GETTING THE DEAL THROUGH

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1 Form

What form do business combinations take?

Under the Companies Act 1956 (Companies Act), a company can be set up either as a private company or a public company. A private company restricts the number of shareholders and the transferability of its shares, as well as prohibiting public share subscription and restricting the acceptance of deposits. A public company does not necessarily mean that the company is listed on a stock exchange, although it can subsequently be listed on one or more stock exchanges in accordance with the guidelines prescribed by the Securities and Exchange Board of India (SEBI) and the provisions of the relevant listing agreement executed with the respective stock exchanges. In addition, businesses could be set up as partnerships or proprietary concerns, although these are typically used for small businesses since the liability of the founders is not limited.

Businesses are usually acquired by the purchase of shares of the target, or, alternatively, the acquisition of the assets of the target. Acquirers look at gaining control over the target company in a variety of ways such as board control, veto rights at the shareholder level, etc.

The merger or amalgamation of two or more companies into one entity, or the demerger of a business division into a new company, requires the approval of the relevant high courts. Courts grant approvals after considering the scheme (setting out the terms and conditions) submitted by the relevant high courts. Two parties may also enter into a joint venture subsequent to which a joint venture company may be set up.

2 Statutes and regulations

What are the relevant regulations and statutes governing business combinations?

Corporate laws

Companies in India are registered and regulated under the provisions of the Companies Act. The Companies Act provides for the fundamental statutory framework for the purchase and sale of corporate entities. Its provisions govern formation, conducting of business, mergers, amalgamations and demergers and the winding up of companies. The Indian Contract Act 1872 (Contract Act) governs and supports the transactions and understanding of the parties in respect of the various business transactions. In addition there are a number of separate legislations that deal with different commercial transactions, such as the transfer of property, the sale of goods, partnerships etc.

Securities laws

The securities market is regulated by SEBI established under the Securities and Exchange Board of India Act 1992 (SEBI Act) and the guidelines, rules and regulations made by SEBI. In relation to acquisitions, SEBI has prescribed the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997 (SEBI Takeover Code) which regulates the acquisition of shares and takeovers of listed companies. Furthermore, companies that are listed on the stock exchanges also have to comply with the requirements of the listing agreements with the respective stock exchanges.

Competition law

The Monopolies and Restrictive Trade Practices Act 1969 (MRTP Act) seeks to ensure that there is no concentration of economic power to the common detriment and provides for the prohibition of monopolistic and restrictive trade practices. The MRTP is sought to be replaced by the Competition Act 2002, which proposes to promote and sustain competition in the markets and to protect the interest of the consumers. This Act is expected to come into force shortly. One of the major changes to be brought in by this legislation will be the pre-merger notification procedure in cases where the merged entity crosses certain thresholds in relation to turnover and market share.

Exchange controls

For cross-border business combinations and transactions, the implications under the Foreign Exchange Management Act 1999 (FEMA) and the regulations issued thereunder by the Reserve Bank of India (RBI) will have to be considered.

Additional issues

Apart from the above, the purchase of shares or assets is not subject to any specific legislation. The legal issues that may arise will vary depending on the manner in which the transaction is structured. Tax considerations may be crucial to the transaction particularly in the context of a slump sale or 'cherry picking' of the assets. The Indian Income Tax Act 1961 (ITA) will serve as an important guide in such cases. Employee-related issues might also require some prior approvals or notifications under the Indian labour laws and need to be kept in mind while structuring a business combination

3 Legal documentation

What type of contracts or other legal documentation are entered into by parties to a business combination?

The legal documentation that is required depends on the specific type of business combination that is being contemplated. In the case of private companies, the sale of shares or assets is normally effected under a share purchase agreement or an asset purchase agreement. Such agreements are usually preceded by a letter of

intent or a memorandum of understanding that incorporates the understanding between the parties and is not binding except with respect to the confidentiality and non-disclosure requirements; such documents do not typically create any legal obligation on the parties to enter into definitive agreements. An asset purchase agreement may result in the formal conveyance of some assets (real property etc), novation agreements in relation to the liabilities that are to be assumed and deeds of assignment for intellectual property. Customer contracts can generally be assigned or transferred with the consent of the third party. Under certain circumstances, the approval of the shareholders will also be required.

In order to merge two or more companies into a single company, or to demerge a business or assets of the business into a separate company, the approval of the high courts is required. It is possible that the parties would enter into a merger agreement, although, in addition, a scheme setting out the terms and conditions of the merger would need to be submitted to the courts and an order approving the merger would need to be obtained. Shareholder approval will also be required.

