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ANALYSING CONTOURS OF LAWS INVOLVED IN MERGER AND ACQUISITION

- Nikita Khanna[1]

Abstract: -

India is considered as an economy with fastest growing pace attaching its growth options with organic, inorganic or any external means. From 'greed to feasibility' all middle market companies consider the option of merger rather than opting for an organic growth. This paper calls attention to cover the legal issues and challenges that a corporate entity faces while indulging itself into the process of Mergers and Acquisitions (inorganic means). Here, the author attempts to dive into the brief study of the legal aspects while introducing the concept of Mergers and Acquisitions- its role and importance (PART I). Part II deals with analysing the various legal frameworks involved in the scheme of M&A of corporate entities. It marks our notice towards the issues pertaining due to the various norms and regulations in the above process. The write-up summarizes the frontier of the various legal processes which leads a corporate entity. This concise overview reconciles our understanding of the merger and acquisitions, while paying consideration to various legal laws involved.

Keywords- Merger, Acquisition, Growth, Merger wave, Entity, Control, Activities, Shares, Relevant Market, Adverse Appreciable Effect on Competition.

I. Introduction to Merger and Acquisition: -

Often what is called an investment in nothing more than two or more entities merging into one[2]. M&A play a vital role for the advancement of any economy- both weak or strong. A wide range of advantages are offered to the entities as by-products of their acquisition or merger.

"A merger is defined as the consolidation of two entities into one, where the assets and liabilities of both the companies are combined together and one of the entities is made defunct in the Registrar of Companies."

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[1] Student at Rizvi Law College, Mumbai
[2] Quote by Susan George.

"Acquisition happens when an entity takes over another entity's stock, assets, liabilities or equity shares and one of the companies' become a subsidiary to other and retains its name in the Registrar of Companies."

In today's era, action of both merger and acquisition are quite common and are marked as extensive significance of growth. There are numerous procedures involved for a successful completion of the M&A of any corporation. It has been considered as a fundamental principle[3] that two corporate entities share a greater profit value than on an individual basis, that is 2+2= 5. Merger offers an additional means of expansion which is the external ones. Firms with limited resources can merge into one which helps in catering their diverse customer needs with abundance of resources. It is examined as the most effective recourse of integration in order to save the companies from down-sizing. The combined synergies of both the entities helps in achieving the economies of scale leading to fulfilling the demands as well as making the product or service even more competitive in the relevant market.

However, one cannot forget that the end result of both the procedure is mainly the expansion of market share and increment of wealth of the shareholders.

Recently, one of the biggest success was reported in the merger of two giant entities into *Vodafone-Idea* which after the merger will nearly have a subscription base of 394 million[4]. The merger took place due the ferocious competitive nature of the Reliance Jio owned by MukeshAmbani. The company came up with exclusive cut-throat prices of providing voice and data packs which disturbed and deteriorated markets for both Vodafone and Idea. The deal resulted between the huge telecoms-Vodafone and Idea was estimated to be valued at USD $23 billion[5]. The main reason due to which the picture of merger crawled in- was the rapid slipping of the customer base and huge debt. The deal how the merger of two big entities will prove to be competitive against the one i.e., Reliance Jio.

II. LAWS INVOLVED: -

M & A of a company goes through various legal frameworks, sanctions, clearances and approvals. Nevertheless, it has marked as a pathway of corporate growth and successful capture of any market. In fact, a merger of a U.S. and Indian company is impacted by

[3] Principle taken Merger and Acquisition Course provided by Enhelion.

[4] https://www.financialexpress.com/industry/technology/idea-cellular-vodafone-india-merger-10-important-things-subscribers-should-know-largest-telecom-service/594887/

[5] https://www.reuters.com/article/us-vodafone-m-a-idea-idUSKBN16R07R

several Indian laws pertaining to foreign investment. Below are the examples of a few of them: -

- **Foreign Exchange Management Act 1999: -**

Foreign Exchange Management Act is ruled out with the objective of promotion of external trade and governance of foreign exchange market in India. It was formulated by the Central Government to put aside all the inadequacies of FERA [6](Foreign Exchange Regulation Act) and tackle the developments in the economic reforms of Indian markets. In terms of FEMA Merger Regulations, a 'Cross border merger' is defined to mean any merger, amalgamation or arrangement between Indian companies and foreign companies in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 notified under the Companies Act, 2013[7].It is not possible for a foreign company to merge with an Indian one except according to the procedure determined by the RBI and various other statutory acts. The regulations prescribed in the above act makes it mandatory for companies involved in cross-border merger to follow the procedures and to furnish reports accordingly. Moreover, it segregates the foreign investment into various groups: Investment made by the non-residents; foreign direct investments, portfolio investments, foreign venture capital investors (FVCI)[8].Nonetheless, let us try to understand the inbound as well as outbound merger in this activity: -

A) Inbound merger: It is a situation when any foreign company merges with an Indian company pursuant to which all the assets and liabilities of foreign company are transferred to the Indian one. The various examples relating to the inbound merger are as follows;

- Abroad /Overseas offices of Foreign Entity to become branch of the Indian Company.
- Acquiring of Assets by the Indian Company abroad while complying with the regulations mentioned in the FEMA.

