key laws governing private M&As in India, this Quick Overview focuses on special rules for

impacting M&As in India that in-house counsel should know about if they plan M&As in India.

## Overview of laws governing private M&As in India

Private M&A transactions in India are principally governed by the (Indian) [Companies Act 2013](#) (“**Companies Act**”).

For M&As, preferred entities in India are private limited companies. Unlike public companies (including the unlisted ones) where shares are freely transferable, private companies offer several benefits to the investors. First and foremost being the restrictions on transferability of shares. The Companies Act recognizes that the shares held in private limited companies are not freely transferable and charter documents of private limited companies (i.e. articles of association) can prescribe share transfer restrictions like a lock-in period, board of directors’ consent as pre-requisite to transfer of shares, etc. It is worthwhile to note that the Companies Act now recognizes inter-se agreements or arrangements between two or more persons as legally enforceable in case of public limited companies. Private companies however are still a ‘preferred mode’ due to conflicting positions taken by various courts in the past regarding transferability of shares in public limited companies. This is very important to the investors / acquirers who want to make a financial investment in a company or wish the promoters to continue with the company with some shareholding for continued interest in the company or skin in the game. Private companies are also preferred due to lesser compliance burdens,

minimum number of shareholders, among other reasons.

India is yet to achieve full capital account convertibility and there are foreign exchange controls in place. Therefore, in case of M&A transactions involving foreign investors, the (Indian) Foreign Exchange Management Act, 1999 (“FEMA”), will apply. Under FEMA, there are very few sectors where foreign investment is prohibited. The sectors where foreign investment is prohibited include atomic energy, railway operations, lottery business, gambling and betting including casinos, manufacturing of cigars and cigarettes, real estate business (excluding development of integrated townships) or construction of farmhouses. In all other sectors, foreign investment is permitted, albeit, in certain sectors it is capped to a prescribed threshold or have sectoral conditionalities. For example, in the case of investment in the insurance sector, foreign investment is capped at 49% under the automatic route. FEMA also permits commonly used structures like earn-outs / deferred payments subject to certain conditions. For example, Under FEMA, consideration up to 25% of the total sale consideration can be deferred up to 18 months without any regulatory approval requirement. Put and call options are also permitted subject to certain conditions, provided such options do not bestow any right to exit at an assured price.

Non-compete and non-solicitation restrictions are also enforceable depending on the facts of each case.

Key Takeaways:

articles of association state about share transfers.

- It is advisable that articles of association are amended in accordance with the shareholders' agreement.
- Determine what sector your company operates in and be aware of the cap on and conditions prescribed under FEMA for foreign investment in that industry.

## Special Rules for Foreign Buyers

We have summarised below key requirements which in-house counsel need to keep in mind when foreign investors are interested in your business in India:

- 1. Investment Instruments:** Foreign investors are permitted to invest in equity shares, compulsorily and fully convertible preferred shares, and compulsorily and fully convertible debentures. Therefore, investments by foreign investors in optionally convertible / hybrid instruments is not treated as equity investment and such instruments are treated as offshore loans (*Refer 5. below*).
- 2. Pricing Guidelines:** Investment by foreign investors in Indian companies can be made at a price not less than the fair market value of the shares of such company computed by independent valuer. However, this condition will not apply in case of purchase of shares of an Indian company by a foreign investor from another foreign investor.
- 3. Sector-related restrictions:** As mentioned above, foreign investments in certain sectors falls under the 'automatic route'

automatic route, investments up to a certain limit do not require prior approval of the government whereas under the 'approval route', investment is allowed only after the prior approval of the government. Additionally, as mentioned above, foreign investment in certain sectors is capped and foreign investors are not permitted to own 100% shareholding of companies engaged in certain sectors. *It is important to note however, majority of sectors like technology, manufacturing, consulting, services have been made easily accessible and 100% foreign investment is permitted without any approval.*

**4. Reporting:** If a foreign investor invests in or acquires securities of an Indian company, such investment / acquisition is required to be reported in the prescribed form to the Reserve Bank of India ("RBI"). To streamline the reporting requirements, the RBI with effect from 1 September 2018 introduced a simplified and consolidated reporting framework.

**5. Restrictions on foreign loans:** Under FEMA, foreign loans to Indian companies are subject to eligibility criteria prescribed for lenders and borrowers, ceilings on interest and other costs, limits on end uses, etc.

**6. Resident Directors:** The Companies Act requires every company to have at least one resident director who has stayed in India for a total period of not less than 182 days in the previous calendar year.

The realm of M&As in India is interspersed with a rigmarole of legislative requirements which includes approvals from the relevant regulators, corporate approvals, consent of lenders and third parties, procedural bottlenecks and seemingly never-ending compliances. In case of a merger, the plan is required to be approved by a special majority of each class of shareholders and creditors. Further, approval of the National Company Law Tribunal (“**NCLT**”) is also a pre-requisite. The NCLTs are usually burdened with several pending matters and final orders approving mergers are issued only after all objections in relation to the scheme are resolved.

Transactions involving a foreign party are administered by the RBI and exchange control laws in India are prone to frequent amendments. Due to the conditions prescribed under FEMA like pricing, sectoral caps, permitted investment instruments, etc usually require well thought transaction structuring keeping in mind the larger commercial objectives.

Although, due diligence is a key tool for any M&A transaction to identify or rather unearth the deal affecting issues, the exact liability and risk element cannot be evaluated due to non-availability of centralised information. For instance, there is no single platform / repository where the details of litigation proceedings can be accessed.

Key Takeaways

ahead. It might take longer than expected to gain approval from that body for your merger.

- Communicate early and often with your lenders, creditors and shareholders to update them on progress or obstacles about approval.

## Recent Regulatory Changes

- 1. Cross border merger Regulations:** In 2018, the RBI had notified the FEMA (Cross border merger) Regulations. This framework along with Companies Act provides the framework for outbound mergers of Indian companies with foreign companies.
- 2. New Insolvency Law:** [Insolvency and Bankruptcy Code 2016](#) was enacted to streamline and consolidate the bankruptcy laws in India. It has created a formal market for M&A transaction involving distressed assets. M&A market in India has since seen an increase in transactions involving stressed assets.
- 3. Amendments to External Commercial Borrowing (“ECB”) Regulation:** The scope of ‘eligible borrowers’ has been widened, allowing all entities that are eligible for making foreign investments to borrow through the ECB route. Further, permitted end use have been widened. The debt funding route in India is gradually being considered as an alternative to the otherwise favoured equity investment route.
- 4. Green Channel:** The Competition Commission of India, in August 2019, amended the Combination Regulations and has put

clearing certain categories of M&A. Under this process, the combination is deemed to have been approved upon filing the notice in the prescribed format. The Green Channel is aimed to sustain and promote a speedy, transparent and accountable review of combination cases, strike a balance between facilitation and enforcement functions, create a culture of compliance and support economic growth.

## Conclusion

The M&A scenario is gradually growing in India by a relative easing of the regulatory ecosystem and consolidation of regulatory filings. The pro-business Government which came into power in 2019 with a strong mandate, is focussing on ease of doing business and generally working towards a favourable business environment. Recent foreign investment policy changes and reduction in income tax rate applicable to corporates, are evidence that India is a key country to watch out for.

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This Quick Overview focuses on special rules for foreign buyers, key hurdles, and recent regulatory changes impacting Mergers & Acquisitions (M&As) in India that in-house counsel should know about if they plan M&As in India. In addition, it will outline key laws governing M&As in India.

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