The other related agreements that may be executed are shareholders' and share subscription agreements, option agreements, voting agreements, employment agreements and licence agreements.

In the case of listed companies, the public offer requirements are triggered if the acquirer acquires 15 per cent or more of the shares or voting rights in a company. In such cases public announcements with the terms and conditions of the offer need to be made. In addition, various disclosures need to be made to the shareholders of the company along with the letter of offer to the existing shareholders.

4 Filings and fees

What governmental or stock exchange filings are required to be made in connection with a business combination? Are there stamp taxes or other governmental fees in connection with completing a business combination?

Any changes in the shareholding of a company are recorded with the registrar of companies (RoC) through the annual returns that are to be filed with the RoC. In the case of mergers, amalgamations or demergers, the order passed by the high court, approving the scheme of arrangement or compromise as proposed by the company, must be filed with the RoC. Share transfers need to be notified to the company (in the case of private companies, such transfers would be subject to the transfer restrictions found in the charter documents of the company). The transfer of shares of an Indian company (by a non-resident shareholder to a resident shareholder and also by a resident to a non-resident) have been liberalised and are now under the automatic route and only requires a post-facto filing with the authorised banks. However, this liberalisation is not applicable where the company is in the financial services sector (such as banks, non-banking financial companies and insurance companies) or where the acquisition of shares triggers the provisions of the SEBI Takeover Code, in which case the requisite approvals from the RBI or the Foreign Investment Promotion Board (FIPB) would be required.

Under the listing agreement, the companies that are listed on the stock exchanges have to notify the stock exchanges in the event of any change in the character of the business of the company. In cases where the proposed business combinations involve consideration that comprises shares to be listed, approval of the relevant stock exchange for listing will be required.

Under the SEBI Takeover Code, an acquirer who has acquired shares or voting rights which entitle the acquirer to more than five, 10 or 14 per cent of the shares or voting rights in a company (together with the company's shares or voting rights, if any, already held by him) is required to disclose the aggregate of his shareholding or voting rights in that company to the company (which in turn is required to disclose the same to each of the stock exchanges on which the company's shares are listed) and to each of the stock exchanges on which the company's shares are listed within two days of (a)the receipt of allotment information or (b)the acquisition of shares or voting rights, as the case may be. Furthermore, after the acquirer has a 15 per cent (but less than 75 per cent) holding in the company, the acquirer has to disclose the acquisitions and sale of every additional 2 per cent of shares or voting rights acquired to the target company and the stock exchanges where the shares of the company are listed. A company must disclose to the stock exchanges, within 30 days of the financial year ending 31 March, the changes in the holding of every person who holds more than 15 per cent of the shares or voting rights as well as the changes in holdings of promoters or persons having control over the company.

Joint ventures may be organised as purely contractual relationships and the provisions governing such relationships are provided in the shareholders and share subscription agreements.

Stamp duty is regulated at a central level as well as at state level in India. Stamp duty payable on the transfer of shares is regulated by the Indian Stamp Act and is currently stipulated at 0.25 per cent of the aggregate consideration. However, this stamp duty is only payable when the shares are in a physical form. If the shares that are transferred are in a dematerialised form, no stamp duty is attracted. Stamp duty payable on the transfer of assets would vary depending on the assets to be transferred and the mode of the transfer. There is a higher stamp duty on the transfer of immovable property as opposed to movable property. One may also be required to pay sales tax at the applicable rates on the transfer of assets. Stamp duty payable on the transfer of assets pursuant to a scheme of amalgamation or merger approved by the high court is considerably lower than the stamp duty payable on a simple asset transfer agreement.

5 Information to be disclosed

What information are public companies required to make available to the public in connection with a business combination?

The obligation of public companies to make information available to their shareholders is regulated by the Companies Act, SEBI Takeover Code and the relevant listing agreements. Companies registered under the Companies Act must make certain filings with the RoC including annual returns and annual accounts. These filings are made available to the public. Public companies are also required to maintain certain registers, which must be open to inspection by the shareholders and the public. Under the provisions of the listing agreements, companies must disclose to the stock exchanges any change in the structure of the company, including capital, ownership, constitution of the board, etc and all such information that will have a bearing on the price of the securities of the company. As per the provisions of the SEBI (Prohibition of Insider Trading) Regulations 1992, (the Insider Trading Regulations) the company is required to disclose all price sensitive information regarding the company to the stock exchanges at the earliest so that the public may access the same.

Under the SEBI Takeover Code, the company must disclose to the stock exchanges where the shares of the company are listed the number of shares held by the persons who have acquired shares or voting rights in the company in excess of 5,

10 and 14 per cent. as well as the holdings of the persons who have acquired 15 per cent of the shares or voting rights in the company.