B) Outbound merger: It is a situation when any Indian entity mergers into a foreign company pursuant to which all assets and liabilities of Indian entity are transferred to

[6]https://en.wikipedia.org/wiki/Foreign_Exchange_Management_Act

[7]https://www.rbi.org.in/sctificripts/NoationUser.aspx?Id=11235&Mode=0

[8] Extract taken from Merger and Acquisition Course provided by Enhelion.

the foreign ones. The following examples explaining the meaning of the outbound merger are as follows;

- Abroad/Overseas offices of Foreign Entity to become office of the Indian entity
- Acquiring of Assets by the foreign Company in India.

One needs to follow the guidelines as stated in the Act. Although, if the transactions fall outside the norms and standards then one needs to obtain the necessary approvals of the authorities mentioned under the Act. Whilst if the permissions are not obtained then the consequence of failure is penalty. Furthermore, if the penalty is not paid then the prosecution proceedings may take place. Section 13 to 35 states Contravention, Appeals and Penalties under which if any person contravenes any rules or regulations the penalty imposed may be 3 times the amount involved in such a contravention. If the amount is not ascertainable then penalty can be up to 2 lakhs[9]. The authorities may also confiscate any currency or property in addition to security. A person can also be made liable for civil imprisonment. It is pronounced that an Indian Entity needs to follow the general regulations on the issuance of any security to any non-resident or recording of transfer of such security to him.

- **Income Tax Act 1961: -**

IT act plays an important role in the process of merger and acquisition; Though, the act does not define the concept of merger but has covered it under the definition of amalgamations. It is a merger of one or more companies with another to form a new entity. Even so an amalgamation must satisfy the below criterion: -

1) All the properties and liabilities of the amalgamating company become that of the amalgamated company.
2) Holding of at least ¾ values of shares by the shareholders in the amalgamating company, become the shareholders in the amalgamated company[10].

Let us examine the act with the help of a scenario: - An Indian resident wants to transfer his entire shareholding capital of an Indian company to a foreign company in exchange for the shares in the latter. Focusing on an important point is the consideration received by the shareholder which would be reduced due to the cost of acquisition as it is computed based on

[9]https://www.bcasonline.org/Referencer201617/Other%20Laws/fema.htm#:~:text=If%20the%20contravention%20is%20a,during%20which%20the%20contravention%20continues.&text=Penalty%20up%20to%203%20times,extend%20to%205%20year%20%2B%20fine

[10]https://www.icsi.edu/media/portals/70/EDSG29062013.pdf

the value of shares in the foreign corporation and not an Indian entity. The amount of the tax will be determined/ valued on the basis shares of the foreign company. IT act contains several provisions to deal with the taxation of various kinds of mergers and acquisitions. Acquisitions can take form of various methods; Share Purchase, Slump Sale, Asset Sale, Merger or Demerger.

Tax issues arises in a domestic M&A when the following regulations are not fulfilled in the transactional process. Section 47 under the IT Act, exempts capital gains on transfer by the shareholders. Allotment of securities or payment of cash as a consideration to the shareholders of the amalgamating company is not 'Transfer as per Section 2 (47) of the IT Act'. Further, Section 115 JB of the act levies MAT on the company and stands for Minimum Alternate Tax, which was launched to reduce the difference between the tax accountability as per income calculation and book profit. Under this, the book profit computed are considered as the total income of the company on which the tax is levied which is 15%[11]. These are the issues which are primarily solved by the ITA while dealing with the domestic M&A.

- **The Companies Act 2013: -**

Under the Companies Act a merger is defined as an arrangement between the merging companies and their respective shareholders. Section 230-34 controls the various activities of mergers and arrangements. It relates to the formation and administration of various foreign companies in India as well as Indian entities[12].There is an entire legal procedure which the entities need to follow under the above act;

- The companies can start the procedure of amalgamation only when it is permitted under their Memorandum of Association. In addition to that, an acquiring company should have the consent in their object clause to carry on with the activity further. In addition to the absence of the above, necessary permissions are required from the board of directors and shareholders.
- Each company must file an application with NCLT (having the jurisdiction over such a company) for calling the meeting of the shareholder or the creditors.

[11]https://www.paisabazaar.com/tax/minimum-alternate-tax-mat/#:~:text=Ans.-,MAT%20or%20Minimum%20Alternate%20Tax%20is%20a%20provision%20in%20Direct,and%20foreign%20companies%20in%20India

[12]https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Mergers___Acquisitions_in_India.pdf

- Approvals for the draft proposal are required from the board of directors of the respective entities.
- Conducting of separate meeting of the shareholders and creditors of the individual companies in order to approve the amalgamation scheme is also required.
- Then there is transfer of assets and liabilities of the acquired company to the acquiring entity.
- Payment from the acquiring company needs to be made to the acquired entity by the way of cash for shares, debentures, stocks, etc. At last, these acquired securities will be listed on the stock exchange.

In addition to this, one of the most important and persistently needed change been brought by Companies act 2013 is to loosen the clasp of thread on cross-border merger i.e., by allowing the inbound and outbound cross- border merger activities. Nevertheless, according to the fresh amendments, it is required to take previous permissions from various authorities consisting of NCLT, creditors, SEBI (for listed companies) or creditors (in case if any).

There are several consequences of not following the provisions specified in the act. The foremost of them being 'de-listing' along with which it can face penal charges. All the codified provisions need to be followed by all the person/entity attached to the M&A transactions.

- **<u>The Competition Act 2002: -</u>**

Competition Law plays an important role in controlling the merger affairs with the aim of regulating international trade and the commercial activities. Political as well as economic issues are the main rationale behind the merger control. It is a safeguard to protect a 'combination' coming into force which causes or is likely to cause an appreciable adverse effect on combination (AAEC) within the market. It is a measure to protect the welfare of free market in order to safeguard the public interest. There are numerous issues that ought to sweep in when the above act is not followed; It shows Market dominance which in turn leads to manipulation/hiking of prices or takeover of dominant position in the market which leaves a negative mark in regulating the affairs of the free market. The previous act which covered the various provisions but in turn was marked obsolete was MRTU (Monopolistic and Restrictive Trade Practices Act) 1969[13]. Today, every merger has to be scrutinised by the Competition Commission of India (CCI) under the provisions of Competition Act 2002. Basically, three

[13]https://www.jagranjosh.com/general-knowledge/competition-act-2002-1553606677-1

types of arrangements are met or explained by the act:

1) Anti-competitive Agreements: -

   Section 3 of the Act deals with two kinds of Anti-competitive agreements namely vertical and horizontal. Vertical agreements are the one entered into by the firms which are operating into different levels of production. They are also called the tie-in agreements and are anti-competitive only if they cause any adverse appreciable effect on competition (AAEC) in the marketplace. Moreover, horizontal agreement denotes the one where the entities are engaged in similar trade whether be it of goods or services. Cartels is one of the forms which shows that the producers pre-fix the prices of their goods or services in the market. In addition to this there are certain generic conditions under Sec 3(3) which provides that an agreement would have an AAEC if the following points are noticed: -

   - ✓ Fixing the prices of goods or services whether directly or indirectly.
   - ✓ Things resulting in collusive bidding or bid rigging.
   - ✓ Limiting the production and supply, technical expertise, any service.

2) Combinations: -

   It is defined as the acquisition of control of shares, any voting rights, assets or acquisition of control of an enterprise. Additionally, it also prescribes the transactional procedure when its financial threshold exceeds. More or less if any combination causes AAEC within the relevant market it is absolutely restricted by the Act.

3) Prohibition on exploiting the dominant position in the marketspace: -

   Dominance is not as such considered to be bad, however the abuse is strictly prohibited by the Competition Commission of India (CCI). An entity is said to be in a dominant position if it is operating without getting affected by the competitive market forces and is able to gain the attention of most of the consumers in its favour. In this an entity acts independently without getting affected by the competitors in the relevant market. Moreover section 4(2) of the Act enlists activities that closely depicts the abuse of dominance by the enterprises that are: -

- ✓ Imposing discriminatory or prices below the general price guidelines.

- ✓ Denying the market access by creating barriers for entry to the new entities.
- ✓ Restricting the technical or scientific developments of various goods and services.

Abuse of Dominance is further bifurcated into two broad categories namely exclusionary and exploitative abuse; where exclusionary is marked by denying entries to the market and exploitative consists in itself predatory pricing schemes.