6 Disclosure requirements for shareholders

What are the disclosure requirements for large shareholders in a company? Are the requirements affected if the company is a party to a business combination?

As discussed earlier, the SEBI Takeover Code requires the acquirer to make disclosure whenever his acquisition of shares or voting rights exceeds the 5, 10 or 14 per cent thresholds. Furthermore, any person who holds more than 15 per cent of the shares or voting rights in any company and a promoter having control over a company, must, within 21 days from the end of each financial year (ie 31 March), make disclosures about their holdings to the company which in turn is required to notify these changes to the stock exchanges where the shares of the company are listed.

Any changes in the shareholding of the company must be disclosed in the annual returns that are to be filed with the RoC. There is no additional disclosure requirement for large shareholders in the light of a potential business combination.

7 Duties of directors and controlling shareholders

What duties do the directors and managers of a company owe to the company's shareholders in connection with a business combination? Do controlling shareholders have similar duties?

The general principle established under the Companies Act is that the directors owe a fiduciary duty to the company and must exercise their powers in the best interests of the company, ie taking into consideration the interests of the various stakeholders of the company (shareholders, creditors, employees and the public interest). The directors of the company must take the requisite steps to fulfil the obligations of the company under the Companies Act, the SEBI Act and the regulations notified thereunder and the relevant listing agreement.

The Insider Trading Regulations provide that a director or officer of a listed company must disclose to the company the number of shares or voting rights held by the director or the officer, within four working days of becoming a director or officer of the company. Under the Companies Act, the directors must disclose to the company the nature of their interest in any contract or arrangement that the company proposes to enter into. The directors must abstain from participating in discussions on contracts or arrangements in which they have a personal interest at board meetings and must also not vote on such contracts or arrangements.

Under the SEBI Takeover Code, the board of directors of the target company have the option to send their comments and recommendations about the offer of the acquirer to the members of the target company.

Once the open-offer commences, the board of directors of the target company cannot, without the approval of the shareholders, after the date of the public announcement of the offer: deal with the assets of the company, other than in the ordinary course of business; issue or allot authorised (but unissued) securities carrying voting rights; enter into material contracts; or appoint any such person to the board having a relationship or interest with or in the acquirer. These restrictions are in force for the entire offer period.

The controlling /majority shareholders in the company have a duty to not oppress the minority shareholders or mismanaging the company. Any shareholder who is oppressed by the actions of the other shareholders or directors can make an application to the Company Law Board for relief.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Approval from the shareholders will be required in the event of the proposed disposal of a business division of a public company.

Any merger and amalgamation or arrangement or demerger of business divisions under Sections 391 to 394 of the Companies Act will require the approval of the shareholders by means of a special resolution (approval by a three-quarters majority).

An Indian acquirer will also require the approval from its shareholders, by way of a special resolution, in the event that its investment in the target company exceeds 60 per cent of the paid-up capital and free reserves of the acquirer.

In addition, any approvals required from the shareholders as per the articles of association of a company will also have to be complied with. Furthermore, in a public company, the issue of shares to persons other than the existing shareholders under a proposed business combination will require the approval of the existing shareholders by means of a special resolution.

9 Hostile transactions

What are the special considerations for unsolicited (hostile) transactions?

The SEBI Takeover Code does not distinguish between a hostile takeover and a solicited offer for takeover. A number of provisions in the SEBI Takeover Code can be used as defences in the event of hostile takeovers subject to the restrictions on the activities of the board of directors of the target company as mentioned above. Competitive bids are allowed under the SEBI Takeover Code. Furthermore, the target company may during the offer period, with the approval of the shareholders, sell, transfer, encumber or otherwise dispose of the assets of the company. Also, with the shareholders' approval, the target company can, during the offer period, issue or allot any authorised but unissued securities carrying voting rights. The target company may also issue shares upon the conversion of debentures that have already been issued or issue shares carrying voting rights upon exercise of option against warrants without shareholder approval.

10 Break-up fees – frustration of additional bidders

Are break-up fees allowed? Are other types of mechanisms allowed to potentially frustrate additional bidders? Describe any 'financial assistance' restrictions and how they can affect business combinations.

Break-up fees are not provided for statutorily. However, parties can agree contractually to the same. Under the Contract Act, damages are generally limited to compensation for such losses as are reasonably foreseeable as the natural loss resulting from non-performance. In most cases, the party breaching the letter of intent/memorandum of understanding is required to reimburse the expenses incurred by the other party in connection with the transaction. However, if the non-breaching party is a foreign party and the party making the payment is an Indian company, the prior approval of the RBI may be required to make the payment of the break-up fees. Indian banks are not permitted to fund companies for the purposes of making a public offer unless it is in the context of a privatisation transaction (ie where the government is selling its shares under the disinvestment programme), subject to certain conditions.