However not to forget, if the compliances provided by the Competition Act are breached, then CCI have various reforms to levy penalties on the breaching entities.

- In cases where an entity or even a person fails to comply with the orders or the directions of the act, he will be liable to a monetary punishment which could extend to a lakh for each a day to even 10 crores at single instance. Further in the case of breach of Sub section (2) of Section 42, the person can be made liable to serve an imprisonment punishment which may extend to 3 years and/or with a penalty of twenty-five crores as the deemed fit by the Chief Metropolitan of Delhi[14].
- When an entity or a person fails to furnish notice to the Commission under sub section (2) of Section 6, then such a person/entity will be imposed a penalty which may extend up to one percent of the total turnover of the assets of such a combination.
- When an entity or a person fails to furnish or makes false statements or/and omits any such information which deems material towards the compliance of the act, then it shall serve a penalty of not less than fifty lakh rupees and can be extended to one crore as deeming fit by the Commission[15].

All inclusive, it is to be noted that all M&A needs to be approved by CCI in order to make a healthy competition within the market with absolutely no scope of the unfair practices. It helps to curb the anti-consumerist behaviour mechanism within the country.

- ➢ **Securities and Exchange Board of India: -**

SEBI is an authority which regulates the entities that are listed and to be listed on stock exchanges in India. Some checks and balances have been introduced by SEBI for dealing with the M&A activities. However, in India the concept of takeover took place in the 20th century but even then, the hostile takeovers were unknown. It started when the efforts were made by Swaraj

[14] https://www.taxmann.com/post/author/admin/page/35/#:~:text=In%20case%20the%20person%20or,each%20day%20of%20non%2Dcompliance.

[15] https://www.taxmann.com/post/blog/716/penalties-under-competition-act-2002

Paul to take over Escorts Ltd. and DCM Ltd[16]. It marked the start of the hostile takeovers though it was unsuccessful by quoting the reasons of technical difficulties. Further to achieve the objectives engrossed in the act, SEBI enacted (Takeover Code) 2011, laying down the procedure which an acquiring company needs to follow for acquiring the majority shares of the acquired company in order to carry on the process in a fair manner.

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 states that if any acquisition of Indian Company involves the issuance of new equity shares or any specified securities by the target to an acquirer then Preferential Allotment regulations are made to be followed comprising of lock in period and pricing of the issue of security or shares.

It has also an enacted act; SEBI (Prohibition of insider trading) Regulations 2015 also comprises of heavy penalties for the person delving into the trading as mentioned in the act.

Even so, various issues tend to crawl in the structure of a Merger if the above legal frameworks are not followed accurately. With the announcement of globalisation, several doors of opportunities were made available in India. This new weapon in the hands of corporate was proved to be beneficial but soon the entities with large amount of disposable income started to exploit the opportunity provided. Therefore, the regulations enacted by the SEBI are a great way to protect the regulatory bodies from the light of sabotages. It is also necessary due to the reasons listed below: -

- It is required for the process to be completed within the desired time-frame.
- The disclosures should be made for all the material transactions affecting the deal at the earliest opportunity provided.
- Further it also provides for the exit opportunity to the investors if they wish to discontinue with the existing management.

With the above regulations, various critical and crucial amendments have been taken place in order to tackle the timely transparent frameworks for facilitating the activities and promoting the interests of the parties.

Conclusion: -

With India becoming more liberalised in terms of foreign investment, more M&A deals are being discussed with rapid zeal. Over the past decade, merger activities have been increased- dealing with varieties and every size of companies with additionally helping single entity to merge with the bigger ones. The basic reason behind M&A is to achieve

[16] https://taxguru.in/sebi/sebi-takeover-code.html

economies of scale, expansion of the customer base while diversifying their products with more advanced technologies and gain more competitive advantage in this cut throat market scenarios. While the process brings immense advantages to the entities it surely has its own cons- a few of them been pointed out above in prospects of legal framework. It is considered as a crucial part of any economy making sure that stakeholder gets their rewards for the efforts they incorporated. It is the best inorganic means of acquisition of a company- leading to the growth with combined synergies.

A corporate entity needs to follow all the legal procedures in order to indulge themselves into the scenario of acquiring or amalgamating any company due to which it has to face a lot of legal difficulties. All of these issues tackled with utmost diligence can lead to successful results for corporate entities. If not, it is mostly going to create a deep pitfall for the corporate entities leading to a heavy loss of their resources. With so much capital and planning on the line it is considered to deal with various legal issues effectively and efficiently.