11 Governmental influence

Other than (i) through relevant competition (antitrust) regulations, or (ii) in specific industries in which business combinations are regulated, can governmental agencies influence or restrict the completion of business combinations?

The government and regulatory agencies are fairly active in regulating a business combination where a foreign entity is involved from the Indian exchange control perspective. For example, any purchase of existing shares of an Indian company requires filings to be done with the details of the transaction and as discussed above, requires the prior approval of the FIPB and the RBI in certain instances. Apart from the above, where the business combination is between two Indian resident entities/parties, there may be a few compliance and filing requirements. If the transaction is structured as a merger or an amalgamation in which case the approval of the high court is required.

12 Conditions permitted

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, can the financing be conditional?

As per the provisions of the SEBI Takeover Code, which regulates a tender offer, an acquirer is generally required to make an offer for at least 20 per cent of the total shares of the target company. However, this requirement is not applicable if the acquirer is making an offer that is conditional upon a minimum level of acceptances. In cases where the acceptance is conditional, the acquirer will be required to deposit in cash a sum that is equivalent to 50 per cent. of the consideration payable under the public offer in an escrow account with the SEBI. The SEBI Takeover Code also prescribes that a public offer can be withdrawn if there is a competitive bid, or the statutory approval required for the offer has been refused, or in any other circumstances as the SEBI may deem fit.

13 Minority squeeze-out

Can minority stockholders be squeezed out? If so, what steps must be taken to do so and what is the timing of the process?

If the public offer results in the public shareholding falling to 10 per cent (or the minimum public shareholding specified in to a company at the time of its listing) or below of the total voting capital of the company, then the acquirer has an option to make an offer to the existing shareholders to delist the company and buy out the shareholders by doing a reverse book building in accordance with the SEBI (Delisting of Securities) Guidelines, 2003 (Delisting Guidelines). The acquirer will be required to submit a letter of offer to the shareholders in this regard. Further, if the minimum public shareholding limit has been breached, it would trigger the compulsory delisting provisions under the delist-Delisting ing Guidelines, under which a company would have to be delisted; however, such a decision is at the discretion of SEBI.

14 Cross-border transactions

What additional legal and regulatory framework, if any, governs cross-border transactions?

Cross-border transactions are also regulated by the provisions of Indian exchange control regulations. In the context of the transfer of shares, the details have been set out in the earlier responses. Asset acquisitions by foreign acquirers will also require prior regulatory approvals.

15 Legal form

Can the legal form of the entity involved in a business combination have an impact on the manner in which it is structured? Do such factors have an impact on cross-border transactions involving entities organised in your jurisdiction?

The legal form of the entity may not materially affect the manner in which the business combination is structured, even in the case of a cross-border transaction, since there are limited options on structuring entities as a business combination.

16 Waiting or notification periods

Other than competition laws, what are the relevant waiting or notification periods for completing business combinations? Are companies in specific industries subject to additional regulations and statutes?

Other than competition laws, the only relevant waiting periods would be in cases where the transaction requires the prior approval of the FIPB or the RBI from the Indian exchange control perspective, if applicable. The SEBI Takeover Code also prescribes certain minimum notification periods for the shareholders in the case of a public offer. Companies operating in certain industries such as the metallurgical industry, telecom industry, etc, require industrial licensing under the provisions of the Industries (Development and Regulation) Act.

17 Tax issues

What are the basic tax issues involved in business combinations?

Any capital gains realised by a person resident in India and any gain arising out of the transfer or sale of a capital asset located in India (whether held by a person resident in India or a non-resident) is subject to tax in India under the Indian Income Tax Act 1961 (the ITA).

Capital gains tax liability would arise when all of the following conditions are satisfied:

- There should be gains or profit on the transfer of the capital assets
- The asset transferred should fall within the meaning of capital assets, which is defined under the ITA to mean property of any kind held by a person, whether or not connected with that person's business or profession
- There should be a transfer of capital assets which is defined to include: the sale, exchange, or relinquishment of the asset; or the extinguishing of any rights therein. There are certain transactions that are specifically exempted from being regarded as a transfer for the purposes of the ITA, such as the transfer of shares in a scheme of amalgamation by an Indian amalgamating company to the amalgamated company, etc subject to fulfilment of conditions as specified. In these cases, capital gains tax will not be payable.

Loss of tax benefits for software companies

Indian software companies benefit from certain significant tax incentives under Indian tax laws. These tax incentives include up to 10 year's tax holiday until the year 2009 from payment of Indian corporate income taxes for income from operations of export oriented undertakings or units located in software technology parks. A special tax regime is also carved out for units located in special economic zones, in which case the tax holiday may extend beyond the year 2009.

While the tax holiday continues with any change in the beneficial ownership of the company, in the case of asset purchases or reconstructions of business, the tax holiday may be lost under certain circumstances.

Carry-forward and set-off of business losses

India does not recognise carry-back of tax losses. However, tax losses arising from business can be carried forward for eight years following the year in which such a loss arose. In the case of a private limited company or a company not listed on the stock exchange, the benefit of carrying-forward of losses is lost if there is a change in shareholding beyond 51 per cent.

Unabsorbed depreciation is added to the depreciation allowance of the next year and is deemed to be part of depreciation for that year, and so on.

18 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits matters in a business combination?

Indian law protects the interests of 'workmen' through a variety of statutes. Many of them have different definitions of 'workmen'. With respect to employees who do not fall within the definition of 'workmen', as per these statutes, there is no protection as such except as may be provided in the applicable local shops and establishments act and the employment contract, if any. One of the significant Indian labour legislations in the context of a merger/acquisition is the Industrial Disputes Act 1947 (the IDA) which applies only to 'workmen', and defines them to mean any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work but does not, inter alia, include any such person who is employed mainly in a managerial or administrative capacity or who, being employed in a supervisory capacity, draws wages exceeding INR1,600 per month or exercises functions of a mainly managerial nature.

In the case of a business combination, the relevant provisions would be those relating to the 'transfer of an undertaking' under the IDA. This section provides that, where there is a transfer of the ownership or management of a company, a 'workman' who has been in continuous employment with the company for not less than a year preceding the date of the transfer, is entitled to notice and compensation unless all of the following conditions are fulfilled:

- The service of the 'workmen' is not interrupted by the transfer
- The terms and conditions of service applicable to the 'workmen' after the transfer are not in any way less favourable to the 'workmen' than those applicable to them immediately before the transfer
- The new employer is, under the terms of the transfer or otherwise, legally liable to pay compensation to the 'workmen', in the event of their retrenchment, on the basis that their service has been continuous and has not been interrupted by the transfer.

In the event that the proposed transfer of the business fails to comply with the conditions set out above, the original employer is obliged to:

- give one month's notice in writing to the 'workmen' indicating the reasons for the transfer or wages in lieu of such notice; and
- pay compensation equivalent to 15 days average pay for every completed year of continuous service or any part thereof in excess of six months.

In addition to the above, the IDA also provides for certificate notification requirements and compensation to be paid to the 'workmen' in the case of the termination of their employment by way of a lay-off, retrenchment or closure of the company.

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In addition to the IDA, the state-specific shops and establishment acts also specify the employer's obligations upon termination of service.

19 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

As per the provisions of the Sick Industrial Companies Act, 1985 (the SICA), if the target company becomes a 'sick industrial company' (defined to mean an industrial company being a company registered for not less than five years, which has at the end of a financial year accumulated losses equal to or exceeding its entire net worth), then within 60 days of the company becoming sick, the board of the company must make a reference to the Board for Industrial and Financial Reconstruction (BIFR). Once the restructuring proceedings commence before the BIFR, the target company is protected from suits, recovery proceedings and winding up petitions. Any sale of assets by the target company during the interim period pending reorganisation will require the special approval of the BIFR, which may be granted on a discretionary basis. The BIFR has the power to restrict the sale of the assets if it is of the view that the sale would not be in public interest.

Winding-up

In the event that a winding-up of the target company has commenced, whether voluntary or involuntary, the prior approval of the official liquidator appointed by the high court of the state where the registered office of the company is situated, will be required for any merger or acquisition. The sale of the assets or shares of a company in winding-up will require the special approval of the official liquidator and will be granted only if the same is in the public interest.

20 Current proposals for change

Are there current proposals to change the regulatory or statutory framework governing business combinations?

- The Competition Act 2002, which provides for pre-merger notifications in the event that the merged entity exceeds certain thresholds etc, is yet to come into effect upon the dates to be notified by the government.
- The SICA Repeal Act has been passed, however it has not been made effective. Once the Act is repealed, the provisions of financially troubled companies will be in accordance with the provisions of the Companies Act, as amended in 2002.
- There is, and has been for some time, a thought to overhaul the Companies Act. This was sought to be done through the Companies (Amendment) Bill 2003, however, the same has been shelved and the government is wondering how the same should be attained.